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Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis

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CONSTRUCTION CLAIMS

RECOVERY OF ECONOMIC LOSS IN TORT FOR CONSTRUCTION DEFECTS: A CRITICAL ANALYSIS

SIDNEY R. BARRETT, JR.*

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I. INTRODUCTION: OF APPLES AND ORANGES

The litigation explosion in construction law over the last thirty years has dramatically increased the liability of contractors and design professionals. In recent years, several courts have accepted arguments against the long-established economic loss doctrine. The economic loss doctrine limits the recovery of damages in tort for product defects when the defect has caused neither a personal injury nor any damages to property other than the manufacturer's work itself. This article will review and analyze the cases in which litigants have attempted to impose liability in tort upon construction contractors for economic loss¹ resulting from construction defects. Further, the article will trace the historical development of recovery for economic loss through the tort theories of negligence² and strict liability.

1. "Economic loss" is defined generally as "damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits — without any claim of personal injury or damage to other property." See Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 918 (1966). The term also encompasses "the diminution in the value of the product because it is inferior in quality and does not work for the general purposes for which it was manufactured and sold." See Comment, *Manufacturers' Liability to Remote Purchasers for "Economic Loss" Damages - Tort or Contract?*, 114 U. PA. L. REV. 539, 541 (1966).

2. The economic loss doctrine has no application to intentional torts, such as the tort of intentional interference with contractual or business relations. In such cases, the very object of the wrongful conduct is to harm the plaintiff's economic interests, and recovery is allowed. *Waldinger Corp. v. Ashbrook-Simon-Hartley, Inc.*, 564 F. Supp. 970 (C.D. Ill. 1983), *aff'd in part, remanded on other grounds sub nom. Waldinger Corp. v.*

The use of tort theories to recover economic loss has received a mixed reception among the state courts.³ Within the construction industry, the issue often arises in the context of contractors' claims against design professionals, seeking recovery of damages resulting from delays or recovery of extra costs resulting from negligently prepared plans and specifications.⁴

By and large, courts that have allowed recovery of economic loss do not speak the same language as the courts that have held fast to the economic loss rule. The analysis employed by courts rejecting the economic loss rule tends to focus on the foreseeability of economic harm as the determinant of liability; those courts applying the economic loss rule to limit recovery often recognize the theoretical problems inherent in expanding the scope of tort duty to include economic interests not traditionally protected by tort law. Opinions from one camp often fail entirely to address the policy concerns of the other. The result is that the two sides of the issue appear as different as apples and oranges.

Defenses available to remote parties, such as privity,⁵ have

CRS Group Engineers, Inc., 775 F.2d 781 (7th Cir. 1985); Santucci Constr. Co. v. Baxter & Woodman, Inc., 151 Ill. App. 3d 547, 502 N.E.2d 1134 (1986); Lumley v. Gye, 2 E. & B. 216, 118 Eng. Rep. 749 (Q.B. 1853).

3. Compare *Santor v. A & M Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965) (carpet manufacturer strictly liable to downstream consumer for economic loss) with *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965) (truck manufacturer strictly liable for personal injuries; economic injuries recoverable under Uniform Commercial Code warranty provisions). See also *infra* text accompanying notes 95-109.

4. See, e.g., *Bates & Rogers Constr. Corp. v. North Shore Sanitary Dist.*, 128 Ill. App. 3d 962, 471 N.E.2d 915 (1984); *Conforti & Eisele, Inc. v. John C. Morris Assocs.*, 175 N.J. Super. 341, 418 A.2d 1290 (Ct. Law Div. 1980), *aff'd*, 199 N.J. Super. 498, 489 A.2d 1233 (Ct. App. Div. 1985); see also Annotation, *Tort Liability of Project Architect for Economic Damages Suffered by Contractor*, 65 A.L.R.3d 249 (1975) (collecting cases).

A thorough analysis of the liability of the design professional for economic losses sustained by a remote contractor is beyond the scope of this article, although some of those policy concerns do overlap with the question of economic loss in construction defect litigation. A major distinction between the two lines of cases is the courts' reliance on RESTATEMENT (SECOND) OF TORTS § 552 (1977) [hereinafter RESTATEMENT], which provides a cause of action in tort against one who "supplies false information for the guidance of others in their business transactions," in actions against design professionals. *Id.* See, e.g., *Malta Constr. Co. v. Henningson, Durham & Richardson, Inc.*, 694 F. Supp. 902 (N.D. Ga. 1988); *Pritchard Bros. v. Grady Co.*, 428 N.W.2d 391 (Minn. 1988).

5. In *Carolina Winds Owners' Ass'n v. Joe Harden Builder, Inc.*, 297 S.C. 74, 80, 374 S.E.2d 897, 901 (Ct. App. 1988), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988), the court defined privity in the context of a construction law

retarded judicial development of the economic loss rule in the construction context. As long as courts clung to the requirement of privity, *caveat emptor*,⁶ or the “completed and accepted” defense,⁷ they did not need to analyze the theoretical problems posed by the recovery of economic loss in tort. As the above defenses have crumbled, some courts have been slow to recognize those problems associated with eliminating the economic loss rule. Indeed, it is not unusual to find appellate courts affirming the award of economic damages without mentioning the issue.⁸

This article will conclude that the economic loss rule should be retained. Courts that reject the economic loss rule generally fail to recognize that tort law historically has refused to impose a duty to prevent economic loss in construction defect cases. It follows, therefore, that because tort law historically has not recognized such a duty, the decision to do so should be made — if at all — as a conscious policy decision based on consideration of the interests of all parties affected and a weighing of the consequences. A weighing of the interests for and against the economic loss rule militates against rejecting it.

II. ORIGINS AND DEVELOPMENT OF THE ECONOMIC LOSS DOCTRINE

A. *Description and Operation of the Economic Loss Doctrine*

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

claim: “The general rule is that a contractor, manufacturer, vendor or furnisher of an article is not liable to third parties who have no contractual relations with him for negligence in the construction, manufacture or sale of such article.” (quoting 2 T. COOLEY, COOLEY ON TORTS 1486 (J. Lewis 3d ed. 1906)). See also 5 A. CORBIN, CORBIN ON CONTRACTS § 778, at 29 (1951).

6. The South Carolina Court of Appeals stated that “where there was no express warranty and no fraud by the seller, [courts] applied the doctrine expressed in the maxim *caveat emptor* (‘let the buyer beware’).” See *C. Ray Miles Constr. Co. v. Weaver*, 296 S.C. 466, 468, 373 S.E.2d 905, 906 (1988).

7. The “completed and accepted” defense asserts that the builder’s liability is terminated upon the completion of his work and acceptance thereof by the owner. See *Young v. Smith & Kelly Co.*, 124 Ga. 475, 52 S.E. 765 (1905).

8. See, e.g., *Oliver v. City Builders, Inc.*, 303 So. 2d 466 (Miss. 1974).

causing physical harm to others.⁹ Simply stated, the economic loss doctrine holds that one may not recover "economic" losses under a tort theory.

An "economic loss" is the loss of an expectancy interest created by contract, often described as the "benefit of the bargain." An economic loss occurs when a product is inferior in quality or does not work for the purpose for which it was intended. Economic losses generally are said to include the diminution in value of an item due to its defective nature, the cost of repairing the defect, the cost of replacement, and the consequent loss of use or lost profits.¹⁰

Courts often have stated that economic losses are not recoverable in tort absent privity of contract. This is somewhat misleading because the economic loss doctrine bars recovery in tort even between parties that are in privity.¹¹ The crux of the doctrine is not privity but the premise that economic interests are protected, if at all, by contract principles, rather than tort principles. At least one court has held that the economic loss doctrine bars recovery in tort regardless of whether a contract remedy is available to the injured party.¹²

When the defective product damages protected interests, either by causing physical harm to an individual or by damaging property other than the product itself, the resultant loss is *not* considered "economic" and recovery for the damage is permitted in tort.¹³ Most courts have had little difficulty in distinguishing

9. See *Sacramento Regional Transit Dist. v. Grumman Flexible*, 158 Cal. App. 3d 289, 294, 204 Cal. Rptr. 736, 739 (1984).

10. See *supra* note 1.

11. See cases cited *infra* at notes 21, 22, and 23; see also *Woodward v. Chirco Constr. Co.*, 141 Ariz. 514, 687 P.2d 1269 (1984) (collapsed fireplace entitled owner to sue his builder in contract for the cost of repairing the fireplace and in tort for the consequential damage to property other than the fireplace caused by the collapse).

12. See *Anderson Elec., Inc. v. Ledbetter Erection Corp.*, 115 Ill. 2d 146, 503 N.E.2d 246 (1986). But see *Latite Roofing Co. v. Urbanek*, 528 So. 2d 1381 (Fla. Dist. Ct. App. 1988).

13. Thus, where a contractor's defective work has resulted in contamination or injury to parts of a construction project built by others, recovery is permitted. See *City of Greenville v. W.R. Grace & Co.*, 640 F. Supp. 559, 664 (D.S.C. 1986) (asbestos contamination); *Shooshanian v. Wagner*, 672 P.2d 455, 464 (Alaska 1983) (toxic fumes from supplier's defective insulation caused "physical alteration" and "physical damage" to home).

Not every interest that might be recognized in other legal contexts as a "property interest" will suffice as "property" for purpose of showing "damage to other property" under the economic loss doctrine. See *Blake Constr. Co. v. Alley*, 233 Va. 31, 34 n.3, 353

the above types of injuries from economic loss.¹⁴ Once the plaintiff has shown that the defect has resulted in injury to a protected interest, some courts will permit recovery of economic losses that otherwise would not be allowed, such as the cost of repairing the defective product.¹⁵ To bring economic losses within the ambit of damages resulting from infringement of a protected interest, however, the property damage must be “legally significant” and not merely incidental to the economic losses.¹⁶

The major debate in this area — and the issue most relevant to the litigation of construction defect cases — is whether *damage to the product itself* should be considered “property damage” or “physical injury,” rather than economic loss. The economic loss doctrine states that when only the work product itself is damaged as a result of its defective nature, the damage is defined as “economic” rather than as “property damage” and is not recoverable in tort. In other words, if the defect and the damage are one and the same, then the defect should not be

S.E.2d 724, 726 n.3 (1987); *see also* *State ex rel. Smith v. Tyonek Timber, Inc.*, 680 P.2d 1148, 1152 (Alaska 1984) (subcontractor sought to recover the cost of replacing a concrete slab from supplier who furnished defective concrete mix used in pouring the slab; court rejected subcontractor’s argument that he had a “property interest” in the slab because the general contractor had given him a limited allowance to purchase concrete used on the job).

14. The concept of “economic losses” has managed to confuse a few courts. In *Barnes v. Mac Brown & Co.*, 264 Ind. 227, 230, 342 N.E.2d 619, 621 (1976), the court stated that all injuries, whether to person or property, ultimately result in economic loss. *See also* *Cosmopolitan Homes, Inc. v. Weller*, 663 P.2d 1041, 1044 n.5 (Colo. 1983) (citing *Barnes* for the proposition that “both injury to one’s person and injury to one’s property result in economic loss”); *Quail Hollow E. Condominium Ass’n v. Donald J. Scholz Co.*, 47 N.C. App. 518, 526, 268 S.E.2d 12, 18 (1980) (equating repairs to work product with “property damages”).

15. *See Reynolds v. Bank of Am.*, 53 Cal. 2d 49, 50-51, 345 P.2d 926, 927-28 (1959) (recovery for loss of airplane use when awaiting replacement); *D & A Dev. Co. v. Butler*, 357 N.W.2d 156, 159 (Minn. Ct. App. 1984) (citing *Minneapolis Soc’y of Fine Arts v. Parker-Klein Assocs. Architects*, 354 N.W.2d 816, 819-20 (Minn. 1984)); *see also* *People Express Airlines, Inc. v. Consolidated Rail Corp.*, 100 N.J. 246, 261 n.4, 495 A.2d 107, 115 n.4 (1985) (recognizing general rule that economic losses that “stand alone” and are not “part of the entire unit or complex of damages caused by an independent threshold tort” cannot be recovered).

16. *See* 2000 *Watermark Ass’n v. Celotex Corp.*, 784 F.2d 1183, 1187-88 (4th Cir. 1986) (“incidental” damage to roofing under defective shingles insufficient); *Chicago Heights Venture v. Dynamit Nobel, Inc.*, 782 F.2d 723, 729 (7th Cir. 1986) (damage to other parts of building caused by defective roof not “legally significant”); *Minneapolis Soc’y*, 354 N.W.2d at 820 n.4 (“relatively minor” damage to mortar caused by failure of defective bricks insufficient).

considered "property damage" for purposes of tort law.¹⁷ In the construction setting, the problem arises when one part of a contractor's or manufacturer's product is defective and causes damage to the rest of the work product. In this situation, some courts permit recovery in tort for all damage to the remaining product.¹⁸ The majority view, however, denies recovery because any damage to the product itself is a commercial expectancy interest protected by contract law, rather than tort law.¹⁹

B. Origins and Development of the Economic Loss Doctrine

The modern economic loss doctrine developed in response to three different jurisprudential concerns: (1) the theoretical difficulties of using conduct-oriented tort standards to protect expectancy interests created by contract; (2) the practical difficulty in fashioning a rule that permits recovery for economic loss without subjecting the defendant to potentially limitless liability; and (3) conflict between an expanded duty in tort and the manufacturer's rights under the Uniform Commercial Code. Although the use of tort theory to recover economic loss implicates each of these concerns, courts have been inconsistent in addressing or even recognizing them.

1. Historical Antecedents: Accountants and Mailcoaches

The economic loss doctrine often is described as a creature of product defect litigation.²⁰ Its historical roots, however, lie in the nineteenth century. For as long as injured plaintiffs have

17. *Sacramento Regional Transit Dist. v. Grumman Flxible*, 158 Cal. App. 3d 289, 294, 204 Cal. Rptr. 736, 739 (1984).

18. *See, e.g., Gherna v. Ford Motor Co.*, 246 Cal. App. 2d 639, 55 Cal. Rptr. 94 (1966) (engine component design caused fire that destroyed automobile); *John R. Dudley Constructors, Inc. v. Drott Mfg.*, 66 A.D.2d 368, 412 N.Y.S.2d 512 (Ct. App. Div. 1979) (defective component resulted in collapse of entire crane).

19. *See, e.g., R.W. Murray Co. v. Shatterproof Glass Corp.*, 697 F.2d 818, 829 n.11 (8th Cir. 1983); *Kiswaukee Community Health Servs. Center v. Hospital Bldg. & Equip. Co.*, 638 F. Supp. 1492 (N.D. Ill. 1986); *Mid-Continent Aircraft Corp. v. Curry County Spraying Serv. Inc.*, 572 S.W.2d 308 (Tex. 1978).

20. *See Carolina Winds Owners' Ass'n v. Joe Harden Builder, Inc.* 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988); *see also* 2000 Watermark Ass'n v. Celotex Corp., 784 F.2d 1183, 1185 (4th Cir. 1986) ("[H]istorically, the only tort action available to the disappointed purchaser suffering an intangible commercial loss was an action for fraud.").

been denied recovery in contract for reasons such as the expiration of statute of limitations for contract actions,²¹ lack of privity,²² unavailability of punitive damages,²³ avoidance of contractual restrictions,²⁴ or simply because the other contracting party is insolvent,²⁵ resourceful lawyers have sought to recover in tort.

Judicial hostility to the use of tort theory to recover purely economic losses predates the twentieth-century battle over product liability. This hostility was motivated primarily by the fear of mass litigation and the concern that traditional tort concepts were not capable of providing clear limitations on potentially limitless liability.²⁶ Defining the scope of tort duty to include only physical harm created “built-in” limits on liability, since any given chain of events in the physical world has finite consequences. Permitting plaintiffs to recover for purely economic losses would result in open-ended liability, since it is virtually impossible to predict the *economic* consequences of a given act.²⁷

The early reluctance to award economic losses is well illustrated in the cases of *Stevenson v. East Ohio Gas Co.*²⁸ and *Ultramares Corp. v. Touche, Niven & Co.*²⁹ In *Stevenson* the defendant’s negligence resulted in a fire that destroyed a factory. Stevenson, a factory worker, sued to recover the wages he lost as a result of the destruction of his work place. The Ohio Court of Appeals observed that “damage resulting from the negligence of one will not in all cases constitute a cause of action.”³⁰ The court

21. See, e.g., *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986).

22. See, e.g., *Crowell Corp. v. Topkis Constr. Co.*, 280 A.2d 730 (Del. 1971); *Crowder v. Vandendeale*, 564 S.W.2d 879 (Mo. 1978), *overruled on other grounds by* *Sharp Bros. Contracting Co. v. American Hoist & Derrick Co.*, 703 S.W.2d 901 (Mo. 1986).

23. See, e.g., *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617 (Tex. 1986).

24. See, e.g., *Cincinnati Gas & Elec. Co. v. General Elec. Co.*, 656 F. Supp. 49, 54-55 (S.D. Ohio 1986).

25. See, e.g., *Juliano v. Gaston*, 187 N.J. Super. 491, 455 A.2d 523 (Ct. App. Div. 1982).

26. See *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200, 203 (Ohio Ct. App. 1946).

27. See *State ex rel. Guste v. M/V Testbank*, 752 F.2d 1019, 1022 (5th Cir. 1985), *cert. denied*, 477 U.S. 903 (1986); Perlman, *Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 61, 71-72 (1982).

28. 73 N.E.2d 200 (Ohio Ct. App. 1946).

29. 255 N.Y. 170, 174 N.E. 441 (1931).

30. 73 N.E.2d at 202 (quoting *First Nat’l Bank v. Marietta & C. Ry. Co.*, 20 Ohio St. 259, 277-78 (1870)).

noted that although other courts had disposed of similar claims by labeling the damages sought as “too remote” or “indirect,” its concern was to prevent the “mass of litigation” that might result if a negligence action could be maintained for economic loss without personal injury or property damage.³¹ If a worker could sue for lost wages, the court reasoned, then so could the power company, sellers of the factory’s products, the neighborhood restaurant that relies on the trade of the factory employees, and so on.³² Based on the above reasoning, the court declined to permit Stevenson to recover for his “economic” loss.

In *Ultramares* the New York Court of Appeals resolved the question of whether an accountant who negligently prepared a financial statement for a client was liable to third parties who relied on its accuracy. The opinion, written by Judge Cardozo, focused on the nature of the accountant’s *duty* in tort. Though his opinion noted that “the assault upon the citadel of privity is proceeding in these days apace,”³³ Judge Cardozo held that an accountant owes no duty to third parties to refrain from negligently causing economic injury. Recognition of such a duty, he reasoned, would expose the hapless accountant

to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.³⁴

Thus, the critical factor in Judge Cardozo’s holding, which restricted tort liability to physical damage, was the possibility of exposing defendants to a crushing burden of liability out of proportion to their fault, rather than privity.³⁵

With very few exceptions,³⁶ Judge Cardozo’s rule that tort

31. See *id.* at 203.

32. See *id.* at 203-04.

33. 174 N.E. at 445. Judge Cardozo’s opinion in *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 111 N.E. 1050 (1916), struck the first major blow against the use of the privity defense in tort actions seeking recovery for personal injuries caused by defective products. Judge Cardozo’s comment on privity in *Ultramares* shows, at least in his respected opinion, that duty, not privity, is the central focus of the economic loss doctrine.

34. 255 N.Y. at 179-80, 174 N.E. at 444.

35. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 107, at 707 (4th ed. 1971).

36. See *infra* notes 78-86 and accompanying text.

law recognizes no duty to avoid negligent infliction of economic loss has withstood challenge.³⁷ Judge Cardozo's concern about the potentially limitless liability of a duty in tort to avoid economic losses remains one of the most persuasive arguments in favor of the modern economic loss rule.³⁸ The Fifth Circuit recently rejected a challenge to the economic loss rule in *State ex rel. Guste v. M/V Testbank*.³⁹ The *Testbank* court noted that the push to delete the restrictions of recovery for economic loss lost its support and by the early 1940s, had failed. "[I]t is an old sword that plaintiffs have here picked up."⁴⁰

Another major impetus behind the development of the economic loss rule was *Winterbottom v. Wright*,⁴¹ an 1842 decision of the English Exchequer that may be one of the most misinterpreted cases in tort history. In *Winterbottom* the defendant had a contract to keep a mailcoach in repair. The plaintiff, a mailcoach driver, was injured when the mailcoach broke down. The Exchequer, Lord Abinger, held that the plaintiff could not maintain an action for breach of contract, but noted in dicta that "unless we confine the operation of such contracts as this to

37. The few courts that have allowed recovery for economic loss in tort have failed to analyze, or even address, the question of whether such a duty exists. For this reason, there are few courts that expressly recognize a tort duty to avoid economic harm. There are many courts, however, that allow recovery without considering this crucial element. See *infra* notes 147-170 and accompanying text.

38. Perhaps the clearest example of the problem might arise in cases involving the closure of a bridge due to its defective design or construction. In such a case, if businesses dependent upon the bridge traffic could sue for lost revenue when the closure dries up their customer base, then the builder potentially would face enormous liability. Bridge cases typically are resolved in the defendants' favor, although the rationales used may vary from lack of duty to foreseeability. See *Leadfree Enters., Inc. v. United States Steel Corp.*, 711 F.2d 805, 808 (7th Cir. 1983) (noting need for "sensible stopping point in order to preclude open-ended, crushing liability on a tortfeasor"); *Nebraska Innkeepers, Inc. v. Pittsburgh-Des Moines Corp.*, 345 N.W.2d 124, 128 (Iowa 1984) (court reluctant to award damages without showing of damage to person or property in which plaintiff has "at least some ownership or property interest"); see also *Ore-Ida Foods, Inc. v. Indian Head Cattle Co.*, 290 Or. 909, 627 P.2d 469 (1981) (employer may not recover economic loss from defendant who negligently caused death of employee); *Rodriguez v. Carson*, 519 S.W.2d 214 (Tex. Civ. App. 1975) (defendant who negligently destroyed employer's truck not liable to employee-truck driver for lost wages). See generally *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 79, 435 N.E.2d 443, 447 (1982) (application of warranty law, rather than strict liability in tort, protects manufacturer from unlimited liability for economic loss).

39. 752 F.2d 1019 (5th Cir. 1985), *cert. denied*, 477 U.S. 903 (1986).

40. *Id.* at 1023.

41. 152 Eng. Rep. 402 (1842).

the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit, would ensue.”⁴² Lord Abinger’s dicta should have been interpreted merely as a condemnation of an unduly broad third-party beneficiary contract theory or, at most, as the “familiar proposition that not every duty assumed by contract will sustain an action sounding in tort.”⁴³ Unfortunately, courts quickly interpreted the case to mean that “a contractor, manufacturer or vendor is not liable to third parties who have no contractual relations with him for negligence in the construction, manufacture or sale of the articles he handles.”⁴⁴ Thus was born the hobgoblin of twentieth-century tort law: the privity defense.

2. *Economic Loss in Negligence*

a. *The Problem With Privity*

To understand the impact that the rise and fall of the privity defense has had on negligence theory and on the economic loss rule in particular, the spheres of interests traditionally protected by the law of contracts and by the law of unintentional torts must be distinguished.

Contract law is designed to enforce the expectancy interests created by agreement between private parties. The law imposes no standards to judge each party’s performance; the only standards are those that the parties have agreed upon. As such, contract law seeks to enforce standards of *quality* as defined in the contract.⁴⁵

In contrast, tort law is designed to secure the protection of

42. *Id.* at 405.

43. Council of Co-Owners Atlantis Condominium, Inc. v. Whiting-Turner Contracting Co., 308 Md. 18, 32, 517 A.2d 336, 343 (1986). *See also* Flintkote Co. v. Dravo Corp., 678 F.2d 942, 945 (11th Cir. 1982) (“In order to maintain an action *ex delicto* because of a breach arising out of a contractual relation the breach must be shown to have been a breach of a duty imposed by law and not merely a duty imposed by the contract”)

44. *See* Huset v. J.I. Case Threshing Mach. Co., 120 F. 865, 867-68 (8th Cir. 1903).

45. *See* Crowder v. Vandendeale, 564 S.W.2d 879, 882 (Mo. 1978), *overruled by* Sharp Bros. Contracting Co. v. American Hoist & Derrick Co., 703 S.W.2d 901 (Mo. 1986); Carolina Winds Owners’ Ass’n v. Joe Harden Builder, Inc., 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *aff’d on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988).

all citizens from the danger of physical harm to their persons or to their property.⁴⁶ Tort standards are imposed by law without reference to any private agreement. They obligate each citizen to exercise reasonable care to avoid foreseeable physical harm to others. As such, tort law primarily is concerned with enforcing standards of *conduct*.

Within this context, economic interests — particularly those relating to the quality of a product — are not interests that tort law traditionally has protected. This view represents the weight of precedent, and modern courts have affirmed it as a conscious policy decision.⁴⁷ Specifically, the benefit of protecting individuals by shifting the burden of economic loss to manufacturers through tort law is insufficient to justify the economic impact such cost-shifting would have on society. Manufacturers' prices would rise as they sought to insure against the possibility that some of their products would not meet the needs of some of their customers.⁴⁸

Nevertheless, the privity defense resulting from the misinterpretation of *Winterbottom v. Wright*⁴⁹ removed an entire class of injuries, personal injuries and property damage caused by negligently manufactured products or structures, from traditional tort protection. Some cases rationalized this anomalous situation by describing the third party's injuries as beyond the scope of foreseeable harm. Typical of such cases was *Huset v. J.I. Case Threshing Machine Co.*⁵⁰ Huset's employer, J.H. Pifer, purchased a negligently designed threshing machine from the

46. See *Sanco, Inc. v. Ford Motor Co.*, 579 F. Supp. 893, 897 (S.D. Ind. 1984), *aff'd*, 771 F.2d 1081 (7th Cir. 1985); *Crowder v. Vandendeale*, 564 S.W.2d 879, 882 (Mo. 1978) *overruled by Sharp Bros. Contracting Co. v. American Hoist & Derrick Co.*, 703 S.W.2d 901 (Mo. 1986); *Heaven v. Pender*, 11 Q.B.D. 503, 509 (1883).

47. See, e.g., *Clark v. International Harvester Co.*, 99 Idaho 326, 335, 581 P.2d 784, 793 (1978); *State ex rel. Western Seed Prod. Corp. v. Campbell*, 250 Or. 262, 269, 442 P.2d 215, 218 (1968), *cert. denied*, 393 U.S. 1093 (1968) (superseded by statute as stated in *State ex rel. La Manufacture Française Des Pneumatiques Michelin v. Wells*, 294 Or. 296, 657 P.2d 207 (1982)).

48. *Seely v. White Motor Co.*, 63 Cal. 2d 9, 19, 403 P.2d 145, 151, 45 Cal. Rptr. 17, 23 (1965); see also *Spring Motor Distribs. v. Ford Motor Co.*, 98 N.J. 555, 579-80, 489 A.2d 660, 672-73 (1985) (court's evaluation of "policy choices about the relative roles of contracts and tort law as the source of legal obligations" leads to the conclusion that "contract law . . . provides the more appropriate system for adjudicating disputes arising from frustrated economic expectations").

49. 152 Eng. Rep. 402 (1842).

50. 120 F. 865 (8th Cir. 1903).

defendant-manufacturer. The machine was designed so that the operator had to walk across the feeder cover to operate it. Shortly thereafter, as a result of the design, Huset's leg was mangled in the machine. The trial court dismissed Huset's complaint against the manufacturer, and he appealed. The Eighth Circuit Court of Appeals stated that tort law places "the duty of everyone to so act himself and to so use his property as to do no unnecessary damage to his neighbors."⁵¹ The court, nevertheless, sustained the manufacturer's use of the privity defense in the name of *Winterbottom v. Wright*:

But when a contractor builds a house or a bridge, or a manufacturer constructs a car or a carriage, for the owner thereof, under a special contract with him, an injury to any other person than the owner for whom the article is built and to whom it is delivered cannot ordinarily be foreseen or reasonably anticipated as the probable result of the negligence in its construction. . . . The limits of the liability for negligence and for breaches of contract in cases of this character are held to be identical. The general rule is that a contractor, manufacturer, or vendor is not liable to third parties who have no contractual relations with him for negligence in the construction, manufacture or sale of the articles he handles.⁵²

The privity defense provided contractors and manufacturers with an unearned exemption from the standards of liability imposed by tort law.⁵³ In 1916, however, the New York Court of

51. *Id.* at 866.

52. *Id.* at 867-68. Even in *Winterbottom v. Wright*, the court was careful to point out that "there is no allegation that the defendant knew that the coach was to be driven by the plaintiff." 152 Eng. Rep. at 404. This comment suggests that the plaintiff's injury could not have been foreseeable to the defendant. Huset's complaint was rescued because the Eighth Circuit interpreted it to be an action for fraud, one of the three "exceptions" recognized to the above-cited "general rule" by the court. *See Huset*, 120 F. at 870-72. The other two exceptions were for an imminently dangerous article "intended to preserve, destroy or affect human life," such as poison or medicine, and the injury to one who is invited to use a "defective appliance" upon the owner's premises. *Id.*

53. One might argue that the special treatment afforded manufacturers by the courts was motivated by a desire to protect and encourage industry. Indeed, at oral argument before the South Carolina Court of Appeals in *Carolina Winds Owners Ass'n v. Joe Harden Builder, Inc.*, 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988), the same concern about what the effect abolition of the economic loss doctrine might have on the construction of low-cost housing was raised.

Appeals' decision in *MacPherson v. Buick Motor Co.*⁵⁴ began the process of dismantling the privity defense. In *MacPherson* the plaintiff was injured when a defective wheel on his automobile collapsed. Rather than sue the dealer, MacPherson sought recovery from the manufacturer of the wheel. Writing for the court, Judge Cardozo brushed aside the privity defense argument and held that a manufacturer may be held liable in tort, "irrespective of contract," for personal injuries caused by any article that would be dangerous if negligently made.⁵⁵ The *MacPherson* holding later was expanded to permit recovery for property damage caused by the defective product, even in situations that posed no threat of personal injury.⁵⁶

In the context of the construction industry, however, the courts developed several other mechanisms besides the privity defense that shielded contractors from liability for injuries to remote parties. As Dean Prosser observed, "This was a field in which the ghost of *Winterbottom v. Wright* died very hard."⁵⁷

Some jurisdictions prevented remote purchasers of improved realty from recovering damages in tort by invoking the doctrine of *caveat emptor*.⁵⁸ Other jurisdictions followed the common-law doctrine of "merger by deed," whereby all contractual obligations of the builder were deemed satisfied and "merged" into the final deed at closing.⁵⁹ Additionally, many states fashioned a rule known as the "completed and accepted defense," under which the builders' liability is terminated upon the completion of his work and acceptance thereof by the owner.⁶⁰ Like the privity defense, these defenses became riddled

54. 217 N.Y. 382, 111 N.E. 1050 (1916).

55. *Id.* at 389, 111 N.E. at 1057.

56. *See, e.g., Dunn v. Ralston Purina Co.*, 38 Tenn. App. 229, 272 S.W.2d 479 (1954) (spoiled horse food).

57. W. PROSSER, *supra* note 35, § 104, at 680. In Colorado it was not until 1972 that the ruling in *MacPherson* was extended to personal injuries resulting from defective construction. *See Wright v. Creative Corp.* 30 Colo. App. 575, 498 P.2d 1179 (1972).

58. *See, e.g., Wells v. Clowers Constr. Co.*, 476 So. 2d 105 (Ala. 1985); *Collier v. Sinkoe*, 135 Ga. App. 732, 218 S.E.2d 910 (1975) (noting exceptions to rule).

59. *See, e.g., P. B. R. Enters. v. Perren*, 243 Ga. 280, 253 S.E.2d 765 (1979).

60. *See, e.g., Young v. Smith & Kelly Co.*, 124 Ga. 475, 52 S.E. 765 (1905); *Daugherty v. Herzog*, 145 Ind. 255, 44 N.E. 457 (1896); Annotation, *Negligence of Building or Construction Contractor as Condition of Liability Upon His Part for Injury or Damage to Third Party Occurring After Completion and Acceptance of the Work*, 58 A.L.R.2d 865 (1958); *see also Kristek v. Catron*, 7 Kan. App. 2d 495, 498, 644 P.2d 480, 482 (1982) ("This principle of the non-liability of building contractors to third parties has a long if

with exceptions and have been rejected outright in most jurisdictions.⁶¹

Properly understood, neither the demise of the privity defense in *MacPherson* nor the rejection of other similar defenses effected an expansion of tort liability. Rather, *MacPherson* simply restored the application of traditional tort standards to manufacturers and contractors for liability for physical harm to remote parties. It placed manufacturers in the position they arguably should have occupied all along — subject to a legal duty of exercising reasonable care to avoid injuring others.⁶² The abolition of the privity defense created no new theory of recovery, but merely eliminated a defense to liability under traditional tort principles.⁶³

b. "Foreseeability" Takes Over the Citadel

In the course of dismantling the privity defense, some

largely discredited history.").

61. See, e.g., *Holmes v. Worthey*, 159 Ga. App. 262, 282 S.E.2d 919 (1981) (limiting *caveat emptor* and rejecting merger by deed), *aff'd*, 249 Ga. 104, 287 S.E.2d 9 (1982); *Kristek v. Catron*, 7 Kan. App. 2d 495, 644 P.2d 480 (1982) (rejecting completed and accepted defense); *Tavares v. Horstman*, 542 P.2d 1275 (Wyo. 1975) (rejecting doctrine of *caveat emptor*).

62. The *MacPherson* opinion contains nothing to suggest that the sphere of interests protected by tort law was expanded beyond freedom from physical harm. Instead, it is clear that Judge Cardozo meant merely to return manufacturers within the traditional scope of tort duties:

[The] presence of a known danger, attendant upon a known use, makes vigilance a duty. We have put aside the notion that *the duty to safeguard life and limb*, when the consequences of negligence may be foreseen, grows out of contract and nothing else. We have put the source of the obligation where it ought to be. We have put its source in the law.

217 N.Y. 382, 390, 111 N.E. 1050, 1053 (1916) (emphasis added).

63. *Wright and Nicholas, The Collision of Tort and Contract in the Construction Industry*, 21 U. RICH. L. REV. 457, 473 (1987). In a sense, the focus on privity itself was a spurious issue since the concept neither justified nor explained why recovery in tort should be denied in certain cases. See *Marcil v. John Deere Indus. Equip. Co.*, 9 Mass. App. 625, 631 n.5, 403 N.E.2d 430, 434 n.5 (1980) ("We believe that the issue of privity merely diverts attention from the fundamental issue [of duty]."). Privity was merely a device chosen by the courts to impose what they believed to be necessary limits on liability in a commercial context. In *A.R. Moyer, Inc. v. Graham*, 285 So. 2d 397, 399 (Fla. 1973), the court characterized privity as "a theoretical device of the common law that recognizes limitation of liability commensurate with compensation for contractual acceptance of risk." See *Clark v. International Harvester Co.*, 99 Idaho 326, 336, 581 P.2d 784, 794 (1978) (privity was "an unfortunate amalgam of tort and contract principles"); *W. PROSSER, supra* note 35, § 93, at 623 (privity was "a fetish").

courts went on to equate the scope of liability in tort with the foreseeability of harm without regard to the *nature* of the harm. These courts permit recovery of economic loss in product and construction defect cases solely on the ground that such economic loss was “foreseeable” to the manufacturer or contractor. Typical of these cases is the Florida Court of Appeals’ decision in *Navajo Circle, Inc. v. Development Concepts Corp.*⁶⁴ In *Navajo Circle* the plaintiff-condominium association sued a remote builder and architect for negligence in the construction of a roof. The plaintiff attempted to recover damages for the roof and the loss of rentals, as well as consequential damage to exterior and interior walls. The trial court dismissed the action for lack of privity. The court of appeals reversed on the following grounds:

The products negligence line of cases was relied on by our supreme court to expand liability in negligence to those who supplied services rather than products. Where it is foreseeable that the plaintiff will suffer the injury sued on, the supplier of the service has a legal duty to use reasonable care to avoid unreasonable risks to that plaintiff in performance of his service.⁶⁵

While the latter statement unquestionably reflects a correct and well-established rule of negligence law regarding *physical* injuries, this rule historically has not employed with reference to the risk of *economic* harm.

Many cases that rely on foreseeability to impose liability for economic harm place great emphasis on *MacPherson v. Buick Motor Co.*, assuming that privity was the only legal barrier that prevented the recovery of economic loss damages from remote parties. Many opinions that rely on *MacPherson* show no awareness of the historic distinction between physical harm and economic loss in negligence. In *Coburn v. Lenox Homes, Inc.*⁶⁶ the

64. 373 So. 2d 689 (Fla. Dist. Ct. App. 1979).

65. *Id.* at 691 (citations omitted). It is doubtful that either *Navajo Circle* or *A.R. Moyer* remain valid precedent in Florida following the Florida Supreme Court’s decision in *Florida Power & Light Co. v. Westinghouse Elec. Corp.*, 510 So. 2d 899 (Fla. 1987), a case involving defective nuclear steam generators. The court rejected the owner’s attempt to recover the cost of repairing the generators under a tort theory, holding that contract principles — rather than traditional concepts of duty, causation, and foreseeability — furnish the appropriate vehicle to allocate risk of economic harm. *Accord* *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 515 So. 2d 180 (Fla. 1987).

66. 173 Conn. 567, 378 A.2d 599 (1977).

Connecticut Supreme Court rejected a homebuilder's privity defense against an owner not in privity with the builder-vendor (subsequent owner). The subsequent owner complained of the negligent construction of a septic tank. The court held that the revolution in the law of negligence, which began with *MacPherson* and resulted in recognition that privity was not a legitimate concern in negligence actions, has produced a rule of law that a builder-vendor should be liable in negligence for foreseeable damage resulting from a defectively constructed house.⁶⁷ Similarly, in *A. E. Investment Corp. v. Link Builders, Inc.*⁶⁸ the Wisconsin Supreme Court held that an architect was liable to a remote lessee for his lost profits, damaged reputation, and loss of goodwill that resulted from the architect's negligently designed building. The architect argued that the issue should be defined as whether an architect has a tort duty to exercise reasonable care to protect remote tenants' future economic losses due to the condition of the building. The court rejected the architect's argument as "too narrow."⁶⁹ Instead, the court offered this simple formula: "A defendant's duty is established when it can be said that it was foreseeable that his act or omission to act may cause harm to someone. A party is negligent when he commits an act when some harm to someone is foreseeable."⁷⁰

The court also rejected a privity defense argument by noting that "the lack of privity does not constitute a policy reason for not imposing liability where negligence is shown."⁷¹ The architect might have replied, however, that the demise of the privity defense does not constitute a policy reason for imposing liability for a species of loss that was not recoverable before the privity defense was created.

The *Lenox Homes* and *Link Builders* opinions misinterpreted *MacPherson* by making foreseeability the sole determinant of duty. Foreseeability raises a legal duty of reasonable care

67. *Id.* at 574-76, 378 A.2d at 602-03.

68. 62 Wis. 2d 479, 214 N.W.2d 764 (1974).

69. *See id.* at 483, 214 N.W.2d at 766.

70. *Id.* at 484, 214 N.W.2d at 766.

71. *Id.* at 488, 214 N.W.2d at 769. *See also* A. R. Moyer, Inc. v. Graham, 285 So. 2d 397, 402 (Fla. 1973) (contractor allowed to seek economic damages in tort from a remote architect; court interpreted *MacPherson* as meaning that a party should be liable in negligence, regardless of privity, for any losses, economic or otherwise, suffered by one who foreseeably may be injured).

only in the context of foreseeable *physical* harm. Under traditional negligence concepts, purely economic losses are outside the scope of recovery regardless of how foreseeable those losses are. For example, it is eminently foreseeable that one's negligence in rupturing a gas or electric line will cause pecuniary losses to businesses dependent on that gas;⁷² negligent damage to a ship may cost seamen their wages⁷³ and tug owners their fees;⁷⁴ damage to a railroad bridge will cause the railroad to lose money in rerouting its trains.⁷⁵ Such liability, however, never has been recoverable in tort.⁷⁶

Many courts that allow foreseeability to govern recovery for economic loss appear unaware that they are expanding tort liability far beyond the scope of negligence that Judge Cardozo envisioned in *MacPherson*. Other courts, however, are aware that permitting recovery for purely economic loss is new ground in negligence theory, but view recovery of economic loss as a logical expansion of *MacPherson*.⁷⁷

Such cases should be distinguished from several recent policy-based decisions in which courts intentionally expanded the sphere of tort interests and recognized a duty in negligence to prevent foreseeable economic harm to others. In *Ales-Peratis Foods International, Inc. v. American Can Co.*⁷⁸ the California

72. See *Kaiser Aluminum & Chem. Corp. v. Marshland Dredging Co.*, 455 F.2d 957 (5th Cir. 1972); *Byrd v. English*, 117 Ga. 191, 43 S.E. 419 (1903).

73. See *In re Great Lakes Towing Co.*, 395 F. Supp. 810 (N.D. Ohio 1974); *Henderson v. Arundel Corp.*, 262 F. Supp. 152 (D. Md. 1966), *aff'd*, 384 F.2d 998 (4th Cir. 1967); *Casado v. Schooner Pilgrim, Inc.*, 171 F. Supp. 78 (D. Mass. 1959); *Hayes v. Luckenbach S.S. Co.*, 92 F. Supp. 684 (D. Mass. 1950);

74. See *Dick Meyers Towing Serv. v. United States*, 577 F.2d 1023 (5th Cir. 1978), *cert. denied*, 440 U.S. 908 (1979).

75. See *Louisville & Nashville R.R. Co. v. M/V Bayou Lacombe*, 597 F.2d 469 (5th Cir. 1979). In *Vicksburg Towing Co. v. Mississippi Marine Transp. Co.*, 609 F.2d 176 (5th Cir. 1980), the dock owner's lost profits were recoverable after defendant negligently damaged his dock. The obvious distinction is that the dock owner had suffered physical damage to a protected property interest.

76. See, e.g., *Morse v. Piedmont Hotel Co.*, 110 Ga. App. 509, 139 S.E.2d 133 (1964); *PPG Indus. v. Bean Dredging, Inc.*, 447 So. 2d 1058 (La. 1984).

77. See *Conforti & Eisele, Inc. v. John C. Morris Assocs.*, 175 N.J. Super. 341, 344, 418 A.2d 1290, 1292 (Ct. Law Div. 1980) (extending architects' liability from property damage to economic loss is "the next logical step"), *aff'd*, 199 N.J. Super. 498, 489 A.2d 1233 (Ct. App. Div. 1985); *State ex rel. Western Seed Prods. Corp. v. Campbell*, 250 Or. 262, 442 P.2d 215 (1968) (farmers' lost profits due to defective seeds recoverable), *cert. denied*, 393 U.S. 1093 (1969).

78. 164 Cal. App. 3d 277, 209 Cal. Rptr. 917 (1985). The defendant, a remote man-

Court of Appeals created the tort of "negligent interference with prospective economic advantage."⁷⁹ The tort is based on a six-part foreseeability analysis. Foreseeability is determined by the following factors: (1) the extent to which the defendant's conduct directly impinged upon the plaintiff's interests; (2) the foreseeability that the defendant's actions would affect plaintiff's interests; (3) the harm suffered; (4) the closeness of the causal link between the defendant's actions and plaintiff's injury; (5) the degree of moral blame attributable to the plaintiff's conduct; and (6) public policy supporting the finding of a duty.⁸⁰

The *Ales-Peratis* court reasoned that by "focusing judicial attention 'on the foreseeability of the injury and the nexus between the defendant's conduct and the plaintiff's injury,' [the six-part test] would effectively limit recovery for negligent interference with prospective economic advantage to situations where a duty of care was reasonably owed and breached."⁸¹ The opinion stated that potentially unlimited liability would not be a problem under the six-part analysis because "here we have a far higher degree of foreseeability of economic injury and a much narrower range of potential liability."⁸²

In *People Express Airlines, Inc. v. Consolidated Rail Corp.*⁸³ the New Jersey Supreme Court specifically recognized a duty of care to take reasonable measures to avoid putting at risk persons whom one should know will suffer economic losses. The New Jersey court held that recovery for pure economic losses were limited to those who were "particularly foreseeable in terms of the type of persons or entities comprising the class, the certainty or predictability of their presence, the approximate numbers of those in the class, as well as the type of economic

manufacturer of cans for use in packaging food products, was aware of the plaintiff's particular needs and how the cans would be used (seafood packaging). When the cans proved to be defective, the plaintiff sued to recover the cost of the cans and the value of a sales contract that was lost when the plaintiff was unable to produce its canned abalone.

79. *Id.* at 290, 209 Cal. Rptr. at 925.

80. *Id.* at 286, 209 Cal. Rptr. at 922 (citing *Biakanja v. Irving*, 49 Cal. 2d 647, 320 P.2d 16 (1958)).

81. *Id.* at 287, 209 Cal. Rptr. at 923 (quoting *J'Aire Corp. v. Gregory*, 24 Cal.3d 799, 808, 598 P.2d 60, 65, 157 Cal. Rptr. 407, 412 (1970)).

82. *Id.* at 290, 209 Cal. Rptr. at 925.

83. 100 N.J. 246, 495 A.2d 107 (1985). *People Express Airlines* suffered a twelve-hour business interruption when an airport was closed due to the defendant-railroad's negligent collision with railroad cars containing explosive gas.

expectations disrupted.”⁸⁴ The court expressed the following reservation, however:

We recognize that some cases will present circumstances that defy the categorization here devised to circumscribe a defendant's orbit of duty, limit otherwise boundless liability and define an identifiable class of plaintiffs that may recover. In these cases, the courts will be required to draw upon notions of fairness, common sense and morality to fix the line limiting liability as a matter of public policy, rather than an uncritical application of the principle of particular foreseeability.⁸⁵

The court concluded that it is better to decide questions of economic loss on an *ad hoc* basis than to cling to a rule that requires “the wholesale rejection of recovery in all cases.”⁸⁶

Other courts have rejected the idea that any theory of economic loss based on “foreseeability,” modified or not, can provide useful standards of conduct. In *State ex rel. Guste v. M/V Testbank*⁸⁷ a mass disaster case arising from the blockage of the Mississippi River Gulf outlet by a chemical spill, the Fifth Circuit rejected the theory that foreseeability could control recovery for economic loss. Recognizing the need for “pragmatic limitations on the doctrine of foreseeability,” the court defended the use of a bright-line test requiring the presence of personal injury or property damage as a condition for recovery of economic loss.⁸⁸ Judge Higgenbotham's opinion for the majority stressed the need for “pre-existing normative guidelines”⁸⁹ in judicial decision-making. The court acknowledged that the traditional rule produces results “at its edge”⁹⁰ that seem unfair. Nevertheless, it could discern no effective limiting principle that would substitute the requirement of physical injury in producing a predictable rule of law. Citing the limits on a court's ability to adjudi-

84. *Id.* at 264, 495 A.2d at 116. The *People Express* ruling recently was adopted by the Alaska Supreme Court in *Mattingly v. Sheldon Jackson College*, 743 P.2d 356 (Alaska 1987), in which a contractor was allowed to sue the defendant-owner for loss of income and profits suffered as a result of the loss of his employees' services. The employees were injured in a trench collapse, allegedly caused by the owner's negligence.

85. *Id.*

86. *See id.* at 254, 495 A.2d at 111.

87. 752 F.2d 1019 (5th Cir. 1985), *cert. denied.*, 477 U.S. 903 (1986).

88. *Id.* at 1025.

89. *Id.* at 1028.

90. *Id.* at 1029.

cate, the opinion stated that without limits on foreseeability, each judge or jury would decide for itself whose damages are too remote or tenuous for recovery, and the result will be “judicial” only in the sense that it draws on the resources of the judiciary.⁹¹

The conflicting opinions of *People Express* and *Testbank* arm advocates on both sides of the economic loss rule debate with persuasive authority. The issue — the need for practical limits on liability for economic loss and the problem in defining a standard of conduct to prevent economic harm — is crucial to the debate over recovery in tort for construction defects. That issue will be discussed later in this article.

3. *Economic Loss in Strict Liability: A Contest of Wills*

The issue of economic loss in strict products liability has received extensive treatment in case law and academic writings.⁹² Although the use of strict liability only rarely has met with success in the construction context,⁹³ the policy arguments advanced in the strict products liability debate have had a profound influence on the litigation of economic loss in construction defect cases.

Strict liability theory originated as a contract-based implied warranty theory because consumers injured by mass-produced consumer products experienced difficulty in proving liability under a fault-based negligence theory. Recovery under implied warranty theory, however, often was defeated by disclaimer, requirements of notice, or by the privity defense. As the privity defense began to erode, the implied warranty theory became a contract theory without a contract. Eventually, most courts abandoned the fiction of warranty and christened a new tort action: strict liability.⁹⁴

91. *Id.* at 1028-29.

92. See *infra* notes 136-147; see also Edmeades, *The Citadel Stands: The Recovery of Economic Loss in American Products Liability*, 27 CASE W. RES. L. REV. 647 (1977).

93. See *infra* notes 129-146 and accompanying text.

94. See Prosser, *The Fall of the Citadel*, 50 MINN. L. REV. 791 (1966). See also *Sacramento Regional Transit Dist. v. Flibble*, 158 Cal. App. 3d 289, 295-96, 204 Cal. Rptr. 736, 740 (1984) (the development of strict liability is “an example of necessary judicial paternalism”). Strict liability has been justified on several grounds. One justification is consumers’ lack of bargaining power against large remote manufacturers. See *Spring Motors Distribs. v. Ford Motor Co.*, 98 N.J. 555, 575, 489 A.2d 660, 670 (1985).

The heart of strict liability is the notion of protecting consumers from unreasonable dangers to their person or their property. As codified in section 402A of the *Restatement (Second) of Torts*,⁹⁵ the doctrine of strict liability imposes liability when a defective product that is unreasonably dangerous to the consumer results in physical harm. When the danger results in physical injury to the consumer or to his property, recovery is permitted regardless of fault.⁹⁶

The problem that has vexed courts and scholars is whether damage to the product itself qualifies as “physical harm” within the meaning of section 402A. The two opposing views on this issue were set out in the New Jersey Supreme Court’s decision in *Santor v. A & M Karagheusian, Inc.*⁹⁷ and the California Supreme Court’s decision in *Seely v. White Motor Co.*⁹⁸

In *Santor* the plaintiff sued a carpet manufacturer for the cost of defective carpet. The court rejected the economic loss rule holding that there was “no just cause” for permitting recovery for personal injuries in some cases but denying recovery in others simply because loss of value is the only damage sustained.⁹⁹ The *Santor* court identified four policy reasons favoring recovery of economic losses. First, the rule was inefficient; if consumers were restricted to their contract rights against intermediate sellers, then an “unduly wasteful process of litigation”¹⁰⁰ would result as sellers, in turn, sued manufacturers. Second, consumers have neither the competence nor the opportunity to inspect the article for defects.¹⁰¹ Third, the mere presence of the article on the market constitutes a representation that it is suitable and safe for its intended use.¹⁰² Fourth,

Another justification is the social desirability of spreading the cost of catastrophic personal injuries to consumers as a class through insurance or an incremental increase in the price of manufacturers’ products. *See id.* at 568, 489 A.2d at 666; Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 389-404, 161 A.2d 69, 86-95 (1960); *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854, 856 (W. Va. 1982).

95. RESTATEMENT, *supra* note 4, § 402A. *See also* Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).

96. RESTATEMENT, *supra* note 4, § 402A.

97. 44 N.J. 52, 207 A.2d 305 (1965).

98. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

99. 44 N.J. at 59, 207 A.2d at 309.

100. *Id.* at 62, 207 A.2d at 310.

101. *Id.* at 64, 207 A.2d at 311.

102. *Id.*

the manufacturer is in a better position to bear the cost of injury than the injured or damaged persons who ordinarily are powerless to protect themselves.¹⁰³ The opinion implies that a distinction between property damage and product damage is an arbitrary one.

In *Seely* the California Supreme Court staked out the contrary position. In that case, the plaintiff purchased a truck that subsequently overturned due to defective brakes. The plaintiff incurred repair costs and lost profits as a result of the accident. The *Seely* court affirmed the judgment against the defendant-seller on a breach of express warranty theory, but rejected the defendant's argument that the doctrine of strict liability "superseded" the scheme of warranty remedies established by the Uniform Commercial Code (UCC).¹⁰⁴ The court held that the doctrine of strict liability was intended to govern only the "distinct problem of physical injuries"¹⁰⁵ and was not intended to undermine the UCC's regulation of economic injuries. The court further recognized that the basic interest protected by warranty law, the quality of the product, is better served by contract remedies and principles:

Although the rules of warranty frustrate rational compensation for physical injury, they function well in a commercial setting. These rules determine the quality of the product the manufacturer promises and thereby determine the quality he must deliver. . . .

The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the con-

103. *Id.* at 65, 207 A.2d at 312.

104. 63 Cal. 2d 9, 15, 403 P.2d 145, 149, 45 Cal. Rptr. 17, 21 (1965).

105. *Id.*

sumer's demands.¹⁰⁶

Finally, the *Seely* court noted that the loss-shifting rationale of strict liability loses its significance in cases when the injury is purely economic. While the risk of personal injury to the individual is a risk that society fairly may impose upon the manufacturer, who then will spread it among the public in the form of higher prices, the loss-shifting rationale "in no way justifies requiring the consuming public to pay more for their products so that a manufacturer can insure against the possibility that some of his products will not meet the business needs of some of his customers."¹⁰⁷

The debate over economic loss in products liability cases involves one element missing from earlier economic loss cases, namely, the courts' concern over impinging on the legislature's power as manifested by the enactment of the UCC. This contest of wills between judicial paternalism and the legislature has taken a decisive turn in favor of the legislature. A clear majority of courts that have considered the issue have adopted the position taken by the *Seely* court and retained retention of the economic loss doctrine.¹⁰⁸ Reluctance to allow tort remedies that produce results contrary to the intricate UCC warranty scheme has led many courts to reject the use of strict liability theories in the commercial context altogether.¹⁰⁹ In fact, even the New Jersey Supreme Court has retreated from its holding in *Santor* in commercial cases.¹¹⁰

C. The "Sudden and Dangerous" Test: All Product Injuries Are Not Created Equal

Thus far, the economic loss doctrine has been portrayed as a bright-line rule. Indeed, many courts employ the doctrine in bright-line form.¹¹¹ In the past several years, however, an inter-

106. *Id.* at 16, 18, 403 P.2d at 150-51, 45 Cal. Rptr. at 22-23 (citation omitted).

107. *Id.* at 19, 403 P.2d at 151, 45 Cal. Rptr. at 23.

108. *See, e.g.*, *Spring Motors Distribs. v. Ford Motor Co.*, 98 N.J. 555, 575, 489 A.2d 660, 669-70 (1985) (collecting cases).

109. *See id.*; *James v. Bell Helicopter Co.*, 715 F.2d 166, 171 (5th Cir. 1983). *Contra* *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854 (W. Va. 1982).

110. *See supra* text accompanying notes 104-07.

111. *See, e.g.*, *State ex rel. Guste v. M/V Testbank*, 752 F.2d 1019 (5th Cir. 1985), *cert. denied*, 477 U.S. 903 (1986); *James v. Bell Helicopter Co.*, 715 F.2d 166 (5th Cir.

mediate form has emerged, which permits recovery in tort for damage to the work product itself under certain circumstances. The intermediate position was originated by the Alaska Supreme Court. In *Morrow v. New Moon Homes, Inc.*¹¹² the plaintiff was denied recovery for a mobile home with a defective furnace, a leaky roof, a leaky bathroom, and several cracked windows. The court relied on *Seely* in denying recovery in strict liability.¹¹³ One year later in *Cloud v. Kit Manufacturing Co.*¹¹⁴ the court permitted the plaintiff to recover damages in strict liability when a defective electric heater in a mobile home caused the sudden destruction of a mobile home by fire. After distinguishing *Morrow* as a case involving a “lemon” rather than an unsafe product, the court identified situations in which the damage to the product itself might qualify as compensable “property damage” rather than economic loss: “We cannot lay down an all inclusive rule to distinguish between the two categories; however, we note that sudden and calamitous damage will almost always result in direct property damage and that deterioration, internal breakage and depreciation will be considered economic loss.”¹¹⁵

The Alaska Supreme Court clarified the two opinions in *Northern Power & Engineering Corp. v. Caterpillar Tractor Co.*¹¹⁶ *Northern Power* was a products liability case in which the oil pressure shut-off valve of a diesel-powered electric generator failed and caused severe damage to the generator’s engine. The court rejected the idea that the “sudden and calamitous” language of *Cloud* was intended as a test to determine what constitutes “property damage.”¹¹⁷ Instead, the court held that recovery in tort for damage to the product was justified when the loss takes place in a manner that creates danger to persons or other property, even though the actual damage ultimately is confined to the product itself.¹¹⁸ Therefore, the court reasoned that although the damage occurred in a sudden manner, the destruc-

1983).

112. 548 P.2d 279 (Alaska 1976).

113. *Id.* at 285-86.

114. 563 P.2d 248 (Alaska 1977).

115. *Id.* at 251.

116. 623 P.2d 324 (Alaska 1981).

117. *See id.* at 328 n.5.

118. *See id.* at 329.

tion of the diesel generator posed no threat of harm to anything or anyone but the product itself, and recovery of the damage should be denied under a theory of negligence or strict liability.¹¹⁹ In other words, if the product is damaged under circumstances that *could* have caused physical harm to other persons or property, then the plaintiff might be able to recover for a purely economic loss. Other courts have adopted the *Northern Power* theory, albeit with modifications.¹²⁰

The sudden and dangerous test has been criticized because the test arguably is unjustified and unworkable.¹²¹ In *East River*

119. See *id.*

120. See, e.g., *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.2d 1165, 1174 (3d Cir. 1981); *Moorman Mfg. v. National Tank Co.*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982). In *Pennsylvania Glass* the Third Circuit proposed to draw the line between tort and contract by

analyzing interrelated factors such as the nature of the defect, the type of risk, and the manner in which the injury arose. These factors bear directly on whether the safety-insurance policy of tort law or the expectation-bargain protection policy of warranty law is most applicable to a particular claim.

652 F.2d at 1173.

In other words, the sudden and dangerous test seeks to distinguish between “the disappointed users . . . and the endangered ones.” See *Russell v. Ford Motor Co.*, 281 Or. 587, 595, 575 P.2d 1383, 1387 (1978) (product loss recoverable if it was a consequence of the kind of danger and occurred under the kind of circumstances, accidental or not, that created an unreasonable danger to person or property). See also *Sanco, Inc. v. Ford Motor Co.*, 579 F. Supp. 893 (S.D. Ind. 1984) (citing *Pennsylvania Glass*), *aff’d*, 771 F.2d 1081 (7th Cir. 1985); *Vulcan Materials Co. v. Driltech, Inc.*, 251 Ga. 383, 306 S.E.2d 253 (1983) (characterizing *Pennsylvania Glass* as an “accident exception” to the economic loss rule); *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854 (W. Va. 1982) (citing *Pennsylvania Glass*).

121. See Ribstein, *Guidelines For Deciding Product Liability Cases*, 29 MERCER L. REV. 493, 500 (1978). The difficulty in using the economic loss rule is illustrated in *Kishwaukee Community Health Servs. Center v. Hospital Bldg. & Equip. Co.*, 638 F. Supp. 1492 (U.D. Ill. 1986), in which the courts stated:

One could reasonably interpret this discussion of economic loss to approve one (or more) of three different tests. A loss is not “economic” and a plaintiff may sue in tort if:

(1) the damage alleged involves anything outside of the product itself (the “bright line” test);

(2) one would not expect the resulting damage to be caused by the product’s failure to perform its intended function (the “commercial expectation” test); or

(3) the damage occurred in a sudden and dangerous manner (the “sudden and dangerous” test).

The last, [sic] test, the “sudden and dangerous” test, could in turn be divided into “potential” and “actual” tests; it is unclear whether the majority’s discussion of sudden and dangerous occurrences treats resulting damages as economic loss if the event *did* cause grave harm or *could have* caused great harm.

*Steamship Corp. v. Transamerica Delaval, Inc.*¹²² the United States Supreme Court addressed the economic loss doctrine in the context of an admiralty case. A set of ship turbines costing \$1.4 million disintegrated because the manufacturer negligently installed certain key components backwards. A unanimous Court rejected recovery for economic loss in negligence and strict liability. The court stated that contract and tort law were separate, that the economic loss rule operated to separate them, and that the rule was necessary to maintain a realistic limit on damages awards. The court reasoned that when a product injures only itself, the tort concern with safety is less and “the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong.”¹²³

Justice Blackmun, writing for the majority, further rejected the sudden and dangerous test. The opinion stated that the test was “too indeterminate to enable manufacturers easily to structure their business behavior.”¹²⁴ The opinion also stated that regardless of the manner in which the damage to the product itself occurs, gradually or through accident, the nature of the loss is “the failure of the purchaser to receive the benefit of its bargain — traditionally the core concern of contract law.”¹²⁵

In the fourth edition of his treatise on the law of torts, Dean Prosser described an automobile destroyed by its own defective brakes as an example of the rule that “the seller’s liability for negligence covers any kind of physical harm, including . . . damage to the defective chattel itself.”¹²⁶ By the time of the fifth edition, that view had changed radically:

Making liability depend upon whether or not the loss results from an “accident” creates a difficult issue and arguably an irrelevant issue with respect to the validity of contract provisions allocating the risk of loss for harm to the defective prod-

Id. at 1497. The court also noted that under any test — “sudden and dangerous” or otherwise — the recovery of damages for economic loss is inconsistent with the major thrust of the economic loss doctrine. Economic losses, the court reasoned, were essentially the failure to receive the “benefit of the bargain,” no matter how they were caused. See *id.* at 1498.

122. 476 U.S. 858 (1986).

123. *Id.* at 871.

124. *Id.* at 870.

125. *Id.*

126. W. PROSSER, *supra* note 35, § 101, at 665.

uct itself to the purchaser. Distinguishing “accidental” damage to the product from mere economic loss is difficult in many cases¹²⁷

A variant of the sudden and dangerous test appeared in *Council of Co-Owners Atlantis Condominium, Inc. v. Whiting-Turner Contracting Co.*¹²⁸ In *Atlantis Condominium* the plaintiff, a condominium association, sued a remote architect and builder, alleging that their negligence in design and construction resulted in a fire hazard that created a risk of personal injury. No “accident” or damage to persons or other property had occurred. The Maryland Court of Appeals held that when a dangerous condition is discovered *before* it results in injury, an action in negligence will lie for the recovery of the reasonable cost of correcting the condition.¹²⁹

This idea has been rejected in several jurisdictions.¹³⁰ In *Carolina Winds Owners’ Association v. Joe Harden Builder, Inc.*¹³¹ the South Carolina Court of Appeals considered the argument in a fact situation similar to the one in *Atlantis Condominium*. The *Carolina Winds* court found several practical problems with a theory that would allow recovery in tort for the

127. W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 101(3), at 709 (5th ed. 1984) [hereinafter PROSSER & KEETON]. In as early as 1978, Dean Keeton wrote that while a “hazardous product that has harmed something or someone can be labeled as part of the accident problem[,] . . . a damaging event that harms only the product should be treated as irrelevant to policy considerations directing liability placement in tort.” Keeton, *Annual Survey of Texas Law: Torts*, 32 Sw. L.J. 1, 5 (1978). See also Sharp Bros. Contracting Co. v. American Hoist & Derrick Co., 703 S.W.2d 901 (Mo. 1986) (en banc) (crane owner denied recovery for the crane’s sudden destruction by its own defective counterweight).

128. 308 Md. 18, 517 A.2d 336 (1986).

129. See *id.* at 35, 517 A.2d at 345.

130. The Maryland Court of Appeals stands alone in permitting recovery in tort for the mere risk of harm. See PROSSER & KEETON, *supra* note 127, § 101, at 710. See *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 789, 332 N.W.2d 39, 44 (1983) (court rejected plaintiff’s argument that he should be able to sue in tort to recover expenses undertaken to repair defective parts to “remove a potential future liability in tort” — the danger of a crane collapse); *Crowell Corp. v. Topkis Constr. Co.*, 280 A.2d 730 (Del. Super. Ct. 1971) (court rejected similar argument by observing that plaintiff’s duty to prevent risk of harm to others is not dependent upon his right to sue others in tort for the cost of removing that risk); see also *People ex rel. Skinner v. Graham*, 170 Ill. App. 3d 417, 524 N.E.2d 642 (1988); *Cincinnati Gas & Elec. Co. v. General Elec. Co.*, 656 F. Supp. 49, 59 (S.D. Ohio 1986) (plaintiff cannot avoid economic loss doctrine by alleging “mere prospect of catastrophe” at nuclear power plant).

131. 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *aff’d on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988).

mere risk of personal injury. First, such a theory is inconsistent with the principle that damages must occur before negligence is actionable.¹³² Second, the fact and extent of the injury and the identity of persons who may be affected are wholly speculative until actual injury occurs.¹³³ Third, no limiting mechanism ensures that the damages recovered will bear a reasonable relationship to the risk of injury.¹³⁴ The court stated:

The difficulty is that there is no principled way to categorize types or degrees of risk for the purpose of establishing liability. To say the determination should be made on a case by case basis is to abandon the attempt at rule governed decision making in favor of ad hoc, post hoc imposition of liability by judges and juries. The calculation of risk . . . is far beyond the competence of judges or juries. . . . [T]here is no guarantee that tort rules of liability, if they could be fashioned, would redistribute these risks in the most rational, economic way.¹³⁵

III. RECOVERY OF ECONOMIC LOSS IN CONSTRUCTION DEFECT LITIGATION

A. Recovery Under Strict Liability Theory

Even in jurisdictions that permit the recovery of economic loss, strict liability has been considered inappropriate for use in a construction context. In *Conolley v. Bull*¹³⁶ the California Supreme Court rejected the use of strict liability in a homeowner's suit against a builder who had constructed a house on poor soil. The court found the policy elements that justify strict liability in product defect actions did not apply in a construction context. It reasoned that unlike a manufacturer, a builder lacks the opportunity to limit or disclaim liability to subsequent purchasers; tracing the source of the defect is easy, and further, the plaintiff has the opportunity to conduct a meaningful inspection of the premises.¹³⁷ Other courts, however, have permitted subse-

132. *Id.* at 87, 374 S.E.2d at 904-05.

133. *Id.* at 87, 374 S.E.2d at 905.

134. *Id.* at 87-88, 374 S.E.2d at 905.

135. *Id.* at 88, 374 S.E.2d at 905.

136. 258 Cal. App. 2d 183, 65 Cal. Rptr. 689 (1968).

137. *Id.* at 196, 65 Cal. Rptr. at 696.

quent purchasers to recover economic loss damages from home builders.¹³⁸

Some courts have permitted plaintiffs to recover for defective mobile homes.¹³⁹ This is not an unreasonable position, given that mobile homes bear more resemblance to the products that traditionally have been the subject of strict liability than to a typical building. Mobile homes are mass-produced and marketed like manufactured products. Further, the manufacturer has complete control over the design and construction, unlike the contractor who must share control with the owner and his architect.¹⁴⁰

The use of strict liability to recover economic loss has been rejected in the construction context for a variety of reasons. Some courts have focused on the inapplicability of the strict lia-

138. The California Court of Appeals later allowed a subsequent homeowner to sue the builder in strict liability for diminution in value and cost of repairs to the house as a result of a defective heating system. *See Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969). Even so, the *Kriegler* court did not cite *Conolly* but, instead, relied on an earlier New Jersey decision, *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 207 A.2d 314 (1965), which permitted recovery for damages under a strict liability theory for personal injury caused by a defective hot water system in a mass-produced home.

The court justified the use of strict liability to builders for the following reasons: (1) the purchaser's reliance on advertised model homes and an implied representation that the builder's skill produced a home reasonably fit for its intended purpose; (2) the purchaser's disadvantage because of unequal bargaining power between the parties; and (3) the purchaser's lack of the expertise to inspect the premises adequately for defects. *See Kriegler*, 269 Cal. App. 2d at 228, 74 Cal. Rptr. at 752-53. The *Kriegler* case is probably best regarded as an anomaly, however. In *Huang v. Garner*, 157 Cal. App. 3d 404, 203 Cal. Rptr. 800 (1984), the California Court of Appeals summarily rejected the use of strict liability by a group of apartment owners seeking recovery from a remote contractor, developer, and architect for the cost of correcting structural defects. *See also Hermes v. Staiano*, 181 N.J. Super. 424, 433, 437 A.2d 925, 929-30 (Ct. Law. Div. 1981) (trial court, which permitted subsequent homeowner to recover damages from a builder in strict liability for flooding and cracked foundations in the basement, stated that "privity of contract is not an element in a products liability action").

139. *See, e.g.*, *Cloud v. Kit Mfg. Co.*, 563 P.2d 248 (Alaska 1977); *Hiigel v. General Motors Corp.*, 190 Colo. 57, 544 P.2d 983 (1975); *Gauthier v. Mayo*, 77 Mich. App. 513, 258 N.W.2d 748 (1977); *Thompson v. Nebraska Mobile Homes Corp.*, 198 Mont. 461, 647 P.2d 334 (1982).

140. *See Coburn v. Lenox Homes, Inc.*, 173 Conn. 567, 573, 378 A.2d 599, 602 (1977) (rejecting use of strict liability in a case involving an ordinary house, court noted that "a house which is not the product of a mass marketing scheme or which is not designed as a temporary dwelling differs from the usual item to which the principles of strict liability have generally been applied").

bility theory. For example, in *Wright v. Creative Corp.*¹⁴¹ the Colorado Court of Appeals noted that typically, no problem exists in finding or proving negligence in construction of a structure due to the purchaser's opportunity to make a meaningful inspection of a structure on real property. Further, the builder cannot disclaim or limit his liability as easily as a commercial manufacturer.¹⁴²

Other courts have permitted defendants to use the economic loss doctrine defense to defend successfully against strict liability claims for economic losses arising from construction defects. Typically, these courts cite the products liability cases that uphold the economic loss doctrine.¹⁴³ In *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*¹⁴⁴ the court rejected a claim for damages against an architect and roof manufacturer when the roof system of the plaintiff's factory cracked and blew off. The court opined that economic loss almost always is incurred by the product's owner — the very person who is in the best position to bargain for warranty protection or a lower contract price.¹⁴⁵

In *Oliver v. City Builders, Inc.*¹⁴⁶ the Mississippi Supreme Court anticipated that strict liability claims against remote builders could result in the possibility of a windfall for subsequent owners. If the original purchaser could be estopped from complaining about the durability of a structure due to his deliberate choice of the quality and type of construction, the court

141. 30 Colo. App. 575, 498 P.2d 1179 (1972).

142. *Id.* at 582-83, 498 P.2d at 1182-83. See also *Cincinnati Gas & Elec. Co. v. General Elec. Co.*, 656 F. Supp. 49, 58-59 (S.D. Ohio 1986) (court found a strict liability claim to be inappropriate in commercial dispute over a nuclear power plant).

143. See, e.g., *Nastri v. Wood Bros. Homes, Inc.*, 142 Ariz. 439, 690 P.2d 158 (1984); *State v. Mitchell Constr. Co.*, 108 Idaho 335, 699 P.2d 1349 (1984); *Local Joint Executive Bd. Culinary Workers Union, Local 226 v. Stern*, 98 Nev. 409, 651 P.2d 637 (1982); *Richman v. Albert*, 127 A.D.2d 992, 513 N.Y.S.2d 46 (N.Y. App. Div. 1987); *Lupinski v. Heritage Homes, Ltd.*, 369 Pa. Super. 488, 535 A.2d 656 (1988); *Nobility Homes, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977) (denying recovery in strict liability but affirming award of damages under negligence theory, which was not challenged on appeal).

144. 626 F.2d 280 (3d Cir. 1980).

145. *Id.* at 288-89.

146. 303 So. 2d 466 (Miss. 1974). The court in *Keyes v. Guy Bailey Homes, Inc.*, 439 So. 2d 670 (Miss. 1983), allowed recovery of economic loss in negligence relying on a rationale that contradicts many of the statements made in *Oliver*. Even so, no court has ever expressly overruled the holding in *Oliver* that strict liability is not available to recover economic losses for a construction defect.

reasoned that a subsequent purchaser should stand in no better position. Moreover, the court saw no way to create a rule permitting recovery in residential cases that could not be applied equally to cases involving commercial structures.¹⁴⁷

B. Recovery Under Negligence Theory

Owners seeking recovery of economic losses have had greater success by using negligence theories than by using strict liability theories. Cases permitting recovery of economic losses due to construction defects may be grouped into several categories. At one end of the spectrum are those cases that permit recovery of economic losses with no analysis at all.¹⁴⁸ In such cases, both the courts and the litigants seem entirely unaware that the damages sought were outside the scope of traditional tort protection. The economic loss issue is neither raised, discussed, nor decided. These decisions generally are not given precedential weight, nor should they be.¹⁴⁹

A number of construction cases focus their attention on criticizing the barriers to recovery: privity,¹⁵⁰ *caveat emptor*,¹⁵¹ and the “completed and accepted” defense.¹⁵² These cases analyze only half of the problem because they do away with existing obstacles to recovery without inquiring whether other conceptual or policy reasons may exist to deny recovery. Thus, in *Moxley v.*

147. 303 So. 2d at 468-69.

148. See, e.g., *Driscoll v. Columbia Realty-Woodland Park & Co.*, 41 Colo. App. 453, 590 P.2d 73 (1978); *Kincaid v. Landing Dev. Corp.*, 289 S.C. 89, 344 S.E.2d 869 (Ct. App. 1986); *Terlinde v. Neely*, 275 S.C. 395, 271 S.E.2d 768 (1980).

149. For examples of such cases, see *James v. Bell Helicopter, Inc.*, 715 F.2d 166, 172 (5th Cir. 1983); *Marcil v. John Deere Indus. Equip. Co.*, 9 Mass. App. Ct. 625, 631 n.4, 403 N.E.2d 430, 434 n.4 (1980); *Hagert v. Hatton Commodities, Inc.*, 350 N.W.2d 591, 595 (N.D. 1984); *Carolina Winds Owners' Ass'n v. Joe Harden Builder, Inc.*, 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988) (distinguishing *Terlinde*); Other cases that have limited precedential value are those in which precedent supporting the economic loss doctrine was available but the court and litigants did not apply it to their case. See e.g., *Gupta v. Ritter Homes, Inc.*, 646 S.W.2d 168, 168 (Tex. 1983) (Texas Supreme Court affirmed the negligence ruling in *Gupta*, but only because parties abandoned issue in their appeal to that court). But see *Jim Walters Homes, Inc. v. Reed*, 711 S.W.2d 617 (Tex. 1986) (Texas does not allow recovery in negligence for economic losses arising in the construction context).

150. See *supra* note 5 and accompanying text.

151. See *supra* note 6 and accompanying text.

152. See *supra* note 7 and accompanying text.

*Laramie Builders, Inc.*¹⁵³ the Wyoming Supreme Court ruled that the doctrine of *caveat emptor* could not be used as a defense to a claim for negligent construction asserted by a remote purchaser. The court recognized the practical legal difficulties that would result from eliminating the barrier between contract and tort, but simply deferred resolution of those problems to another day.¹⁵⁴

Several courts have allowed recovery after overruling the "completed and accepted" defense. The defense insulates builders from liability for any losses occurring after the structure is completed and turned over to its first owner. In *Simmons v. Owens*¹⁵⁵ the court allowed a subsequent purchaser to sue the builder for wood rot and termite infestation caused by excessively low clearance of the exterior siding. After eliminating the completed and accepted defense, the Florida Court of Appeals justified recovery by stating that the ordinary purchaser of a home is not qualified to determine when or where a defect exists.¹⁵⁶

Courts, without addressing or recognizing any fundamental difference between recovery for economic loss and recovery for personal injuries, also have permitted recovery after striking down the privity defense.¹⁵⁷ Typical of these cases is *Juliano v. Gaston*.¹⁵⁸ The trial court granted summary judgment in favor of a remote subcontractor. The plaintiff, a homeowner, claimed the subcontractor's negligence resulted in extensive damages. The appellate court, in reversing the summary judgment, held that "there is no impediment, conceptual or practical, to the recovery of this category of damages in a negligence action by the pur-

153. 600 P.2d 733 (Wyo. 1979).

154. "We have no idea what defenses may be interposed [to such a negligence claim] or what our views might be as to any such defenses presented upon a full development of this case in the trial court." *Id.* at 736.

155. 363 So. 2d 142 (Fla. Dist. Ct. App. 1978).

156. The court relied on an exception to that defense for latent dangerous conditions or unreasonable risks. It offered no explanation for its conclusion that rotted exterior siding presents a danger to the occupants of a house. *See id.* at 143; *see also* *Kristek v. Catron*, 7 Kan. App. 2d 495, 496-98, 644 P.2d 480, 482-83 (1982) (in reaching a similar result, court saw no reason, other than the discredited concept of privity, to bar recovery for economic losses).

157. *See, e.g., Oates v. JAG, Inc.*, 314 N.C. 276, 333 S.E.2d 222 (1985); *Dellinger v. Lamb*, 79 N.C. App. 404, 339 S.E.2d 480 (1986); *Newman v. Tualatin Dev. Co.*, 287 Or. 47, 597 P.2d 800 (1979).

158. 187 N.J. Super. 491, 455 A.2d 523 (Ct. App. Div. 1982).

chaser against a subcontractor.”¹⁵⁹ The *Juliano* court relied extensively on *Barnes v. Mac Brown & Co.*,¹⁶⁰ in which the issue was not one of negligence but whether recovery under the theory of an implied warranty of fitness for habitability should be extended to subsequent purchasers.¹⁶¹ The *Barnes* court, however, expressed sentiments that have been quoted repeatedly in negligence cases such as *Juliano*:

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. . . . 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?¹⁶²

Such a sentiment is easy to understand but has been criticized as a “false dilemma.”¹⁶³ There is no reason for the homeowner to wait until a personal injury occurs to exercise his contract remedies. More importantly, as the dissenting judges noted in *Barnes*, it simply fails to address the commercial impact of al-

159. *Id.* at 498, 455 A.2d at 526.

160. 264 Ind. 227, 342 N.E.2d 619 (1976).

161. Although most courts follow the majority view of denying recovery in tort for economic losses, some will permit recovery for such losses under the implied warranty theory. See Sheed, *The Implied Warranty of Habitability: New Implications, New Applications*, 8 REAL EST. L.J. 291 (1980); Annotation, *Liability of Builder-Vendor or Other Vendor of New Dwelling for Loss, Injury or Damage Occasioned by Defective Condition Thereof*, 25 A.L.R.3d 383 (1969). To the extent that recovery is permitted in implied warranty without a showing of privity, the theory becomes in effect “strict liability” and is subject to the same criticisms and shortcomings as recovery under a tort theory. See Redarowicz v. Ohlendorf, 92 Ill. 2d 171, 187-88, 441 N.E.2d 324, 332 (1982) (Ryan, C.J., dissenting). But see *Lemke v. Dagenois*, 130 N.H. 742, 792-95, 547 A.2d 290, 296-98 (1988) (permitting recovery of economic loss under implied warranty of workmanship theory for latent defects for a reasonable period of time).

162. 264 Ind. 729, 230, 342 N.E.2d 619, 621 (1976).

163. See *Carolina Winds Owners' Ass'n v. Joe Harden Builder, Inc.*, 297 SC 74, 374 S.E.2d 897 (Ct. App. 1988), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988).

lowing tort law to upset the allocation of risk expectancies under a contractual agreement between the parties.¹⁶⁴

Some courts recognize that economic loss traditionally has not been a protected interest under tort law, but view recovery of economic harm as the logical result of the elimination of the privity defense.¹⁶⁵ In *Cosmopolitan Homes, Inc. v. Weller*¹⁶⁶ the court upheld a subsequent homeowner's negligence claim against the original builder for settlement, cracking, and movement of the foundation. The court justified its decision largely on consumer-protection grounds, citing the builder's superior knowledge, the homeowner's inability to inspect for defects, and the tremendous impact that a defective home might have on the "family budget."¹⁶⁷ Significantly, the court limited recovery in tort to cases of latent or hidden defects, reasoning that the buyer already may have received a reduced price to reflect patently obvious deterioration or deficiencies. The dissenting judges criticized the majority's failure to distinguish between the question of *to whom* the duty is owed and the question of *what* duty is owed.¹⁶⁸ They argued that the flaw in the majority opinion lies in its assumption that a legal duty has been breached merely because the damages are foreseeable. The dissenters fur-

164. See 264 Ind. at 232-33, 342 N.E.2d at 621-22 (Debuler, J., dissenting). A federal court applying Indiana law in a negligence action later distinguished *Barnes* on the grounds that it was an implied warranty case and that the *Barnes* court, therefore, was not required to consider the collision between tort and contract principles represented by the Uniform Commercial Code. See *Sanco, Inc. v. Ford Motor Co.*, 579 F. Supp. 893, 897 (S.D. Ind. 1984) (federal court found the existing precedent "inconclusive" and determined that Indiana would uphold the economic loss doctrine in a products liability context), *aff'd*, 771 F.2d 1081, 1086 (7th Cir. 1985).

165. See, e.g., *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 111 N.E. 1050 (1916); see also *supra* notes 64-77 and accompanying text.

166. 663 P.2d 1041 (Colo. 1983).

167. See *id.* at 1045; see also *Drexel Properties, Inc., v. Bay Colony Club Condominium, Inc.*, 406 So. 2d 515, 520 (Fla. Ct. App. 1981) (recovery of economic losses in tort will deter sloppy workmanship); *Keyes v. Guy Bailey Homes, Inc.*, 439 So. 2d 670, 672 (Miss. 1983) (damages recovery permitted to protect innocent purchasers from a major financial catastrophe against which they have no practical means of protecting themselves); *McMillan v. Brune-Harpeneau-Torbeck Builders, Inc.*, 8 Ohio St. 3d 3, 5, 455 N.E.2d 1276, 1278 (1983) (permitting recovery of economic losses in tort encourages better workmanship and accountability of contractors). But see *Oliver v. City Builders, Inc.*, 303 So. 2d 466, 468 (Miss. 1974) (court noted that purchaser may protect himself against misfortune by insisting on a warranty and warned that adoption of rule to protect homeowner would apply with equal force to structures of every kind).

168. See *id.* at 1046 (Rovira, J., dissenting).

ther characterized the builder's duty of workmanlike construction as one arising solely in contract.¹⁶⁹ Finally, the dissent noted that the majority's holding could not be limited to homebuilders except by judicial fiat and criticized the latent defect requirement as "the sheerest form of *ipse dixit*,"¹⁷⁰ without foundation in the principles of tort law.

Another group of cases employs an analysis that makes foreseeability the determinant of liability for economic harm. Some courts do not address the question of whether the duty to avoid economic harm, however foreseeable, is within the traditional tort concepts of duty.¹⁷¹ Other courts, while addressing the issue, use foreseeability to create a tort duty for prevention of economic harm.¹⁷²

These latter courts use the six-factor analysis employed in *Ales-Peratis Foods International, Inc. v. American Can Co.*,¹⁷³ to determine whether the economic loss was a foreseeable consequence of the negligence on the part of construction contractors. In these cases, the liability runs to subsequent owners or tenants of the structures the contractors build. In *J'Aire Corp. v. Gregory*,¹⁷⁴ the California Supreme Court found a landlord's renovation contractor liable in negligence for the lost profits of a tenant whose restaurant was closed due to the contractor's delay in completing his work. In finding that there was a "special relationship" between the contractor and the tenant, the court focused on the foreseeability of economic harm as the "key component" and "primary consideration" in establishing a duty.¹⁷⁵ The court held that resolving such cases on a case-by-case basis, focusing judicial attention on foreseeability, proximate cause, and

169. See *id.* at 1048-49.

170. *Id.* at 1050. See *supra* notes 146-147.

171. See, e.g., *Parliament Towers Condominium v. Parliament House Realty, Inc.*, 377 So. 2d 976 (Fla. Dist. Ct. App. 1979); *Quail Hollow E. Condominium Ass'n v. Donald J. Scholz Co.*, 47 N.C. App. 518, 525, 268 S.E.2d 12, 15 (1980) (finding a distinction between economic loss and property damage "neither dispositive nor persuasive"); *Keel v. Titan Constr. Corp.*, 639 P.2d 1228 (Okla. 1981); *American Reciprocal Insurers v. Besonette*, 241 Or. 500, 405 P.2d 529 (1965).

172. See, e.g., *Ales-Paratis Foods Int'l, Inc. v. American Can Co.*, 164 Cal. App. 3d 277, 209 Cal. Rptr. 917 (1985); *J'Aire Corp. v. Gregory*, 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979).

173. 164 Cal. App. 3d 277, 209 Cal. Rptr. 917 (1985). See *supra* notes 78-83.

174. 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979).

175. *Id.* at 806, 598 P.2d at 64, 157 Cal. Rptr. at 411.

the nexus between the defendant's conduct and the plaintiff's injury, is preferable to a rule that bars recovery of economic loss in all cases.¹⁷⁶

As might be expected from courts following established rules of law, there is far greater uniformity of rationale in those cases that follow the economic loss doctrine. In general, these courts emphasize the social desirability of allowing parties to define expectancy interests and allocate risk through contract without interference from legally imposed tort standards.

Courts also deny recovery for economic losses on the basis of such defenses as *caveat emptor*.¹⁷⁷ Other courts deny recovery under a straightforward analysis that recognizes that economic loss simply is not within the range of interest protected by tort.¹⁷⁸ Persuaded by products liability cases enforcing the economic loss doctrine, courts of Georgia and Idaho have denied recovery in tort for construction defects.¹⁷⁹

In *Jim Walter Homes, Inc. v. Reed*¹⁸⁰ the Texas Supreme Court held that a claim for negligent supervision in the construction of a home, which results solely in economic loss, can be

176. *Id.* at 807-08, 598 P.2d 60 at 64-65, 157 Cal. Rptr. at 412. *See also* Huang v. Garner, 157 Cal. App. 3d 404, 203 Cal. Rptr. 800 (1984) (allowed recovery in negligence but not in strict liability). A similar analysis was followed in *Brown v. Fowler*, 279 N.W.2d 907 (S.D. 1979), when a subsequent purchaser sued the builder for structural problems resulting from construction of a house on ten feet of fill dirt. In applying the six-part foreseeability test, the court recognized that imposing a duty on the part of the builder is essentially a policy determination. *See id.* at 909. *See generally* Hawthorne v. Kober Constr. Co., 196 Mont. 519, 640 P.2d 467 (1982) (court permitted subcontractor-plaintiff to recover damages for defendant-suppliers' negligent performance of a supply contract with the general contractor).

177. *See, e.g.,* Woolridge v. Rowe, 477 So. 2d 296 (Ala. 1985); Wells v. Clower Constr. Corp., 476 So. 2d 105 (Ala. 1985); *see also* Holmes v. Worthey, 159 Ga. App. 262, 282 S.E.2d 919 (1981) (*caveat emptor* still the rule for defects that are discoverable through ordinary diligence), *aff'd*, 249 Ga. 104, 287 S.E.2d 9 (1982).

178. *See, e.g.,* Crowell Corp. v. Topkis Constr. Co., 280 A.2d 730 (Del. Super. Ct. 1971); Lumber Prods., Inc. v. Hiriart, 255 So. 2d 783 (La. Ct. App. 1971). In *Local Joint Executive Bd. Culinary Workers Union Local 226 v. Stern*, 98 Nev. 409, 651 P.2d 637 (1982), the court denied recovery of lost wages for the employees of the MGM Hotel from the architect whose negligence allegedly caused the fire that destroyed the hotel. The court was not distracted by the economic loss debate surrounding product liability; it relied on early maritime cases and *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200 (Ohio Ct. App. 1946).

179. *See* McClain v. Harveston, 152 Ga. App. 422, 263 S.E.2d 228 (1979); Tusch Enters. v. Coffin, 113 Idaho 37, 740 P.2d 1022 (1987); *State v. Mitchell Constr. Co.*, 108 Idaho 335, 699 P.2d 1349 (1984); .

180. 711 S.W.2d 617 (Tex. 1985).

characterized only as a breach of contract, and the plaintiff may not recover damages under tort theories.¹⁸¹ In *Morrow v. L.A. Goldschmidt Associates, Inc.*¹⁸² the court affirmed the dismissal of a homeowner's claim for punitive damages based on the defendant builder's "wilful and wanton misconduct."¹⁸³ Because the builder's alleged negligence resulted only in the cost of repair, without personal injury or property damage, the court held that there could be no liability in tort even if the breach of contract had been willful and wanton.¹⁸⁴

Although dicta in the case subsequently was overruled in *Sharp Brothers Contracting Co. v. American Hoist & Derrick Co.*,¹⁸⁵ one of the most influential economic loss cases in the construction context is the 1978 Missouri Supreme Court decision in *Crowder v. Vandendeale*.¹⁸⁶ In *Crowder* the court denied a subsequent homeowner's claim against the builder for the expenses of repairing the settlement cracks in the driveway, the structure's brickwork, and the foundation slab. The issue was "whether builders have a duty, enforceable by an action in tort, to protect prospective purchasers from damage consisting of deterioration or 'loss of bargain.'" ¹⁸⁷ The court concluded that no duty should be created and drew a distinction between the *safety* interests protected by tort law and the *quality* interests protected by contract principles:

A duty to use ordinary care and skill is not imposed in the abstract. It results from a conclusion that an interest entitled to protection will be damaged if such care is not exercised. Traditionally, interests which have been deemed entitled to protection in negligence have been related to *safety* or freedom from physical harm. Thus, where personal injury is threatened, a duty in negligence has been readily found. Property interests

181. The court held that even an intentional or grossly negligent breach of contract would not support an award of punitive damages absent a showing of a "distinct tortious injury with actual damages." *Id.* at 618.

182. 112 Ill. 2d 87, 492 N.E.2d 181 (1986).

183. *Id.* at 98, 492 N.E.2d at 186.

184. *See id.*, 492 N.E.2d at 185.

185. 703 S.W.2d 901 (Mo. 1986). Dicta in *Crowder* indicated that plaintiffs might recover money for damages to the product itself. This was overruled in *Sharp Brothers*, 703 S.W.2d at 903.

186. 564 S.W.2d 879 (Mo. 1978), *overruled on other grounds*, *Sharp Bros. Contracting Co. v. American Hoist & Derrick Co.*, 703 S.W.2d 901 (Mo. 1936).

187. *Id.* at 880.

also have generally been found to merit protection from physical harm. However, where mere deterioration or loss of bargain is claimed, the concern is with a failure to meet some standard of *quality*. This standard of quality must be defined by reference to that which the parties have agreed upon.¹⁸⁸

The court recognized that a duty in tort to prevent economic loss would be beneficial to certain classes of plaintiffs, such as those whose contract claims are barred by the statute of limitation or those who have not entered into a contract with the builder. The court, however, found the benefits of protecting these classes outweighed by the builders' right to disclaim or otherwise allocate the risk of economic harm through contract.¹⁸⁹

Another influential opinion came out of Illinois in *Redarowicz v. Ohlendorf*.¹⁹⁰ The court applied products liability principles to a subsequent homeowner's tort claim for latent structural defects and assorted leaks. The court began by stating that the measure of liability in tort is not determined by privity or by foreseeability, but by the scope of the duty owed to the plaintiff.¹⁹¹ Quoting dictum in *Crowder* that tort law seeks only to protect safety interests, the court concluded that a complaint alleging qualitative defects does not belong in tort:

To recover in negligence there must be a showing of harm above and beyond disappointed expectations. A buyer's desire to enjoy the benefit of his bargain is not an interest that tort law traditionally protects. . . . While the commercial expectations of this buyer have not been met by the builder, the only danger to the plaintiff is that he [will] be forced to incur additional expenses¹⁹²

Redarowicz has been applied to both residential and commercial construction disputes.¹⁹³

188. *Id.* at 882 (emphasis in original).

189. *See id.* at 883. *Cf. R.W. Murray Co. v. Shatterproof Glass Corp.*, 697 F.2d 818 (8th Cir. 1983) (involving a defective glass curtain wall on a commercial project); *Nastri v. Wood Bros. Homes, Inc.*, 142 Ariz. 439, 690 P.2d 158 (Ct. App. 1984) (similar facts); *But see Lempke v. Dagenais*, 130 N.H. 782, 792-95, 547 A.2d 290, 296-98 (1988) (overruling *Ellis v. Robert C. Morris, Inc.*, 128 N.H. 358, 513 A.2d, 951 (1986), a case that followed *Crowder* to hold that a defendant was *not* liable for economic loss).

190. 92 Ill. 2d 171, 441 N.E.2d 324 (1982).

191. *See id.* at 176, 441 N.E.2d at 326.

192. *Id.* at 177, 441 N.E.2d 327.

193. *See, e.g., Chicago Heights Venture v. Dynamit Nobel, Inc.*, 782 F.2d 723 (7th

In *Minneapolis Society of Fine Arts v. Parker-Klein Associates Architects*¹⁹⁴ the Minnesota Court of Appeals adopted the sudden and dangerous formulation of the economic loss rule. The plaintiff, a building owner, brought a suit in tort against a brick manufacturer to recover the six million dollars he spent to correct the deterioration in walls constructed with the defendant's brick. The court first rejected the plaintiff's claim that damage to the mortar between the bricks qualified as damage to "other property." The court reasoned that to use such relatively minor damage as a condition to recovery in tort would thwart the policies of the economic loss rule.¹⁹⁵ The court distinguished damage resulting from deterioration, internal breakage, depreciation, and the failure of a product to meet contractual expectations from damage resulting from a hazardous condition or a sudden and calamitous occurrence.¹⁹⁶

Other courts have commented on the amount of property damage necessary to establish a tortious injury. The Fourth Circuit found damage to roofing felts caused by removal of defective shingles to be merely "incidental" to the economic losses.¹⁹⁷ In *State ex rel. Smith v. Tyonek Timber, Inc.*¹⁹⁸ the Alaska Supreme Court held that a subcontractor had no "property interest" in the concrete slab he had made, despite the fact that the cost of purchasing the defective concrete mix from the defendant had come out of the subcontractor's materials allowance. Interestingly, the court turned down the defendant's invitation to apply the six-factor foreseeability test formulated in a California opinion, *Biakanja v. Irving*.¹⁹⁹ The *Tyonek* court stated that the first factor — the extent to which a transaction was intended to benefit the plaintiff — would disqualify a remote party in any event.²⁰⁰

Cir. 1986); *Kiswaukee Community Health Servs. Center v. Hospital Bldg. & Equip. Co.*, 638 F. Supp. 1492 (N.D. Ill. 1986); *Anderson Elec., Inc. v. Ledbetter Erection Corp.*, 115 Ill. 2d 146, 503 N.E.2d 246 (1986); *Wheeling Trust & Sav. Bank v. Tremco Corp.*, 153 Ill. App. 3d 136, 505 N.E.2d 1045 (1987).

194. 354 N.W.2d 816 (Minn. 1984).

195. *See id.* at 820 n.4.

196. *See id.* at 821.

197. *See* 2000 Watermark Ass'n v. Celotex Corp., 784 F.2d 1183, 1187-88 (4th Cir. 1986).

198. 680 P.2d 1148 (Alaska 1984).

199. 49 Cal. 2d 647, 320 P.2d 16(1958). *See also Tyonek Timber*, 680 P.2d at 1152.

200. *See* 49 Cal. 2d at 647, 320 P.2d at 16.

The New York Court of Appeals in *Schiavone Construction Co. v. Elgood Mayo Corp.*²⁰¹ adopted an intermediate economic loss rule similar to that outlined in *Minneapolis Society*. The court adopted Justice Silverman's dissent from the appellate decision below. Justice Silverman expressed the view that the economic ramifications of expanding tort recovery to include economic loss are so extensive and unforeseeable that expansion properly should be effected by the legislature after investigation, rather than by a court in the context of a particular case.²⁰²

In *Stuart v. Coldwell Banker Commercial Group*²⁰³ the Washington Supreme Court refused to recognize a cause of action for negligent construction. The court expressed its sympathy for the plaintiff-homeowner's association, whose property suffered from water rot due to defective woodwork. Even so, the court found that a tort remedy would "unduly upset the law on which expectations are built and business is conducted."²⁰⁴ In adopting the sudden and dangerous modification of the economic loss rule, the court particularly was concerned about the possibility that certain buyers would reap a windfall by lowering their purchase price to reflect deterioration and then suing the builder for the cost of repair.²⁰⁵

The most complete treatment of the subject appears in the South Carolina Court of Appeals' decision, *Carolina Winds Owners' Association v. Joe Harden Builder, Inc.*²⁰⁶ In *Carolina Winds* the court denied a condominium association recovery in tort against the remote builder and his surety. The opinion noted that economic interests traditionally have been protected by the law of contract, rather than tort, because tort law seeks to vindicate a person's interest in the security of his person and his estate.²⁰⁷ Defective construction does not result from a builder's failure to conform to a standard of care required by law but

201. 56 N.Y.2d 667, 436 N.E.2d 1322, 451 N.Y.S.2d 720 (1982).

202. *Schiavone Construction*, 81 A.D.2d 221, 229, 439 N.Y.S.2d 933, 938 (1981) (Silverman, J., dissenting).

203. 109 Wash. 2d 406, 745 P.2d 1284 (1987).

204. *Id.* at 418, 745 P.2d at 1290.

205. *See id.* at 421-22, 745 P.2d at 1292.

206. 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988).

207. *Id.* at 82, 374 S.E.2d at 902.

from a standard of quality imposed by contract.²⁰⁸ The court expressly rejected the position taken by the Maryland Court of Appeals in *Council of Co-Owners Atlantis Condominium, Inc. v. Whiting-Turner Contracting Co.*,²⁰⁹ which held that economic loss should be recoverable in tort for the creation of a life-threatening risk.²¹⁰ The *Carolina Winds* court found that the *Atlantis Condominium* theory was unworkable in practice and at variance with fundamental precepts of negligence theory.²¹¹

IV. CONCLUSION: A QUESTION OF QUALITY

Historically, it is clear that tort law never imposed a duty on the part of construction contractors to protect owners from economic losses arising from buildings that lose their value or require repairs. As such, any decision to extend a tort duty to construction contractors is an exercise in judicial policy-making and should be made only after weighing all competing interests and policies, as well as considering the practical impact upon litigation. Ultimately, the decision must serve the best interests of society as a whole.²¹²

The first interests to consider are those of the injured party. In the context of construction defects, the injured party is the owner of a defective building. The owner of a defective building has a contract remedy against either the seller or, if the building was constructed especially for the owner, against the contractor or architect. In contracting for purchases, owners have an opportunity to bargain for some form of warranty or guarantee to protect against the possibility that the building will not fulfill their expectations. As a practical matter, therefore, the economic loss doctrine is an obstacle only to two classes of injured owners: (1) those who failed to bargain for the contract right to be compensated for economic loss; and (2) those whose contract rights are worthless because the seller is insolvent. Because no rule of law can protect the second class while ignoring the first, the issue

208. *Id.* at 82-83, 374 S.E.2d at 902.

209. 308 Md. 18, 517 A.2d 336 (1986).

210. *See id.* at 35, 517 A.2d at 345.

211. *See Carolina Winds*, 297 S.C. at 86-88, 374 S.E.2d at 904-906 (1988).

212. *See W. PROSSER, supra* note 35, § 53, at 325-26 (characterizing duty as “the sum total of those considerations of policy which lead the law to say that the particular plaintiff is entitled to protection”).

becomes one of providing recovery in tort to those who fail to secure for themselves a remedy in contract.

The law of contract traditionally has permitted the builder to define, and thus limit, his obligations to the owner through agreement. The law of negligence creates an exception to this right of contract in the case of injury to the owner or his property. The law gives to the owner the right to be free from physical harm and imposes upon the builder the duty to protect that right. Naturally, a cost is associated with that duty: the expense of construction methods designed to secure minimum safety standards. Because the standard, protection against harm from collapse or physical danger, is objective, the cost can be ascertained and internalized in the cost of construction. This results in incrementally higher costs to the consuming public as a whole, but society should be willing to impose the duty and pay the cost because it has made a simple value choice; society values freedom from physical harm more than it values freedom of contract.

Imposing a tort duty to construct a building that will not cause *economic harm* to its owner — assuming such a duty is capable of definition — will impose an incrementally larger cost on society. This cost also will be internalized and spread among the consumers of construction services. Eliminating economic loss, therefore, is really a question of whether the consuming public as a whole should bear the cost of economic losses sustained by those who failed to bargain for adequate contract remedies. The answer to this question is “no” for three reasons. First, the owner can protect himself contractually; second, there are several practical obstacles to shifting the risk of economic losses; and third, judicial administration of a duty to prevent economic loss is difficult, if not impossible.

A. *The Myth of the Helpless Homeowner*

Because so many of the reported construction defect cases arise in the residential context, courts often have assumed a consumer protection orientation that indulges in unfounded assumptions about the need to protect innocent and helpless homeowners from the depravities of monolithic contracting corporations. This is a serious mischaracterization of the homebuilding industry, which is dominated by small, closely

held corporations and family businesses investing large amounts of borrowed capital in each project. More importantly, however, it has obscured the fact that principles developed in the residential construction context will have equal application in the highly sophisticated world of commercial and industrial construction.²¹³

The construction industry is not characterized by the unequal bargaining positions of a typical retail consumer and manufacturer. While an individual has no realistic chance of negotiating with soft drink or automobile manufacturers over the nature of the products' design, manufacture, or warranty, such is not the case in construction. In commercial construction, potential owners have considerable control over the nature of the "product" they are buying. Owners, through their architects and the process of establishing a construction budget, decide what is built and how it will be built. It is completely unlike the "take it or leave it" contract imposed by mass-marketers that prompted the courts to open new avenues of relief for the consumer.

Similarly, the purchaser of a new or "used" building is in a much better position to inspect for possible defects than the buyer of a mass-produced consumer item. Many courts that permit recovery of economic loss for construction defects have based their decision on the assumption that the average homebuyer is not competent to inspect a house for defects.²¹⁴ This assumption is questionable with regard to commercial construction, where owners and construction lenders routinely pay architects or professional inspectors to monitor compliance with design and code requirements. Similar options are available for the homebuyer who has his house custom built. Even in the case

213. Judge Rovira, dissenting in *Cosmopolitan Homes, Inc. v. Weller*, 663 P.2d 1041 (Colo. 1983), observed:

There is no principled way for this court — or any court — to limit the reasoning to the case of homebuilders; it can do so only by judicial fiat. While such line-drawing is appropriate for a legislative body — indeed that is its primary function — it is singularly inappropriate for a judicial body.

Id. at 1050.

214. See, e.g., *Cosmopolitan Homes*, 663 P.2d at 1045; *Coburn v. Lenox Homes, Inc.*, 173 Conn. 567, 575, 378 A.2d 599, 602-03 (1977); *Drexel Properties, Inc. v. Bay Colony Club Condominium, Inc.*, 406 So. 2d 515, 520 (Fla. Dist. Ct. App. 1981); *Simmons v. Owens*, 363 So. 2d 142, 143 (Fla. Dist. Ct. App. 1978); *McDonough v. Whalen*, 365 Mass. 506, 512, 313 N.E.2d 435, 438-39 (1974); *Keyes v. Guy Bailey Homes, Inc.*, 439 So. 2d 670, 671-72 (Miss. 1983).

of used housing, the importance and enormous expense of the purchase make it reasonable to expect the buyer to hire a professional house inspector.²¹⁵ In any event, the homeowner is in a position to negotiate a warranty or reduction in purchase price to reflect the risk of hidden defects. Unlike most consumer goods, price and warranty are almost always negotiable in the sale of realty. In recent years, the growth of commercial homeowner warranty programs has made protection available for latent defects at a relatively low price. Sympathy for a disappointed homeowner is just and natural, but it must be tempered with a realistic appraisal of his bargaining power and the options available to him. Moreover, sympathy cannot be allowed "to lead to the creation of a logically inconsistent and vague theory of recovery that fails to provide useful precedent."²¹⁶

B. Practical Obstacles to Loss Shifting

The basic function of tort law is to shift the burden of loss from the injured plaintiff to one who is at fault (under negligence theory) or to one who is better able to bear the loss and prevent its occurrence (under strict liability). In the mass production or distribution of products, the manufacturer is able to absorb and spread the impact of its customers' losses through insurance and incremental price increases. In the construction context, however, there are two practical obstacles to this model of loss-shifting.

The first obstacle is that as a practical matter, a construc-

215. The Ohio Supreme Court in *Mitchem v. Johnson*, 7 Ohio St. 2d 66, 218 N.E.2d 594 (1966), stated:

[R]eal estate buyers generally experience little difficulty in securing express warranties or guarantees if they are insistent. . . . [T]he purchase of real estate is invariably preceded by a lengthy period of inspection, consideration and negotiation. One does not purchase land under conditions in any way similar to the purchase of home permanent, cooking appliances, soap or electric blankets.

Id. at 71-72, 218 N.E.2d at 598 (citations omitted). *Accord* *Wright v. Creative Corp.*, 30 Colo. App. 575, 498 P.2d 1179 (1972). Similarly, the Mississippi Supreme Court noted in *Oliver v. City Builders, Inc.*, 303 So. 2d 466 (Miss. 1974), that "a purchaser may insist upon having included [in the contract of sale] any warranty or guaranty that he may desire as to buildings standing upon it, and, of course, he may refuse to purchase if the prospective vendor will not agree." *Id.* at 469.

216. See *Stuart v. Coldwell Banker Commercial Group*, 109 Wash. 2d 406, 407, 745 P.2d 1284, 1285 (1987).

tion contractor cannot obtain liability insurance against the risk of defects in his own work product.²¹⁷ Such risks routinely are excluded from the comprehensive general liability insurance policies written for construction companies. The contractor who faces a claim for defective workmanship does so alone.

The second obstacle relates to the nature of the construction bidding process. Most projects undertaken by contractors are unique, "one of a kind" buildings designed especially for a particular owner and a particular purpose. In addition, much of a contractor's work will be awarded through competitive bidding. Assuming that the law could devise a tort standard for the prevention of economic loss that would enable the builder to ascertain what to do and how much it will cost, he still would be required to make this calculation on a project-by-project basis, taking into account the owners' and subsequent owners' specific expectations. He then would have to factor those costs into his bid.

In a business where bids often are calculated by simply estimating the actual cost of construction, adding fifteen percent for profit and overhead and competing against other bids of unknown amount and composition, it is unrealistic to expect sophisticated risk evaluation and cost distribution to occur. For this reason, contractors rely heavily on their contracts to allocate and limit the risk of economic loss such as those caused by delays, defects, unforeseen conditions, and changes in design.

C. Difficulties of Judicial Administration of a Duty to Prevent Economic Loss

By far the most compelling argument against recognition of a tort duty to prevent economic harm is the difficulty in defining and administering such a duty. The function of tort law is to prescribe standards for the regulation of conduct. Therefore, the law must offer a uniform standard of conduct to which the builder can conform. This standard is relatively easy to define

217. See, e.g., *Gary L. Shaw Builders, Inc. v. State Auto. Mut. Ins. Co.*, 182 Ga. App. 220, 355 S.E.2d 130 (1987); *Sturla, Inc. v. Fireman's Fund Ins. Co.*, 67 Haw. 203, 684 P.2d 960 (1984); *Indiana Ins. Co. v. DeZutti*, 408 N.E.2d 1275 (Ind. 1980); *Century I Joint Venture v. United States Fidelity & Guar. Co.*, 63 Md. App. 545, 493 A.2d 370 (1985); *Lusalon, Inc. v. Hartford Accident & Indem. Co.*, 400 Mass. 767, 511 N.E.2d 595 (1987); *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979).

when avoidance of physical danger to persons or their property is concerned; a "reasonable builder" can be expected to know which actions may result in collapse or danger of physical harm. A standard that purports to guard against economic losses or mere "defects" is another matter altogether. It seeks, in effect, to legislate a minimum standard of *quality* by requiring the builder to construct a building that will not need unreasonable repairs. It is difficult to see how courts enforcing such a duty can define and distinguish acceptable from unacceptable conduct in construction of a building. It is easy to punish builders for creating condominiums with sagging floors; it is more difficult to define for them, in advance, the types of "defects" and the time period in which they will be liable should those defects appear.

A closely related concern is that the builder does not solely determine the quality of a building — that is, the extent to which it will remain free of defects. In most projects, the quality of a structure is determined primarily by the architect acting in concert with the owner. Working within cost restrictions established by the owner, the architect specifies materials, fixtures, electrical and mechanical systems, interior finishes, type and extent of structural bracing, and, often, particular construction methods. Frequently, the contractor is required to downgrade methods or materials in order to reduce a construction budget. Unlike the manufacturer of a power saw or a soft drink, the construction contractor is not the "father of the transaction." Yet, conventional tort law has no defense or rule that can aid the contractor or subcontractor who did only what he was told — indeed, what his contract obligated him to do.²¹⁸

Moreover, all buildings are not created equal, nor are they intended to be equal. The quality and durability of a structure are a function of the design and the budget as much as the contractor's workmanship. These factors vary from one project to

218. The Florida Court of Appeals in *Strathmore Riverside Villas Condominium Ass'n v. Paver Dev. Corp.*, 369 So. 2d 971 (Fla. Dist. Ct. App. 1979), relied on the same reasoning to deny recovery against a remote contractor under an "implied warranty" theory. The court, however, did not explain why the same reasoning would not apply equally applicable to the use of tort theories against remote parties. *See also* *Cosmopolitan Homes, Inc. v. Weller*, 663 P.2d 1041, 1049-50 (Colo. 1983) (Rovira, J., dissenting) (noting the "awkward position" of the contractor who complies with plans and specifications that create a condition desired by original owner but unacceptable to subsequent owner).

another. There is a world of difference between the reasonable expectations of a purchaser of a new \$1.5 million mansion and a purchaser of a ten-year-old wooden bungalow built for temporary use. If the respective purchasers are to be permitted to sue the builder in tort for conditions that require costly repairs, then the courts must devise a uniform standard to determine which conditions will be considered the result of unreasonably poor work and which will be seen as the result of ordinary and expected deterioration. Presently, no such standard exists. Rusty pipes in the mansion may be inexcusable and unacceptable, but in the bungalow they may be par for the course. And what of a purchaser who simply is unwilling to pay the extra cost to construct a plumbing system that would remain rust-free for ten years?

This difficulty presents the potential for an unjustified windfall to the subsequent owner, who may obtain a better bargain in tort from the contractor than the one he made in contract with the seller! The original owner may have gladly bargained for minimum standards in return for a low price, and the subsequent owner may have negotiated a still lower price from the original owner to reflect this fact. Having received his bargain, the subsequent owner should not be allowed to impose tort liability on the builder for failing to build in accordance with higher standards of care than the original owner paid for or required. A possible “windfall” is more problematic in the commercial context where the parties are presumably knowledgeable and sophisticated enough to determine quality and risk, and they adjust their bargain accordingly.

Foreseeability is not a practical mechanism for limiting or defining a tort duty to prevent economic losses. Historically, foreseeability was never intended or employed as the sole determinant of liability. Practically, it cannot serve that function. Taken literally, it would turn every breach of contract into a tort. Under what circumstances could a party breaching a contract *not* foresee that economic harm will result to the other party? Similarly, in the context of construction defects, virtually all economic harm would be foreseeable since every builder knows that repairs will be necessary if he performs his work in a “negligent” manner. With respect to the foreseeability of the class of persons affected, the concept is even less useful. For example, even among courts that have recognized a tort duty to

protect against economic loss, there is no agreement as to whether it is "foreseeable" that a structure will change ownership in the near future.²¹⁹

The proponents of foreseeability may have taken to heart Judge Cardozo's lesson on privity in *MacPherson v. Buick Motor Co.*,²²⁰ but they have missed his lesson in *Ultramares v. Touche, Niven & Co.*²²¹ Foreseeability does not solve the problem of potential unlimited liability out of proportion with the fault. It certainly is foreseeable to the builders of bridges or shopping centers that shutting down the bridge or mall to repair defects will cause business interruption and lost profits to hundreds of businesses dependent on those structures for their livelihood. If such risks are to be imposed on the builder, it is not difficult to imagine what will happen to the cost of building bridges.

This problem might be solved by a judicial fiat, such as by limiting recovery of economic losses to those with a fee interest in the building. Courts certainly have engaged in such line-drawing before.²²² Such a solution is hardly less arbitrary, however, than the distinctions drawn by a bright-line economic loss rule. The practical problems inherent in creating a tort action for economic losses²²³ are not remedied by the adoption of the sudden

219. See, e.g., *Coburn v. Lenox Homes, Inc.*, 173 Conn. 567, 573, 378 A.2d 599, 602 (because house is "generally a long-term investment," which does not "generally change owners or occupants frequently," builder "may not have reasonably been expected to anticipate a change in ownership"). But see *Cosmopolitan Homes*, 663 P.2d at 1045 ("Given the mobility of most potential home owners, it is foreseeable that a house will be sold to subsequent purchasers.").

220. 217 N.Y. 382, 111 N.E. 1050 (1916).

221. 255 N.Y. 170, 174 N.E. 441 (1931).

222. For example, in *Ryan v. New York Cent. R.R.*, 35 N.Y. 210 (1866), the New York Court of Appeals adopted a rule that a railroad that negligently starts a fire is liable in damages to the owner of property immediately adjoining the tracks but not to properties damaged as the fire spreads outward to land beyond the adjoining properties. The court's rationale simply was that the loss was an uninsurable, and potentially ruinous, risk for the railroad.

223. The present state of the economic loss doctrine in California is eloquent testimony to the difficulties in administering a tort duty to prevent economic loss. Having ruled in *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965), that economic loss is not recoverable in strict liability or negligence for product defects, the courts promptly allowed the recovery of economic loss for a poorly graded lot in strict liability in *Avner v. Longridge Estates*, 272 Cal. App. 2d 607, 77 Cal. Rptr. 633 (1969) and *Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969). Meanwhile, California courts have issued conflicting opinions on the question of

and dangerous test or by the adoption of a six-factor foreseeability test.

To their credit, the above tests do attempt to identify the relevant policy considerations at stake in a case when the plaintiff seeks to recover for damages to the work product alone. It is debatable, however, whether these two modes of analysis provide the courts with a tool to resolve upcoming cases or, instead, with another dilemma. Like many judicially crafted “tests” that attempt to convert abstract policy concerns into a step-by-step guide to decisionmaking, the sudden and dangerous test and the six-part foreseeability analysis are sufficiently pliable to enable a judge or jury to fashion any result they may desire.

Such an analysis also is of little use as a guide to govern future conduct. The goal of tort law is not only to compensate the victim for his injury, but also to deter future injury by establishing standards of conduct. If those standards can only be understood in hindsight of a jury, then the function of deterrence is lost. Additionally, the sudden and dangerous test approach adds no *deterrent* value to the traditional tort standard. Under the traditional negligence standard, the builder is subjected to liability if he creates a condition that causes physical harm to others. Builders will take no different or additional precautions if told that they will be liable for creating a condition that *might* cause physical harm to others.

A bright-line test, which denies recovery across the board when the damage sustained is solely economic, produces results that are predictable to contracting parties and are relatively simple to employ in judicial decisionmaking. Predictability and consistency of result are not the only virtues to expect in a rule of law, but they are necessary virtues. These elements are required to permit persons to govern their conduct and structure their commercial transactions, and they are necessary to ensure that adjudication is conducted in a fair and even-handed

recovering economic loss under a negligence theory. See *Sacramento Regional Transit Dist. v. Grumman Flexible*, 158 Cal. App. 3d 289, 204 Cal. Rptr. 736 (1984); *Huang v. Garner*, 157 Cal. App. 3d 404, 203 Cal. Rptr. 800 (1984); *J'Aire Corp. v. Gregory*, 24 Cal. App. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979) (allowed recovery in negligence but not in strict liability).

A federal district court reviewing the above opinions described the progression of California case law as “inexplicable.” See *Golden Eagle Distr. Corp. v. Burroughs Corp.*, 103 F.R.D. 124, 129 (N.D. Cal. 1984), *rev'd*, 801 F.2d 1531 (9th Cir. 1986).

manner.

Perhaps more than any other industry, the construction industry is "vitally enmeshed in our economy and dependent on settled expectations."²²⁴ The parties involved in a construction project rely on intricate, highly sophisticated contracts to define the relative rights and responsibilities of the many persons whose efforts are required — owner, architect, engineer, general contractor, subcontractor, materials supplier — and to allocate among them the risk of problems, delays, extra costs, unforeseen site conditions, and defects.²²⁵ Imposition of tort duties that cut across those contractual lines disrupts and frustrates the parties' contractual allocation of risk and permits the circumvention of a carefully negotiated contractual balance among owner, builder, and design professional. Indeed, the "*right* of the parties to make their own bargain as to economic risk" is impaired.²²⁶

Other avenues of relief, which do not carry the burdens and social cost of recovery in tort, are available to the owner. If the owner failed to negotiate an adequate contractual remedy in his purchase agreement, he can seek an assignment of the seller's contract rights against the builder. Such an assignment would permit the owner to shift the loss back to the builder without depriving the builder of the right to define his obligations through the contracting process. If additional protection is needed, then the legislature could impose a bonding requirement on developers of residential housing to secure performance of repair work.

Contractors, owners, and design professionals are better suited to allocate economic risks among themselves, rather than to have such risks allocated for them by a rule of law that draws no distinctions between the risks generated by a defective carpet and those generated by a defective twenty-story office building. The economic loss doctrine best protects the parties' right to

224. *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wash. 2d 406, 421, 745 P.2d 1284, 1292 (1987).

225. See *Bernard Johnson, Inc. v. Continental Constructors, Inc.*, 630 S.W.2d 365, 371 (Tex. Civ. App. 1982); *Blake Constr. Co. v. Alley*, 233 Va. 31, 35, 353 S.E.2d 724, 727 (1987) ("The parties involved in a construction project resort to contracts and contract law to protect their economic expectations.").

226. *Crowder v. Vandendeale*, 564 S.W.2d 879, 881 (Mo. 1978) (emphasis in original), *overruled on other grounds*, *Sharp Bros. Contracting Co. v. American Hoist & Derrick Co.*, 703 S.W.2d 901 (Mo. 1986).

make that allocation of risk by contract.