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Placing the Commercial and Economic Loss Problem in the Construction Industry Context, 41 J. Marshall L. Rev. 39 (2007)

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PLACING THE COMMERCIAL AND ECONOMIC LOSS PROBLEM IN THE CONSTRUCTION INDUSTRY CONTEXT

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I. INTRODUCTION[1]

Economic loss problems are contextual.[2] Unfortunately, too many economic loss cases use a doctrinal approach that ignores context. Without a doubt, the construction industry cases are in disarray. This Article analyzes the problem of claims for purely economic loss in the construction industry and concludes that courts should pay far greater attention to the commercial context in which these problems arise.

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1. This Article concludes the author's three-part series that underscores the importance of context in analyzing risk allocation in the construction industry. *See generally* Carl J. Circo, *When Specialty Designs Cause Building Disasters: Responsibility for Shared Architectural and Engineering Services,* 84 NEB. L. REV. 162 (2005) [hereinafter *Specialty Designs*] (discussing liability in specialty design construction contracts); Carl J. Circo, *Contract Theory and Contract Practice: Allocating Design Responsibility in the Construction Industry,* 58 FLA. L. REV. 561 (2006) [hereinafter *Contract Theory*] (examining how courts and the construction industry determine liability under design contracts).

2. *See, e.g.*, Ellen M. Bublick, *Economic Torts: Gains in Understanding Losses*, 48 ARIZ. L. REV. 693, 701-04 (2006) (providing a brief discussion of the importance of context-by-context analysis for economic loss cases); Dan B. Dobbs, *An Introduction to Non-Statutory Economic Loss Claims*, 48 ARIZ. L. REV. 713, 733 (2006) (stating that a single economic loss rule would create illogical results due to the contextual nature of the claims); Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749, 750-51 (2006) (detailing a system for determining when and why a person is subject to liability for economic loss); Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 ARIZ. L. REV. 857, 859, 869-70 (2006) (noting that the economic loss rule does not stem from a single principle); Oscar S. Gray, *Some Thoughts on The Economic Loss Rule and Apportionment*, 48 ARIZ. L. REV. 897, 898 (2006) (referring not to a single economic loss rule but to a broader concept that applies in distinct contexts).
The leading text on construction law also emphasizes the importance of analyzing economic loss problems within the proper industry context. *See* JUSTIN SWEET & MARC M. SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS, 289-90 (Thompson 7th ed. 2004) (examining the "commercial world" and the increasingly important role of tort law in purely economic loss construction cases).

Controversy,[3] confusion,[4] disagreement,[5] and even stinging criticism[6] accompany economic loss problems in building construction cases. Many cases purport to resolve these problems by invoking the economic loss rule, a per se bar to recovery that might be better confined to products liability law. The building construction cases present a cafeteria of sumptuously conflicting and ambiguous offerings. Pronouncements of state law on the issue contrast mightily.[7] But it is not merely the jurisdictional variations that manifest the debate's complexity. Conflicting cases

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3. *See, e.g.*, Sandarac Ass'n v. W.R. Frizzell Architects, Inc., 609 So. 2d 1349, 1352 (Fla. Dist. Ct. App. 1992) ("The economic loss rule is stated with ease but applied with great difficulty."); Patricia H. Thompson & Christine Dean, *Continued Erosion of the Economic Loss Rule in Construction Litigation by and Against Owners*, CONSTRUCTION LAW., Fall 2005, at 36 (discussing the difficult application of the economic loss doctrine "as it pertains to noncontracual claims for economic damages" in the construction context).

4. *See, e.g.*, Moransais v. Heathman, 744 So. 2d 973, 980 (Fla. 1999) ("We must acknowledge that our pronouncements on the rule have not always been clear and, accordingly, have been the subject of legitimate criticism and commentary."); John J. Laubmeier, *Demystifying Wisconsin's Economic Loss Doctrine*, 2005 WIS. L. REV. 225, 255-56 (discussing whether Wisconsin's economic loss rule will ultimately be applied to residential real estate purchases); Emily M. Usow, *Redefining the Professional Service Contract: The Evolution and Deconstruction of Florida's Economic Loss Rule*, 8 U. MIAMI BUS. L. REV. 1 (1999) (detailing the evolution of Florida law regarding the economic loss rule).

5. *See generally* Anthony L. Meagher & Michael P. O'Day, *Who Is Going to Pay for My Impact? A Contractor's Ability to Sue Third Parties for Purely Economic Loss*, CONSTRUCTION LAW., Fall 2005, at 27, 29-31 (highlighting conflicting reasoning of recent cases discussing the application of the economic loss doctrine).

6. For example, in dissenting from the majority's opinion in *Olson v. Richard*, 89 P.3d 31, 34 (Nev. 2004), allowing a residential purchaser to sue for purely economic loss due to negligent construction, Justice Becker argued that an opinion decided by the court only two years earlier established definitively that Nevada law precluded just such a claim "and the fact that the composition of the court has changed is not a sufficient reason for reconsidering the issue." *See also infra* note 9 (citing dissenting opinions in several economic loss cases).

7. *Compare* Coburn v. Lenox Homes, Inc., 378 A.2d 599, 602-03 (Conn. 1997) (refusing to extend implied warranty liability for economic loss to a subsequent purchaser), *with* Barnes v. Mac Brown and Co., Inc., 342 N.E.2d 619, 620 (Ind. 1976) (extending economic loss based on an implied warranty to a subsequent purchaser); *compare* Kennedy v. Columbia Lumber & Mfg. Co., 384 S.E.2d 730, 737-38 (S.C. 1988) (holding that a builder may be liable to subsequent residential purchasers for purely economic loss), *with* Casa Clara Condo. Ass'n v. Charley Toppin & Sons, Inc., 620 So. 2d 1244, 1246 (Fla. 1993) (reaching the opposite conclusion, finding a subsequent residential purchaser may not sue the builder for negligent construction). *See also* Jody Bedenbaugh, *Liability of Design Professional for Purely Economic Loss in South Carolina*, 53 S.C. L. REV. 701, 710-14 (2002) (contrasting Florida and South Carolina cases applying the economic loss rule).

often emerge within a single jurisdiction,[8] strenuous dissents[9] and heavily qualified concurrences abound,[10] and more than one high court has reversed itself or awkwardly corrected course.[11]

This Article argues that, in construction cases, the rule-based debate over claims for purely economic loss should yield to more significant construction law questions. Should a per se rule that achieved its present vitality primarily because it efficiently limits liability for defective products apply at all to defective building design and construction? Does the economic loss conundrum merit a revitalized legal perspective that recognizes the industry's unique circumstances? If a claim seeks to reallocate a commercial risk, should it matter whether the harm suffered includes a physical as well as an economic consequence? If the resilient building construction marketplace is left free to allocate commercial and economic losses contractually, will it develop a more efficient framework than tort law can ever hope to impose on the industry?

The argument here is that courts should eschew a broad brush approach to economic loss problems in favor of an inquiry that considers the commercial context in which economic loss problems arise in building construction cases. Courts sometimes use the duty construct to frame the central policy issue of tort law. With that approach in mind, the better question is not whether tort law, viewed as a singular legal institution, should provide a remedy for purely economic loss; it is whether or in what

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8. *See, e.g.*, *Moransais*, 744 So. 2d at 974-75 (addressing conflicting opinions of the Florida District Courts of Appeal); Lempke v. Dagenais, 547 A.2d 290, 297-98 (N.H. 1988) (holding that subsequent purchasers may recover economic loss in breach of implied warranty), *overruling* Ellis v. Robert C. Morris, Inc., 513 A.2d 951 (N.H. 1986).

9. *See, e.g.*, Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 289-90 (Penn. 2005) (Cappy and Saylor, JJ., dissenting); Fireman's Fund Ins. Co. v. SEC Donohue, Inc., 679 N.E.2d 1197, 1202 (Ill. 1997) (Heiple, J., dissenting); Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n, 560 N.E.2d 206, 213 (Ohio 1990) (Brown, J., dissenting); Sewell v. Gregory, 371 S.E.2d 82, 86-90 (W. Va. 1988) (Neely, J., dissenting); Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041, 1046-51 (Colo. 1983) (Ravira, J., dissenting).

10. *See, e.g.*, Presnell Constr. Managers, Inc. v. EH Constr., LLC, 134 S.W.3d 575, 583-91 (Ky. 2004) (Keller, J., concurring) (explaining the importance of the economic loss rule); Real Estate Mktg., Inc. v. Franz, 885 S.W.2d 921, 928, 929 (Ky. 1994) (Wintersheimer and Prater, JJ., concurring in part and dissenting in part) (discussing diverging views on the requirement of privity in economic loss cases across different jurisdictions).

11. *See, e.g., Kennedy*, 384 S.E.2d at 734-36, *overruling* Carolina Winds Owners' Ass'n v. Joe Hardin Builders, Inc., 374 S.E.2d 897 (S.C. Ct. App. 1988); Gary Ashman, Note, *The Long and Winding Road of Economic Loss Doctrine in* Calloway v. City of Reno, 3 NEV. L. J. 167 (2002) (recounting the Nevada Supreme Court's reversal on the application of the economic loss rule to residential construction).

situations courts should impose a tort duty on those participating in a building construction project to avoid causing purely economic harm to others. The thesis of this Article is that a vigorous economic loss defense best fits the construction industry context because an efficient construction industry requires predictable and quantifiable risk assessment to support risk allocation by contract. To the extent that unequal bargaining power makes a contractual approach unacceptable in some settings, such as residential construction, legislatures rather than courts should craft a solution equal to the problem.

Part II of this Article briefly reviews the economic loss problem as a matter of tort law generally. Part III explores and critiques how the courts have dealt with the most common theories for recovering purely economic loss in building construction cases. Part IV argues that the construction industry cases are incoherent because they fail to place the debate in its proper industry context. Part V outlines an alternative approach that would continue to restrict tort recovery for commercial and economic losses in building construction cases, while at the same time facilitate recovery when justified on contract principles. Although this Article mainly addresses the construction industry cases, the recommendations made in Part V are also relevant to other commercial and economic loss problems.

II. THE ECONOMIC LOSS PROBLEM IN TORT LAW

A. Physical Harm and Economic Loss in Tort Law

As a conceptual matter, U.S. tort law distinguishes between harm that has a physical dimension and harm that is solely economic.[12] Tort law does not, however, prohibit recovery for economic loss. Although the torts with the oldest pedigrees,[13] such as battery[14] and trespass to property,[15] involve harmful physical

12. Under the Restatement, physical harm refers to "physical impairment of the human body or of real property or tangible personal property." RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL HARM § 4 (Proposed Final Draft No. 1, 2005). The ongoing work on the Third Restatement of the Law of Torts includes a now nearly-completed division dedicated exclusively to torts involving physical harm that expressly reserves the topic of torts involving only economic harm. *Id.*, Introduction at xli-xlii (Proposed Final Draft No. 1, 2005); *see also* RESTATEMENT (SECOND) OF TORTS § 766C (1979) (restricting liability for "pecuniary harm not deriving from physical harm" in actions for negligent interference with contract).

13. The common law writ of trespass required direct physical contact with the plaintiff's person or property. Later, the common law writ of trespass on the case emerged and provided a potential remedy for harm resulting indirectly from the defendant's conduct. *See* Charles O. Gregory, *Trespass to Negligence to Absolute Liability*, 37 VA. L. REV. 359, 361-65 (1951).

14. RESTATEMENT (SECOND) OF TORTS § 13 (1965).

contact, even the common law form of action for trespass on the case sometimes provided a remedy for purely economic loss.[16] Additionally, tort remedies are routinely available to compensate for economic loss suffered in conjunction with physical harm.[17]

Contemporary tort law also comfortably affords remedies for the intentional infliction of economic loss in a variety of contexts, including fraud,[18] intentional interference with another person's performance of a contract,[19] intentional interference with a prospective contractual relationship,[20] and intentional interference with an inheritance or gift.[21] What is more pertinent to this discussion is that several unintentional torts also protect economic interests. These include, for example, negligent misrepresentation[22] and malpractice by accountants,[23] lawyers,[24] and other professionals.[25]

In other circumstances, however, contemporary courts routinely deny recovery in tort for the unintentional infliction of

15. RESTATEMENT (SECOND) OF TORTS § 158 (1965).

16. *See* Chambers v. Spruce Lighting Co., 95 S.E. 192 (Va. 1918) (concluding that if the plaintiffs could prove the amount of their lost profits with reasonable certainty, they could recover in trespass on the case based on the defendants' neglect of a duty imposed by law).

17. Courts frequently state the rule barring recovery for economic loss in terms that make this clear. "We hold contract principles more appropriate than tort principles for resolving economic loss without an accompanying physical injury or property damage." Fla. Power & Light Co. v. Westinghouse Elec. Corp., 510 So. 2d 899, 902 (Fla. 1987).

18. *See* RESTATEMENT (SECOND) OF TORTS § 525 (1977) (providing liability for fraudulent misrepresentation); *id.* § 526 (describing when a misrepresentation is fraudulent); *id.* § 527 (explaining when an ambiguous representation constitutes fraud); *id.* § 529 (stating that an incomplete representation may be fraudulent); *id.* § 530 (declaring that a misrepresentation as to one's intentions or those of a third party may be fraudulent); *id.* § 550 (establishing liability for fraudulent concealment).

19. *See id.* § 766A (establishing liability to a third party for the intentional interference with the performance of a contract).

20. *See id.* § 766B (promulgating a rule that one who intentionally interferes with another's prospective contract is liable to the other).

21. *See id.* § 774B (providing that one who intentionally interferes with inheritance or gifts is subject to liability for the loss).

22. *See id.* § 552 (stating that one who negligently provides information for the guidance of others can be liable for resulting pecuniary loss).

23. *See* Jodi B. Scherl, *Evolution of Auditor Liability to Noncontractual Third Parties: Balancing the Equities and Weighing the Consequences*, 44 AM. U. L. REV. 255, 268 (1994).

24. *See* Douglas A. Cifu, *Expanding Legal Malpractice to Nonclient Third Parties – At What Cost*, 23 COLUM. J. L. & SOC. PROBS. 1, 4 (1989).

25. *See generally* Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513, 1527 (1985) (discussing economic loss in the context of "third-party situations in which the victims are members of a general class who suffer economic loss as a consequence of the defendant's carelessness").

purely economic loss.[26] Courts and commentators frequently refer to the economic loss rule or the economic loss doctrine as an overarching principle.[27] Outside of products liability law, however, the cases lack coherence on matters such as the scope, function, and rationale of any principle dealing with purely economic loss.

A brief historical overview shows that early opinions denying recovery for purely economic loss did not instinctively connect the validity of a tort cause of action with the classification of the harm as either physical or economic. Leading cases decided in the first half of the twentieth century seem blind to the distinction between physical and economic harm. They resolved economic loss problems by resorting to other devices, including proximate cause,[28] privity,[29] and duty.[30] Some early cases blended views on two or more of these notions in ways that seem to blur rather than clarify the rationale involved.[31]

Consider the 1903 case of a printing company that lost production time when a builder working for a neighboring business negligently damaged conduit for electric utility lines.[32]

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26. *See, e.g.*, Town of Alma v. Azco Constr., Inc., 10 P.3d 1256, 1264 (Colo. 2000) (holding that a party suffering purely economic loss from a breach of contract may not assert a tort claim); Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 450-52 (Ill. 1982) (discussing case law precedent denying a tort claim based on economic loss).

27. *See, e.g.*, *Bilt-Rite Contractors*, 866 A.2d at 287-88 (referring alternatively to the economic loss rule and the economic loss doctrine); BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66, 71-73 (Colo. 2004) [hereinafter *Dufficy*] (economic loss rule); Calloway v. City of Reno, 993 P.2d 1259, 1261 (Nev. 2000) [hereinafter *Calloway II*] (economic loss doctrine); Jim's Excavating Serv., Inc. v. HKM Ass'n, 878 P.2d 248, 252 (Mont. 1994) (economic loss doctrine); *Kennedy*, 384 S.E.2d at 736-37 (economic loss rule); Matthew W. Gissendanner, *Tort Recovery for Defective Products Posing a Threat of Bodily Harm: An Exception to the Economic Loss Rule?*, 57 S.C. L. REV. 619 (2006) (economic loss rule); *see also* John D. Finerty, Jr. & Charles J. Crueger, *A Commentary On The Economic Loss Doctrine Under The Rule Of Cease Electric And Cascade Stone*, 89 MARQ. L. REV. 137, 137 (2005) (economic loss doctrine). I refer to the principle involved as a rule rather than a doctrine primarily because selecting one term over the other serves the interest of consistency. One might also suggest that the status of doctrine seems a bit too elevated for something as uncertain in its scope and application as the observation that in most jurisdictions tort law sometimes precludes recovery for economic loss. *Id.*

28. *See, e.g.*, Rickards v. Sun Oil Co., 41 A.2d 267, 269 (N.J. 1945). *See generally* G. EDWARD WHITE, TORT LAW IN AMERICA 92-96 (2003); Fleming James Jr. & Roger F. Perry, *Legal Cause*, 60 YALE L. J. 761, 763 (1951).

29. *See* Byrd v. English, 43 S.E. 419, 421 (Ga. 1903). *See generally* Scherl, *supra* note 23, at 265-70 (discussing the historical development of the law of contractual privity).

30. *See, e.g.*, H.R. Moch Co. v. Rensselaer Water Co., 159 N.E. 896, 898-99 (N.Y. 1928).

31. *See, e.g.*, *Rickards*, 41 A.2d at 268.

32. *Byrd*, 43 S.E. at 421.

The company could not recover from the builder for the lost business. "It is only the proximate injury that the law endeavors to compensate."[33] The negligent act did not damage the plaintiff's property because the conduits belonged to the utility. The plaintiff's loss resulted because the damage to the lines inside the conduit made it temporarily impossible for the utility to deliver electricity to the plaintiff. Under these circumstances, the plaintiff's tort theory would lead to results the court viewed as patently absurd. That theory could make the builder liable "without limit to the number of persons who might recover on account of the injury done to the property of the company owning the conduits."[34] Because the plaintiff's legal right to electricity derived from the contract with the utility (a relationship that did not involve the builder), recovery for the plaintiff's losses from the power interruption could be had from the utility alone, and then only if and to the extent the plaintiff could establish an actionable breach of the service contract.[35] In part, the holding combines proximate cause and privity reasoning, but the case may also suggest the less theoretical rationale that courts must establish some practical limits on tort liability.

Robins Dry Dock & Repair Co. v. Flint,[36] a 1927 United States Supreme Court case, is sometimes cited as early authority for a broad rule against recovery in a negligence action for purely economic loss.[37] In that case, a ship owner hired a dry dock company, which negligently damaged the ship while it was docked. The Court held that the plaintiff who chartered the ship from the owner could not recover from the dry dock company for the resulting delay for repairs. The controlling statement of tort law offered by Justice Holmes is a narrow principle, not expressly tied to the economic character of the loss. Justice Holmes explained that "as a general rule, at least, a tort to the person or property of one man does not make the tortfeasor liable to another merely because the injured person was under a contract with that other

33. *Id.* at 421. Although the analysis suggests a restrictive view of proximate cause, the court expressly held that the successful defense theory was distinct from the builder's alternative defense based on a proximate cause argument. *Id.*

34. *Id.* at 420.

35. *Id.* Based on the court's summary of the petition, it seems that even in those early days of the commercial use of electricity the utility had the foresight to include in its service contract an express provision that exonerated it under these circumstances. *Id.*

36. 275 U.S. 303 (1927).

37. *See, e.g.*, Local Joint Executive Bd., Culinary Workers Union, Local No. 226 v. Stern, 651 P.2d 637, 638 (Nev. 1982) (holding that the common law rule still applies and that absent privity of contract or "injury," a plaintiff may not recover); People Express Airlines, Inc. v. Consol. Rail Corp., 495 A.2d 107, 109 (N.J. 1985) (discussing a *per se* rule barring recovery for economic loss unless the conduct was negligent and resulted in physical harm).

unknown to the doer of the wrong. The law does not spread its protection so far."[38]

A 1945 New Jersey case held that a barge company could not be liable to business owners for profits lost when the company's pilot negligently damaged a draw bridge that provided the only road access onto the island where the businesses were located.[39] The opinion draws on more or less equal doses of duty, proximate cause, foreseability, and a general concern for maintaining sensible limits on the reach of tort liability.[40]

The role of privity of contract in restricting tort remedies deserves special mention. Some early cases involving economic loss stumbled on the privity requirement, which has now lost much of its vigor in tort law.[41] By requiring privity, the courts eliminated tort remedies in many situations in which only an indirect nexus existed between the defendant's conduct and the plaintiff's loss, whether physical[42] or economic.[43] Privity does not involve the nature of the harm suffered; rather it looks for a legally significant nexus or relationship between the plaintiff and the defendant. Privity is a slippery and sometimes malleable concept, but for present purposes Justice Pound captured its essence when he suggested in a 1927 case that the evidence must show that the plaintiff is someone to whom the defendant "is bound by some relation of duty, arising out of public calling, contract or otherwise."[44]

While the courts in the first half of the twentieth century were applying notions of privity, proximate cause, and duty to economic loss cases, they were also engaged in the more significant process of defining tort law.[45] In that process, the underlying concepts most useful in controlling tort liability for economic loss were

38. *Robins Dry Dock*, 275 U.S. at 309 (citation omitted).

39. *Rickards*, 41 A.2d at 268.

40. *Id.* at 268-70.

41. *See, e.g.*, *Kennedy*, 384 S.E.2d at 736 (affirming that privity of contract is no longer necessary when bringing a cause of action for breach of an implied warranty).

42. *See, e.g.*, Ford v. Sturgis, 14 F.2d 253, 254 (D.C. Cir. 1926) (applying restrictive privity and proximate cause notions to bar recovery from a steel contractor for the death of a patron caused by the structural collapse of the building). Perhaps the most famous case imposing privity as a condition to recovery for physical harm is *Winterbottom v. Wright*, 10 M & W. 109, 152 Eng. Rep. 402 (Ex. 1842).

43. *See, e.g.*, *Byrd*, 43 S.E. at 419 (holding that the plaintiff could not recover damages from defendant for lost business because there was no privity of contract between the parties).

44. Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp., 157 N.E. 272, 273 (N.Y. 1927).

45. It may be more accurate to say that the courts at that time were creating Tort as a distinct branch of law. *See* WHITE, *supra* note 28, at 3-19.

transforming in ways that required the courts to rethink the economic loss problem.

B. Expanding Tort Liability for Economic Loss

Glanzer v. Shepard,[46] a Cardozo opinion decided in 1922, molded the analytic framework that still governs many economic torts today. The court held that defendants engaged by a seller to certify bean weight could be liable to the buyer in tort for the buyer's overpayment based on the defendants' erroneous certificate. Relying on the nascent products liability precedent of *MacPherson v. Buick Motor Co.*,[47] the Court of Appeals rejected rigid limitations dependent on a direct contractual relationship or privity and opted for a broader concept of tort duty arising from the specific situation.

> In such circumstances, assumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed. We do not need to state the duty in terms of contract or of privity. Growing out of a contract, it has none the less an origin not exclusively contractual. Given the contract and the relation, the duty is imposed by law.[48]

In other words, an obligation undertaken via a contract between A and B can create a relationship between B and C that generates sufficient public interest to convince a court to impose a duty on B for C's protection. Using a contractually created obligation to justify an additional legal duty, theoretically independent of the contract, became a significant building block for expanding the tort system.[49] The significance of this remarkable development for the construction industry will soon become clear.[50] But first it is important to see how the doctrine of *Glanzer v. Shepard* took root in other situations.

One of the most influential opinions expanding tort liability for purely economic loss came a generation later in *Biakanja v. Irving*.[51] In that case, the California Supreme Court allowed an action by an intended will beneficiary who suffered loss because a notary public improperly drafted the will. The court cited the products liability cases and related developments in tort law to

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46. 135 N.E. 275 (N.Y. 1922).

47. 111 N.E. 1050 (N.Y. 1916).

48. *Glanzer*, 135 N.E. at 276.

49. *See* Rabin, *supra* note 25, at 1527-28 (discussing economic loss recovery in situations where the defendant's negligence injured a third party). On the significance of *Glanzer v. Shepard* to the development of the law generally, see WHITE, *supra* note 28, at 131-32.

50. *See infra* Part III.B (explaining how recovery for a third party harmed by a defendant's negligence expanded into recovery for negligent infliction of economic harm in the construction industry).

51. 320 P.2d 16 (Cal. 1958).

support a "greatly liberalized" privity of contract rule.[52] The case famously advanced the transition of tort analysis from the rigid principles prevailing at the beginning of the century to a broader, policy-based inquiry that weighed a range of relevant considerations and that placed a special emphasis on foreseeability.[53]

> The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.[54]

Borrowing logic and phrase from *Glanzer v. Sheppard*, the court held that this progressive approach justified a theory for the intended beneficiary because "the 'end and aim' of the transaction was to provide for the testamentary devise to the plaintiff."[55] Contemporary tort cases frequently apply the *Biakanja* factors when the question is whether liability should extend to a situation of first impression.[56]

Just over a decade later, the California Supreme Court carried the analysis to the limits of logic. Chief Justice Traynor's opinion for a 4-3 majority held that a savings and loan association could be liable in negligence to purchasers of defectively constructed homes the defendant financed.[57] Traynor held that the plaintiffs' allegations were sufficient to permit a finding that the defendant's sloppy loan underwriting practices violated the standard of care it owed to its shareholders.[58] Then, applying the *Biakanja* factors, Traynor held that the lender "was clearly under a duty to the buyers of the homes to exercise reasonable care to protect them from damages caused by major structural defects."[59] As in the earlier opinions expanding tort liability for purely economic loss, the influence of products liability theory figured

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52. *Id.* at 18.

53. For a general discussion of the impact of *Biakanja v. Irving*, see Rabin, *supra* note 25, at 1518-21.

54. *Biakanja*, 320 P.2d at 19.

55. *Id.*

56. *See, e.g.*, Colbert v. B.F. Carvin Const. Co., 600 So. 2d 719, 725 (La. Ct. App. 1992); Westerhold v. Carroll, 419 S.W.2d 73, 81-82 (Mo. 1967).

57. Connor v. Great W. Sav. & Loan Ass'n, 447 P.2d 609, 617 (Cal. 1969).

58. *Id.* at 616-17. The majority rejected the plaintiffs' argument that the developer and the lender were joint venturers. *Id.* at 615-16. The degree of involvement and control the lender exercised over the lender, however, played a role in several of the *Biakanja* factors. *Id.* at 617-18.

59. *Id.* at 617.

prominently. "At least since *MacPherson v. Buick Motor Co.* there has been a steady expansion of liability for harm caused by the failure of defendants to exercise reasonable care to protect others from reasonably foreseeable risks."[60] Other courts have not been as eager to carry this expansion as far as Traynor was, at least not in the context of a lender's liability for construction defects.[61] In dissent, Justice Burke highlighted the logical flaw in Traynor's analysis by substituting a similarly careless individual lender for the savings and loan association. "In that situation could it be said that the individual's failure to exercise prudence and care in protecting himself gives rise to a duty of care to others? I think not."[62]

In *People Express Airlines, Inc. v. Consolidated Rail Corp.*,[63] decided more than twenty-five years after *Biakanja v. Irving*, the New Jersey Supreme Court turned a spotlight on the growing perception that courts should restrict negligence law to cases involving physical harm.

> This appeal presents a question that has not previously been directly considered: whether a defendant's negligent conduct that interferes with a plaintiff's business resulting in purely economic losses, unaccompanied by property damage or personal injury, is compensable in tort. The appeal poses this issue in the context of the defendants' alleged negligence that caused a dangerous chemical to escape from a railway tank car, resulting in the evacuation from the surrounding area of persons whose safety and health were threatened. The plaintiff, a commercial airline, was forced to evacuate its premises and suffered an interruption of its business operations with resultant economic losses.[64]

Unlike the courts in *Glanzer v. Sheppard* and *Biakanja v. Irving*, the New Jersey Supreme Court was not satisfied to address the broad questions of privity, proximate cause, duty, foreseeability, and the logical limits of tort liability. The court launched a frontal attack on any bright-line restriction against recovery in tort for economic loss. The court judged this assault necessary because "a virtually per se rule barring recovery for economic loss unless the negligent conduct also caused physical

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60. *Id.* at 619 (citations omitted).

61. "[T]he *Connor* rule has not met with widespread acceptance . . . subsequent cases have indicated that liability will only be imposed in unusual circumstances where the lender's activities clearly exceed those of a normal lender." Smith v. Tyonek Timber, Inc., 680 P.2d 1148, 1152 (Ala. 1984); *see also* Melissa Cassedy, *The Doctrine of Lender Liability*, 40 U. FLA. L. REV. 165, 173-77 (1988) (illustrating the narrow interpretation other courts have given the *Connor* rule).

62. *Connor*, 447 P.2d at 626.

63. 495 A.2d 107 (N.J. 1985).

64. *Id.* at 108.

harm has evolved throughout this century."[65] That predicate for the opinion is more surprising than the court's holding that the plaintiff's complaint stated a cause of action. The authorities the court cited for this per se rule do not, either individually or collectively, evidence an established, broad-based judicial hostility to purely economic loss as a category of harm as much as they reflect the judicial instinct that some consequences of negligence are either too remote or too widespread for an orderly tort system to address.[66]

Having thus posited the existence of a per se rule evolved over the century, the court then cited numerous cases decided during that same period that permitted recovery of purely economic loss.[67] From this cast of cases, the court reasoned that a per se rule should be rejected in favor of a case-by-case approach turning on foreseeability and the policy considerations inherent in defining the concepts of duty and the limits of tort liability.[68] The court could have conserved much judicial energy by drawing a more direct inference from all of the cases cited: A century of torts cases,

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65. *Id.* at 109.

66. As direct support for its claim that a "virtually *per se* bar" has evolved, the court cited *Robins Dry Dock* and *Byrd*, both of which are discussed in Part II.A of this Article. *People Express Airlines*, 495 A.2d at 109. The court also cited *Stevenson v. E. Ohio Gas Co.*, 73 N.E.2d 200 (Ohio Ct. App. 1946). *Id.* The *Stevenson* court held that that the plaintiff could not recover for lost wages caused by a gas explosion at the defendant's plant that ignited such a large fire in the vicinity that the plaintiff was unable to work at his employer's nearby place of business until eight days after the explosion. *Stevenson*, 73 N.E.2d at 204. While the concluding language in *Stevenson*, when read in isolation, suggests a per se bias against purely economic loss claims, the case is probably better understood as simply a reaction against the unmanageable judicial burden of providing a tort remedy for every remote consequence of a negligent act. *Id.* at 203-04. "[T]he principal reason that has motivated the courts in denying recovery in this class of cases is that to permit recovery of damages in such cases would open the door to a mass of litigation . . . ." *Id.* at 203. In other words, one can read the case not as announcing an economic loss rule, but as using the rationale of *Robins Dry Dock* to set practical limits when negligence results in a condition, such as a fire, that could produce extensive, free-standing economic damage that is traceable, yet remote. The *People Express Airlines* court also cited RESTATEMENT (SECOND) OF TORTS § 766C (1979), which is not a broad rule prohibiting recovery for purely economic loss, but a far narrower rule that applies only to the tort of negligent interference with contract or prospective contractual relation. The only other cited case is *Cattle v. Stockton Waterworks Co.*, 10 Q.B. 453 (1875), which held, on proximate cause grounds, that a tunnel contractor could not recover from a water company for interference and delay of the project resulting from damage that water pipes caused to land owned by the contractor's employer. *Cattle*, 10 Q.B. at 457. In short, the cases cited do not support the New Jersey court's claim of a "virtually *per se* rule" that "has evolved throughout this century." *People Express Airlines*, 495 A.2d at 109.

67. *People Express Airlines*, 495 A.2d at 112-18.

68. *Id.* at 116, 118.

whether or not involving physical harm, shows an imperfect progression from the dominance of rigid liability principles to more flexible standards that balance factors such as those recognized in *Glanzer v. Sheppard* and *Biakanja v. Irving*. In this sense, perhaps *People Express* overreacts. Even if that is so, the case helps set the stage for an enduring battle between those who believe that tort policy can police itself and those who argue for a bright line to mark the outer limits of tort liability.

While many other cases have contributed to the expansion of tort liability for purely economic loss,[69] the cases discussed here adequately demonstrate the phenomenon for these introductory purposes. As Part III will show, *Glanzer v. Sheppard* and *Biakanja v. Irving* have played an especially important role in developing the professional negligence and negligent misrepresentation theories for recovering purely economic loss in building construction cases. A review of the construction cases, however, must await one further aspect of the economic loss problem in tort law generally. The grand development of tort law that expanded into matters of economic as well as physical harm predictably produced judicial concern over the potentially unlimited reach of tort. That concern led to one development that has been especially influential in the construction industry cases – the economic loss rule of products liability law.

C. Establishing Limits on Recovery for Economic Loss

Given the importance of products liability in expanding tort remedies, it is not surprising that construction industry cases often draw on products liability law for guidance in establishing liability limits.[70] Not surprising, but it is unfortunate. The extraordinary developments that yielded products liability law reflect uniquely irresistible forces of scholarly opinion and public policy in reaction to the widely perceived risks of dangerous products manufactured and marketed on a mass basis.[71] The enterprise liability theory that eventually evolved now efficiently shifts many costs of those risks to the manufacturing industry.

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69. *See* Eileen Silverstein, *On Recovery in Tort for Pure Economic Loss*, 32 U. MICH. J. L. REFORM 403 (1999).

70. *See, e.g.*, *Azco Constr.*, 10 P.3d at 1259-64; *Floor Craft*, 560 N.E.2d at 208; Malta Constr. Co. v. Henningson, Durham & Richardson, 694 F. Supp. 902, 906 (N.D. Ga. 1988).

71. *See generally* WHITE, *supra* note 28, at 168-72 (attributing the expansive development of products liability law to the policy agendas of leading scholars and appellate judges of the time); George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461, 465-505 (1985) (discussing the "conceptual revolution" in American jurisprudence, including the development of products liability case law supporting recovery in spite of the economic loss rule).

But a theory based on such a broad social policy itself admits no logical limit. Is every enterprise to bear all associated costs? Should the law treat all commercial enterprises equally?

To maintain balance, most jurisdictions have embraced some form of an economic loss bar as a sensible limit in products liability cases.[72] The rationale of the products liability cases, however, does not a priori apply with equal force to other instances of expanded tort theory. Indeed, one of this Article's major arguments is that the courts facing economic loss claims in building construction cases should not adopt or adapt the economic loss rule of products liability law. But, as Part III demonstrates, the construction industry cases have in fact relied heavily on both the language and justifications of products liability's economic loss rule. For that reason, an overview of how the products liability cases have dealt with purely economic loss is an essential prelude to a review of the building construction cases.

Although Chief Justice Traynor's opinion in *Seely v. White Motor Co.*[73] is the seminal authority for the economic loss rule in products liability cases, the United States Supreme Court's *East River* opinion[74] may offer the most powerful articulation of the principle involved. As a preliminary matter, the Court held that federal admiralty law "incorporates principles of products liability, including strict liability."[75] In light of the deference that many building construction cases give to the economic loss rule of products liability law, several excerpts from Justice Blackmun's opinion merit reflection. He began by recognizing both the policy justification for products liability law and the potentially unlimited reach it portended. In a concise overview, Blackmun tipped his hat equally to Traynor's influence and Professor Grant Gilmore's wit.

> Products liability grew out of a public policy judgment that people need more protection from dangerous products than is afforded by the law of warranty. *See Seely v. White Motor Co.*, 63 Cal.2d 9, 15, 45 Cal. Rptr. 17, 21, 403 P.2d 145, 149 (1965). It is clear, however, that if this development were allowed to progress too far, contract law would drown in a sea of tort. *See* G. Gilmore, The Death of Contract 87-94 (1974). We must determine whether a commercial product injuring itself is the kind of harm against which public policy requires manufacturers to protect, independent of any contractual obligation.[76]

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72. *See generally* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 868-70 (1986) [hereinafter *East River*]; Gissendanner, *supra* note 27, at 619.

73. 403 P.2d 145 (Cal. 1965).

74. 476 U.S. 858 (1986).

75. *Id.* at 860.

76. *Id.* at 866 (internal citations omitted).

The opinion continued with the obligatory acknowledgment of Justice Cardozo's role, along with a well placed citation to a famously prescient Traynor concurrence.

> The paradigmatic products-liability action is one where a product "reasonably certain to place life and limb in peril," distributed without reinspection, causes bodily injury. *See, e.g., MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 289, 111 N.E. 1050, 1051, 1053 (1916). The manufacturer is liable whether or not it is negligent because "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. *Escola v. Coca Cola Bottling Co. of Fresno*, 24 Cal.2d at 462, 150 P.2d at 441 (opinion concurring in judgment)."[77]

Next, Blackmun approached the crux of the matter before the Court.

> For similar reasons of safety, the manufacturer's duty of care was broadened to include protection against property damage. Such damage is considered so akin to personal injury that the two are treated alike.
>
> In the traditional "property damage" cases, the defective product damages other property. In this case, there was no damage to "other" property. Rather, the first, second, and third counts allege that each supertanker's defectively designed turbine components damaged only the turbine itself.[78]

On the crucial question of purely economic loss, the state courts offered conflicting conclusions. On one side stood the majority of the courts, which followed *Seely v. White*'s determination to halt enterprise liability at purely economic loss, based on the rationale that "preserving a proper role for the law of warranty precludes imposing tort liability if a defective product causes purely monetary harm."[79] At the other end of the spectrum, a minority of courts preferred the rule "that a manufacturer's duty to make nondefective products encompasse[s] injury to the product itself, whether or not the defect created an unreasonable risk of harm."[80] The leading case in support of this position was *Santor v. A & M Karagheusian, Inc.*,[81] decided by the New Jersey Supreme Court, whose resistance to a per se bar to recovery for economic loss has already been noted in this Article.[82]

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77. *Id.* at 866-67.

78. *Id.* at 867 (citations omitted).

79. *Id.* at 868.

80. *Id.* at 868-69.

81. 207 A.2d 305, 312-313 (N.J. 1965), *overruled by* Alloway v. Gen. Marine Indus., 695 A.2d 264 (N.J. 1997).

82. *See supra* notes 62-67 and accompanying text (reviewing the New Jersey court's position that recovery for purely economic loss should be allowed in products liability cases).

Blackmun sided with Traynor. His rationale balanced the common factors that appear in countless opinions that seek sensible limits to expanding tort liability. First is judicial respect for contractual risk allocation. Contract no less than tort holds a place in the panoply of social policy. The opinion sounded this theme even before it considered the contrasting approaches of the state courts and the lower federal courts. "Obviously, damage to a product itself has certain attributes of a products-liability claim. But the injury suffered – the failure of the product to function properly – is the essence of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain."[83] Later, the opinion returned to the contract-tort distinction, but this time adding an instinctive call for limits on nonconsensual liability. "The minority view fails to account for the need to keep products liability and contract law in separate spheres and to maintain realistic limitation on damages."[84]

The opinion next considered whether the policy reasons supporting products liability extend to purely economic loss.

> When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong.
>
> The tort concern with safety is reduced when an injury is only to the product itself.... [W]hen a product injures itself, the commercial user stands to lose the value of the product, risks the displeasure of its customers who find that the product does not meet their needs, or, as in this case, experiences increased costs in performing a service. Losses like these can be insured. Society need not presume that a customer needs special protection. The increased cost to the public that would result from holding a manufacturer liable in tort for injury to the product itself is not justified.
>
> Damage to a product itself is most naturally understood as a warranty claim. Such damage means simply that the product has not met the customer's expectations, or, in other words, that the customer has received "insufficient product value..." The maintenance of product value and quality is precisely the purpose of express and implied warranties....
>
> Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies. In exchange, the purchaser pays less for the product. Since a commercial situation generally does not

83. *East River*, 476 U.S. at 867-68.
84. *Id.* at 870-71.

> involve large disparities in bargaining power, we see no reason to intrude into the parties' allocation of risk.[85]

After this extended discussion primarily concerned with the distinct roles of contract and tort in our legal system, the opinion turned more directly to another theme courts commonly consider in cases of purely economic loss – on what basis to draw the line when courts impose liability as a matter of policy. It is significant that Blackmun did not speak of overarching principles of tort law, but only of policy considerations specific to manufacturing enterprises.

> In products-liability law, where there is a duty to the public generally, foreseeability is an inadequate brake.... Permitting recovery for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums. It would be difficult for a manufacturer to take into account the expectations of persons downstream who may encounter its product. In this case, for example, if the charterers – already one step removed from the transaction – were permitted to recover their economic losses, then the companies that subchartered the ships might claim their economic losses from the delays, and the charterers' customers also might claim their economic losses, and so on. "The law does not spread its protection so far."[86]

The case held that, for purposes of products liability law as incorporated into the general maritime law, "a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself."[87] Notice that the Court limited the holding to commercial relationships involving manufactured goods. It did not announce a broad principle about recovery of purely economic loss in tort actions. Indeed, in a footnote that cited an influential Cardozo opinion, the Court expressly reserved ruling on "the issue whether a tort cause of action can ever be stated in admiralty when the only damages sought are economic."[88] The holding, therefore, is limited to a specialized area of the law – products liability in a commercial setting – and to a particular kind of economic loss – injury to the product itself.

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85. *Id.* at 871-73 (internal citations omitted).

86. *Id.* at 874.

87. *Id.* at 871.

88. *Id.* at 871 n.6. The Cardozo opinion referenced *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931), which held that a creditor who relied on inaccurate financial statements certified by the debtor's accountants could not recover from the accountants on a negligence theory. The opinion's carefully crafted limits on the liability theory of *Glanzer v. Sheppard* significantly influenced professional malpractice and negligent misrepresentation law. *See generally* WHITE, *supra* note 28, 131-36 (discussing Cardozo's reasoning in both *Ultramares* and *Glanzer*).

The products liability cases that implement *Seely* and *East River* offer the most prominent and highly developed response to the economic loss problem. Moreover, as Part III will show, the economic loss rule of the products liability cases has played a large role in the still evolving judicial approach to economic loss problems in the construction industry. The debate over the economic loss problem, however, does not end with products liability law or with the Supreme Court's decision in *East River*. Beyond products liability law, the debate continues over the circumstances under which tort law should compensate victims of purely economic loss.[89] As Part II.B demonstrates, tort law provides remedies for many economic torts, and it often does so without articulating any doctrinal approach that is uniquely based on the economic character of the injury involved. In his insightful analysis written more than a generation ago, Professor Rabin argued that the legitimate concern in tort cases over purely economic loss derives not from some categorical distinction between physical harm and purely economic harm, but from a rational judicial fear of excessively widespread tort liability.[90] He concluded that the source of "the sustained reluctance of the courts to extend liability for economic loss" stems from "a deep abhorrence to the notion of disproportionate penalties for wrongful behavior."[91] In other words, judicial common sense insists on reasonable tort liability limits, but it does not necessarily insist that tort law must treat economic harm differently from physical harm.

There will be limits, of course; the law will not redress all consequences of tortious conduct. The challenge is to establish coherent limits. In the early era of expanding tort liability, Justice Holmes could simply explain that at some point "[t]he law does not spread its protection so far."[92] In products liability law, the majority of courts use the physical-economic distinction to set the limits, yet even in *East River*, Justice Blackmun returned to Holmes's less precise rationale.[93]

In other areas, the courts allow or deny recovery for purely economic harm not by applying a bright-line rule, but because they sense, to use Professor Rabin's analysis, that the claim seeks a penalty disproportionate to the wrong. But can the courts articulate guidelines for principled decisions about proportionality? Or, to invoke Justice Holmes's standard, can the

89. *See* Symposium, *Dan B. Dobbs Conference on Economic Tort Law*, 48 ARIZ. L. REV. 693, 696-97 (2006); *see also* Usow, *supra* note 4, at 10-13; Silverstein, *supra* note 69.

90. Rabin, *supra* note 25, at 1527-33.

91. *Id.* at 1534.

92. *Robins Dry Dock*, 275 U.S. at 309.

93. 476 U.S. at 874.

courts explain how to identify when the claim seeks to spread the law's protection too far? Parts III and IV will argue that the courts have failed to develop a coherent approach to the economic loss problem in building construction cases in part because, whether permitting or denying recovery, they have adhered too closely to a rule-based approach reflective of products liability law and too little on the less well developed principles that apply to economic harm in other areas of tort law.

The American Law Institute has recently turned its attention to the economic harm problem as the topic of a new project for the Restatement (Third) of Torts.[94] Perhaps the pending Restatement will ultimately provide a coherent framework for analyzing economic loss claims for all circumstances. But for now, at least outside products liability law, the law offers no comprehensive principles for limiting economic torts.[95] Under these circumstances, the courts must operate more narrowly by asking why tort law should or should not support recovery of purely economic loss in specific contexts. In considering this question in building construction cases, Part III.A briefly demonstrates the confusion of the economic loss cases. The remainder of Part III analyzes the most common legal theories for recovering purely economic loss in the construction industry.

III. PATTERNS, THEORIES, AND EMERGING DISTINCTIONS IN THE CONSTRUCTION INDUSTRY CASES

A. The Obscure Hyperbole of the Economic Loss Rule in Construction Cases

Although construction industry opinions and commentary often refer to the economic loss rule,[96] it is impossible to distill from the cases a consistent rule of national standing or even a majority approach to the economic loss problem in the construction industry setting. Although a legal principle governing purely economic loss surely has achieved rule status under the products liability law of most jurisdictions,[97] its counterpart in construction

94. RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS (Council Draft No. 1 2006). The preliminary work on the Restatement promptly inspired a new wave of scholarly analysis about how tort law addresses economic loss claims. *See* Symposium, *supra* note 89, at 694.

95. While the current literature offers no coherent jurisprudence of economic harm, "it is undeniable that over the course of a century the courts have come to attach particular significance to the problem of personal injury." Rabin, *supra* note 25, at 1532.

96. *See, e.g.*, *infra* notes 99-119 (identifying construction cases that cite the economic loss rule).

97. *See supra* Part II.C (describing the development of the economic loss rule and its application in the product liability context).

law is doubtful, except in a few jurisdictions.[98] As demonstrateded in the following subparts, the relevant authorities are too inconsistent and incoherent to define reliable guidelines on the issue.[99] What makes the situation even more confounding is that courts ruling on economic loss claims in construction industry cases sometimes issue rash proclamations either announcing or denying that some version of an economic loss rule applies to construction industry cases.

The Nevada Supreme Court deserves special mention for conflicting and exaggerated principles concerning the economic loss problem in the construction industry. *Calloway v. City of Reno*[100] was a residential construction defect case that the court decided in 2000. The opinion comes after a 1998 order withdrawing the court's 1997 opinion in the same appeal. The 1997 opinion held that, in certain circumstances, purchasers of newly constructed homes may recover purely economic loss from subcontractors responsible for negligent defects.[101] In its 2000 opinion, following a rehearing of the appeal, the court turned about and held that the economic loss rule barred the claims. The court relied on a products liability treatise for the sweeping proposition that "there can be no recovery in tort for purely economic losses."[102] Later in the opinion, the court reinforced this categorical prohibition: "Purely economic losses fall outside the purview of tort recovery, even if such losses are foreseeable."[103] Additionally, the court offered the unqualified declaration that "the economic loss doctrine applies to construction defects cases."[104] Taken literally, at least the first two statements are belied by the well-established tort remedies for both the intentional and negligent infliction of economic loss in certain circumstances.[105]

Perhaps the Nevada court felt obliged to underscore its ultimate holding in the case. Not only was it abandoning its 1997 opinion in the same appeal, but the new result overruled two earlier cases[106] and disapproved what the court characterized as

98. *See, e.g.*, *Azco Constr.*, 10 P.3d at 1264 (articulating the Colorado economic loss rule in a construction industry setting).

99. This problem is often recognized in the cases and literature. *See, e.g.*, *Moransais*, 744 So. 2d at 980 (citing several inconsistent decisions); Thompson & Dean, *supra* note 3 (discussing the current application of the economic loss doctrine in the construction context).

100. 993 P.2d 1259 (Nev. 2000).

101. Calloway v. City of Reno, 939 P.2d 1020, 1025-26 (Nev. 1997) [hereinafter *Calloway I*] (per curiam), *superseded by Calloway II*, 993 P.2d at 1263.

102. *Calloway II*, 993 P.2d at 1263.

103. *Id.* at 1270.

104. *Id.* at 1266.

105. *See supra* notes 17-25 and accompanying text (discussing tort recovery available for intentional and negligent causation of economic loss).

106. *Calloway II*, 993 P.2d at 1270-72, *overruling* Charlie Brown Constr. Co.

dictum from two other cases.[107] One of the disapproved statements announced that "the economic loss doctrine was never intended to apply to construction projects . . . ."[108] One Justice filed a separate opinion in the 2000 appeal concurring in part and dissenting in part,[109] and the Chief Justice filed a separate dissenting opinion that would have followed the cases disapproved by the majority. "While our prior decisions in this area of the law are neither consistent nor uniformly well reasoned, they do show a clear reluctance to apply the economic loss doctrine to construction defect cases and, in dicta, expressly state just that."[110]

A brief per curiam opinion issued by the Nevada Supreme Court four years later offered a curious epilogue to *Calloway*.[111] That case held that a homeowner could recover purely economic loss attributable to negligent construction defects. True, the opinion was based on the court's interpretation of a statute enacted while the *Calloway* case was pending, but the court's conclusion that the legislature must have meant the statute to create a cause of action for negligent construction arguably goes well beyond anything the legislation suggests. In a well-reasoned dissenting opinion, one Justice argued that the statute did not create a cause of action or otherwise affect the application of the Nevada economic loss rule to construction cases and, the dissenter quipped, "the fact that the composition of the court has changed is not a sufficient reason for reconsidering the issue."[112]

The economic loss problem sometimes seems to trigger an irresistible tendency toward hyperbole. One court initially limited its bright line economic loss pronouncement to an extremely narrow spectrum of cases: "The cases uniformly hold that a person who sustains economic loss only cannot recover in damages from persons whose negligent conduct damages bridges."[113] That rule was fully adequate to resolve the case before the court in which business owners sued those allegedly responsible for defectively constructing a bridge that provided access to the business premises. But promptly after noting the consistent results of the

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v. Boulder City, 797 P.2d 946 (Nev. 1990) *and* Worrell v. Barnes, 484 P.2d 573 (Nev. 1971).

107. *Calloway II*, 993 P.2d at 1265, 1268, *disapproving of* Nat'l Union Fire Ins. Co. v. Pratt & Whitney, 815 P.2d 601, 603 (Nev. 1991) *and* Oak Grove Investors v. Bell & Gossett Co., 668 P.2d 1075, 1080 (Nev. 1983).

108. *Nat'l Union Fire Ins.*, 815 P.2d at 603.

109. *Calloway II*, 993 P.2d at 1272 (Maupin, J., dissenting).

110. *Id.* at 1277 (Rose, J., dissenting). *See generally* Ashman, *supra* note 11 (commenting on the Nevada Supreme Court's refusal to accept the application of the economic loss rule to residential construction).

111. *Olson*, 89 P.3d 31.

112. *Id.* at 34 (Becker, J., dissenting).

113. Neb. Innkeepers, Inc. v. Pittsburgh-Des Moines Corp., 345 N.W.2d 124, 126 (Iowa 1984).

cases involving those specific circumstances, the court offered as the controlling rationale the "well-established general rule" that "a plaintiff who has suffered only economic loss due to another's negligence has not been injured in a manner which is legally cognizable or compensable."[114]

Other cases also broadly declared a tort rule that categorically bars recovery of purely economic loss.[115] The courts commonly attribute the rule to the need for a bright line to mark the boundary between tort and contract,[116] as if some primal force requires such order in the legal universe. The cases have not explained why, if this is so, our legal system comfortably tolerates some torts either exclusively or primarily concerned with purely economic loss.[117]

Other contrasting but equally broad pronouncements in construction industry cases have rejected any rule against recovery of purely economic loss at least in certain situations.[118] Still other cases have denied the rule's application within a more limited area of construction law. For example, a Rhode Island case held that "the economic loss doctrine is not applicable to consumer transactions."[119] The issue before the court involved a claim by a residential purchaser that an engineer had negligently reported inaccurate soils data relied upon by the plaintiff.[120] It is unclear whether the court intended to limit the holding to residential construction or to extend it to all consumer transactions.

This short introductory essay on the literary aura of the economic loss problem in construction cases illustrates the tension between the soul of contemporary tort law, which yearns to remedy wrongs, and the ever-present practical concern to establish reasonable liability limits. Tort principles now aggressively afford remedies for physical harm, but only haltingly do so for economic harm. As noted, many of the cases insist that this must be so to

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114. *Id.*

115. *See, e.g.*, Snow Flower Homeowners Ass'n v. Snow Flower, Ltd., 31 P.3d 576, 579-81 (Utah Ct. App. 2001).

116. The most elegant articulation comes from *East River*: "It is clear, however, that if this development were allowed to progress too far, contract law would drown in a sea of tort." 476 U.S. at 866; *see also infra* Part III.B.2 (discussing the hypothetical boundary line that is drawn between tort and contract law for construction cases).

117. *See supra* notes 15-24 and the accompanying text (discussing the application of tort law for claims involving economic loss).

118. *See, e.g.*, Ins. Co. of N. Am. v. Cease Elec., Inc., 688 N.W.2d 462, 472 (Wis. 2004) (announcing a "bright line rule" that the economic loss rule is inapplicable to claims for the negligent provision of services); *Jim's Excavating Serv.*, 878 P.2d at 252 (concluding that most jurisdictions "have rejected the economic loss doctrine" in the construction industry setting).

119. Rousseau v. K.N. Constr., Inc., 727 A.2d 190, 193 (R.I. 1999).

120. *Id.* at 191-92.

preserve the distinction between contract and tort. Whether or not that argument is valid, it offers a convenient reminder of a critical distinction: No economic loss problem in this same sense exists in contract law. When the issue is contractual liability, the ancient doctrine of *Hadley v. Baxendale*[121] provides the limiting mechanism, not as a bright-line rule, but as a judicially managed concept of foreseeable damages.

In this environment, construction lawyers representing clients who have suffered purely economic loss must first analyze liability in reference to the available theories, knowing that some courts will be skeptical of tort claims. What the balance of this Part will show is that many cases recognize several viable alternative theories to recover purely economic loss in construction cases, and that a progressive level of sophistication (some might say sophistry) emerges as these theories move away from breach of contract to theories of tortious infliction of economic loss. As Subparts B, C, and D explain, the primary theories include breach of implied warranty, ordinary negligence, professional negligence, negligent misrepresentation, and products liability.

Because purely economic loss is a problem of tort law, this Article takes little note of breach of express contract cases, which, if supported by the facts, afford the most direct remedies for purely economic loss in construction cases.[122] For a different reason, this Article has only a passing interest in the building construction cases that adopt a products liability theory. Although some products liability cases involving the construction industry are noteworthy for their treatment of purely economic loss,[123] the highly developed economic loss rule of products liability law has been adequately addressed elsewhere.[124] It may be safely ignored for present purposes except to the extent that it serves as a foil or analogy in some of the cases discussed in the balance of this Part. Professional negligence and negligent misrepresentation merit distinct exploration, and Subparts C and D address those theories in detail. For reasons that will soon be apparent, implied warranty and ordinary negligence are best taken up together now.

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121. 9 Exch. 341; 156 Eng. Rep. 145 (1854).

122. *See, e.g.*, Follansbee Bros. Co. v. Garrett-Cromwell Eng'g Co., 48 Pa. Super. 183, 190-91 (1911) (holding that, in an action for loss caused by faulty construction, the plaintiff was permitted to present evidence that defendant breached its contractual promise to provide furnace design plans similar to those of two existing plants).

123. *See, e.g.*, *Snow Flower*, 31 P.3d at 579-81; Commercial Distrib. Ctr., Inc. v. St. Regis Paper Co., 689 S.W.2d 664, 667 (Mont. Ct. App. 1985).

124. *See generally* Christopher Scott D'Angelo, *The Economic Loss Doctrine: Saving Contract Warranty Law From Drowning in a Sea of Torts*, 26 U. TOL. L. REV. 591 (1995).

B. Negligence

1. Careless Performance of Contractual Activity

Construction industry disputes normally involve economic harm, which may or may not be accompanied by personal injury or physical damage. While diverse and complex causes contribute to construction disputes, some of the most common factors include simple carelessness, inattention to detail, and the failure to follow proper standards, methods, or techniques – that is, the lack of due care in the performance of construction activities. Usually, one or more contracts govern the activities involved. Under what circumstances should legal policy (as contrasted to private contract) establish a remedy when those involved in building construction inadvertently inflict economic harm?

When the claim is ordinary negligence, courts apply familiar rules. "An action in negligence can be maintained when a plaintiff shows that a defendant breached a duty of care owed to the plaintiff and this breach proximately caused an injury to the plaintiff resulting in actual damages."[125] Periodically, construction industry cases test the limits of negligence policy, and the courts invoke the expansionary concepts of contemporary tort law. Thus, more than one court has invoked the *Biakanja* factors explicitly[126] or has applied a similarly expansive tort analysis[127] when presented with what amounts to a claim for the negligent infliction of economic harm arising from building construction.[128] But, as

125. Lutz Eng'g Co. v. Indus. Louvers, Inc., 585 A.2d 631, 635 (R.I. 1991); *see id.* (holding that an architectural and engineering firm hired by the general contractor owed no duty to review shop drawings for the protection of a subcontractor).

126. *See, e.g.*, Conforti & Eisele, Inc. v. John C. Morris Assocs., 418 A.2d 1290, 1292 (N.J. Super. Ct. 1980) (allowing the factors to be used in New Jersey to determine liability); *Westerhold*, 419 S.W.2d at 81 (permitting the indemnitor of surety not in privity to bring negligence suit after balancing the factors).

127. *See, e.g.*, Caldwell v. Bechtel, Inc., 631 F.2d 989, 999-1003 (D.C. Cir. 1980) (holding that consultant engineering firm's contractual control over jobsite safety regulations created a special relationship between the firm and plaintiff's employee under which the firm owed a duty to employee to protect him from foreseeable risks).

128. *See, e.g.*, Berkel & Co. Contractors, Inc. v. Providence Hosp., 454 So. 2d 496, 502-03 (Ala. 1984) (concluding that when a party reasonably relied upon a contract between a contractor and a subcontractor, a negligence claim was available against the subcontractor); *Westerhold*, 419 S.W.2d at 81 (holding that the architect could be liable to the indemnitor of the contractor's surety for payments made under the surety bond based on the architect's failure to use ordinary care in certifying the amount of work completed and materials supplied by the contractor); U.S. *ex rel.* Los Angeles Testing Lab. v. Rogers & Rogers, 161 F. Supp. 132, 135 (S.D. Cal. 1958) (holding that the federal court should use California law and the *Biakanja* factors to determine negligence).

Part II.B demonstrates, the courts have sometimes tamed theories that threaten potentially unlimited liability by refusing to allow plaintiffs to resort to tort theories to recover purely economic loss.

2. *The Contract-Tort Boundary Metaphor in Construction Cases*

Because contracts govern most construction activities, contract doctrine may compete with tort doctrine when economic harm claims arise in the construction industry. Some situations aptly correspond to the contract-tort boundary metaphor that courts and commentators frequently use to justify some form of an economic loss bar in tort.[129] For example, when residential purchasers appealed the dismissal of their negligence suit against the builder to recover damages for the repair or replacement of a defective roof, a Georgia court required less than one hundred and fifty words to rule, giving the crux of its legal analysis in only two short sentences.[130] "Appellant simply sued for loss of the benefit of his bargain. Such damages are not recoverable in negligence."[131]

The logic of drawing an imaginary line between contract and tort remedies is evident in many situations in which the plaintiff and the defendant have entered into a contract relating to a construction project. Especially when one contracting party asserts a tort claim to recover purely economic loss from the other contracting party, it seems natural to ask whether the claim improperly encroaches into contract territory. If, as a factual matter, the plaintiff is suing for benefit-of-the-bargain damages solely because the defendant breached the contract between the two parties, there is no need to resort to tort law.[132] Not even the

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129. "The economic loss doctrine marks the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others." Sidney R. Barnett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. REV. 891, 894 (1989); *see also* Prendiville v. Contemporary Homes, Inc., 83 P.3d 1257, 1259-60 (Kan. Ct. App. 2004) (holding that the homeowner was barred from negligence recovery because the harm was limited to the house itself); *Calloway II*, 993 P.2d at 1265-66 (holding that townhouse owners could not sue for strict products liability because townhouses were not "products"). Although the metaphor reflects the rule-based preference of many cases, the principle involved is considerably more circumspect. "We recognize, of course, that warranty and products liability are not static bodies of law and may overlap . . . . Nonetheless, the main currents of tort law run in different directions from those of contract and warranty, and the latter seem to us far more appropriate for commercial disputes of the kind involved here." *East River*, 476 U.S. at 873 n.8.

130. McClain v. Harveston, 263 S.E.2d 228, 228 (Ga. Ct. App. 1979).

131. *Id.* (quoting from Chrysler Corp. v. Taylor, 234 S.E.2d 123, 124 (1977)).

132. *See, e.g.*, *Prendiville*, 83 P.3d at 1263 (holding that allowing a homeowner to sue the builder for negligent construction "would essentially nullify the express warranty agreed upon by the parties").

geometric expansion of tort theory wrought by the past century of case law repeals the rule that mere breach of contract is not a tort[133] – there must be an independent duty.[134] Tort liability attaches to contract default only if the court concludes that the default also breaches a duty imposed by law.[135]

The problem is more complex, however, than simply staking a metaphorical boundary line between two legal constructs. Neither contract nor tort provides fixed points of reference, and the same conduct or circumstances may give rise to both contract remedies and tort remedies.[136] Moreover, tort theories have expanded phenomenally as courts have repeatedly elected to impose new obligations that implement a progressive policy of protecting the body politic from an increasing list of harmful risks found in the human environment, sometimes including the risk of economic harm.

Under these conditions, construction lawyers now instinctively look for alternative theories when a traditional breach of contract action is either unavailable or inadequate for a plaintiff's purposes. "Plaintiffs find a tort remedy attractive because it often permits the recovery of greater damages than an action on a contract and may avoid the conditions of a contract."[137] For example, the plaintiff may prefer a negligence theory if the primary contractual basis of liability depends on an express warranty that has expired[138] or the contractual warranty provisions are limited.[139] In other situations, negligence theory

133. *See, e.g.*, Thomson v. Epsey Huston & Assocs., Inc., 899 S.W.2d 415, 420 (Tex. App. 1995) (concluding there was no injury beyond the subject of the contract itself); Clark-Fitzpatrick, Inc. v. Long Island R.R., 516 N.E.2d 190, 193 (N.Y. 1987) ("It is a well established principle that a simple breach of contract is not to be considered a tort unless a legal duty independent of the contract itself has been violated.").

134. *See supra* notes 45-60 and accompanying text (explaining the development of recovery for economic harm based on contractual and judicially-created duties of care).

135. "Because of this contractual obligation to the owner, the architect owes a further duty, sounding in tort, to the contractor who relies upon the design to his economic detriment." Mayor & City Council v. Clark-Dietz & Assoc. Eng'rs, Inc., 550 F. Supp. 610, 624 (N.D. Miss. 1982). *See also Kennedy*, 384 S.E.2d at 737.

136. "If a builder performs construction in such a way that he violates a contractual duty *only*, then his liability is only contractual. If he acts in a way as to violate a legal duty, however, his liability is both in contract and in tort." *Kennedy*, 384 S.E.2d at 736.

137. *Casa Clara*, 620 So.2d at 1245.

138. *Azco Constr.*, 10 P.3d at 1258.

139. *Compare Fla. Power & Light*, 510 So.2d at 903 (holding that the owner of a power plant could not recover repair costs under negligence theory from designer and manufacturer of generators that leaked) *with Commercial Distrib. Ctr.*, 689 S.W.2d at 670 (determining that the owner of an underground storage facility could recover in strict liability from a

may support a claim against a target defendant with whom the plaintiff has no contractual relationship, which may be especially useful if the plaintiff is unlikely to recover from the contract party[140] or if the plaintiff has already settled with the contract party for less than the total damages claimed.[141] Or the plaintiff may wish to pursue punitive damages under a tort theory[142] or may decide to argue for strict liability in tort because evidence of a defect is available but its cause is not.[143]

3. *Encroaching on the Boundary – Implied Warranty*

For reasons that may already be obvious, the story of implied warranty in construction cases is entwined with that of expanding liability in negligence. Implied warranty lives in the twilight between contract and tort. So much so that, at least in construction defect cases, the implied warranty and negligence theories seem nearly redundant. It was on that basis that a residential builder in a Colorado case argued that "a claim for negligence against a builder is indistinguishable as a matter of proof from a claim of breach of implied warranty of habitability."[144] The court disagreed, and it did so predictably by invoking the arising-out-of-contract-but-distinct-from-contract doctrine that has long been part of tort jurisprudence.[145] "An obligation to act

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manufacturer and installer of metal brackets that failed and caused overhead refrigeration components to collapse).

140. *See, e.g.*, *Olson*, 89 P.3d at 32 (describing homeowners who asserted a negligence claim against subcontractors after the builder ran out of money and abandoned the project); E.C. Ernst, Inc. v. Manhattan Const. Co., 551 F.2d 1026, 1031-32 (5th Cir. 1977) (detailing subcontractor's delay claims against the contractor that were barred by an express limitation in the contract between those parties could seek delay damages from the project architect on a negligence theory).

141. *See* Berschauer/Phillips Constr. Co. v. Seattle School Dist. No. 2, 881 P.2d 986, 989 (Wash. 1994) [hereinafter *Berschauer*]; Seattle W. Indus., Inc. v. David A. Mowat Co., 750 P.2d 245, 248-49 (Wash. 1988) (holding that the subcontractors' settlement agreements did not extinguish the designing corporation's liability). *Cf.* Terlinde v. Neely, 271 S.E.2d 768, 768-69 (S.C. 1980) (allowing the subsequent purchaser of a residence to sue the builder for negligent construction for which the builder had already settled with the original purchaser who sold the property to the plaintiff).

142. *See* F. D. Borkholder Co. v. Sandock, 413 N.E.2d 567, 570-71 (Ind. 1980) (affirming lower court's finding that the evidence supported the award of punitive damages under various torts, including gross negligence).

143. *See, e.g.*, *Commercial Distrib. Ctr.*, 689 S.W.2d at 667-70 (finding plaintiff could not establish which subcontractor was responsible for defect in metal support brackets used in refrigeration system for underground warehouse).

144. *Cosmopolitan Homes*, 663 P.2d at 1042.

145. *See, e.g.*, Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 88-89 (S.C. 1995) (holding that, even absent privity of contract, a project engineer owed a duty to a contractor not to design or supervise the project negligently); *Glanzer*, 135 N.E. at 276 (holding that

without negligence in the construction of a home is independent of contractual obligations such as an implied warranty of habitability."[146] In an explanation that adheres closely to the accepted doctrinal script, the court explained that, in the case of residential construction, this independence does not deny the obvious relationship between the obligation to avoid negligence in the performance of the contract and the contractual obligation itself. "A contractual obligation gives rise to a common law duty to perform the work subject to the contract with reasonable care and skill."[147]

This reasoning reflects an established tort principle, already discussed in this Article[148] that empowers a court to tease a tort duty from a contractual undertaking without violating the equally fundamental principle that mere breach of contract cannot itself be the basis of a tort claim. The underlying tort analysis is that a contractual undertaking may create, in addition to the express contractual arrangement, a legally distinct, special relationship from which the law imposes on one of the contracting parties a duty to act with reasonable care to avoid harming another (who may either be the other contracting party or a stranger to the contract).[149] Based on this legal alchemy, a court that imposes an obligation on a builder by implying a warranty of habitability or a warranty of sound construction is arguably engaged in contract law policy, while a court that imposes an obligation on a builder to avoid negligent defects is engaged in tort law policy.[150]

Courts have regularly implied a warranty of quality into contracts for work or services.[151] This is especially so with respect

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the defendants owed a duty of care to the plaintiffs based on a contract between the defendants and a third party).

146. *Cosmopolitan Homes*, 663 P.2d at 1042.

147. *Id.* at 1043.

148. *See supra* Part II.B (discussing the development of a tort-based recovery for economic losses).

149. "Given the contract and the relation, the duty is imposed by law." *Glanzer*, 135 N.E. at 276. Cases establishing the tort of architectural malpractice often used this analysis. *See, e.g.*, Eveleth v. Ruble, 225 N.W.2d 521, 523-24 (Minn. 1974). *See generally* Note, *Architectural Malpractice: A Contract-Based Approach*, 92 HARV. L. REV. 1075 (1979). The same justification regularly appears in construction industry cases in which a court imposes liability for negligent performance of obligations that stem from a contractual undertaking even though there is no privity of contract between plaintiff and defendant. *See, e.g.*, *Griffin Plumbing & Heating*, 463 S.E.2d at 88; *Rogers & Rogers*, 161 F. Supp. at 135-36.

150. *See* William K. Jones, *Economic Losses Caused by Construction Deficiencies: The Competing Regimes of Contract and Tort*, 59 U. CIN. L. REV. 1051, 1059-60 (1991).

151. *See, e.g.*, Zenda Grain & Supply Co. v. Farmland Ind., Inc., 894 P.2d 881, 890 (Kan. Ct. App. 1995) (implying into a contract for management services a warranty to perform "skillfully, carefully, diligently, and in a workmanlike manner"); Wawak v. Stewart, 449 S.W.2d 922, 933 (Ark. 1970)

to residential construction, where the courts have implied expansive warranties,[152] although courts have also implied at least a simple warranty of sound construction into commercial contracts.[153] These implied warranty cases often provide an adequate basis to award purely economic loss for construction defects, but they cannot always do so gracefully. The most common illustration of this theoretical problem involves the liability of builders to those who purchase defective projects from the original owners. The circumstances strain the contractual roots of implied warranty theory when the property owner has no contractual relationship with the builder or other prospective defendant. To the extent that the implied warranty theory is a matter of contract law, subsequent purchasers must convince a court to imply a contractual obligation into a non-contractual relationship. This looks like contract jurisprudence imitating tort policy. Although many courts have taken that theoretical leap in favor of subsequent purchasers, especially for residential consumers, not all have.[154]

4. Crossing the Boundary – Defective Construction as Negligence

Negligence provides a natural alternative to implied warranty. Subsequent purchasers who are disappointed with the quality of construction are especially likely to assert a claim of negligent construction. Because construction defects often cause repair costs and diminished property values without physical harm, negligent construction claims often attract the defense that negligence is not a sufficient basis to recover purely economic loss. A recent Arizona case[155] involved a negligent construction claim brought by a business condominium owners' association. The court held that Arizona's implied warranty of good workmanship does not extend to a subsequent purchaser of a commercial building and that the economic loss rule precludes a party from

(discussing a trend toward implying into a contract for construction and sale of a new residence warranties "of inhabitability, sound workmanship, or proper construction").

152. Hershewe v. Perkins, 102 S.W.3d 73, 75-76 (Mo. App. Ct. 2003)(holding seller liable to home buyers under a theory of implied warranty); Centex Homes v. Buecher, 95 S.W.3d 266, 273 (Tex. 2002) (explaining the distinction in Texas between the implied warranty of habitability and the implied warranty of good workmanship, which "recognizes that a new home builder should perform with at least a minimal standard of care.").

153. *See* 3 PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 9:67 (2002) (discussing common law express warranties, guarantees, and correction remedies and the implied warranty of workmanlike performance).

154. *See infra* Part III.B.4 (discussing defective construction as negligence and how negligence provides an alternative to a claim of implied warranty).

155. Hayden Bus. Ctr. Condo. Ass'n v. Pegasus Dev. Corp., 105 P.3d 157 (Ariz. Ct. App. 2005).

circumventing contract remedies by recasting a contract claim as a tort.[156]

As already noted, courts have regularly implied significant warranties of quality construction into residential building contracts, and many courts have extended those implied warranties to subsequent residential purchasers.[157] But because the courts have not uniformly used implied warranty theory to protect subsequent purchasers, creative lawyers representing disappointed buyers of pre-owned residences frequently tender negligence as the alternative theory.[158] The courts have reacted inconsistently to this tactic.[159] Because the cases on either side of the issue reflect the policy views of different courts about whether to extend or to curb consumer protection, these decisions have limited interest for present purposes. It is sufficient here simply to note that in reaching conflicting results, the courts have made fundamental policy decisions characteristic of contemporary tort theory in consumer situations.

For example, on one side of this policy divide, the South Carolina Supreme Court enthusiastically imposed responsibility for the negligent infliction of economic harm on a home builder even though the builder never sold the house to any consumer at all but instead transferred it to a creditor who in turn sold it to the consumer.[160] The result flowed inevitably from an established judicial commitment to consumer protection. "We have made it clear that it would be intolerable to allow builders to place defective and inferior construction into the stream of commerce. The practical difficulties facing today's new home buyer mandate that we allow a buyer to ordinarily proceed against both the builder and seller, or either of them."[161]

The Florida Supreme Court came down on the other side of the debate in *Casa Clara Condominium Association v. Charley Toppin & Sons, Inc.*,[162] in which a homeowner brought a negligent infliction of economic loss claim against a subcontractor with whom the homeowner had no direct contract. The court rejected the claim based on Florida's economic loss rule, which has had a long and complex history in Florida's tort law.[163]

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156. *Id.* at 159.

157. *See generally* George Lefcoe, *Property Condition Disclosure Forms: How the Real Estate Industry Eased the Transition from Caveat Emptor to "Seller Tell All,"* 39 REAL PROP. PROB. & TR. J. 193, 209-13 (2004); E.F. Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 CORNELL L. Q. 835 (1967).

158. *See* Jones, *supra* note 150, at 1077-83.

159. *Id.*

160. *Kennedy*, 384 S.E.2d at 733, 736.

161. *Id.* at 736 (citations omitted).

162. 620 So. 2d 1244 (Fla. 1993).

163. *See* Usow, *supra* note 4.

> We are urged to make an exception to the economic loss doctrine for homeowners. Buying a house is the largest investment many consumers ever make . . . and homeowners are an appealing, sympathetic class. If a house causes economic disappointment by not meeting a purchaser's expectations, the resulting failure to receive the benefit of the bargain is a core concern of contract, not tort, law. There are protections for homebuyers, however, such as statutory warranties, the general warranty of habitability, and the duty of sellers to disclose defects, as well as the ability of purchasers to inspect houses for defects. Coupled with homebuyers' power to bargain over price, these protections must be viewed as sufficient when compared with the mischief that could be caused by allowing tort recovery for purely economic losses. Therefore, we again "hold contract principles more appropriate than tort principles for recovering economic loss without an accompanying physical injury or property damage." If we held otherwise, "contract law would drown in a sea of tort." We refuse to hold that homeowners are not subject to the economic loss rule.[164]

Subsequent developments in Florida's economic torts jurisprudence cast some doubt on the continuing vitality of the *Casa Clara* opinion.[165] But apparently the case remains good law at least for the specific situation involved in that case.[166]

While these conflicting residential defect cases present an interesting and important consumer protection policy debate, they say little about the policies that should determine whether or to what extent the law should distinguish between physical and economic harm. Of far greater interest on that issue are a few cases that hold or imply that different results should apply to defect claims brought by subsequent purchasers depending on whether the theory advanced is implied warranty or negligence. Two cases in this category that reach opposite conclusions notably highlight the status of purely economic loss claims in construction cases.

In ruling on a subsequent purchaser's construction defect claim, the North Carolina Supreme Court first held that "regardless of the validity of any claim based on breach of an

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164. *Id.* at 1247 (citations and footnotes omitted).

165. *See Moransais*, 744 So. 2d at 975-76 (Fla. 1999) (holding that professional negligence claims can be brought against individual professionals even if there is no privity of contract between the homeowner and the professional).

166. In *Indem. Ins. Co. v. Am. Aviation, Inc.*, 891 So. 2d 532, 534 (Fla. 2004) the court held that "the 'economic loss doctrine' or 'economic loss rule' bars a negligence action to recover solely economic damages only in circumstances where the parties are either in contractual privity or the defendant is a manufacturer or distributor of a product, and no established exception to the application of the rule applies." By quoting from *Casa Clara* with apparent approval, the court seems to have left the case intact at least in the context of a claim against a subcontractor who supplies materials. *See id.* at 536 n.1.

implied warranty, plaintiffs' complaint sufficiently states a claim for negligence."[167] The court then held that a subsequent residential purchaser should be able to recover purely economic losses for negligent construction. The court was especially persuaded by this policy-laden argument:

> The ordinary purchaser of a home is not qualified to determine when or where a defect exists. Yet, the purchaser makes the biggest and most important investment in his or her life and, more times than not, on a limited budget. The purchaser can ill afford to suddenly find a latent defect in his or her home that completely destroys the family's budget and have no remedy for recourse. This happens too often. The careless work of contractors, who in the past have been insulated from liability, must cease or they must accept financial responsibility for their negligence. In our judgment, building contractors should be held to the general standard of reasonable care for the protection of anyone who may foreseeably be endangered by their negligence.[168]

In an area of the law so beset by conflicting and shifting opinions, it is fitting irony that the North Carolina Supreme Court adopted this language from a Florida Court of Appeals case that was effectively overruled a few years later when the Florida Supreme Court decided *Casa Clara*, a case that itself now seems endangered or at least severely limited.[169]

The New Hampshire Supreme Court also authorized a subsequent residential purchaser to recover purely economic losses.[170] The interesting twist, however, is the court's holding that purely economic losses may be recovered only under an implied warranty claim and not a negligent construction claim.

> We have previously denied aggrieved subsequent purchasers recovery in tort for economic loss and denied them recovery under an implied warranty theory for economic loss. *See Ellis v. Morris supra*. The court in *Ellis* acknowledged the problems a subsequent purchaser faces, but declined to follow the examples of those cases which allow recovery. The policy arguments relied upon in *Ellis* for precluding tort recovery for economic loss, in these circumstances, accurately reflect New Hampshire law and present judicial scholarship, and, as such, remain controlling on the negligence claim.[171]

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167. Oates v. JG, Inc., 333 S.E.2d 222, 225 (N.C. 1985).

168. *Id.* at 225-26 (quoting from Simmons v. Owens, 363 So.2d 142 (Fla. Dist. Ct. App. 1978), *disapproved by Casa Clara*, 620 So. 2d at 1248 n.9).

169. *See supra* notes 164-65 and accompanying text.

170. *Lempke*, 547 A.2d 290. While the case involved construction of a garage, because the opinion is peppered with references to residential construction and home builders, one can infer that the property was residential. *Id.* at 291.

171. *Id.* (citations omitted).

Having thus summarily resolved to stand by the precedent against the negligence claim, the court next turned to the implied warranty claim. As a first step in the analysis, the court held that privity should no longer be required on a claim for breach of a builder's implied warranty of good workmanship.[172] This led the court to consider "whether we should allow recovery for purely economic harm, which generally is that loss resulting from the failure of the product to perform to the level expected by the buyer and is commonly measured by the cost of repairing or replacing the product."[173]

> Much theoretical debate has taken place on whether to allow economic recovery and whether tort or contract is the most appropriate vehicle for such recovery.
>
> It is clear that the majority of courts do not allow economic loss recovery in tort, but that economic loss is recoverable in contract, and that economic loss recovery "is consistent with the policy of warranty law to protect expectations of suitability and quality. . . ." However, what is less clear is whether courts allow recovery for economic loss on an implied warranty theory, without privity, in situations such as ours.
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> . . .
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> We agree with the courts that allow economic recovery in implied warranty for subsequent purchasers, finding as they have that the contention that a distinction should be drawn between mere "economic loss" and personal injury is without merit. Why there should be a difference between an economic loss resulting from injury to property and an economic loss resulting from personal injury has not been revealed to us. When one is personally injured from a defect, he recovers mainly for his economic loss. Similarly, if a wife loses a husband because of injury resulting from a defect in construction, the measure of damages is totally economic loss. We fail to see any rational reason for such a distinction.
>
> If there is a defect in a stairway and the purchaser repairs the defect and suffers an economic loss, should he fail to recover because he did not wait until he or some member of his family fell down the stairs and broke his neck? Does the law penalize those who are alert and prevent injury? Should it not put those who prevent personal injury on the same level as those who fail to anticipate it? The vendee has a right to expect to receive that for which he has bargained.[174]

The opinion provided no convincing reason why a consumer protection policy this strong takes effect under an implied

172. *Id.* at 294.
173. *Id.* at 296.
174. *Id.* at 296-97 (quoting extensively from Barnes v. Mac Brown & Co., 342 N.E.2d 619 (Ind. 1976)).

warranty theory but not under an ordinary negligence theory. Nor did it explain why a residential purchaser "has a right to expect to recover" from a builder with whom the purchaser never dealt "that for which he has bargained" with someone else. The dissenting opinion by Justice Souter suggested that the majority's distinction between negligent construction and implied warranty merely masked the absence of any "justification to repudiate the rationale unanimously adopted by this court a mere two years ago."[175]

The cases ruling on property owners' claims for economic loss resulting from defective construction, especially those involving residential construction, show no consistent momentum in one direction or the other. Perhaps public policy considerations that differ from one jurisdiction to another will continue to produce inconsistent results for the foreseeable future.[176] Eventually, state legislatures may take up the problem of defective residential construction, as some already have.[177]

5. *Beyond Construction Defects*

Economic loss claims by owners of defective projects present the most common construction industry situations in which negligence may serve as the basis for recovering purely economic loss in tort. But they are not the only ones. Errant construction activity frequently causes adverse economic consequences for those who do not own the project under construction, sometimes even for those who have no involvement in the project at all. As previously discussed, some early construction industry cases, reflecting the status of tort theory at the time, used proximate cause and foreseeability to dispose of claims brought by remote plaintiffs, and they did so with little, if any, consideration of the distinction between physical and economic harm.[178] As more expansive

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175. *Id.* at 298 (Souter, J., dissenting).

176. Chief Justice Rose, of the Nevada Supreme Court, provided one example of how local considerations may influence the debate in this passage from a dissenting opinion in *Calloway II*:

> The economic loss doctrine is a judicial creation – it is not a statute that we are compelled to follow. It is a principle of law we can adopt or reject depending on what better serves Nevadans. With so much hasty construction taking place in Nevada today, I think the better path would be to arm our home purchasers with all available remedies, when faced with a defectively constructed home, rather than the one taken by the majority today.

993 P.2d at 1278.

177. *See generally* BRUNER & O'CONNOR, *supra* note 153, at § 9:49 (discussing state governments that have provided special legislation for residential construction professionals).

178. *See, e.g.*, *Ford*, 14 F.2d at 255 (holding that a contractor could not be liable to a third person injured by the collapse of the contractor's structure); *Byrd*, 43 S.E. at 421 (affirming summary judgment against business owner because contractor had no legal duty to the business owner).

theories of tort liability took hold in the courts, the negligence cases shifted distinctly away from any single factor toward a more openly policy-laden process of balancing multiple factors to determine whether or not to impose a duty of care on the defendant.[179] Outside of the residential defect cases, however, if the remote plaintiff's theory is ordinary negligence, the results remain predominated against liability.[180] Negligent construction has not, at least for now, achieved wide recognition as a valid claim in the absence of physical harm.

The California Supreme Court has been more receptive than other courts to claims of economic loss based on negligent construction. The watershed event was the court's decision in *J'Aire Corp. v. Gregory*,[181] a case involving a contractor's delay in completing improvements at the Sonoma County Airport. The year was 1979, an era before the economic loss rule took hold in construction industry cases in other jurisdictions. In *J'Aire*, the court recognized "a cause of action for negligent loss of expected economic advantage."[182] The plaintiff was the tenant operating a restaurant in leased premises being improved under a contract between the County of Sonoma and the defendant contractor.[183] The opinion did not mention any terms of the lease between the plaintiff and the county, except that the lease obligated the county to provide heat and air conditioning.[184]

Although the construction contract did not specify a target completion date, the tenant "alleged the work was to have been completed within a reasonable time as defined by custom and usage."[185] The plaintiff also alleged that specific requests had been made of the defendant for timely completion.[186] The construction delay prevented the tenant from operating its restaurant business, resulting in the loss of business and profits.[187] Although the

179. *See supra* Part II.B (discussing the concept of tort liability for economic loss).

180. *See, e.g.*, *Hayden Bus. Ctr.*, 105 P.3d at 160-61 (holding breach of implied warranty of good workmanship is a contract claim that can only be brought by a party to the contract); *Azco Constr.*, 10 P.3d at 1264-66 (applying the economic loss rule to deny plaintiff's claim for tort liability where defendant's failure to perform sounded in contract); *Smith*, 680 P.2d at 1154 (holding that absent privity of contract, the economic loss rule barred recovery); Local Joint Executive Bd. of Las Vegas, Culinary Workers Union, Local No. 226 v. Stern, 651 P.2d 637, 638 (Nev. 1982) (declining to overrule the economic loss rule and adopt the minority view allowing recovery for negligent interference with economic expectations).

181. 598 P.2d 60 (Cal. 1979).

182. *Id.* at 63.

183. *Id.* at 61.

184. *Id.*

185. *Id.*

186. *Id.* at 61, 63.

187. *Id.* at 62.

plaintiff originally asserted claims both under a third party beneficiary theory and negligence, when the trial court sustained the defendant's demurrer, the plaintiff only appealed as to the negligence cause of action.[188]

The court's discussion opened, as one would expect, with a duty analysis:

> Liability for negligent conduct may only be imposed where there is a duty of care owed by the defendant to the plaintiff or to a class of which the plaintiff is a member. A duty of care may arise through statute or by contract. Alternatively, a duty may be premised upon the general character of the activity in which the defendant engaged, the relationship between the parties or even the interdependent nature of human society. Whether a duty is owed is simply a shorthand way of phrasing what is "the essential question whether the plaintiff's interests are entitled to legal protection against the defendant's conduct."
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> . . .
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> Even when only injury to prospective economic advantage is claimed, recovery is not foreclosed. Where a special relationship exists between the parties, a plaintiff may recover for loss of expected economic advantage through the negligent performance of a contract although the parties were not in contractual privity.[189]

The court next applied the *Biakanja* factors to the facts pled and concluded that the contractor "had a duty to complete construction in a manner that would have avoided unnecessary injury to appellant's business, even though the construction contract was with the owner of a building rather than with appellant, the tenant."[190] One of the factors that weighed into the court's analysis was that the defendant's conduct "was particularly blameworthy since it continued after the probability of damage was drawn directly to respondent's attention."[191] In responding to the defendant's economic loss argument, the court placed special emphasis on the fact that the harm to the plaintiff's business was foreseeable.[192]

The *J'Aire* decision may represent an especially significant exception among the negligent construction cases. This is certainly true if one reads the opinion to impose on a contractor a duty of care in favor of all whose economic interests may be foreseeably harmed by the contractor's negligence. The opinion did not, however, necessarily establish a liability standard that broad. Perhaps the court viewed the case as presenting unusual

188. *Id.*
189. *Id.* at 62-63 (internal citations omitted).
190. *Id.* at 64.
191. *Id.* at 63.
192. *Id.* at 64-66.

circumstances entitled to special weight under the moral blame and public policy factors of the *Biakanja* formula because the complaint could be read to assert "wilful failure or refusal of a contractor to prosecute a construction project with diligence."[193] Whatever significance the case may have in an abstract sense, it has not influenced negligent construction cases in other jurisdictions to the same extent as California cases have in other areas of tort law, and it may well evidence a unique California jurisprudence on economic loss.[194]

Taken together, the negligence cases show only that ordinary negligence in construction activities cannot be completely dismissed as a basis to recover purely economic loss, especially if the plaintiff is a residential owner in a jurisdiction with a strong consumer protection perspective. By contrast, courts have been more receptive to professional negligence and negligent misrepresentation claims. But as the following Subparts C and D show, the construction cases involving these alternative tort theories do not present a coherent body of law.

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193. *Id.* at 63. The meaning of the court's full statement on this point is ambiguous. The language quoted in the text made reference to a regulatory penalty for a licensed contractor who willfully delays a project. It is not clear that the court read the complaint to plead willful delay. The quoted passage probably suggests only that the court believed that the disciplinary penalty for willful delay showed that California public policy supported holding a contractor liable for the consequences of avoidable delays. The court reasoned that, even though the legislative penalty for willful delay "does not provide a basis for imposing liability where the delay in completing construction is due merely to negligence, it does indicate the seriousness with which the Legislature views unnecessary delays in the completion of construction." *Id.* at 64.

194. Even within California, the significance and influence of *J'Aire* remains uncertain. *See* BRUNER & O'CONNOR, *supra* note 153, § 17:97 (finding that the California courts have viewed the *J'Aire* decision differently and characterized it as a limited exception to the general rule). Moreover, one could argue that the California Supreme Court has been unusually open to economic loss claims even in products liability cases. *See* Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268 (2004) (noting that the economic loss rule did not bar a buyer's fraud and intentional misrepresentation claims against the seller of a defective product even though the same conduct was the basis for a breach of contract claim); *see also* Christopher W. Arledge, *Is the California Supreme Court Confusing the Boundaries of the Economic Loss Rule?*, ORANGE COUNTY LAW., May 2005, at 22 (criticizing the *Robinson Helicopter* opinion's failure to clarify where the economic loss rule ends and where tort law begins). *Robinson Helicopter* may not in fact represent a California deviation with respect to claims based on misrepresentation. *See infra* Part III.D (discussing how courts have treated negligent misrepresentation claims more favorably than other tort claims for purely economic loss in construction cases).

C. Professional Negligence

The specialized rules of professional negligence apply to architects, engineers, and other design professionals.[195] Clients may assert malpractice claims either in contract or in tort, and they often proceed under both theories.[196] Professional negligence represents a long-standing basis upon which a design professional's client may recover purely economic loss in tort.[197] Even so, courts sometimes proclaim an economic loss bar so sweeping that it seems to cast doubt on the right of the design professional's own client to proceed on a tort theory absent some physical harm.[198]

It is not surprising, therefore, that significant theoretical questions arise when a non-client brings a professional negligence claim to recover economic loss from a design professional. In one common situation, a builder or subcontractor sues the owner's architect or engineer to recover additional costs or delay damages caused by errors in the design or by improper professional services rendered during construction.[199] In these situations, design professionals routinely raise lack of privity as a defense and also argue that purely economic damages should not be available. Over the past three decades, an impressive assortment of courts

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195. *See Moransais*, 744 So. 2d at 975-76 (discussing professional negligence of engineers employed by home inspection company); *see also* Davidson & Jones, Inc. v. County of New Hanover, 255 S.E.2d 580 (N.C. Ct. App. 1979) (addressing professional negligence of surveyor or civil engineer as well as architect); *Eveleth*, 225 N.W.2d at 524-25 (noting rules of professional negligence concerning engineers).

196. *See generally* Kenneth I. Levin, *Duties and Liabilities of the Architect-Engineer to the Owner, in* 1 CONSTRUCTION LAW HANDBOOK, § 4.03 (Robert F. Cushman & James J. Myers eds., 1999) (noting that in many jurisdictions, an owner can sue a design professional for malpractice under a tort theory of negligence and breach of contract).

197. *See, e.g.*, Eggers Partnership, 82-1 B.C.A. (CCH) ¶ 15,630 (IBCA 1982) (permitting recovery of economic loss resulting from an architect's negligent design of a roof); *Eveleth*, 225 N.W.2d at 528-31 (discussing an engineer's negligence in the design of a new water treatment plant and whether recovery of economic loss in tort is appropriate); Scott v. Potomac Ins. Co., 341 P.2d 1083, 1087 (Ore. 1959) (concluding that the hospital had a valid malpractice claim against the architect for economic loss).

198. *See supra* Part III.A (discussing the difficulty in extracting a consistent approach to the economic loss issue in construction cases).

199. *See, e.g.*, A.R. Moyer, Inc. v. Graham, 285 So. 2d 397 (Fla. 1973) (detailing a claim where a general contractor sued a supervising contractor for damages caused by the negligence of the architect); Aetna Ins. Co. v. Hellmuth, Obata & Kassabaum, Inc., 392 F.2d 472 (8th Cir. 1968) (discussing a suit brought by contractor's surety against an architectural firm for negligent supervision of the construction project); *Rogers & Rogers*, 161 F. Supp. at 132 (describing a general contractor's counterclaim against an architect for negligent misrepresentation and subsequent damages).

has rejected these defenses.[200] Other courts, however, continue to struggle with whether and when either or both of these defenses should bar the claim.[201]

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200. *See, e.g.*, Ellis-Don Constr., Inc. v. HKS, Inc., 353 F. Supp. 2d 603, 607 (M.D. N.C. 2004) (noting that North Carolina's economic loss rule did not limit tort actions that arose in the absence of a contract); Hydro Investors, Inc. v. Trafalgar Power, Inc., 227 F.3d 8, 17 (2d Cir. 2000) (concluding that the privity rule is not always applied in negligence cases); *Rousseau*, 727 A.2d at 190 (holding that privity of contract was not needed in the tort action between a contractor and an engineer); *Griffin Plumbing & Heating*, 463 S.E.2d at 85 (rejecting the lack of privity defense in a negligence action between a contractor and design engineer); Mid-Western Elec., Inc. v. DeWild Grant Reckert & Assocs. Co., 500 N.W.2d 250, 254 (S.D. 1993) (noting that in South Dakota, a cause of action exists for economic damage in the professional negligence context, even in the absence of contractual privity); Guardian Constr. Co. v. Tetra Tech Richardson, Inc., 583 A.2d 1378, 1387 (Del. Super. Ct. 1990) (rejecting a design engineer's argument that construction companies could not recover for purely economic losses due to lack of privity of contract); Forte Bros., Inc. v. Nat'l Amusements, Inc., 525 A.2d 1301, 1303 (R.I. 1987) (noting that, despite the absence of privity, a general contractor who suffered economic loss proximately caused by the inadequate performance of a site engineer had a cause of action sounding in negligence); Waldor Pump & Equip. Co. v. Orr-Schelen-Mayeron & Assoc., Inc. 386 N.W.2d 375, 376-77 (Minn. Ct. App. 1986) (rejecting an engineer's lack of privity defense against a subcontractor's negligence claim and finding that harm to subcontractors as a result of the engineer's negligent drafting or interpretation of deisgn specifications was foreseeable); Donnelly Constr. Co v. Obert/Hunt/Gilleland, 677 P.2d 1292, 1295-96 (Ariz. 1984) (noting that a cause of action for negligent misrepresentation does not require privity); *Mayor & City Council*, 550 F. Supp. at 610 (concluding that the design professional breached its contractual duty and was negligent in its design, and therefore was liable to the contractor for additional construction expenses); *Conforti & Eisele*, 418 A.2d at 1290 (rejecting a design professional's defense that no contractual privity existed); *Davidson & Jones*, 255 S.E.2d at 580 (holding that a general contractor or a subcontractor could sue an architect, even in the absence of privity, for economic loss foreseeably resulting from the architect's negligence); *A.R. Moyer*, 285 So. 2d at 397 (noting that a contractor who may be foreseeably injured or who may sustain an economic loss proximately caused by the negligent performance of a contractual duty of an architect may bring a cause of action against the architect, notwithstanding the absence of privity).

201. *See, e.g.*, Hanover Ins. Co. v. Corrpro Co., 312 F. Supp. 2d 816 (E.D. Va. 2004) (involving a suit between an inspector and a contractor's surety in the absence of contractual privity); *Berschauer*, 881 P.2d 986 (holding that the economic loss rule did not allow a general contractor to recover purely economic damages from a design professional in tort); *Floor Craft*, 560 N.E.2d at 206 (refusing to assign liability to an architect in the absence of privity of contract); *Malta Constr.*, 694 F. Supp. at 902 (holding that the general contractor's tort allegations fell within the negligent misrepresentation exception to the economic loss rule and therefore were not barred); *Fireman's Fund Ins.*, 679 N.E.2d at 1197 (holding that the economic loss doctrine barred recovery in a tort action against an engineer for purely economic loss); *Thomson*, 899 S.W.2d at 415 (holding that the economic loss rule bars recovery under a negligence claim); 2314 Lincoln Park W. Condo. Ass'n v. Mann, Gin, Ebel & Frazier, Ltd., 555 N.E.2d 346, 348 (Ill. 1990) (noting that purely economic losses are not recoverable in a tort action based simply on the

The privity defense retains some limited life. For example, New York still requires "actual privity of contract between the parties or a relationship so close as to approach that of privity."[202] But historic forces work convincingly against its continued vitality in most jurisdictions. A defense based on privity of contract typically asserts that because the design professional's duty of care under tort law stems from a contractual relationship, the professional duty of care runs only in favor of a party to that contract.[203] When applied to a plaintiff who suffers foreseeable harm, that argument retains little force under prevailing tort theory.[204] The non-client's theory is derived from the same rationale that imposes a tort duty of professional care in favor of the design professional's client. "The contract merely furnishes the occasion, or creates the relationship which furnishes the occasion, for the tort."[205] Once the plaintiff establishes the relationship giving rise to an independent duty of care under tort law, lack of privity is no defense in most jurisdictions. The reason reflects the historic battle long since won against the traditional privity defense.

> We cannot ignore the half century of development in negligence law originating in MacPherson and are impelled to conclude that the position and authority of a supervising architect are such that he ought to labor under a duty to the prime contractor to supervise the

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defeated expectations of one party); Widett v. U.S. Fidelity and Guar. Co., 815 F.2d 885, 887 (2d Cir. 1987) (holding that under New York law, an architectural firm was not liable either in tort or contract to a subcontractor absent privity between them); Blake Constr. Co. v. Alley, 353 S.E.2d 724, 727 (Va. 1987) (holding that, absent privity, a contractor was not entitled to recover from an architectal firm for purely economic losses).

202. Ossining Union Free Sch. Dist. v. Anderson LaRocca Anderson, 539 N.E.2d 91, 94 (N.Y. 1989). "It is well settled in New York, however, that professionals are not liable either in tort or contract absent privity." *Widett*, 815 F.2d at 886, *citing* Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931).

203. *See, e.g.*, *Presnell Constr. Managers*, 134 S.W.3d at 579; *Mid-Western Elec.*, 500 N.W.2d at 253; Shoffner Indus., Inc. v. W.B. Lloyd Constr. Co., 257 S.E.2d 50, 54-55 (N.C. Ct. App. 1979).

204. *See, e.g.*, *Moransais*, 744 So. 2d at 977-79 (providing reasons why a lack of privity between a plaintiff and defendant does not bar a negligence claim); *Mid-Western Elec.*, 500 N.W.2d at 253-54 (stating that a privity requirement in negligence claims would condone professionals negligently performing their work); *Shoffner Indus.*, 257 S.E.2d at 54-55 (explaining why lack of privity does not bar a negligence claim). "[T]he expansion of liability to third parties now establishes the proposition that a contractor hired by the client to construct a building, although not in privity with the architect, may recover from the architect any extra costs resulting from the architect's negligence. To hold otherwise would require that we ignore the modern concepts of tort liability." *Id.* at 55.

205. *Id.* at 54-55 (*quoting from* Toone v. Adams, 262 N.C. 403, 407, 137 S.E.2d 132, 135 (1964)).

project with due care under the circumstances, even though his sole contractual relationship is with the owner.[206]

Knowing that privity has lost its luster, counsel for design professionals increasingly argue instead that the same policy-based economic loss rule commonly applied in products liability cases should also bar a non-client's professional malpractice claim. In contrast to the privity defense, the economic loss argument presents a more formidable hurdle for contemporary courts. Design professionals advance the familiar case for an economic loss bar. Plaintiffs react with equally familiar responses. In the end, an increasing number of cases reject a per se bar against purely economic loss for design malpractice.[207] Because the debate over the economic loss rule dominates the recent cases, a few selected opinions illustrating the competing arguments merit careful review.

Initially, recall that some jurisdictions do not adhere to a broad rule barring recovery for purely economic losses even under products liability law.[208] In those jurisdictions, a court may quickly dispose of any argument for a special rule barring recovery of purely economic loss in a design malpractice case.[209] In other jurisdictions, courts have rejected the economic loss defense on the basis that the bias against purely economic damages is unique to products liability jurisprudence.[210]

Some of the cases that reach the opposite result and bar recovery seem to do so based on a mechanical transfer of the products liability rule and rationale to professional malpractice cases.[211] In other jurisdictions, however, the economic loss rule has

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206. *Id.* at 55. Although the quoted language retains force as a general rationale for imposing on a project architect a relatively broad duty of care, contemporary design contracts often expressly relieve the architect of any duty to supervise construction means and methods. *See infra* note 220 and accompanying text (stating that the project architect's broad duty is logical when the architect's power is comparable to "economic life or death," but that most design contracts limit an architect's power in order to limit possible liability).

207. *See supra* note 201 (providing cases in which the court does not bar design malpractice claims because the loss was purely economic).

208. *See supra* Part II.C (articulating and discussing the different positions adopted by various jurisdictions related to economic losses in products liability cases).

209. *See* Best Friends Pet Care, Inc. v. Design Learned, Inc., No. X06CV0001697555, 2003 WL 22962147 (Conn. Super. Ct., Dec. 3, 2003); *see also Conforti & Eisele*, 418 A.2d at 1292.

210. *Mid-Western Elec.*, 500 N.W.2d at 253-54; *Waldor Pump & Equip.*, 386 N.W.2d at 377.

211. *See, e.g.*, *Prendiville*, 83 P.3d at 1259-60 (noting that the economic loss doctrine stands for the proposition that, outside of products liability law, a party cannot recover in tort when the law of contract should apply); *Blake Constr.*, 353 S.E.2d at 727 (explaining that, in construction contexts, parties protect against purely economic losses by way of contract negotiation).

taken hold as a tort law policy that transcends products liability law.[212] In those jurisdictions, a design malpractice plaintiff who seeks purely economic damages and who faces a motion to dismiss or a motion for summary judgment must marshal arguments for an exception to the rule. In these situations, many opinions evaluate predictable, substantive themes that reflect the tension between the alluring power of expanded tort theory and the judicial instinct for reasonable liability limits. In effect, and not uncommonly through express citation, these courts follow a process consistent with the *Biakanja* formula.[213]

Some of the most thoughtful opinions rejecting a per se rule have held that the decisive factors are whether the plaintiff's economic loss is foreseeable and whether it is closely connected to the defendant's malpractice.[214] Others emphasized that circumstances may establish a special relationship between the defendant and the plaintiff that is similar to that between a professional and a client. On that basis, these opinions imposed a duty of professional care that is independent from the defendant's purely contractual obligations.[215] Other equally thoughtful opinions, by contrast, apply the economic loss rule on the broad theoretical basis that in building construction matters, no less than in product sales, contract principles are more applicable than

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212. *See* Silverstein, *supra* note 69, at 409-22 (describing the history and development of the economic loss rule in tort litigation).

213. *See, e.g.*, *Conforti & Eisele*, 418 A.2d at 1292 (identifying the factors raised in *Biakanja* for determining liability for negligence, and concluding that based upon such factors, a design professional could be required to answer in tort to a contractor who suffers purely economic losses as a result of the design professional's negligence); *Westerhold*, 419 S.W.2d at 81 (stating that while each and every factor itemized in *Biakanja* need not be present to sustain a cause of action for negligence, they must be weighed along with the traditional policy reasons for limiting lawsuits for negligent performance of a duty under a contract to those in privity of contract).

214. *See, e.g.*, *Mid-Western Elec.*, 500 N.W.2d at 254 (instructing trial courts to look to the foreseeability of injury if contract breach were to occur in order to determine the duty of a deisgn professional defendant); *Donnelly Constr.*, 677 P.2d at 1295-96 (ruling that, "design professionals are liable for foreseeable injuries to foreseeable victims which proximately result from their negligent performance of their professional services."); *Davidson & Jones*, 255 S.E.2d at 584 (holding that in absence of privity, a general contractor or a subcontractor would still be able to sue an architect for a foreseeable economic loss originating from the design professionals' duty of care).

215. *See, e.g.*, *Griffin Plumbing & Heating*, 463 S.E.2d at 87-88 (describing that a multitude of states have recognized an exception to the economic loss rule when a special relationship between the design professional and the contractor is present); *Mayor & City Council*, 550 F. Supp. at 623-24 (stating that Mississippi law imposed on design professionals a duty, much like that imposed on other professionals, to "exercise ordinary professional skill and diligence"); *Davidson & Jones*, 255 S.E.2d at 584 (clarifying that an architect has a duty to exercise abilities typically demonstrated by similarly situated architects when completing a project).

tort principles when economic harm is not accompanied by physical harm.[216]

In this array, a few opinions especially stand out because they attempted to give due weight to factors endemic to professional services rendered in the building construction setting. That is to say, some opinions reflect a contextual approach similar to the one this Article advocates. Some courts, for example, have been dissuaded from applying a broad economic loss bar because to do so would effectively eliminate professional malpractice remedies against certain professionals whose errors often threaten significant pecuniary damage but rarely bring physical harm.[217] This argument holds special force with respect to malpractice by accountants and lawyers, but it also sometimes applies to design malpractice. The courts are struck by the incongruity of recognizing a consistent professional standard of care for all professional services while effectively removing some professions from the prospect of liability for malpractice.

Several other courts view the relationship between a project architect and a builder as one in which the architect has so much power over the contractor that the law must impose a duty on the architect to avoid causing economic harm to the contractor.[218] Although this argument has force when the architect's authority is so extensive that it is "tantamount to a power of economic life or death,"[219] contemporary construction and design services agreements commonly avoid that degree of control for the very purpose of reducing the architect's risk of tort liability.[220] For this

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216. *Moransais*, 744 So. 2d at 980 .

217. *See, e.g.*, *Hydro Investors*, 227 F.3d at 18 (stating that despite some professional malpractice cases' holdings that the economic loss bars recovery when pure economic loss is at issue, the better choice is to permit recovery for economic loss in a narrow exception of cases dealing with liability stemming from a breach of a professional duty because if such an exception did not exist, recovery would be barred in many malpractice actions); *Moransais*, 744 So. 2d at 983 (recognizing that applying the economic loss rule to actions against design professional would eliminate those causes of action because they generally allege purely economic losses).

218. *See, e.g.*, *Ellis-Don Constr.*, 353 F. Supp. 2d at 605 (explaining that under North Carolina case law, a lawsuit by a contractor against an architect may be maintained even in the absence of privity because of the degree of power design professionals hold over contractors); *Forte Bros.*, 525 A.2d at 1303 (reversing summary judgment for defendant architect on plaintiff contractor's appeal, because the court found that the architect owed the contractor a duty to perform professionally); *A.R. Moyer*, 285 So. 2d at 401 (referring to law review comments and prior case law proposing that a design professional's liability should be in accordance with the amount of power the design professional holds over the contractor); *Rogers & Rogers*, 161 F. Supp. at 135-36 (acknowledging the power imbalance between an architect and contractor).

219. *Rogers & Rogers*, 161 F. Supp. at 136.

220. *See* SWEET & SCHNEIER, *supra* note 2, at 269-71 (reiterating that

reason, one might doubt the validity of this rationale as applied to many contemporary construction projects.

In 1994 the Supreme Court of Washington decided *Berschauer/Phillips Construction Co. v. Seattle School District*,[221] in which a contractor sued the owner's architect and its structural engineering consultant on the basis that their negligence in design and inspection caused project delays.[222] The court's opinion is unusually perceptive in recognizing unique construction industry factors that counsel caution when one participant in a project asserts that it has incurred additional costs because of the conduct of another participant with whom the claimant has no contractual relationship. Before the court turned its attention to the construction industry context, however, it paid homage to one of the most familiar justifications for barring recovery of purely economic loss in tort cases.

> The economic loss rule marks the fundamental boundary between the law of contracts, which is designed to enforce expectations created by agreement, and the law of torts, which is designed to protect citizens and their property by imposing a duty of reasonable care on others. The economic loss rule was developed to prevent disproportionate liability and allow parties to allocate risk by contract.[223]

Courts frequently sound this theme not only in construction industry cases[224] but also in many other claims involving purely economic loss.[225]

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contracts often limit the design professional's risk of tort liability by carefully limiting the design professional's power and control over the contractor and the construction process).

221. 881 P.2d 986 (Wash. 1994).

222. *Berschauer*, 881 P.2d at 988. Although the court's brief summary of the contractor's claims may be read to suggest that the contractor advanced an ordinary negligence theory, the case is appropriately considered within the professional negligence context because the contractor solely alleged negligent performance of professional duties by the owner's architect, the structural engineering consultant, and a construction inspection firm. *Id.* at 988-99. The court's resolution of the case made it unnecessary to analyze the plaintiff's principal legal theory.

223. *Id.* at 989-90 (citations omitted).

224. *See, e.g.*, *Prendiville*, 83 P.3d at 1263 (holding that the economic loss doctrine applied in a residential construction defect case where rights and liabilities of the parties were governed by contract and express warranties); City Express, Inc. v. Express Partners, 959 P.2d 836, 838 (Haw. 1998) (holding that a tort action for negligent misrepresentation seeking recovery for economic losses was not available to a party in privity of contract with a design professional).

225. *See* Laubmeier, *supra* note 4, at 231-34 (distinguishing between tort and contractual remedies and discussing the need to preserve that distinction when considering the application of the economic loss doctrine).

Having set the stage, the court explained the special reasons for preferring contract over tort to resolve purely economic loss claims arising in the construction industry.

> We . . . maintain the fundamental boundaries of tort and contract law by limiting the recovery of economic loss due to construction delays to the remedies provided by contract. We so hold to ensure that the allocation of risk and the determination of potential future liability is based on what the parties bargained for in the contract. We hold parties to their contracts. If tort and contract remedies were allowed to overlap, certainty and predictability in allocating risk would decrease and impede future business activity. The construction industry in particular would suffer, for it is in this industry that we see most clearly the importance of the precise allocation of risk as secured by contract. The fees charged by architects, engineers, contractors, developers, vendors, and so on are founded on their expected liability exposure as bargained and provided for in the contract . . . .
>
> A bright line distinction between the remedies offered in contract and tort with respect to economic damages also encourages parties to negotiate toward the risk distribution that is desired or customary. We preserve the incentive to adequately self-protect during the bargaining process. If we held to the contrary, a party could bring a cause of action in tort to recover benefits they were unable to obtain in contractual negotiations. [226]

In *BRW, Inc. v. Dufficy & Sons, Inc.*,[227] the Colorado Supreme Court refined *Berschauer's* contextual analysis. A detailed summary of the facts pled by the plaintiff is essential to understand how the commercial circumstances influenced the decision.[228] The City and County of Denver entered into a contract with BRW under which BRW agreed to design two bridge projects and to provide additional professional services during

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226. *Berschauer,* 881 P.2d at 992-93 (citations omitted). Professor Gergen cites *Berschauer* as an example of one way in which courts sometimes apply a general principle precluding tort liability for economic loss when "the claimant could have obtained redress for the harm from the actor by contract with the actor or through a chain of contracts reaching back to the actor . . . ." Gergen, *supra* note 2, at 764. The Washington Supreme Court was also influenced by the Washington legislature's decision to deny recovery in products liability claims for purely economic loss. *Berschauer,* 881 P.2d at 993. The nonsequitur in that part of the court's analysis seems obvious. The legislative decision in the products liability area most likely reflects the same policies unique to products liability theory that have led the majority of courts to apply the economic loss rule in that area of the law without regard to the fact that other tort theories permit recovery of purely economic losses. *See supra* Part II.C (showing how construction negligence cases reference products liability precedent when considering economic loss).

227. 99 P.3d 66 (Colo. 2004).

228. The summary in the text adopts the abbreviations the opinion uses to refer to the parties.

construction, and BRW in turn hired a consulting firm, PSI, to inspect the construction.[229] The City eventually entered into a contract with a general contractor, Kraemer, to build the bridges in accordance with BRW's design, and Kraemer subcontracted a portion of the work to a company that further subcontracted with Dufficy to fabricate and paint parts of the steel structures.[230] Dufficy encountered substantial problems and additional costs that it claimed resulted from defects in BRW's plans and from negligent inspections by PSI.[231] Dufficy's subcontract required that it prosecute any claims relating to the contract under the City's administrative claims procedure, and Dufficy did this and ultimately settled with the City and Kraemer.[232]

While the administrative claim was pending, Dufficy filed the suit against BRW and PSI.[233] Dufficy claimed that BRW's painting specifications, which Dufficy was required to follow, were inappropriate for Denver's altitude and arid climate and that PSI was negligent in carrying out its role in inspecting and giving instructions relating to the paint system.[234] The trial court dismissed Dufficy's claims based on Colorado's economic loss rule, but the court of appeals reversed on the basis that the rule did not bar recovery of purely economic losses that allegedly flowed from a defendant's breach of an independent tort duty owed to a plaintiff with whom the defendant had no contract.[235] This rationale by which a court imposes a duty of care on a professional as a matter of tort policy reflects the dominant underlying theory of professional negligence cases.[236] Starting from this basis, because Dufficy had no contractual relationship with either BRW or PSI, and because the court of appeals held that design professionals owe to contractors and subcontractors an independent tort duty of care in performing professional services in circumstances such as those that Dufficy pled, the court of appeals held that the trial court's dismissal of the claims was error.[237]

The Colorado Supreme Court granted the defendants' petition for certiorari. In its opinion reversing the court of appeals and upholding the trial court's dismissal of Dufficy's claims, the court stressed the conflict between Dufficy's theory of liability and the

229. *Id.* at 67-68.
230. *Id.* at 68.
231. *Id.* at 69-70.
232. *Id.* at 69-71. Those parties reached their settlement after the court of appeals ruled, but it is not clear what effect the decision of the court of appeals may have had on the settlement negotiations. *Id.* at 71.
233. *Id.* at 70.
234. *Id.*
235. *Id.* at 70-71.
236. *See Specialty Designs*, *supra* note 1, at 177-79 (arguing that negligence dominates over contract law in design defect cases).
237. *Dufficy*, 99 P.3d at 71.

consensual risk allocation scheme contemplated by the web of interrelated contracts among the multiple participants involved the bridge projects. By asking the court to impose on BRW and PSI a duty to perform their professional services with due care to avoid causing Dufficy economic harm, Dufficy was, in effect, petitioning for retrospective reallocation of risk – a judicially imposed substitute for the consensual regime established by the participants to the project.

The court's next analytic step was its most significant one. The court particularized the economic loss policy debate for application to the building construction circumstances involved.

> Dufficy claims that it did not have an "opportunity . . . to bargain directly with PSI and BRW over the risk of the harm which would result from defective specifications and negligent project administration." We disagree and hold that the economic loss rule applies when the claimant seeks to remedy only an economic loss that arises from interrelated contracts.
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> The economic loss rule applies between and among commercial parties for three main policy reasons, none of which depends upon or is limited to the existence of a two-party contract: (1) to maintain a distinction between contract and tort law; (2) to enforce expectancy interests of the parties so that they can reliably allocate risks and costs during their bargaining; and (3) to encourage the parties to build the cost considerations into the contract because they will not be able to recover economic damages in tort.
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> In the context of larger construction projects, multiple parties are often involved. These parties typically rely on a network of contracts to allocate their risks, duties, and remedies . . . .
>
> In such a contract chain, the parties do have the opportunity to bargain and define their rights and remedies, or to decline to enter into the contractual relationship if they are not satisfied with it. Even though a subcontractor may not have the opportunity to directly negotiate with the engineer or architect, it has the opportunity to allocate the risks of following specified design plans when it enters into a contract with a party involved in the network of contracts. In this situation, application of the economic loss rule encourages a subcontractor to protect itself from risks, holds the parties to the terms of their bargain, enforces their expectancy interests, and maintains the boundary between contract and tort law.
>
> The policies underlying the application of the economic loss rule to commercial parties are unaffected by the absence of a one-to-one contract relationship. Contractual duties arise just as surely from

> networks of interrelated contracts as from two-party agreements. . . .[238]

As already mentioned, the most important step in the court's analysis was to recognize that a complex, highly developed, and commercially coherent risk allocation relationship may exist among participants in a construction project even though they are not all parties to the same contracts. It may be but a slight elaboration to say that the court implicitly held that when one participant in a construction project seeks to recover its economic losses from another participant a court should not look for an independent tort duty of care without first inquiring whether the multi-party operational structure involved has already allocated the risk of liability at issue. If so, a court should not reallocate the risk as a matter of tort policy if the most significant result of doing so is to reduce the costs the structure imposes on one of the participants.

By thoughtfully placing in context the commercial relationships involved, the *Berschauer* and *Duffícy* cases stand apart from the more conventional approaches of other cases in which non-clients seek purely economic loss based on design malpractice. In the process, those two cases begin to point the way to a more rigorous and sophisticated analysis that courts might adopt whenever one participant in a construction project sues for a retrospective realignment of commercial risk allocation. The wisdom of this approach becomes more apparent when the basis of the claim shifts from professional negligence to the rather slippery theory of negligent misrepresentation.

D. Negligent Misrepresentation

Negligent misrepresentation has become the most facile tort theory available to a construction project participant who would recover purely economic loss from another participant. Negligent misrepresentation draws legitimacy from the groundbreaking decision in *Glanzer v. Shepard*,[239] the significance of which this Article has previously noted.[240] Cardozo's 1922 analysis of the liability of careless bean weighers radiates throughout the negligent misrepresentation jurisprudence.[241]

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238. *Id.* at 72 (citations omitted).

239. 135 N.E. 275 (N.Y. 1922).

240. *See supra* Part II.B (examining *Glanzer*, an early case recognizing tort liability for economic loss, and its progeny).

241. *See* RESTATEMENT (SECOND) OF TORTS § 552, cmt. g (1977) (utilizing the facts in *Glanzer v. Shepard*). Negligent misrepresentation cases arising in the construction industry frequently cite *Glanzer v. Shepard*. *See, e.g.*, *Guardian Constr.*, 583 A.2d at 1382; *Ossining Union Free Sch. Dist.*, 539 N.E.2d at 93; Craig v. Everett M. Brooks Co., 222 N.E.2d 752, 755 (Ma. 1967).

In contemporary law, the Restatement articulates the tort of negligent misrepresentation succinctly, but with only subtle reference to commercial context:

> Information Negligently Supplied for the Guidance of Others
>
> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.[242]

Not only does the Restatement recognize negligent misrepresentation as a valid theory for tort recovery, it expressly contemplates recovery of purely economic loss,[243] even in the construction industry setting.[244] Many cases hold that the Restatement essentially exempts negligent misrepresentation claims from the economic loss rule,[245] or they at least imply that it

242. RESTATEMENT (SECOND) OF TORTS § 552. Subsection (3) deals with those who have a public duty to provide information and is not commonly involved in building construction cases. Subsection (3) states: "The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them." *Id.*

243. RESTATEMENT (SECOND) OF TORTS § 552B.

244. RESTATEMENT (SECOND) OF TORTS § 552, cmt. h, illus. 9.

245. *See, e.g.*, *Bilt-Rite Contractors*, 866 A.2d at 286 (determining the architect could be held liable for economic loss under theory of negligent misrepresentation despite lack of privity); Hewitt-Kier Constr., Inc. v. Lemuel Ramos & Assoc., Inc., 775 So. 2d 373, 375 (Fla. Dist. Ct. App. 2001) (holding architect liable to contractor for foreseeable harm to subcontractors relying on architect's design); *Jim's Excavating Serv.*, 878 P.2d at 254-55 (holding that the contractor may recover purely economic losses against an engineer or architect when design professional could foresee parties at risk in relying on the information supplied).

does,[246] although the availability of economic damages in other cases seems to turn on the particular facts involved.[247]

One of the earliest and most influential cases relying on negligent misrepresentation as a basis for purely economic damages in a construction industry case was decided in 1958 by a federal district court applying California law.[248] The court's principal holding was that the owner's architect could be held liable to the general contractor under the theory of the *Biakanja* case if the evidence established that the architect was negligent in reviewing concrete test results and approving pre-formed structures (referred to as bents).[249] As an alternative basis, the court held that by approving the test reports the architect negligently represented to the owner that the structures conformed to the project specifications. The court reasoned:

> [I]nsofar as the counterclaim alleges that the architect negligently interpreted and construed reports of tests on the concrete and then authorized the incorporation of the bents into the building, the contractor in effect asserts a claim of negligent misrepresentation by the architect, with reasonably foreseeable reliance thereon by the contractor to the latter's detriment. This is so because authorization to incorporate the bents into the building, given by the architect, who is admittedly responsible for overseeing the work of the testing laboratories and for supervising construction to assure conformity with specifications, must be taken to imply a representation, first, that the architect has inspected the bents and reviewed the tests performed on the concrete of which they were made, and second, that both the bents and the concrete therein conform to specifications.[250]

Although negligent misrepresentation claims in construction industry cases commonly involve purely economic loss, it is

246. *See, e.g.*, John Martin Co. v. Morse/Diesel, Inc. 819 S.W.2d 428, 431-34 (Tenn. 1991) (allowing a claim for economic loss under § 552); *Guardian Constr.*, 583 A.2d at 1385-86 (permitting a negligent misrepresentation claim based on economic damages alone); Robert & Co. Assoc. v. Rhodes-Haverty Partnership, 300 S.E.2d 503, 504 (Ga. 1983) (accepting rationale of § 552 and claims for purely economic loss); *Donnelly Constr.*, 677 P.2d at 1296-97 (allowing a negligence claim against design professional without privity of contract).

247. *See, e.g.*, Nat'l Steel Erection, Inc. v. J.A. Jones Constr. Co., 899 F. Supp. 268, 274 (N.D. W. Va. 1995) (concluding that allowing the subcontractor to recover from the owner's engineer "would permit it to recover benefits it was unable to obtain in contract negotiations"); *John Martin Co.*, 819 S.W.2d at 431 (resisting the construction manager's motion for summary judgment, the trade contractor argued that the record supported its contention that under the particular circumstances it had no choice other than to rely to its detriment on information the owner's construction manager provided).

248. *Rogers & Rogers*, 161 F. Supp. at 135-36.

249. *Id.*

250. *Id.* at 136.

interesting that this seminal case addressed only whether to recognize the tort of negligent representation and not whether it mattered that the plaintiff suffered no physical harm.[251]

Another relatively early case held that a surveyor retained by a real estate developer could be held liable to a general contractor hired by the developer to build roads based on the surveyor's work.[252] The court affirmed a directed verdict for the surveyor on the first count, which alleged an intentional or reckless misrepresentation because the evidence failed to support those theories. The second count simply alleged that the surveyor was negligent in providing measurements and plans and in setting stakes for the road work.[253] Although the plaintiff had not characterized the surveyor's negligence "in making plans and in placing stakes" as misrepresentations, the court concluded that "[s]uch acts are a form of representation."[254] The court held that the surveyor could be held liable for negligent misrepresentation for negligently placed stakes that the surveyor knew the plaintiff would rely on to establish the starting points for the road work.[255]

Participants in a construction project, especially those involved in design or coordination or construction management, frequently provide to their clients plans, inspection results, reports, or other services that the client passes along to another participant.[256] These circumstances create the potential for negligent misrepresentation claims in a wide variety of recurring situations.

For example, a building purchaser who relied on inaccurate information in an inspection report concerning the building's condition may have a negligent misrepresentation claim against the inspection firm even though the seller rather than the buyer commissioned the report.[257] Similarly, a trade contractor may

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251. This may reflect that, especially under California tort jurisprudence, the primary concern limiting liability is "the specter of widespread tort liability . . . and that economic loss cases lacking this feature do not receive distinctive treatment." Rabin, *supra* note 25, at 1514-15.

252. *Craig*, 222 N.E.2d at 755.

253. *Id.* at 753.

254. *Id.* at 754.

255. *Id.* at 754-55.

256. Several cases cited in this discussion of negligent misrepresentation illustrate. *See, e.g.*, *John Martin Co.*, 819 S.W.2d at 429 (holding that a subcontractor can make a negligent misrepresentation claim against a construction manager even absent privity); *Guardian Constr.*, 583 A.2d at 1386 (explaining that construction companies had a valid negligent misrepresentation claim against a design engineer because it knew the construction companies would rely on its calculation); *Donnelly Constr.*, 677 P.2d at 1296-97 (holding the architect could be liable for negligent misrepresentation to a construction company who relied on the calculations when it submitted its bid).

257. *See Robert & Co. Assoc.*, 300 S.E.2d at 504 (emphasizing that the

have a negligent misrepresentation claim against the owner's construction manager who provides inaccurate information in the course of supervising or directing the work.[258] Additionally, as has already been noted, negligent misrepresentation claims are not limited to situations involving express representations.[259] A negligent misrepresentation claim based on indirect or implied representations may have special force if the owner's architect or engineer has extensive authority over the contractor[260] or if the design professional's services are for the express purpose of giving the contractor essential information.[261]

In the construction industry setting, a negligent misrepresentation claim may prove more adaptable than claims based on ordinary negligence and professional negligence. For example, a negligent misrepresentation claim may succeed even though, aside from the circumstances involving the misrepresentation, no special relationship exists between the plaintiff and the defendant that would be sufficient to support a negligence claim.[262] Moreover, an alternative count in negligent misrepresentation frequently offers a viable companion to a professional negligence count.[263] And a participant in a construction project who is unable to establish a third-party beneficiary claim based on the defendant's deficient performance under a contract with another participant may be able to characterize the defendant's actions as involving negligent misrepresentations.[264] Negligent misrepresentation is also an attractive alternative to a professional negligence claim if the

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inspection firm knew the seller would use the report to encourage prospective purchasers).

258. *See John Martin Co.*, 819 S.W.2d at 429 (explaining that the construction manager was responsible for providing the plans and specifications to the subcontractors).

259. *See Craig*, 222 N.E.2d at 754-55 (holding that the contractor reasonably relied on the location of survey stakes placed by the owner's civil engineer); *Rogers & Rogers*, 161 F. Supp. at 132 (stating that the architect and architect's consultant tested and approved pre-formed concrete structural elements before the contractor's installation).

260. *See Rogers & Rogers*, 161 F. Supp. at 132 (relating that the architect was responsible for supervising all aspects of the construction).

261. *See Craig*, 222 N.E.2d at 755 (concluding that the damages suffered by a contractor for errors made by the civil engineer were recoverable).

262. *See, e.g.*, Mosser Constr., Inc. v. W. Waterproofing Co., No. L-05-1164, 2006 WL 1944934 at *3 (Ohio Ct. App. July 14, 2006) (stating that recovery in a negligent misrepresentation claim is possible if there is a "sufficient nexus" among the parties involved); *Malta Constr.*, 694 F. Supp. at 908 (holding an "intended beneficiary" to a contract between an engineer and subcontractor had a right to sue for breach of that contract).

263. *See, e.g.*, *Guardian Constr.*, 583 A.2d at 1387 (concluding both a negligent and negligent misrepresentation suit is possible even without privity among the parties).

264. *Id.*

defendant is not a recognized design professional or was not necessarily functioning in that capacity.[265] Additionally, a plaintiff who sues a design professional for negligent misrepresentation might avoid the need for expert testimony to establish a breach of the professional standard of care, which would be essential if the claim were based on professional negligence.[266]

A 1990 Delaware case identified one aspect of the negligent misrepresentation theory that may be especially important in justifying recovery of economic loss whether or not purely economic loss is available under other tort theories.[267] The court held that a project engineer should be liable for foreseeable economic losses if, as part of its role in designing a project, the engineer "negligently obtained and communicated incorrect information specifically known and intended to be for the guidance of Plaintiffs, and if it is specifically known and intended that Plaintiffs would rely in calculating their project bids on that information, and if Plaintiffs rely thereon to their detriment."[268] This observation seems to distinguish many negligent representation situations, which involve a relatively small class of identifiable potential plaintiffs, from cases in which tortious conduct could have widespread economic consequences. The Restatement also places significance on this factor by imposing liability on the defendant only to "the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it."[269]

As all of these authorities show, courts have increasingly accepted the negligent representation theory when they have perceived that one participant in a construction project has reasonably and foreseeably relied on information provided by another participant. In response to this growing risk of liability, defendants have vigorously argued against recovery for purely economic loss.[270] Often, the defendant or the court explicitly

265. *See Presnell Constr. Managers*, 134 S.W.3d at 582 (holding a construction manager liable to contractor for supplying faulty information).

266. *See generally* SWEET & SCHNEIER, *supra* note 2, at §14.06 (explaining that in order to support a conclusion that the defendant has not performed up to ordinary professional standards, expert testimony is generally required to establish the professional standard).

267. *Guardian Constr.*, 583 A.2d at 1378.

268. *Id.* at 1386.

269. RESTATEMENT (SECOND) OF TORTS § 552(2)(a) (1977).

270. *See, e.g.*, *John Martin Co.*, 819 S.W.2d at 430 (describing defendant's argument against "recovery for economic losses in the absence of privity"); *Craig*, 222 N.E.2d at 754-55 (discussing whether the law should allow purely economic losses); *Guardian Constr.*, 583 A.2d at 1381-86 (detailing the case law behind defendant's argument against recovery because there was no contract between the parties).

frames the question as whether, as a policy matter, negligent misrepresentation is an appropriate exception to whatever version of the economic loss defense the jurisdiction has already adopted.[271] On this question, several courts have stood firmly against giving special treatment to negligent misrepresentation claims.[272] With only a few exceptions, however, the construction industry cases denying recovery for purely economic loss based on negligent misrepresentation have done so primarily by invoking somewhat mechanical rules[273] or narrow grounds unique to the facts before them.[274]

The Washington Supreme Court's opinion in *Berschauer*,[275] which has already been highlighted in reference to the professional negligence theory,[276] stands out because it provided policy arguments for a restrictive response to a negligent misrepresentation claim in the construction industry setting. Precedent and logic required the court to acknowledge the negligent misrepresentation theory upon which the contractor based its claim against the project architect and to concede that the Restatement supports recovery of economic loss in construction

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271. *See, e.g.*, Nota Constr. Corp. v. Keyes Assoc., Inc., 694 N.E.2d 401, 405 (Mass. App. Ct. 1998) (stating that negligent misrepresentation is an exception to the economic loss doctrine); *Malta Constr.*, 694 F. Supp. at 906 (explaining that a claim for negligent misrepresentation is an exception to the "strict privity-economic loss rule").

272. *See, e.g.*, *Duffy*, 99 P.3d at 74-75 (holding that "contract principles override tort principles," barring subcontractor's claim for negligent misrepresentation); Preston v. Condon Constr. & Realty, Inc., 690 N.W.2d 885, 885 (Wis. Ct. App. 2004) (holding that the economic loss doctrine applies to consumer transactions); *Nat'l Steel Erection*, 899 F. Supp. at 272 (granting summary judgment for defendant in a negligent misrepresentation claim); Williams & Sons Erectors, Inc. v. S.C. Steel Corp., 983 F.2d 1176, 1181 (2d Cir. 1993) (holding under New York law that there must be "privity of contract or a relationship closely approaching it").

273. *See, e.g.*, David Pflumm Paving & Excavating, Inc. v. Foundation Servs. Co., 816 A.2d 1164, 1168 (Pa. Super. 2003) (stating that recovery is only allowed if plaintiff "suffered losses in addition to his economic loss"); *Fireman's Fund Ins.*, 679 N.E.2d at 1199 (listing three instances in which a plaintiff could recover: the plaintiff suffers personal injury or property damage; fraud; and negligent misrepresentation involving information supplied in a business transaction); *Williams & Sons Erectors, Inc.*, 983 F.2d at 1182 (holding that the relationship between the parties must be "so close as to approach that of privity").

274. *See* IT Corp. v. Ecology & Envtl. Eng'g, 275 A.D.2d 958, 960 (N.Y. App. 2000) (explaining that a party can only recover if there is actual privity or a relationship similar enough to be deemed equivalent to privity); Tex. Tunneling Co. v. City of Chattanooga, 329 F.2d 402, 408 (6th Cir. 1964) (holding plaintiff's evidence did not present a proper "vehicle in which to make a new advance in the law of torts").

275. *Berschauer*, 881 P.2d at 993.

276. *See supra* notes 220-24 (providing examples and explanations on professional negligence in the construction industry).

industry cases.[277] Nonetheless, the court identified countervailing considerations that required limiting the contractor to its right to recover its economic losses solely from the school district with which it had an agreement (and with which the contractor had already reached a settlement).

> We hold that when parties have contracted to protect against potential economic liability, as is the case in the construction industry, contract principles override the tort principles in § 552 and, thus, purely economic damages are not recoverable . . . .
>
> There is a beneficial effect to society when contractual agreements are enforced and expectancy interests are not frustrated. In cases involving construction disputes, the contracts entered into among the various parties shall govern their economic expectations. The preservation of the contract represents the most efficient and fair manner in which to limit liability and govern economic expectations in the construction business. Berschauer/Phillips' recovery of economic damages is therefore limited to those damages recovered from the District and to those assigned contractual claims that survive this appeal.[278]

Several other courts have relied on the *Berschauer* analysis to deny recovery of purely economic losses in construction industry cases based on negligent misrepresentation, but they have not contributed significantly to the Washington Supreme Court's analysis.[279]

Overall, influenced significantly by Section 552 of the Restatement of Torts, the courts have more consistently approved negligent misrepresentation than any other tort theory for recovery of purely economic loss in construction industry cases. What remains to be considered is how well any of the theories resonate with the reality of commercial risk allocation in the construction industry.

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277. *Berschauer*, 88 P.2d at 993.

278. *Id.* The mention of assigned contractual claims referred to the assignment, as part of the settlement between the school district and the contractor, of any damage claims the district had under its contracts with the design and testing firms.

279. *Dufficy*, 99 P.3d at 74-75; SME Indus., Inc. v. Thompson, Bentulett, Stainback & Assoc., Inc., 28 P.3d 669, 683-84 (Utah 2001); Rissler & McMurray Co. v. Sheridan Area Water Supply Joint Powers Bd., 929 P.2d 1228, 1234-35 (Wyo. 1996); *see Nat'l Steel Erection*, 899 F. Supp. at 272-74 (holding that contract principles override tort principles). *But see* Grynberg v. Questar Pipeline Co., 70 P.3d 1, 13 (Utah 2003) (calling into doubt the continuing significance of *SME Industries*).

IV. RETHINKING THE COMMERCIAL AND ECONOMIC LOSS PROBLEM IN THE CONSTRUCTION INDUSTRY

A. Making Law in Context

Sound judicial process melds legal principles with living facts. This is what makes the process contextual. It happens when trial courts apply accepted legal principles to well-developed facts in routine cases. And it also happens when appellate judges develop new legal principles or modify existing ones in response to changing circumstances. The law, especially tort law, demands attention to these two variations because facts that make for a routine case at one stage in the law's development may later come to light under changing circumstances. In other words, it is not enough that judges take care to decide routine cases only after the parties have a fair opportunity to develop the facts. When a claim seeks to expand or modify existing liability theories, courts, especially at the appellate level, must make an adequate assessment of the relevant facts, including the context in which the claim arises.

Leading cases addressing the economic loss problem illustrate this point. In the early part of the twentieth century, judges managed tort liability through such devices as proximate cause and privity. These accepted tort principles provided logical bases for limiting tort liability in relatively common situations, including those involving purely economic loss.[280] As changes in society fueled a tort liability expansion, influential jurists and scholars led a revolution in tort theory that produced more sophisticated and discerning legal principles.[281]

The California Supreme Court expressed this phenomenon well with its influential decision in *Biakanja v. Irving*.[282] "The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors . . . ."[283] The particular factors the court identified in that opinion provided a non-exhaustive list of considerations for courts to use in future cases to make the policy judgment concerning tort liability. Among other things, the *Biakanja* factors emphasize that modern tort theory involves a normative assessment that takes into account many

280. *See, e.g.*, *Robins Dry Dock*, 275 U.S. at 308 (holding plaintiff could not recover because the contract was between the defendant and the owner of the vessel, not plaintiff); *Byrd*, 43 S.E. at 421 (stating only plaintiffs who have a direct contract with defendant can be compensated).

281. *See generally* WHITE *supra* note 28, at xxiii-xxviii (providing an analysis of the changing concepts in tort law and how leading legal scholars and judges shaped the law).

282. 320 P.2d 16 (Cal 1958).

283. *Id.* at 19.

relevant circumstances. These circumstances include the relationship between the plaintiff and the event or transaction involved, the relationship between the defendant's conduct and the plaintiff's injury, and the relationship between the defendant's conduct and the values and goals that tort law serves.[284] Applying contemporary tort policy to economic loss claims arising in construction projects requires an exceptionally thorough appreciation of context, especially the commercial context in which construction activity occurs.

B. The Controlling Relevance of Interdependent Commercial Relationships in Building Projects

Courts cannot adequately address economic loss problems in construction cases based on a superficial perception of the building construction industry. Contemporary building projects generate economic loss problems having far more complex policy implications than those that courts face when an inaccurate weight certificate inflates the sales price of beans[285] or when an ineptly drawn will allows the testator's property to pass to the wrong relative.[286] Most construction projects create complex commercial relationships among the participants that present thorny problems nearly unique to the industry. In a common project structure, an owner may hire an architect, who in turn hires several engineers and other specialized design consultants who together produce reams of design documents and information used by many other participants who themselves enter into multiple commercial arrangements with manufacturers, suppliers, installers, and others.

The relationships involved in building design and construction activities are made even more complex by the overlapping technical activities involved. Tort standards should invoke methodical analysis when the project requires that designers, builders, manufacturers, suppliers, and consultants act in concert to produce a power plant that will achieve optimum efficiency,[287] a glass atrium that will survive an earthquake,[288] or a roof that will withstand a hurricane[289] or arctic wind gusts.[290]

These complex webs of interdependence may seem to be the stuff of special relationships upon which tort theory properly

284. *Id.*
285. *See Glanzer*, 135 N.E. at 275.
286. *See Biakanja*, 320 P.2d at 18.
287. *See* CIT Group/Equip. Fin., Inc. v. ACEC Main, Inc., 782 F. Supp. 159, 162 (D. Me. 1992).
288. *See* Filmland Dev., Inc. v. Turner Constr. Co., Nos. B136497, B140556, 2002 WL 31693595, at *1 (Cal. Ct. App. Dec. 3, 2002).
289. *See* Blake v. Hi-Lu Corp., 781 So. 2d 1122, 1123 (Fla. 2001).
290. *See* Aleutian Constructors v. United States, 24 Cl. Ct. 372, 377 (1991).

imposes duties of care.[291] But which participants in a project are so situated in relation to other participants that they should have a duty to protect the others from certain commercial risks? Participants in a construction project who contract with one another rarely do so for the benefit of other participants in the project. And each participant enters into the temporary social compact of the project with a full understanding of the commercial perspectives of the other participants. This is not to say that a duty established under a construction contract never provides a legitimate basis to impose a tort duty in favor of other participants who are not parties to that contract. But courts should not impose tort duties in these circumstances without thoroughly analyzing the commercial context of construction projects. An owner hires design professionals to serve as experts, advisors, and representatives for the owner's specific purposes. The same owner may hire one or more builders, manufacturers, and suppliers to deliver a project that meets the owner's particular needs. General contractors hire subcontractors and consultants and divide the construction tasks among them. The design and construction functions may be differentiated or combined in many alternative ways. In almost all of these cases, relatively detailed documents and specialized customs and practices establish reasonable commercial expectations of the participants. Those contracts reflect each participant's judgment about the costs of performance in light of that participant's scope of responsibility and risk exposure.

In other words, industry contracting structures are deliberate exercises in risk and responsibility allocation. Participants price their services based on careful analyses of the costs of performance, including the costs of assumed risks. When courts allocate or re-allocate risks after the fact, they risk upsetting an important apple cart. A thorough appreciation of the relationships involved requires an appreciation of the consensual risk allocation process that underlies those relationships.

C. The Seductive Folly of a Rule-Based Approach

This portrait of commercial relationships in the construction industry might suggest that purely economic losses should never be recoverable when one participant sues another in tort. If the industry implicitly requires the participants to allocate the

291. The court in *Davidson & Jones* stated: "Where breach of [an architectural services] contract results in foreseeable injury, economic or otherwise, to persons so situated by their economic relations, and community of interests as to impose a duty of due care, we know of no reason why an architect cannot be held liable for such injury. Liability arises from the negligent breach of a common law duty of care flowing from the parties' working relationship." 255 S.E.2d at 584.

commercial risks of the project through their contracts, then perhaps courts should never use tort doctrines to reallocate those risks. In other words, perhaps sound policy requires a broad economic loss rule for the construction industry, albeit for different reasons than those the courts commonly give.

A rule-based approach to economic loss claims is seductive because it promises predictability and judicial economy. It also seems to offer a workable answer to a crucial question of tort policy: Where should tort liability stop? A per se rule barring purely economic loss claims supports a definite boundary line between tort and contract. Finally, a rule that distinguishes physical harm from purely economic harm seems to offer a more legitimate way to regulate tort liability than the principles courts used in the past for that purpose. In particular, the older notions of privity and proximate cause too often barred tort recovery in compelling cases involving physical harm,[292] and the more modern foreseeability standard is insufficient to keep tort liability reasonably restrained.[293]

These desires for predictability, regulation of unduly widespread tort liability, and a clear boundary between tort and contract occupy a central role in the leading cases that proclaim a broad tort principle against purely economic loss claims. Too often, however, those cases uncritically transfer the rationale for the economic loss rule of products liability law into a construction industry context. In doing so, those courts fail to recognize that a unique commercial context justifies a rule-based approach when manufactured products cause purely economic loss.

Taken as a whole, the line of construction industry cases that establish a per se economic loss bar provides a striking example of the fallacy of the transplanted category.[294] The justification for an economic loss rule limiting the liability of product manufacturers does not necessarily justify a similar limit on the liability of those involved in building construction. Products liability law primarily results from a judicial policy decision to protect consumers from the risk of physical harm created by products, which is a risk uniquely within the control of manufacturers and one that is beyond any risk allocation functions that product sales transactions can achieve. Courts that have adopted an economic

292. *See supra* note 42 (providing one case that used privity and proximate cause to deny recovery for physical harm and another case that used privity as a condition for recovery for physical harm).

293. *See supra* notes 56-60 (citing cases in which the court considered foreseeability when holding that a defendant may be liable to a plaintiff in tort, although there was no privity between the two parties).

294. *See* Moffatt Hancock, *Fallacy of the Transplanted Category*, 37 CANADIAN B. REV. 535, 535-36 (1959). The fallacy of the transplanted category refers to the illogical application of a legal principle appropriate for one context to an entirely different context. *Id.* at 555.

loss bar in products liability cases have simply determined that the same policy concerns that require aggressive protection from the risk of physical harm do not apply when a product causes purely economic loss. A matching result is not necessarily valid in the case of economic risks inherent in building construction. Applying theories that prevail outside of products liability law, a court might well conclude that a typical construction project inherently creates an environment of economic interdependence that should impose a duty of care on some participants to avoid causing economic loss to others.

Given the development of tort theory over the past hundred years, a fixed rule barring most economic loss claims arising in the construction industry unnecessarily immunizes an important and risky category of human behavior. Modern tort theory and policy provide no logical reason to preclude recovery for purely economic loss in construction cases altogether. Moreover, the evolution of tort law inevitably dooms a per se rule barring purely economic loss. Even in jurisdictions that proclaim a broad economic loss rule that extends beyond products liability claims, the exceptions threaten to swallow the rule.[295] And where the usual exceptions are more narrowly applied, the economic loss rule may produce illogical results in building construction cases.[296]

D. Finding a Principled Approach

There are important policy reasons to prefer a more principled approach toward the economic loss problem in construction industry cases. As Part III demonstrates, the interdependent relationships that infuse significant economic risks into every construction project invite tort claims based on negligence, professional malpractice, and negligent misrepresentation. Several cases discussed in Part III also show

295. Laubmeier, *supra* note 4, at 235-56; *see, e.g.*, *Malta Constr.*, 694 F. Supp. at 906-07 (using negligent misrepresentation as an exception to the economic loss rule); *see also* Usow, *supra* note 4, at 1-3 (stating that Florida courts have created numerous exceptions to the economic loss rule). For example, in some jurisdictions a contractor who cannot recover economic loss from the owner's architect on a professional negligence theory may successfully recast the same claim so that it falls within a negligent misrepresentation exception to the jurisdiction's version of the economic loss rule. *Malta Constr.*, 694 F. Supp. at 906-07.

296. *See supra* notes 171-76 (identifying construction cases that used the economic loss rule to reach illogical results); *see also Thomson*, 899 S.W.2d at 420-22 (barring economic loss claims based on the defendant's negligence in performing duties under an engineering inspection contract but permitting economic loss claims based on the defendant's negligence in performing duties under an engineering services contract for the same project because the negligent inspection caused damage to the project itself, which was the subject of that contract, but the negligent design services allegedly affected portions of the project other than the portions the defendant designed).

that, outside of products liability law, it is difficult to justify a bar to recovery that is based solely on the character of the loss suffered. But that does not necessarily mean that tort theories should readily permit recovery of purely economic loss in construction industry cases.

The cases simply do not provide a satisfactory framework for addressing economic loss problems in the construction industry. But several of them highlight some of the most relevant considerations. Because of its special significance in expanding tort liability, *Biakanja v. Irving* provides a convenient point of departure. By openly embracing the policy function of negligence law in that case, the California Supreme Court helped to free tort analysis from rigid formulas. But the circumstances in which that case arose did not require the court to employ the same degree of sophisticated analysis that the construction industry requires. The relationship between a notary who drafts a will and the testator's intended beneficiary presents far clearer policy questions than do the relationships created by even the simplest construction project. The *Biakanja* factors are relevant to any negligent infliction of economic loss claim, yet the opinion itself provides little guidance for a claim that arises in the context of highly structured commercial relationships, as typically exist in building construction problems.

Another decision by the California Supreme Court, *J'Aire Corp. v. Gregory*,[297] shows the problem more clearly. In *J'aire* the California Supreme Court applied the *Biakanja* factors in a building construction context and held that a builder hired by a landlord to improve leased premises owed a tort duty of care to the tenant to complete the project on a timely basis. The court's failure to express sufficient interest in the full context involved creates considerable doubt about the wisdom of the case. The appeal stemmed from the trial court's judgment of nonsuit of the tenant's claim against the builder. If the court had merely held on appeal that further factual development was required to determine whether or not the builder owed a tort duty to the tenant under the *Biakanja* factors, the case would be correct, or at least unremarkable. But the meager facts pled were insufficient to justify the duty that the court definitively imposed on the builder.

Far more information than what the pleadings disclosed would be required to know whether the holding comports with sound tort policy. Why did the construction contract itself fail to establish a completion date for the contractor's work? Was that a factor in the negotiations between the landlord and the builder? Given that the lease obligated the landlord to provide certain

297. 598 P.2d 60 (Cal. 1979).

improvements to the tenant, should the tenant have any remedies for delayed completion beyond those available to it under the lease? Did the lease or applicable law limit the liability of the landlord (a public entity) for delays in completion of the leased space? If so, does that suggest that the tenant, as part of the bargain, accepted the commercial risk of delay? How likely is it that the construction contract price reflected the risk that the court allocated to the builder? Is it reasonable to conclude that the builder would have agreed to a contract imposing on it liability to the tenant for construction delays without insisting on a significant increase to the contract price? In light of the extensive negotiations that often occur between a landlord and a tenant and between a landlord and a builder when the leased space requires improvements, one must wonder whether the court's holding allowed the tenant to obtain from the builder, with whom it had no consensual relationship, economic protection that it was unable to secure in its negotiations with the landlord.

A Seventh Circuit opinion in a case not involving building construction provided an especially useful example of a contextual approach that may be relevant whenever negligent commercial activity produces economic loss. In that case, the owner of a cement plant sued to recover purely economic loss caused by a tanker truck accident that blocked access to the plant.[298] The court proposed an extreme example to illustrate the importance of deciding the case within the context in which commercial transportation occurs on the nation's highways and streets.

> At oral argument in the instant case, for example, the appellant contended in response to a hypothetical question that a defendant would be liable to all of the tenants in the Empire State Building who lost business as a result of the defendant's negligence in causing the access to the building to be closed. The appellants argued that this result would be fair and noted that the tortfeasor would be paid to assume that risk . . . .
>
> Obviously, the price that a carrier would demand in order to compensate for the real risk of being put out of business if sued by even a few of the tenants in the Empire State Building would be great. Furthermore, it is doubtful that insurance companies would be willing to cover such large risks.[299]

A contextual approach is even more important when economic loss claims arise in construction industry cases. In the first instance, this is because project structures commonly evidence the participants' deliberate allocation of the key commercial risks involved. Moreover, when two participants assess the risks

298. Dundee Cement Co. v. Chemical Lab., Inc., 712 F.2d 1166 (7th Cir. 1983).

299. *Id.* at 1171.

involved in their contractual arrangement, they do not necessarily do so in a bilateral vacuum. Their assessments take place in the context of a web of connected commercial relationships that should reflect the roles of the multiple project participants. Participants price their services based on the risks they assume, and they know that the pricing and negotiation process requires that each participant have a fair opportunity to assess its costs before agreeing to commercial terms.

Several construction industry cases have recognized the importance of an industry perspective toward economic loss claims. The Virginia Supreme Court offered the following analysis in rejecting a contractor's claim for economic loss allegedly caused by an architect's failure to exercise due care in performing services required by the architect's contract with the project owner:[300]

> The parties involved in a construction project resort to contracts and contract law to protect their economic expectations. Their respective rights and duties are defined by the various contracts they enter. Protection against economic losses caused by another's failure properly to perform is but one provision the contractor may require in striking his bargain. Any duty on the architect in this regard is purely a creature of contract.[301]

Other courts have expressed similar concerns in construction cases, especially when one participant in a project seeks to impose tort liability on another participant. "Construction projects are characterized by detailed and comprehensive contracts that form the foundation of the industry's operations. Contracting parties are free to adjust their respective obligations to satisfy their mutual expectations."[302]

A federal court applying West Virginia law made a similar point in rejecting a subcontractor's negligent misrepresentation claim against the project supervisor retained by the owner, reasoning that to allow the subcontractor to recover under the circumstances involved "would permit it to recover benefits it was unable to obtain in contract negotiations."[303] This, the court concluded, was especially inappropriate because the subcontractor, which had a contract with the owner's construction manager but no contract with the project supervisor, was sophisticated and "was well aware of the economic risks associated with its business when it negotiated with" the construction manager.[304]

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300. *Blake Const.*, 353 S.E.2d at 724-27.

301. *Id.* at 727.

302. Am. Towers Owners Ass'n v. CCI Mech., Inc., 930 P.2d 1182, 1190 (Utah 1996); *see also*, *City Express*, 959 P.2d at 840 (denying recovery for negligent misrepresentation based upon purely economic loss because contracting parties are free to define their obligations in the contract).

303. *Nat'l Steel Erection*, 899 F. Supp. at 274.

304. *Id.*

Two other construction industry cases already discussed at length also provide useful examples of approaches to economic loss problems that are sensitive to the construction industry context. The *Duffícy* and the *Bershauer* cases[305] thoughtfully analyzed claims brought by one project participant against another in light of the construction industry backdrop – the "precise allocation of risk as secured by contract"[306] and the "network of agreements of which all parties had notice that defined the commercial relationships."[307] But both opinions announced per se economic loss rules that might be used in future cases to stifle rather than to facilitate a comprehensive investigation of the relevant commercial context. In other words, *Duffícy* and *Bershauer* tempt overly broad interpretations. What those two cases either failed to recognize or only dimly recognized is that courts should be wary of claims to recover commercial losses arising in the construction industry not because the law must preserve some imaginary boundary between tort and contract or to serve some other similarly abstract jurisprudential objective, but more simply because courts should hold construction industry participants to the risk allocation compact of the commercial relationships determined by a specific project structure.

E. Too Tangled to Tort?

Two decades ago, Professor Rabin correctly argued that tort jurisprudence does not justify or require a categorical distinction between physical harm and economic harm.[308] At that time, he was particularly interested in showing that cases rejecting economic loss claims often can be "understood as a manifestation of concern about widespread tort liability . . . ."[309] More recently, Professor Rabin has observed that "the constraints imposed by the economic loss rule do not . . . reflect any single normative principle. Correspondingly, the cases do not comprise a single generic category guided by a unified set of underlying policy considerations . . . ."[310] These observations are especially important to keep in mind when the economic loss problem arises

305. *See supra* notes 220-36 and accompanying text (providing a detailed analysis of *Duffícy* and *Bershauer*, and explaining the holdings and the courts' reasoning).

306. *Berschauer*, 881 P.2d at 992.

307. *Duffícy*, 99 P.3d at 73.

308. *See* Rabin, *supra* note 25, at 1534-38. Professor Rabin also emphasized the importance of considering the economic loss problem in context, although he referred to context in a somewhat different sense than used in this Article. *Id.* at 1518-21. He analyzed pure economic loss in relation to the development of tort law as a whole, asking whether or not economic loss claims, as a category, "warrant special treatment." *Id.* at 1517.

309. *Id.* at 1528.

310. Rabin, *supra* note 2, at 859.

in the construction industry context. In construction industry cases, the critical question often is not whether the claim threatens unmanageably widespread liability, but whether it improperly seeks to impose on one participant a duty to protect another participant from a commercial risk not allocated in that way by the consensual structure of the project. Courts should not lightly invoke tort theories to allocate or reallocate risks that have figured into actual commercial relationships.

Most purely economic losses in building construction cases involve relational knots that are so entangled in consensual risk allocation schemes that they should not be remedied under tort theories. For reasons already discussed, however, the commercial context of the construction industry does not necessarily require that courts adopt a per se rule barring tort recovery of economic loss. Rather, in construction industry cases, the courts should recognize a commercial loss defense that reflects the consensual context in which most building construction occurs. In effect, sound tort theory should caution against recovery of commercial losses in most construction industry cases, although specific circumstances will occasionally justify recovery.[311]

V. A CONTRACTUAL PERSPECTIVE ON COMMERCIAL AND ECONOMIC LOSSES IN THE CONSTRUCTION INDUSTRY

"We must view the act in its setting, which will include the implications and the promptings of usage and fair dealing."[312]

A. Placing Commercial and Economic Loss Claims in a Construction Industry Setting

The construction industry cases that address economic loss problems require courts to meld legal principles and facts in specialized and intricate commercial contexts. Cases already noted demonstrate the importance of a contextual approach for each of the three primary tort theories commonly involved in economic loss claims arising in the construction industry – ordinary negligence, professional malpractice, and negligent misrepresentation. As Part III shows, courts in different jurisdictions define or apply the negligence, malpractice, and negligent misrepresentation tests in contrasting ways that frequently produce conflicting results in factually similar situations.

311. Judicial policies promoting consumer protection or renouncing unconscionable bargains or contracts of adhesion present the most likely rationales for allowing recovery of commercial or economic loss in construction industry cases. *See infra* Part V.B.1 and note 327 and accompanying text (discussing authorities on consumer claims and contracts of adhesion).

312. *Glanzer*, 135 N.E. at 276.

When properly applied in construction industry cases, all of the established theories should lead courts to give appropriate weight to the industry context. In several instances, the differences in result from one jurisdiction to the next do not reflect conflicting tort policies. Rather, they demonstrate that courts using substantially similar policy principles may reach different conclusions depending at least in part on how well they understand the industry setting in which the claims arise. The better reasoned opinions have recognized that when purely economic loss claims arise in the construction industry, context is not merely relevant; it may be the determinative factor in the policy analysis. The question, then, is not whether the courts should consider industry context in an economic tort case, but how the courts can best identify and wisely weigh the pertinent commercial considerations when the claim arises within the building construction industry. In effect, courts must recognize that it is more important to ask whether the loss involved is essentially a product of commercial risk allocation than whether the loss involves physical harm.

The proposals that follow reflect the view that meaningful, deliberate risk allocation regularly occurs throughout the construction industry. From this perspective, traditional contract principles retain vitality, and respect for private contracts should restrain courts.[313] With that bias in mind, before presenting these proposals in full, it is appropriate to anticipate objections based on empirical scholarship that paints "a picture of contract law diminished in its scope, distinctiveness and theoretical grandeur."[314] Commercial arrangements and disputes may often occur in environments in which contract doctrine is "overshadowed by reputational and other informal 'non-contractual' controls."[315] But building construction occurs within an industry heavily influenced by sophisticated risk assessment and risk management

313. For a more extensive contractual perspective on the construction industry, see *Contract Theory*, *supra* note 1, at 572-82, 618-22. Too much judicial restraint, however, can produce an overly restrictive economic loss rule that mechanically bars recovery when negligent performance of a contract causes harm to one who is not a party to the contract. *See* Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813, 824 (2006) (arguing that "contract law today increasingly emphasizes abstraction over contextualization").

314. Marc Galanter, *Contract in Court; or Almost Everything You May or May Not Want to Know About Contract Litigation*, 2001 WIS. L. REV. 577, 578 (2001). *See generally* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58 (1963) (providing a seminal study of the gap between contract principles as perceived in the legal academy and in society); Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465 (1985) (arguing that academic contract law is not an accurate reflection of its actual operation).

315. Galanter, *supra* note 314, at 578.

strategies.[316] Even if many participants in the industry find that individualized, comprehensive risk allocation is impractical, the contractual structures within which they operate reflect the collective practices of an industry dominated by sophisticated risk management analysis.[317] Courts can only rationally resolve economic loss problems in construction cases by placing the claims in the context of this industry characteristic.

B. Solving Commercial and Economic Loss Problems in the Contexts in Which They Occur

To this point, this Article has used legal theories as an organizing device to review the commercial and economic loss problem in the construction industry. For that reason, earlier subparts separately considered ordinary negligence, professional malpractice, and negligent misrepresentation. Unlike a review of the existing status, a proposed solution to the problem should at least begin by considering the recurring circumstances in which the problem arises in the construction industry. Accordingly, this Subpart initially distinguishes claims along situational rather than theoretical grounds.

1. Residential Owners

One might expect that judicial empathy for consumers would lead most courts to impose a duty of care on residential builders and developers to protect home buyers from defective construction. Indeed, those cases that rule for the homeowners sometimes enthusiastically present a consumer protection motive.[318] A judicial preference for consumers is defensible, especially when a court honestly expresses and explains it. The analysis in many of the residential construction cases falters, however, by failing to recognize that considerations unique to the construction industry should at least figure into the interest balancing process.[319] Many

316. *See generally* BRUNER & O'CONNOR, *supra* note 153, §§ 7:1-:247 (analyzing risk management practices in the construction context).

317. *See Contract Theory*, *supra* note 1, at 573-75 (arguing that the construction industry has developed "highly structured methods" to manage risk).

318. *See, e.g.*, *Coburn*, 378 A.2d at 602-03 (declining to extend builder-vendor warranty to subsequent purchasers, however, extending liability for negligence from builder-vendor relationship); *Kennedy*, 384 S.E.2d at 734 (holding that a homebuyer may sue builder for economic loss both under an implied warranty theory and under a negligence theory); *Cosmopolitan Homes*, 663 P.2d at 1045 (extending protection to subsequent homebuyers and explaining that the builder is more knowledgeable and in a better position to evaluate a home).

319. Several of the cases fail even to mention such obvious industry factors as negotiated warranties and pricing to reflect potential liability for negligence. *See, e.g.*, *Oates*, 333 S.E.2d at 225 (stating that the absence of

other cases, including several recent ones, have resisted the consumer protection instinct and held that a home buyer must rely exclusively on contract remedies against a seller who is either a builder or a developer. The problem with these cases is not that they were insufficiently sensitive to consumer protection. The problem is that many of these cases relied too much on formulistic statements and justifications of an economic loss rule crafted and developed primarily from products liability cases.[320]

Not all of the cases have missed the mark. One case that refused to impose a tort duty on a residential builder offered this contextual analysis in support of basing the liability of residential builders on duties assumed under contract rather than those imposed by tort policy:

> Construction projects are characterized by detailed and comprehensive contracts that form the foundation of the industry's operations. Contracting parties are free to adjust their respective obligations to satisfy their mutual expectations. For example, a developer can contract for low-grade materials that meet only minimum requirements of the building code. When the developer sells those units, a buyer should not be able to turn around and sue the builder for the poor quality of construction. Presumably the buyer received what he paid for or he can bring a contract claim against his seller. Meanwhile, if the developer has a problem with the builder, he too will have a contract remedy. A buyer can avoid economic loss resulting from defective construction by obtaining a thorough inspection of the property prior to purchase and then by either obtaining insurance or by negotiating a warranty or reduction in price to reflect the risk of any hidden defects.[321]

The wisdom of this analysis is that it tries to consider the circumstances in which homes are built and sold. One could argue persuasively that the court was wrong to conclude that a residential buyer can effectively manage the risk of defective construction by careful inspection, insurance, or negotiations. But the court was right to weigh that possibility as a relevant factor. Moreover, the court correctly recognized that in residential construction, in contrast to product manufacturing, the affected parties other than the consumer regularly rely on comprehensive contracts to establish commercial expectations. Precisely because individual negotiations manipulate the relationship between price

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contractual privity does not affect a claim for negligence); *Sewell*, 371 S.E.2d 82, 85 (holding that a negligence claim may be brought by subsequent homeowners despite lack of privity).

320. *See, e.g.*, *Prendiville*, 83 P.3d at 1259-60; *Calloway II*, 993 P.2d at 1263.

321. *Am. Towers*, 930 P.2d at 1190-91. To the extent that *American Towers* applies the economic loss rule of products liability law, the Utah Supreme Court subsequently raised questions about the continuing authority of the case. *See Grynberg*, 70 P.3d at 13.

objectives and quality, a court should be cautious about imposing its own post-negotiation construction standards.

These considerations should be especially important when a homeowner sues the builder-seller or a subcontractor, supplier, or consultant hired by the builder-seller. This is so because the transaction that should establish the homeowner's expectations is the sales transaction between the homeowner and the builder. This is why courts inspired to protect consumers should be more willing to do so by implying warranties into the contractual relationship between the homeowner and the seller rather than by imposing non-contractual obligations based on perceived special relationships. An implied warranty theory, unlike a negligence or strict liability approach, leaves room for individual risk allocation. For example, implied warranty jurisprudence may allow limited express warranties to override implied warranties,[322] and it may even admit the possibility of a valid warranty disclaimer that is a conspicuous and reasonable component of an actual bargained-for exchange between the builder and the buyer.[323] Similarly, contract warranties, including implied ones, may be assigned by the original buyer to a subsequent purchaser of the residence (expressly or by implication from the circumstances). In these ways, implied warranties permit consumer protection to exist within a contractual environment.

Especially complex considerations apply when a homeowner sues a participant in the construction process who did not sell the residence to the homeowner. When properly employed in these cases, the test under contemporary tort theory involves a policy exercise that requires a sophisticated evaluation of the context in which these consumer claims arise. Are consumers who purchase recently constructed homes essentially helpless to protect themselves from shoddy construction? Are market forces insufficient to curb the problem? Do purchasers have adequate remedies against their direct sellers? Do economic considerations support imposing the risk of faulty construction on builders as a policy matter? In these cases, courts must balance the policies in favor of consumer protection with the commercial realties of residential construction. It may well be sound economic policy to hold builders to implied warranties that remain enforceable by subsequent purchasers for a reasonable time after the home is constructed. Also, in light of the number of thinly capitalized homebuilders, it may be reasonable to impose liability on negligent subcontractors whose defective work creates an immediate and foreseeable risk of harm to the ultimate purchaser.[324] But a court

322. *See* Carter v. Quick, 563 S.W.2d 461, 463 (1978).

323. *See* Bullington v. Palangio, 45 S.W.3d 834, 839 (Ark. 2001).

324. "With so much hasty construction taking place in Nevada today, I think the better path would be to arm our home purchasers with all available

should also be open to evidence that the risk of the defect involved was calculated into the bargain made by either the original or subsequent purchaser, or that a settlement of a prior owner's claim involving the defect operated as a final adjustment. For reasons just discussed, an implied warranty approach that expresses the policy decision in contract notions may encourage results that are more consistent with the realities of the residential sales market than will the competing approaches that completely abandon contract theory.

In summary, economic loss claims based on residential construction require courts to consider both the need for consumer protection and the possibility of commercial risk allocation. To the extent that cases reflect variations in the way courts in different jurisdictions strike the balance, inconsistency in the cases reveals no essential flaw in the judicial process. But when courts blindly protect consumers without considering commercial realities, they may produce windfall recoveries and inefficient risk allocation. At the other extreme, when they mechanically apply an economic loss bar they may inadvertently and unjustifiably shield shoddy construction practices.

For the same reasons that courts should be circumspect when a residential purchaser seeks extra-contractual remedies, they should be even more cautious about interjecting tort duties into a contractual relationship between commercial participants in construction projects. This observation leads to a distinction involving commercial participants in the construction industry that may seem arcane but that is nonetheless valid. The following Subparts B.2 and B.3 separately consider claims involving commercial participants that are parties to the same contract and those that are not. While this may appear to revive the privity of contract rules of bygone days, in fact it only seeks to give commercial reality its due.

2. *Commercial Claims Between Contracting Parties*

The case for insisting on a contractual analysis of an economic loss claim is strongest when the plaintiff and the defendant entered into a contractual arrangement to define their commercial relationship in reference to the project. Claims of negligent performance frequently emerge in disputes between contracting commercial participants in the construction industry. In these situations, the courts have been relatively quick to recognize that, by resorting to negligence theory, the plaintiff is asking the court

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remedies, when faced with a defectively constructed home, rather than the one taken by the majority today." *Calloway II*, 993 P.2d at 1279 (Rose, C.J., dissenting).

to reallocate contractual risks after the fact.[325] These results comport well with the commercial context, and they require no special rules that turn on the nature of the harm the plaintiff suffers.

The main exception that commonly arises involves design malpractice claims made by a design professional's client. In this limited circumstance courts have held that a special relationship exits between the client and the design professional that arises from the design services contract but that is separate from the contract. This corruption of the consensual relationship is unnecessary and leads to confusion in the law. By giving due regard to industry usage and customs, the courts could rationally imply into every agreement for design services a professional performance standard that would produce sensible results without wholly transforming a contractual relationship into one governed by tort policy.

3. Commercial Claims Without a Direct Contractual Relationship

The most difficult economic loss questions that arise in the construction industry – and the ones on which the cases are in greatest discord – arise when one participant in a construction project seeks to recover commercial loss from another participant with whom the claimant has no direct contractual relationship. Too many courts eagerly adopt the rationale that interdependence in a construction project creates special relationships that justify a duty of care under tort law.[326] The fact is that the relationships involved may well be special in an entirely different sense. The relationships among participants in a construction project often reflect deliberate risk allocation strategies that affect how the participants establish their fees, calculate their costs and profits, and insure and otherwise manage their risks. Courts should not easily impose on one participant a tort duty to protect another participant from commercial loss. The critical distinction in these cases is not whether the harm is purely economic rather than at least partially physical; the key question is whether the claim seeks to upset the commercial risk allocation determined by the project's contractual structure.

Above all else, courts should make one overriding change in how they apply tort theories to economic loss claims brought by commercial participants in construction projects. They should

325. *See, e.g., Azco Constr.*, 10 P.3d at 1264 (stating that a party suffering only economic loss cannot assert a claim for negligence unless the contract assigned a duty of care); *City Express*, 959 P.2d at 839-40 (limiting recovery from a design professional to contract remedies only).

326. *See supra* Part III.B (demonstrating the conflicting holdings of courts permitting recovery for economic loss under a claim of negligence and those looking solely to the contract terms).

examine openly and thoroughly whether a tort duty to protect others from economic loss is consistent with the total commercial context that the participants themselves have accepted as the project regime. The relevant considerations are not limited to the terms of any express contract between the plaintiff and the defendant. Commercial participants in construction projects understand that each participant must be able to assess the costs of performance. They also know that the accepted method for transferring risk to others in the construction industry nearly always involves at least two critical steps. First, expressly identify the risk involved and the nature and extent of the proposed risk allocation. Second, adopt a consensual re-assessment of the costs associated with the risk transfer. This is not to say that all participants have equal bargaining position, but only that even participants with little negotiating leverage make a knowing, deliberate, and commercial decision either to accept the project's express risk allocation structure or not to participate in the project. Where bargaining inequality is extreme, courts remain free to grant relief from unconscionable bargains and contracts of adhesion.[327]

Of the existing opinions, those of *Bershauer* and *Duffy*, which have already been reviewed extensively,[328] once again may

327. With good reason, some scholars find contemporary courts too "deferential" to adhesion contracts. *See* Feinman, *supra* note 313, at 824 (noting that transformations in contract law have led to judicial consideration of assent when analyzing contracts of adhesion); Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 FORDHAM L. REV. 761, 788-89 (2002) (explaining how contract language and contract law have changed and that courts give greater deference to adhesion contracts). But a court viewing context holistically as this Article advocates would consider the extent to which any participant in a construction project held dominant power over any other participant. *See generally* Pardee Constr. Co. v. Superior Court, 123 Cal. Rptr. 2d 288, 293 (Cal. Ct. App. 2002) (concluding that contracts between residential builder and purchasers were contracts of adhesion, and contractual waivers of jury trial and of the right to seek punitive damages were unconscionable); Rich & Whillock, Inc. v. Ashton Dev. Inc., 204 Cal. Rptr. 86, 91 (Cal. Ct. App. 1984) (subcontractor was not bound by settlement agreement that was the product of economic duress). While subcontractors often depict themselves as helpless to bargain with powerful prime contractors, it goes too far to suggest that most construction subcontracts are contracts of adhesion. The bargaining positions of subcontractors vary extensively, but even smaller subcontractors who often feel compelled to accept the terms of form contracts benefit from the collective influence of subcontractors' trade associations, which commonly participate in the industry-wide discussions that produce the standard contracting structures. *See generally* SWEET & SCHNEIER, *supra* note 2, at 607-10. *See also supra* notes 313-16 and accompanying text (noting risk allocation in the construction industry). The extent to which unequal bargaining position prevents meaningful negotiation in the construction industry as a whole is an interesting topic for another time.

328. *See supra* notes 222-38, 275-79 and accompanying text (discussing

point the way. It should not matter whether a plaintiff who suffered economic loss can attribute the loss to carelessness, professional negligence, or even misinformation by a participant on whom the plaintiff is dependent but with whom the plaintiff has no contractual relationship. The plaintiff who opted into a construction project decided to participate based on the express contract or contracts to which it is a party, not based on some unspoken social standard of commercial behavior discernable by judges as a matter of law after the fact. As the *Berschauer* court said in this situation: "The fees charged by architects, engineers, contractors, developers, vendors, and so on are founded on their expected liability exposure as bargained and provided for in the contract."[329] That is, the fees are based on the project's contractual risk allocation regime and not on non-contractual duties that courts might impose after a risk becomes an actual cost. And the absence of a contract between the plaintiff and the defendant does not take the matter outside of the consensual, commercial context of the construction project. "Contractual duties," as the *Dufficy* court observed, "arise just as surely from networks of interrelated contracts as from two-party agreements."[330]

The implicit insight of the *Bershauer* and *Dufficy* opinions is that each project participant must price its proposal by estimating the costs of performance, including the costs of assumed liability for commercial losses. The project's contractual arrangements should determine whether the participant will be liable to those other than its direct client for commercial risks inherent in the construction process. This approach to commercial risk allocation in the construction industry should lead courts to sounder decisions in the recurring factual situations in which one participant asserts an economic loss claim against another participant. To demonstrate this point, one need only return briefly to the three most popular tort theories for recovering purely economic loss in construction industry cases.

Negligent construction. A traditional negligence analysis must ask whether policy considerations justify imposing a duty on one participant to avoid causing commercial or purely economic loss to another. When courts in construction industry cases balance the factors involved in that policy, they should always take into account the relevant industry and project context. For purposes of a motion to dismiss or for summary judgment, courts should craft principles that invite the party defending against a commercial or economic loss claim to allege facts or adduce evidence that could show that a judicially imposed duty would be

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Berschauer and *Dufficy*).

329. *Berschauer*, 881 P.2d at 992.

330. *Dufficy*, 99 P.3d at 72.

inconsistent with the project's contractual structure. The *J'Aire* circumstance comes immediately to mind.[331] The case was before the court on pleadings that left open too many questions about the relevant commercial context. On what basis could the court conclude that the lease between the owner-landlord and the plaintiff-tenant was an incomplete commercial basis for allocating solely to the tenant the risk that the leased premises would not be completed on the tenant's business schedule? Similarly, what allegations justified imposing on the builder-defendant a duty to the tenant to complete the leasehold improvements on a schedule protective of the tenant's commercial interests when apparently neither the lease nor the construction contract supported that result? These questions do not conclusively negate the builder's duty to the tenant, but they show that the pleadings presented an incomplete basis for imposing that duty, and they raise the specter of judicial tinkering with commercial bargains.

Professional negligence. Consider again the project participant, say a general contractor, whose performance and profit depend on the services of another participant's design professional, say the owner's architect. If the general contractor fails to negotiate for express contractual rights against that design professional, courts should at least consider the possibility that in the total circumstances of the network of commercial relationships involved, the general contractor has made a commercially reasonable decision to underwrite the owner's, not the architect's, credit. Under these circumstances, established contract doctrine and industry practice transfer the contractor's risk of defective design to the owner.[332] The contractor who is reluctant to look exclusively to the owner's net worth if the design services prove defective or erroneous should not expect a court to reallocate any part of the commercial risk to the design professional. The contractor could negotiate with the owner for third-party beneficiary status under the design services agreement or it could propose some other consensual form of direct access against the design professional. This would permit the owner and its design professional to assess and price the proposed risk transfer. As any contractor's attorney knows, this approach would almost invariably lead to discussions about insurance, contractual liability limits, and other risk management techniques.[333] A court viewing the circumstances with hindsight will usually have no basis for guessing how these commercial participants might have

331. *See J'Aire*, 598 P.2d at 63 (holding a builder owed a tenant of the contracting owner a duty of care to finish a project in a timely manner).

332. United States. v. Spearin, 248 U.S. 132, 135-37 (1918).

333. *See Specialty Designs*, *supra* note 1, at 170-73 (explaining how the risk of design and defect liability can be effectively addressed through risk management techniques).

resolved the tricky risk allocation issues if the general contractor had elected to put them on the negotiating table.

This is not to say that the courts should adopt a per se rule barring tort recovery in these situations. Exceptional considerations may (rarely) justify a judicial reallocation of commercial risks. Indeed, the contextual analysis may be especially intricate when the claim asserts negligent professional services (or negligent misrepresentation), as is often the case when a contractor or subcontractor suffers loss attributable to the acts and omissions of the owner's design professional. Courts may reasonably inquire whether, under the specific circumstances, the contractor or subcontractor was so helplessly dependent on the design professional that tort law should intervene to impose a duty of care on the design professional to protect the non-client from commercial risks. Did the design professional knowingly and voluntarily accept a role upon which other project participants would reasonably rely? Do concerns for safety and sound building practices dictate that a professional negligence standard should regulate the activities of architects and engineers that threaten economic harm to non-client participants in the project? But these are not the only relevant questions. Does the commercial structure of the project indicate that the contractor or subcontractor made a decision to look solely to the owner to recover commercial losses caused by the owner's design consultants? Did the structure invite the architect to price its services without reference to potential liability to participants other than the owner? In light of industry customs and practices, did the participant who suffered the commercial loss have commercially reasonable risk management alternatives to avoid abject reliance on the owner's design professional?

Negligent misrepresentation claims. Most of the discussion of professional negligence applies as well to claims of negligent misrepresentation. While courts should (and undoubtedly will) continue to resort to the Restatement to resolve negligent misrepresentation claims involving the construction industry,[334] they should recognize that the Restatement already invites a contextual approach. In particular, the courts should carefully focus attention on whether, in light of the project's contractual structure, the plaintiff's loss results from "justifiable reliance upon the information"[335] the defendant provided. Courts evaluating negligent misrepresentation claims in construction industry cases must not allow a project participant to use that doctrine as a

334. *See supra* Part III.D (discussing how courts treat claims of negligent misrepresentation more favorably than other claims of negligence in economic loss cases).

335. RESTATEMENT (SECOND) OF TORTS § 552(1) (1977).

subterfuge "to recover benefits it was unable to obtain in contract negotiations."[336]

C. A Commercial Loss Defense for Economic Tort Claims in the Construction Industry

The core defect in construction industry cases dealing with the commercial and economic loss problem is not simply that the courts have usually failed to appreciate the construction industry context in which the claims arise. The complex and sometimes subtle realities of the construction industry are hardly subjects for judicial notice. The tort principles that determine whether or not purely economic loss may be recovered should require counsel to develop the evidence to expose the actual commercial context in which the economic loss occurred.

Under these circumstances, what construction law requires is a commercial loss defense rather than an economic loss rule. Any time a plaintiff asserts an economic loss claim in the construction industry setting, tort law should recognize a defense on the ground that the claim asserted is inconsistent with the commercial risk allocation structure knowingly adopted by the parties. The main function of a commercial loss defense would be to invite evidence to show whether the risk involved figured significantly into the commercial terms upon which the defendant made the decision to participate in the project. Evidence concerning related contracts, the project structure, and established industry customs and practices should all be relevant to the defense.

VI. CONCLUSION

Current legal principles governing economic loss claims in construction industry settings are incoherent because the prevailing tort analysis does not give adequate attention to industry context. Except when a consumer protection rationale justifies a countervailing policy, courts should recognize contractual structures that deliberately allocate liabilities arising from interdependent relationships among construction project participants. This analytic approach will allow the industry to develop efficient risk management practices to govern recurring patterns of behavior. As the most important step in this transition, courts should replace the overstated economic loss rule with a commercial loss defense that will put economic torts in the appropriate context. These same considerations should apply not only to claims arising in the construction industry, but also to economic loss claims presented in many other commercial contexts.

336. *Nat'l Steel Erection*, 899 F. Supp. at 274.