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ECONOMIC LOSS: COMMERCIAL CONTRACT LAW LIVES

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I. INTRODUCTION

In 1974, Grant Gilmore proclaimed that contract law was dead, transformed into a branch of the burgeoning body of tort law.[1] The validity of this claim is open to debate,[2] but it is generally

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1. GRANT GILMORE, THE DEATH OF CONTRACT (1974).
2. "Reviewers found much of Gilmore's account inaccurate, incomplete, ex-

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agreed that tort theories of recovery have become more prominent in areas once dominated by the rules of contract.[3] Product liability is no exception. The previous century witnessed a virtual abandonment of warranty—a contract theory—in favor of strict liability for defective products, a new tort theory.[4]

The ascendance of tort law in product liability cases has understandable appeal in the context of bodily injury suffered by a consumer. Tort law is a flexible remedy, responsive to the specific facts of a case, the quality of the parties' conduct, and the extent to which an injury has affected the plaintiff's very personal circumstances. Tort doctrines arguably have less appeal, however, in the commercial context. Predictability and a common understanding of the "ground rules" for business transactions are important policy concerns typically undermined by the flexibility that gives tort law its vigor.

Standing guard at the crossroads of tort and contract is the economic loss doctrine. Late in the last century, Minnesota moved to forestall the "death of contract" in commercial settings when first the state courts, and then the state legislature, adopted this doctrine. Recent years have seen that doctrine clarified. However, several issues surrounding recovery for economic loss are not been resolved. Careful attention to the foundational principles of the economic loss doctrine should allow Minnesota courts in the next century to prevent commercial law from "drown[ing] in a sea of tort."[5]

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aggerated or unoriginal." Robert A. Hillman, *The Triumph of Gilmore's "The Death of Contract"*, 90 NW. U. L. REV. 32, 32 (1995) (citing James R. Gordley, *The Death of Contract*, 89 HARV. L. REV. 452 (1975) (book review); Robert W. Gordon, *The Death of Contract*, 1974 WIS. L. REV. 1216 (1974) (book review); Morton J. Horwitz, *The Death of Contract*, 42 U. CHI. L. REV. 787 (1975) (book review); Ralph J. Mooney, *The Rise and Fall of Classical Contract Law: A Response to Professor Gilmore*, 55 OR. L. REV. 155 (1976); Richard E. Speidel, *An Essay on the Reported Death and Continued Vitality of Contract*, 27 STAN. L. REV. 1161 (1975); Richard Danzig, *The Death of Contract and the Life of the Profession: Observations on the Intellectual State of Legal Academia*, 29 STAN. L. REV. 1125 (1977); Anthony J. Waters, *For Grant Gilmore*, 42 MD. L. REV. 865 (1983)).

3. Mark Pettit, Jr., *Freedom, Freedom of Contract, and the "Rise and Fall,"* 79 B.U.L. REV. 263, 265-66 (1999); Barry Perlstein, *Crossing the Contract-Tort Boundary: An Economic Argument for the Imposition of Extracompensatory Damages for Opportunistic Breach of Contract*, 58 BROOK. L. REV. 877, 877-78 (1992).

4. Greenman v. Yuba Power Prods., Inc., 377 P.2d 897 (Cal. 1963); William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791 (1966).

5. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986).

In this article, I will discuss the relatively brief history, and a blueprint for the future, of the economic loss doctrine in Minnesota. Initially, I will examine the origin of the doctrine and the policy concepts upon which it is founded. Second, I will look at how the doctrine has developed in Minnesota since its recognition in 1981. Finally, I will discuss three illustrative examples of outstanding issues regarding economic loss and how Minnesota courts should address them in coming years.

II. FOUNDATIONS OF THE ECONOMIC LOSS DOCTRINE

The economic loss doctrine can trace its ultimate origins to the Uniform Commercial Code (U.C.C.). The Code was promulgated in 1951, adopted with minor revisions by Pennsylvania in 1953, and adopted by all the remaining states but one over the ensuing fifteen years.[6] The overriding purpose of the U.C.C. was the creation of a single, uniform body of law to govern commercial transactions throughout the United States. This purpose is evident from both the terms of the Code and commentary upon it.[7]

The economic loss doctrine first emerged in recognizable form in 1965 when the California Supreme Court decided *Seely v. White Motor Company*.[8] In that case, the plaintiff purchased a truck that "galloped," or bounced violently. For nearly one year after the purchase, the dealer repeatedly attempted to fix the problem, and sought advice from the manufacturer's representatives. None of these attempts succeeded. On one occasion, while slowing down to make a turn, the plaintiff found the truck's brakes did not work, and the truck overturned.[9] The plaintiff was not hurt, but the truck was severely damaged.[10]

Chief Justice Traynor, writing for the majority, affirmed the lower court's judgment for the plaintiff on the basis of breach of express warranty.[11] However, he rejected the alternative strict liability claims, because that doctrine was intended only to govern cases involving physical injuries. Chief Justice Traynor explained that this was a logical extension of existing tort law:

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6. Richard E. Speidel, et al., COMMERCIAL LAW TEACHING MATERIALS 6 (4th ed. 1987).
7. *Infra* Part I.A.
8. 403 P.2d 145 (Cal. 1965).
9. *Id.* at 147.
10. *Id.*
11. *Id.* at 148.

> A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone.[12]

Seely has been widely followed, and may be considered to have set the stage for widespread recognition of the economic loss doctrine.[13]

The origins and subsequent development of the economic loss doctrine reveal several fundamental reasons for its existence.

A. *Uniformity Of Commercial Law*

The principal policy basis for the doctrine is maintaining a uniform and predictable body of commercial law. The Uniform Commercial Code was an attempt to organize a coherent framework for the law of commercial transactions. The Code was a response to the problem described so eloquently near the turn of the twentieth century:

> I am told that an American lawyer who wishes to keep abreast of the current of judicial decision has to take in some fifty-eight volumes of Law Reports each year. In America, there is no choice between common law on the one hand and statute law on the other. Each state is independent in matters of legislation and judicature. The American lawyer, therefore, has to deal not with one but with forty streams of common law, each of which is liable to be disturbed by the action of an independent Legislature. But Commerce knows nothing of State boundaries, and it seems intolerable that if a man in Chicago makes a

12. *Id.* at 151. The *Seely* court did depart from some prior law. The New Jersey Supreme Court had previously permitted a carpet purchaser to recover in strict liability for the diminished value of carpeting that developed cosmetic defects. Santor v. A & M Karagheusian, Inc., 207 A.2d 305, 312 (N.J. 1965). Chief Justice Traynor specifically declined to follow *Santor*, stating, "only if someone had been injured because the rug was unsafe for use would there have been any basis for imposing strict liability in tort." *Seely*, 403 P.2d at 151.

13. M. STUART MADDEN, PRODUCTS LIABILITY § 22.21 at 335 (2d ed. 1988).

> contract with a man in New York, his rights and duties cannot be determined without an elaborate investigation into the conflict of laws. The only possible remedy that I can see for this state of affairs is codification.[14]

And so, fifty years later, came the U.C.C. The Code was largely a response to the perceived need for a more homogeneous and predictable body of rules for trade.[15]

Exclusivity of U.C.C. remedies is critical to this uniformity. After all, ready access to remedies outside the Code would introduce a great deal of uncertainty in potential commercial litigation. The U.C.C. would become nothing more than a fallback position, the residual remedies to which parties and courts resort when no tort theory quite fits. That was not what the framers had in mind. The U.C.C. was envisioned as an authoritative body of law, from which commercial traders could determine in advance the legal rules applicable to a particular transaction. The purpose of the Code is better served by a system that minimizes the influence of external rules. The economic loss doctrine protects this interest by excluding tort remedies from broad categories of commercial disputes.

B. Underpinnings Of Strict Liability

Strict liability is the paradigm example of the rise of tort in the twentieth century. Product liability litigation was transformed by the advent of strict liability and similar theories. Strict liability, however, is specifically designed to fit the unique context of personal injuries in a consumer setting. Modern strict liability theory flows in large part from the rule of absolute responsibility for unwholesome foodstuffs, which required special treatment because of their propensity to cause serious bodily harm.[16] The early cases

14. M.D. Chalmers, *Codification of Mercantile Law,* 19 L.Q. REV. 10, 17 (1903) (quoted in Speidel, *supra* note 6).

15. MINN. STAT. § 336.1-102 (West 1999). Professors White and Summers have described the environment in which the U.C.C. developed: "Moreover, a major objective of the 'uniform acts' [promulgated prior to the U.C.C.] had been to promote uniformity. But not all states enacted the acts, and the courts of the states rendered countless nonuniform 'judicial amendments.' By 1940 there was growing interest in commercial law reform." JAMES J. WHITE & ROBERT S. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 3 (2nd ed. 1980).

16. Greenman v. Yuba Prods., Inc., 377 P.2d 897, 900 (Cal. 1963) ("Recognized first in the case of unwholesome food products, such liability has now been extended to a variety of other products that create as great or greater hazards if defective.").

emphasized the special obligations flowing from *dangerous* products, those that posed a risk to the health and safety of users.[17] The economic loss doctrine recognizes and gives meaning to the important distinction between personal injury and property damage. Social interests in health and safety may outweigh the commercial interests represented by the U.C.C., but where that social policy is not implicated, commercial interests may once again carry the day.[18]

Strict liability is also founded on the relatively helpless position of the consumer with respect to commercially marketed products. Chief Justice Traynor's seminal opinions stressed that modern purchasers have little opportunity to inspect a product for potential hazards.[19] Strict liability results from the judgment that injuries resulting from undiscovered faults are more appropriately the responsibility of sellers, who are in a better position than buyers to prevent such faults. Courts adopting strict liability also relied upon the substantial difference in bargaining power between sellers and consumers.[20] According to this analysis, even if an individual buyer did identify a design change he or she thought would make the product safer, the manufacturer would be unlikely to respond to the suggestion. At the same time, mass consumers cannot realistically expect to negotiate terms of purchase with manufacturers, and therefore cannot protect themselves by contractually shifting the risk of loss.

C. *Freedom To Contract*

The typical economic justification for strict liability is alloca-

17. *Id.* ("A manufacturer is strictly liable in tort when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that causes *injury to a human being.*") (emphasis added); Escola v. Coca-Cola Bottling Co. of Fresno, 150 P.2d 436, 440 (Cal. 1944) (Traynor, J., concurring) ("Even if there is no negligence, however, public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards *to life and health* inherent in defective products that reach the market.") (emphasis added).

18. The U.C.C. itself recognizes the same distinction between personal injury and property damage. Sellers of goods may disclaim or limit certain warranties, but no disclaimer may exclude liability for personal injuries resulting from product defects. *See, e.g.,* MINN. STAT. § 336.2-719(3) (West 1999) ("Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable"); Peter M. Kinkaid & William J. Strutz, Note, *Enforcing Waivers in Products Liability*, 69 VA. L. REV. 1111 (1983).

19. Greenman, 377 P.2d at 900; Escola, 150 P.2d at 440 (Traynor, J., concurring).

20. Iowa Elec. Light & Power Co. v. Allis-Chalmers Mfg. Co., 360 F. Supp. 25, 32 (S.D. Iowa 1973).

tion of "external" costs to the party best able to bear and prevent them. All liability schemes, of course, allocate losses among the parties. The question in this context is whether the parties are entitled to determine allocation for themselves. Strict liability *enforces* a loss allocation because the social interest in protecting consumers' health and safety justifies intervention in the system. The economic loss doctrine protects commercial parties' ability to determine their own allocation as a component of the terms of the deal.

The concept of "freedom to contract" rarely arises in modern American legal opinions.[21] However, it is a critical basis for not only the economic loss doctrine, but for the organization of this country's economy. The economic loss doctrine gives effect to the parties' arrangements for allocating risk of loss. Tort claims interfere with enforcement of the contract terms, and therefore ought to be disfavored in commercial disputes.

III. EVOLUTION OF ECONOMIC LOSS IN MINNESOTA

The economic loss doctrine has a relatively brief history in Minnesota. It was first recognized in full form at the start of the 1980's. A look at the development of the doctrine reveals two distinct phases coinciding with each of the decades in which the rule has prevailed. However, at each step, the policy bases for the economic loss doctrine are easily detected.

A. *Initial Phase—The 1980's*

1. Superwood—*The Rule Announced*

Although the economic loss doctrine emerged elsewhere in the 1960's, Minnesota did not embrace it until 1981. In that year, the Minnesota Supreme Court decided *Superwood Corp. v. Siempelkamp Corp.*[22] The plaintiff had purchased an industrial press from the defendant manufacturer. After twenty-one years of service, the press failed, causing no injury and no damage to the surrounding equipment. The plaintiff brought both contract and tort claims in federal district court. The court dismissed the contract claims on

21. "According to some commentators...freedom to contract, thought to be so dominant in the latter part of the nineteenth century, is becoming increasingly circumscribed by other social concerns and purposes." Pettit, *supra* note 3, at 265.

22. 311 N.W.2d 159 (Minn. 1981), *overruled by* Hapka v. Paquin Farms, 458 N.W.2d 683 (Minn. 1990).

statute of limitations grounds.[23] It certified to the Minnesota Supreme Court the question of whether the product liability claims were viable.[24]

The supreme court rejected plaintiff's tort claims, permitting only U.C.C. remedies. The opinion stressed the need to maintain the integrity of the Code:

> The U.C.C. clarifies the rights and remedies of parties to commercial transactions...The recognition of tort actions in the instant case would create a theory of redress not envisioned by the legislature when it enacted the U.C.C. Furthermore, tort theories of recovery would be totally unrestrained by legislative liability limitations, warranty disclaimers and notice provisions. To allow tort liability in commercial transactions would totally emasculate these provisions of the U.C.C. Clearly, the legislature did not intend for tort law to circumvent the statutory scheme of the U.C.C.[25]

Superwood, therefore, acknowledged the distinct nature of commercial transactions. The uniform and predictable nature of Code rules and remedies is identified as being critical to facilitating trade. Product liability theories, by implication, are relegated to a different, extra-commercial context.

Importantly, the Minnesota Supreme Court recognized *all* elements of the U.C.C. as worthy of preservation. When the legislature adopted the Code, it did not merely enact the rules for interpreting sales contracts, it also enacted "liability limitations, warranty disclaimers and notice provisions." Thus, the integrity of the U.C.C. extends to the whole Code, including defenses and remedy limitations.

Superwood announced the new rule: "economic losses that arise out of commercial transactions, except those involving personal injury or damage to other property, are not recoverable under the tort theories of negligence or strict products liability."[26] This brief formulation left ample room for further interpretation.

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23. *Id.* at 160 n.1.
24. *Id.* at 160.
25. *Id.* at 162.
26. *Id.*

2. Minneapolis Society Of Fine Arts—*Component Products*

Among the elements of the *Superwood* rule most open to interpretation is the exception for "damage to other property." What constitutes "other property" is not always entirely clear. In *Minneapolis Society of Fine Arts v. Parker Klein Associates Architects, Inc.*,[27] the state supreme court had an opportunity to lend guidance on that subject. The plaintiff owned a building designed by the defendants. Certain bricks integrated into the building failed. The plaintiff brought both tort and contract claims, arguing that the tort claims were valid because the building into which the bricks were placed was "other property."[28]

The court rejected this argument and the plaintiff's tort claims. Noting that *Superwood* did not provide much insight into the definition of "other property," the court considered the effect of tort claims on the efficacy of the U.C.C.

> [Plaintiff] has failed to prove physical damage to property other than the brick itself. To hold that buildings constitute 'other property' would effectively overrule *Superwood* as to every seller of basic building materials such as concrete, brick or steel because the 'other property' exception would always apply. The UCC provisions as applicable to component suppliers would be totally emasculated.[29]

The presumption, in the case of commercial property damage, is therefore that Code remedies are the only option. The "other property" element of the doctrine is a limited exception. In nearly all commercial settings, the Code should prevail.

3. S.J. Groves—*Predominance Of Contract Claims*

The next major Minnesota case, *S.J. Groves & Sons Co. v. Aerospatiale Helicopter Corp.*,[30] was important both for its result and its reasoning. The case arose from a helicopter crash in Bolivia involving a vehicle owned by a commercial entity. The pilot was killed,

27. 354 N.W.2d 816 (Minn. 1984).

28. *Id.* at 818-19.

29. *Id.* at 819-20. *See also* Trans. Corp. of Am., Inc. v. Int'l Bus. Mach. Corp., Inc., 30 F.3d 953, 957-58 (8th Cir. 1994) (finding no damage to other property where allegedly defective disk drive caused damage only to other components of a computer system).

30. 374 N.W.2d 431 (Minn. 1985).

and his heirs subsequently settled their wrongful death action.[31] The crash destroyed the helicopter and also indisputably caused damage to only a small amount of other property—(a radio and two headsets in the helicopter)—when it went down. The owner sued the manufacturer in both contract and tort, seeking to recover all damages under all theories. The plaintiff claimed the existence of damage to some other property allowed it to "bootstrap" tort claims for the entire amount.[32]

The court rejected that effort. "[T]o allow a party to sue in tort to recover substantial damages because of relatively minor damages to 'other property' would thwart the policy implications of *Superwood*."[33] Those policy implications included the unwarranted expansion of the "other property" exception. If plaintiffs need only identify some item of property other than the product itself, no matter how insignificant, tort litigation would be utterly unrestrained. Nearly every plaintiff could at least create a fact issue on the existence of other property damage, holding the resolution of a commercial dispute hostage to determination of tort liability. Consequently, the critical issue to be determined is not whether some independent piece of property suffered damage. It is whether the injury *on the whole* is one properly treated as a commercial transaction.[34]

Just as noteworthy as this result was the court's explanation of the policy foundations of the economic loss doctrine:

> It is clear that this certified question comes to us in the context of a commercial plaintiff with economic bargaining power substantially equivalent to that of the seller. As such, Groves had the opportunity to bargain both as to the product's specifications and as to the risk of loss from defects in it. This power to negotiate means that Groves could have bargained for more extensive warranty protection and consequently any failure of coverage is attributable not to 'gaps' in consumer remedies that tort remedies should correct, but, rather, to the plaintiff's

31. *Id.* at 432.
32. *Id.* at 434 n.2.
33. *Id.* at 434.
34. In a similar vein, see McCarthy Well Co., Inc. v. St. Peter Creamery, Inc., 410 N.W.2d 312, 315 (Minn. 1987) (noting economic loss doctrine as recognized in *Superwood* is based upon importance of not upsetting remedies of U.C.C., and therefore does not apply to contracts primarily concerned with the provision of services instead of goods, which are not governed by the Code).

conscious choice.[35]

The *Groves* court thus explicitly read into Minnesota jurisprudence the self-protection elements of the doctrine.

B. *Second Phase—The 1990's*

After recognizing and clarifying the terms of the doctrine in the 1980's, the Minnesota Supreme Court turned to a more fundamental reexamination of the rule in the 1990's. After a decade of experience with the doctrine, it was clear a new formulation was required.

1. Hapka—*More Limitation Than Exception*

Neither *Superwood* nor its progeny adequately explained the importance of preserving tort claims for damage to other property. Whatever interest this exception served, by 1990 it had become more trouble than it was worth. Litigation to determine whether tort claims were valid was overwhelming the clarity and predictability the Code was supposed to provide.

The court had its chance to rectify the situation in *Hapka v. Paquin Farms*.[36] There, a commercial farmer purchased seed potatoes from the defendant. Those potatoes turned out to be diseased, and the infectious condition spread to potatoes purchased from other sources. The other potatoes clearly qualified as other property, and the farmer sought to bring tort claims on that basis.

The *Hapka* court noted that *Superwood*'s reference to "other property" was dicta, and rejected the distinction:

> The steady stream of litigation attempting to qualify for the exceptional treatment of damage to other property has convinced us that the exception represents a retreat to the common law in derogation of the essence of the Uniform Commercial Code: a complete and independent statutory scheme enacted for the governance of all commercial transactions. The Code itself indicates that the U.C.C. is intended to displace tort liability.
>
> [T]he law is entitled to expect the parties to commercial transactions to be knowledgeable and of relatively equal bargaining power so that warranties can be

35. *Groves*, 374 N.W.2d at 434.
36. 458 N.W.2d 683 (Minn. 1990).

> negotiated to the parties' mutual advantage. Having negotiated the warranties and any limitations of liability, that a defective product causes damage to other property should not defeat the liability parameters the parties have set by opening the door to tort theories of recovery. . . . If the Code is to have any efficacy, parties engaged in commercial activity must be able to depend with certainty on the exclusivity of the remedies provided by the Code in the event of a breach of their negotiated agreement.[37]

Hapka shifted the analytical emphasis from the nature of the damage (a relatively fortuitous factor) to the nature of the transaction. The more commercial the setting, the more exclusive the reliance on the U.C.C.

2. Den-Tal-Ez—*The Merchant Orientation*

Hapka addressed the economic loss doctrine broadly, without stating specific limits on its reformulation of the rule. Uncomfortable with such a wide-ranging expansion of U.C.C. exclusivity, the court turned again to the issue in 1992. *Lloyd F. Smith Co., Inc. v. Den-Tal-Ez, Inc.*[38] dealt with another undisputed case of property damage. The product involved was a motorized dental chair. It allegedly caused a fire that resulted in extensive damage to the dental office, building, furnishings, records and office equipment. The plaintiff sought to recover for the full extent of the property damage, and challenged the *Hapka* limitations.

Den-Tal-Ez produced a comprehensive breakdown of economic loss scenarios. The court held that the dentist was not an experienced merchant of dental chairs. Although they were part of the equipment regularly used in the office, the chair was not the subject of any of the dentist's economic transactions.[39] Since the plaintiff was not a merchant in this product, the sale of the chair was more accurately treated as a consumer transaction rather than a commercial transaction. As a result, tort claims were permitted:

> [T]he U.C.C. provides the exclusive remedy for other property damages arising out of a sale of goods only when that sale fits *Hapka*'s narrow definition of a 'commercial transaction,' *i.e.*, where the parties to the sale

37. *Id.* at 688.
38. 491 N.W.2d 11 (Minn. 1992).
39. *Id.* at 16-17.

> are dealers in the same goods or, to use a more precise term, 'merchants in goods of the kind.' In actions for damages to other property which arise from a sale of goods between parties who are not 'merchants in goods of the kind,' such as in the case here, the tort remedies of negligence and strict liability are always available, even if the parties can sue under the U.C.C. as well. And, of course, an action for damage to the defective product itself is always limited to a U.C.C. based recovery.[40]

In discussing the issue, the *Den-Tal-Ez* court identified three different categories of product liability plaintiffs, and three different sets of policy priorities. The first category was those persons who suffered personal injuries. Those persons are permitted to sue in tort, even many years after the sale, when a warranty action would be barred by the statute of limitations. When a plaintiff suffers bodily harm, the court reasoned, "the law's concern for compensating personal injury outweighs the commercial need for a relatively short limitation period."[41]

The second category consists of merchants in goods of the kind which suffer only property damage. These plaintiffs—"experienced merchants engaged in the buying and selling of their stock in trade"[42]—are limited strictly to U.C.C. remedies.[43] In these cases, the primary policy issue ought to be meeting the commercial need for reasonable control of the risk of a defective product. Exclusive warranty remedies with short statutes of limitations best serve this need.[44] This is described as the rule of *Hapka*.[45]

The final category is "consumer" purchasers that suffer property damage. This category includes commercial entities that are not merchants in goods of the kind, such as the dentist at issue in *Den-Tal-Ez*.[46] These plaintiffs are limited to U.C.C. remedies only when seeking to recover for damage to the product itself. Otherwise, because these were not truly commercial transactions involving parties with relatively equal capacity to protect themselves, tort remedies are available.[47]

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40. *Id.* at 17 (footnote omitted).
41. *Id.* at 16.
42. *Id.*
43. *Id.* at 17.
44. *Id.* at 16.
45. *Id.* at 17.
46. *Id.* at 16-17.
47. *Id.*

3. *Section 604.10—The Legislature Responds*

With significant commercial interests involved, politicization of the economic loss doctrine was virtually inevitable. *Hapka* produced a quick legislative reaction. Fearful of the effects of the decision on "quasi-commercial" entities (notably farmers), the legislature enacted a statute to codify the economic loss doctrine, and to at least partially preserve the other property exception.

As originally enacted, the statute read:

> (a) Economic loss that arises from a sale of goods that is due to damage to tangible property other than the goods sold may be recovered in tort as well as in contract, but economic loss that arises from a sale of goods between parties who are each merchants in goods of the kind is not recoverable in tort.
>
> (b) Economic loss that arises from a sale of goods, between merchants, that is not due to damage to tangible property other than the goods sold may not be recovered in tort.
>
> (c) The economic loss recoverable in tort under this section does not include economic loss due to damage to the goods themselves.[48]

Den-Tal-Ez provided an important clarification of the "merchant" language used in this statute.

The legislature has twice returned to this statute. In 1993, it added a new subsection:

> (d) The economic loss recoverable in tort under this section does not include economic loss incurred by a manufacturer of goods arising from damage to the manufactured goods and caused by a component of the goods.[49]

This amendment codified the common law, ensuring that *Minneapolis Society of Fine Arts* remained good law. The second amendment, in 1998, concerned contractual fraud claims, and is discussed *infra.*

IV. INTO THE TWENTY-FIRST CENTURY

The past century saw Minnesota courts establish the economic

48. MINN. STAT. § 604.10 (West 1991).
49. MINN. STAT. § 604.10 (West 1993).

loss doctrine and develop its theoretical foundation. As one might expect, twenty years is not long enough to answer all of the significant questions about the new doctrine. Thus, important issues have recently become apparent. In coming years we can expect to see these issues decided. Hopefully, the answers will come from a careful application of the policy interests underlying the doctrine.

A. Definition Of "Merchants In Goods Of The Kind"

Both the common law and statutory versions of the economic loss doctrine in Minnesota now primarily protect merchants in goods of the kind at issue.[50] What is not entirely clear coming into the new century, though, is precisely what determines whether a party is a merchant in goods of the kind. Obviously, the phrase refers to commercial entities and not "ordinary" consumers. Equally obviously, following *Den-Tal-Ez*, not all commercial buyers are merchants in every good they purchase.

The primary dispute in this arena is whether one must be a "dealer" of the good—must engage in both the purchase and sale of the specific product as part of one's regular business activities—to be a merchant in the good. The Minnesota Supreme Court has not addressed this issue, but the local federal court has extended economic loss protection to those who do not "deal" in the product.

In *Board of Regents v. Chief Industries, Inc.*,[51] the plaintiff was the University of Minnesota. Nine years prior to suit, it bought a grain drying unit for use in its agricultural research facility. When the unit failed, it caused a fire that damaged the building and its contents. The University claimed it fell into the third *Den-Tal-Ez* category—non-merchants—because it did not sell grain dryers as part of its regular business.[52] The court drew guidance from section 2-104 of the U.C.C., which indicates that the term "merchant" includes not only those who deal in a particular good, but also those who have specialized knowledge of the good.[53] Additional

50. The Minnesota Court of Appeals has made it clear that the doctrine does not apply *exclusively* to merchants, however. *Cf.* State Farm Mut. Auto. Ins. Co. v. Ford Motor Co., 572 N.W.2d 321, 324 (Minn. Ct. App. 1997) ("[T]he economic loss doctrine does not exempt consumer goods or non-merchant transactions"; however, non-merchants may bring tort claims for damage to other property).

51. 907 F. Supp. 1298 (D. Minn. 1995), *aff'd*, Regents of the Univ. of Minn. v. Chief Indus., Inc., 106 F.3d 1409 (8th Cir. 1997).

52. *Chief Indus.*, 106 F.3d at 1411.

53. *Id.* (citing MINN. STAT. § 336.2-104 (West 2000)).

support came from *Den-Tal-Ez*, in which the Minnesota Supreme Court emphasized not "dealership," but "the plaintiff's sophistication, knowledge, and bargaining power with respect to a particular product."[54] Because the University had a great deal of specialized knowledge of the product and its uses, and was a large and sophisticated trading partner, it could be considered a merchant of grain dryers and was barred from asserting tort claims.

The Minnesota Court of Appeals, on the other hand, has read the term "merchant" much more restrictively. In *Jennie-O Foods, Inc. v. Safe-Glo Products Corp.*,[55] the plaintiff was a commercial turkey farmer and processor. It brought suit against the manufacturer of barn heaters that allegedly caused two very damaging fires.[56] The court considered the defendants' objections to the tort claims under section 604.10.[57] Stressing that the U.C.C. defines only the term "merchant," not "merchants in goods of the kind," the court rejected *Chief Industries* as purportedly inconsistent with *Den-Tal-Ez*.[58] Therefore, the court held "that Jennie-O was not a merchant in goods of the kind with respect to heaters and is not barred from recovering in tort."[59]

In coming years, Minnesota courts would do well to follow *Chief Industries* rather than *Jennie-O*, as it more correctly enforces the principles supporting the economic loss doctrine. Under our legal and economic system, parties generally ought to be held responsible for setting the terms of their own transactions. Only when significant inequalities preclude one party from adequately protecting itself should the courts provide extra-contractual remedies. Inequalities can result from an imbalance of information (and thus an inability to understand the risks against which one must be protected), or from an imbalance of economic power (and thus an inability to negotiate the terms one needs). Sophisticated and knowledgeable commercial parties suffer from no such inequalities and therefore need no additional protection, whether or not they are dealers. A proper reading of *Den-Tal-Ez* supports this conclusion. In that case, the Minnesota Supreme Court recognized that while dealers are merchants in goods of the kind, that phrase

54. *Id.* at 1412.
55. 582 N.W.2d 576 (Minn. Ct. App. 1998).
56. *Id.* at 577-78.
57. *Id.* at 578
58. *Id.*
59. *Id.* at 579.

is a "more precise term" than "dealer."[60]

From a doctrinal standpoint, there is no reason to limit economic loss protection solely to dealers. Reselling a manufacturer's product to the mass market does not inherently impart sophisticated knowledge of a product, nor does it give one any greater leverage over the manufacturer in negotiating warranty terms. In fact, non-dealer merchants might actually be in a stronger position relative to a product manufacturer. When the manufacturer produces highly demanded goods and permits only a limited number of dealers to sell them, the manufacturer has a great deal of influence over those dealers. The dealer must fear termination of its access to a popular and profitable product line, and therefore cannot make excessive demands of its supplier.

At the same time, making "dealership" the determining factor would be unfair to plaintiffs. Not all dealers are likely to develop sophisticated knowledge of a product's characteristics and risks. Retail sellers, for instance, might carry thousands of product lines and brands. A retailer's expertise with regard to each particular product would be very limited, and so it might be unfair to apply the doctrine in some retail contexts.

B. Fraud And Misrepresentation

Superwood had presented the Minnesota Supreme Court with negligence and strict liability claims. In announcing the economic loss doctrine, the court discussed the broad concept of "tort liability in commercial transactions."[61] Negligence and strict liability are not the only forms of tort liability likely to arise, though. When a product does not live up to a buyer's expectations, the buyer can increasingly be expected to assert claims for fraud as well.

Minnesota courts have provided little guidance on whether the economic loss doctrine applies to such claims. One unpublished court of appeals decision, *ETM Graphics, Inc. v. City of St. Paul*,[62] held that "the broad language in *Hapka* clearly prevents appellants

60. *Den-Tal-Ez*, 491 N.W.2d at 17 ("[T]he U.C.C. provides the exclusive remedy for other property damages arising out of a sale of goods only when that sale fits *Hapka's* narrow definition of a "commercial transaction," i.e., where the parties to the sale are dealers in the same goods or, to use a more precise term, merchants in goods of the kind.").

61. *Superwood*, 311 N.W.2d at 162.

62. No. C2-91-2103, 1992 WL 61394 (Minn. Ct. App., Mar. 31, 1992).

from bringing a [fraud] action outside the purview of the U.C.C."[63] The federal district court for Minnesota originally determined that *Superwood* did not preempt common law fraud and misrepresentation claims,[64] but subsequently found the reasoning of *ETM Graphics* persuasive.[65]

An appropriate resolution of this issue would bring most, but not all, fraud claims within the scope of the economic loss doctrine. No doubt, there are instances of real and legitimately actionable fraud in commercial transactions. However, fraud claims cannot be allowed to become simply another variation on the breach of contract theme. When the alleged fraud consists of failure to perform a promise embodied in the contract (i.e., the failure to provide a conforming product), the claim for fraud becomes nothing more than a universal escape clause from U.C.C. remedies. Rather than being a controlling source of stable and predictable rules for trade, the Code would be valid only as long as the plaintiff desired it to be.

The Eighth Circuit Court of Appeals grappled with this issue in 1998 and recognized a critical distinction Minnesota should adopt. *AKA Distributing Company v. Whirlpool Corp.*,[66] held that the economic loss doctrine can indeed apply to claims of fraud and misrepresentation. However, "the presence of a governing commercial contract neither preempts nor eliminates the need for all fraud claims to which the parties' dealings may give rise."[67] Instead, a plaintiff is entitled to assert fraud that is "outside of or collateral to the contract."[68] The *AKA Distributing* position strikes an appropriate balance between the interests surrounding the economic loss doctrine. It preserves the U.C.C. as the authoritative source of rules governing the sale of goods itself. By reference to the Code, buyers and sellers can determine with confidence the likely extent of exposure for losses resulting from the failure of the goods themselves. However, the Code does not provide any protection against

63. *Id.* at *2 (internal citation omitted).

64. N. States Power Co. v. Int'l. Tel. and Tel. Corp., 550 F. Supp. 108, 111-12 (D. Minn. 1982).

65. *In re* Grain Land Coop, 978 F. Supp. 1267, 1279-80 (D. Minn. 1997); Upsher-Smith Lab., Inc. v. Mylan Lab., Inc., 944 F. Supp. 1411, 1435 (D. Minn. 1996); Nelson Distrib., Inc. v. Stewart-Warner Indus. Balancers, 808 F. Supp. 684, 687-88 (D. Minn. 1992).

66. 137 F.3d 1083 (8th Cir. 1998).

67. *Id.* at 1086.

68. *Id.*

extra-contractual fraud. Warranties may be perfectly adequate to cover property damage when the product fails to perform as promised, but they do not suffice when the seller has made promises not directly running to the quality of the goods. For instance, a product manufacturer may engage the buyer with assurances that it is well-capitalized and the picture of financial health. Warranty claims seem a less appropriate option if those kinds of assurances prove false to the buyer's detriment. A tort action for fraud in such an instance would not threaten the U.C.C. because it would not replace an existing and limited Code-based remedy. It would instead address an issue outside the purview of the Code and therefore a proper subject for tort relief.[69]

Fraud claims have received recent legislative and judicial attention due to prominent litigation involving a Minnesota corporation. Marvin Windows, a major manufacturing company headquartered in Warroad, Minnesota, has engaged in protracted litigation with PPG Industries, Inc., a Pennsylvania-based manufacturer. Marvin purchased a wood preservative treatment from PPG, and it used this treatment on wood windows it manufactured and sold. Marvin claimed the preservative treatment was defective because it failed to prevent those windows from rotting prematurely, and that it suffered economic harm when it repaired and replaced those windows.[70] The district court initially applied the economic loss doctrine to preclude Marvin's tort claims, which consisted of negligence, strict liability, fraud and misrepresentation, except to the extent it sought damages for property other than the windows themselves.[71] PPG then sought summary judgment on the warranty claims on the grounds that they were barred by the statute of limitations because Marvin stopped purchasing the preservative treatment more than four years prior to bringing suit.

While the motion for summary judgment was pending, Marvin approached the state legislature and sought an amendment to the economic loss statute that it hoped would revive the dismissed tort claims.[72] The statute, passed during a special session in the spring

69. Suneel Arora, Note, *Fraud and Negligent Misrepresentation Claims Under Minnesota's Economic Loss Doctrine After* AKA Distributing Co. v. Whirlpool Corp., *137 F.3d 1083 (8th Cir. 1998) and the 1998 Legislative Amendments For Marvin Windows*, 25 WM. MITCHELL L. REV. 1501, 1537-41 (1999).

70. Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 34 F. Supp. 2d 738, 741 (D. Minn. 1999).

71. *Id.*

72. Arora, *supra* note 69, at 1533.

of 1998, added a new subsection (e) to section 604.10: "This section shall not be interpreted to bar tort causes of action based upon fraud or fraudulent or intentional misrepresentation or limit remedies for those actions."[73]

The amendment also contained language characterizing itself as a clarification of the law, rather than a substantive change, and making the new provisions effective with regard to pending actions.[74] All such language was an attempt to ensure that Marvin could rely upon the amendment in its litigation against PPG.[75]

AKA Distributing and similar cases demonstrate the importance of this issue, and should raise a cautionary flag against legislating an economic loss doctrine in response to perceived political crises. In fact, sober reflection in the wake of the 1998 special session has raised some serious concerns about the Marvin amendment. It appears the Minnesota legislature may revisit its hurried work,[76] and it would be wise to consider the *AKA Distributing* framework as it does so.

C. *Statutory Claims*

Minnesota, like most states, has enacted consumer protection statutes that often play a role in product liability litigation. For instance, an aggrieved purchaser might seek to recover not only for strict liability and negligence, but also under the Consumer Fraud Act,[77] the Unlawful Trade Practices Act,[78] or the False Statements in Advertising Act.[79] These tort-like statutory remedies are aimed at consumers, but commercial buyers can qualify as consumers under the right circumstances. As an example, the Minnesota Supreme Court has permitted a church, which purchased faulty roofing materials, to assert a claim against the manufacturer under the Con-

73. Act of Apr. 22, 1998, 1st Spec. Sess., ch. 2, 1998 Minn. Laws 2322 (codified as amended at Minn. Stat. § 604.10).

74. *Id.*

75. This attempt was unsuccessful. *Marvin Lumber & Cedar*, 34 F. Supp. 2d at 743-44 (applying amendment only to actions under section 604.10 and not under common law; since Marvin purchased the disputed product prior to enactment of that statute, its action was governed by the common law economic loss doctrine). The Eighth Circuit affirmed on this issue. Marvin Lumber & Cedar Co. v. PPG Indus., Inc., __ F.3d __, No. 99-1424, 2000 WL 1182809, at *8 (8th Cir. Aug. 22, 2000).

76. Arora, *supra* note 69, at 1541 n.301.

77. MINN. STAT. § 325F.68-.70 (West 2000).

78. MINN. STAT. § 325D.09-.16 (West 2000).

79. MINN. STAT. § 325F.67 (West 2000).

sumer Fraud Act.[80]

As *Church of the Nativity* demonstrated, such statutory tort claims can implicate the economic loss doctrine every bit as much as a strict liability claim. The church's claims were permissible, because it was not a merchant within the meaning of the U.C.C. and therefore its purchase was treated as an ordinary consumer transaction.[81] These statutory claims pose much the same issue as the question of who should count as a merchant in goods of the kind at issue in a products case.[82] Decisions in this area, therefore, should continue to focus on the extent of the plaintiff's knowledge of the product and sophistication as a commercial entity. No experienced and savvy business should be permitted to invoke consumer protection statutes any more than it should enjoy the right to seek recovery under a negligence or strict liability theory. If the plaintiff qualifies as a merchant in goods of the kind, it must be held solely to U.C.C. remedies.

V. CONCLUSION

The last twenty years have seen rapid development of the economic loss doctrine in Minnesota. After *Superwood*, the Uniform Commercial Code has been a much more secure refuge for business transactions in this state. As the twenty-first century commences, more questions remain. The answers, however, may be derived from principles firmly established during the 1980's and 1990's.

80. Church of the Nativity of Our Lord v. Watpro, Inc., 491 N.W.2d 1, 7 (Minn. 1992).

81. *Id.* at 8.

82. *Marvin Lumber & Cedar Co.*, __ F.3d __, No. 99-1424, 2000 WL 1182809, at *9 (8th Cir. Aug. 22, 2000).

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