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Contract Law

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I. COURT LIMITS TORT REMEDIES IN CONTRACT

In *Myrtle Beach Pipeline Corp. v. Emerson Electric Co.*[1] the federal district court limited further the availability of tort remedies in breach of contract cases. The court barred a negligence claim arising from a component part's failure that resulted in substantial damage to property not owned by the plaintiff. Relying on the economic loss rule,[2] the court held that where "sophisticated parties to a commercial transaction have negotiated a contract, . . . and the product injures only itself . . . , contract law, specifically the Uniform Commercial Code, and not tort law, provides the exclusive rights and remedies of the parties."[3] The court expanded the economic loss rule's effect by defining restrictively the "other property" limit to the rule. The court held that any property not owned by the plaintiff did not constitute other property.[4] In dicta, the court provided an even more limiting definition of other property, theoretically consistent with the rationale supporting the economic loss doctrine: "[T]he 'other property' exception is not met if: . . . injury to this 'other property,' even if owned by a plaintiff, were, or should have been, contemplated by the contract."[5] *Myrtle Beach Pipeline* expands the application of the economic loss rule and limits the encroachment of tort remedies onto contract law. South Carolina courts have not addressed the economic loss rule's application in the commercial context.[6] This article will focus on

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1. 843 F. Supp. 1027 (D.S.C. 1993).

2. Economic losses include "damages for inadequate value, costs of repair, and replacement of defective goods, or for consequent loss of profits [and] generally cannot be recovered in a tort action. These losses represent the buyer's contractual expectation interest, and the buyer's remedy, if any, must be based on the product's warranty." Mark A. Kaprelian, Note, *Privity Revisited: Tort Recovery by a Commercial Buyer for a Defective Product's Self-Inflicted Damage*, 84 MICH. L. REV. 517, 518 (1985) (footnotes omitted). A majority of the states and the United States Supreme Court in *East River Steamship Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858 (1986), have endorsed the rule to bar tort claims in certain contexts. *See* Eric A. Kekel, Comment, *Oregon's Products Liability Law and the Problem Of Economic Loss*, 28 WILLAMETTE L. REV. 565, 571-78 (1992).

3. *Myrtle Beach Pipeline*, 843 F. Supp. at 1053.

4. *Id.* at 1055.

5. *Id.* at 1057.

6. The South Carolina Court of Appeals adopted the economic loss rule in *Carolina Winds Owners' Ass'n v. Joe Harden Builder, Inc.*, 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988), *overruled in part by* Kennedy v. Columbia Lumber & Mfg. Co., 299 S.C. 335, 384 S.E.2d 730 (1989). In *Carolina Winds* the court recognized that the rule would bar any recovery "[u]nless the plaintiff has contracted with a party who warrants, expressly or impliedly, that the product

the court's definition of other property and not on the rule's general applicability.[7]

Plaintiff Myrtle Beach Pipeline Corporation (Myrtle Beach), a conglomeration of corporations and their insurers, supplied and stored fuel for the United States government at Myrtle Beach Air Force Base. Myrtle Beach contracted with the government to install a fuel metering system, and hired Gonzalo Anciro (Anciro) to design the system. Anciro recommended that a subsidiary of defendant Emerson Electric Company (Emerson) supply the air eliminator necessary for the metering system.[8]

In the parties' contract for the air eliminator, Emerson expressly disclaimed all implied warranties, including the warranty of merchantability, and limited any remedy to repair or replacement of the defective part.[9] Emerson sold the part to Myrtle Beach for $1,145. The part failed, spilling fuel onto the air base. Myrtle Beach eventually settled the dispute with the government for $80,000 and, more substantially, agreed to bear the costs of cleaning up the 123,000 gallons of spilled fuel.[10] Myrtle Beach brought this action seeking to recover its costs of the settlement under theories of strict liability, negligence, breach of implied warranty, and violation of the South Carolina Unfair Trade Practices Act.[11] The first district judge[12] granted the defendant's motions for partial summary judgment on the unfair trade practices and the strict liability claims. In this opinion, the court granted defendant Emerson summary judgment on the breach of implied warranty and negligence claims.[13]

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meets a standard of quality, value, or fitness for an intended use . . . ." *Carolina Winds Owners' Ass'n,* 297 S.C. at 82, 374 S.E.2d at 902. The South Carolina Supreme Court later limited the rule's application holding that the "'economic loss' rule will still apply where duties are created *solely* by contract." *Kennedy,* 299 S.C. at 347, 384 S.E.2d at 737 (emphasis in original) (footnote omitted).

South Carolina courts never have addressed the economic loss rule's application in the commercial context. *See* Kershaw County Bd. of Educ. v. United States Gypsum Co., 302 S.C. 390, 393, 396 S.E.2d 369, 371 (1990). However, the Fourth Circuit has embraced the rule's application in the commercial context. *E.g., Laurens Elec. Coop., Inc. v. Altec Indus., Inc.*, 889 F.2d 1323 (4th Cir. 1989); *2000 Watermark Ass'n v. Celotex Corp.*, 784 F.2d 1183 (4th Cir. 1986); *Purvis v. Consol. Energy Prods. Co.*, 674 F.2d 217 (4th Cir. 1982).

7. The South Carolina courts have not addressed the "other property" issue as it relates to ownership of the injured property.

8. *Myrtle Beach Pipeline,* 843 F. Supp. 1031-32.

9. *Id.* at 1031-32.

10. *Id.* at 1032.

11. *Id.* at 1032.

12. The case was transferred to Judge Traxler as part of the judge's beginning caseload. *Id.* at 1032 n.1.

13. *Myrtle Beach Pipeline*, 843 F.Supp. at 1065-66.

Having determined that South Carolina law applied,[14] the court turned to the contract claims. The court found that the implied warranties were expressly disclaimed and that the express warranty limited plaintiff's recovery to repair and replacement. Because of the parties' limited remedy provision, the plaintiff could not recover the clean-up costs.[15]

The court barred the negligence claims after a detailed analysis of the economic loss rule's applicability in South Carolina. The court began with a discussion of the rule's adoption by the Supreme Court in *East River Steamship Corp. v. Delaval Inc.*,[16] which held that a defendant had no duty to prevent a product from injuring itself.[17] Thus, when a product's failure did not cause damage to a person or other property, the plaintiff could not recover in tort. The *Myrtle Beach Pipeline* court discussed the Supreme Court's justification of this ruling. Tort law concerns safety while contract law addresses products' failures to perform as warranted.[18] In the realm of contract, the parties are free to allocate risk however the parties desire. The tort concern for safety is diminished when the product has injured itself and not other persons or property; parties' freedom to allocate risk is paramount. Where the parties have allocated that risk, the court reasoned, tort law should not reassign the risk.[19]

Having discussed the Supreme Court's interpretations of the rule, the court then traced its adoption in South Carolina.[20] The court noted that although the South Carolina courts have not addressed the rule in the commercial context, case law recognizes the rule in the consumer arena.[21] In *Carolina Winds,* the South Carolina Court of Appeals adopted the economic loss rule.[22] Later, in *Kennedy*, the supreme court expressed its reservations to the economic loss rule's wide application but noted that where duties are grounded solely in contract, the rule would bar tort claims if the product injures only itself.[23]

Because the South Carolina courts had not addressed the rule's application in the commercial context, the court explored the rule's application by the Fourth Circuit Court of Appeals,[24] concentrating on the cases *Purvis*, *2000 Watermark*, and *Laurens*.

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14. *Id.* at 1032-34.
15. *Id.* at 1035-48.
16. 476 U.S. 858 (1986).
17. *Id.* at 871.
18. *Myrtle Beach Pipeline*, 843 F. Supp. at 1049.
19. *Id.* at 1048-49.
20. *Id.* at 1050-51.
21. *Id.* at 1050-51.
22. *See supra* note 6.
23. *See supra* note 6.
24. *Myrtle Beach Pipeline*, at 1051-56.

The court began with a discussion of *Purvis*. In *Purvis* the Fourth Circuit applied the economic loss rule to bar the tort claim because the plaintiff's loss resulted from mere product ineffectiveness.[25] The *Myrtle Beach Pipeline* court noted that the *Purvis* court based its application of the rule on the parties' ability to define contractually their own rights and remedies.[26] Interference by the courts would give one party a better bargain.[27] The Fourth Circuit noted further that a court had a duty to enforce bargains as written because parties had already allocated risk to maximize their own gain from the transaction.[28]

In *2000 Watermark* the Fourth Circuit addressed the rule's application where property other than the product itself had been injured.[29] The court reaffirmed the rule's application as defined in *Purvis*, noting further that were the rule not applied, the legislature's adoption of the Uniform Commercial Code warranty disclaimer provisions would be undermined.[30] More importantly, *2000 Watermark* defined other property as property whose injury, if the product failed, was not contemplated by the parties.[31] The Fourth Circuit's definition, rejecting a literal interpretation of other property, remains consistent with *Purvis*' concern of noninterference with the parties' allocation of risk.

Myrtle Beach Pipeline next addressed *Laurens,* which similarly recognized the economic loss rule's application in a commercial context where the product's failure injured only itself.[32] In that case the Fourth Circuit further stressed the inappropriateness of a court reallocating risk for sophisticated parties in a commercial transaction.[33] The Fourth Circuit noted that tort law deals with the concern for the individual consumer, but such a concern has no place in the commercial world where self-protection and allocation of risk occur.[34]

In light of these decisions, the *Myrtle Beach Pipeline* court found that "if sophisticated parties to a commercial transaction have negotiated a contract, . . . and the product injures only itself and not other property belonging to the plaintiff, . . . contract law, specifically the Uniform Commercial Code, and

25. *Purvis,* 674 F.2d at 223.

26. *Myrtle Beach Pipeline,* 843 F. Supp. at 1051 (citing *Purvis,* 674 F.2d at 222).

27. *Id.*

28. *Id.* (citing *Purvis* 674 F.2d at 222).

29. *2000 Watermark,* 784 F.2d at 1183.

30. *Id.* at 1186.

31. *See Myrtle Beach Pipeline,* 843 F. Supp. at 1052 (citing *2000 Watermark,* 784 F.2d at 1187-88).

32. *Laurens,* 889 F.2d at 1323.

33. *Id.* at 1326.

34. *Id.*

not tort law, provides the exclusive rights and remedies of the parties."[35] The court noted the parties' ability to protect their own interests and the absence of personal injury. The court based its holding on the South Carolina courts' adoption of the economic loss rule where rights were solely contractual, a desire to avoid undermining the legislature's adoption of warranty disclaimer provisions, and the parties' bargain. The court held that the loss was economic and that Myrtle Beach's claim was barred because the other property injured, the base, did not belong to Myrtle Beach.[36] Thus Myrtle Beach's remedy remained entirely contractual.

Having relied on Myrtle Beach's lack of ownership, the court proceeded to discuss further the "other property" exception to the economic loss rule.[37] The court held that the economic loss rule would bar recovery of injury to property other than the product itself when the injury to the other property was, or should have been, contemplated by the parties' contract.[38] The court further based its definition of other property on the realities of commercial transactions: The failure of the product to perform as expected is not beyond the comprehension of the parties, and any loss that is a foreseeable result of that product's failure should not be recoverable in tort.[39] The parties' contract allocates the risk of this loss.

The court then rejected a public policy exception to the economic loss rule.[40] The court rejected also plaintiff's indemnification claims, holding that a plaintiff could not recover through indemnification where no underlying tort or contract claim existed.[41]

The court correctly barred plaintiff's recovery because the cleanup costs did not constitute other property. In holding that Myrtle Beach could not recover for damage to property not owned by Myrtle Beach, the court relied on a number of cases that did not specifically address the issue of recovery where plaintiff did not own the other injured property.[42]

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35. *Myrtle Beach Pipeline,* 843 F. Supp. at 1053.

36. *Id.* at 1056.

37. *Id.* at 1056-62.

38. *Id.* at 1057.

39. *Id.*

40. *Myrtle Beach Pipeline*, 843 F. Supp. at 1061-62. The plaintiff argued that, in light of the huge environmental hazard caused by the air eliminator's failure, the economic loss rule should not arbitrarily bar tort recovery. The court rejected this contention specifically, citing *Public Service Enterprise Group, Inc. v. Philadelphia Electric Co.*, 722 F. Supp. 184 (D.N.J. 1989), where the New Jersey District Court refused to recognize a public policy exception to the economic loss rule when the economic damages were caused by nuclear material.

41. *Myrtle Beach Pipeline*, 843 F. Supp. at 1063-65.

42. The court relied on several cases that state that the plaintiff owned the other injured property; however, the plaintiff's ownership of the other property was not at issue in those cases. *Laurens*; *Purvis*; *Neibarger v. Universal Coops, Inc.*, 486 N.W.2d 612 (Mich. 1992); and *Carolina Winds Owners' Ass'n.* Myrtle Beach also relied on *Tourist Village Motel, Inc. v.*

In *Cooley v. Salopian Industries, Ltd.*,[43] the plaintiff purchased poultry equipment from the defendant. When the equipment failed, the plaintiff sought recovery in contract and in tort. The South Carolina District Court held that any claims in strict liability were barred.[44] The court held that strict liability "requires an allegation of damages 'for physical harm thereby caused [by the product in a defective condition unreasonably dangerous] to the ultimate user or consumer or to his property . . . .'"[45] The court stressed that no other property was injured, and thus, the economic loss rule barred recovery in strict liability.[46]

The *Myrtle Beach Pipeline* court relied also on *Held v. Mitsubishi Aircraft International, Inc.*,[47] which addressed the "other property" issue. In *Held*, the plaintiff purchased an airplane from defendant who disclaimed numerous warranties and limited plaintiff's remedies in the event of the airplane's failure. The plane was destroyed in a crash, and the plaintiff sought to recover, among other things, the cost of settlement of a suit brought by a passenger against the plaintiff.[48]

The court held that the plaintiff could not recover the cost of the settlement because the plaintiff's claim was barred by the economic loss rule.[49] The court rejected the plaintiff's arguments that other persons (the passengers) were injured, which would negate the rule's bar of a claim under a strict liability theory.[50] In *Held,* the court relied on *Cooley* and the language of *Restatement* § 402A to reach its holding.

Myrtle Beach argued that the court's "other property" definition did not harmonize with *City of Greenville v. W.R. Grace & Co.*[51] In that case the Fourth Circuit permitted the city to recover economic losses from an asbestos manufacturer. The *Myrtle Beach Pipeline* court distinguished *City of Greenville* on a number of grounds.[52]

Massachusetts Eng'g Co., 801 F. Supp. 903 (D.N.H. 1992), which does not address the ownership distinction.

43. 383 F. Supp. 1114 (D.S.C. 1974).

44. *Id.* at 1119.

45. *Cooley*, 383 F. Supp. at 1119 (alterations in original) (quoting RESTATEMENT (SECOND) OF TORTS § 402A (1965)). The *Restatement* and the comment have been enacted by South Carolina's legislature. S.C. CODE ANN. § 15-73-10 to -30 (Law. Co-op. 1977).

46. *Id.* at 1119.

47. 672 F. Supp. 369 (D. Minn. 1987).

48. *Id.* at 372-73.

49. *Id.* at 374.

50. *Id.* at 376-77. The court refused to carry the rationale to the negligence claim because the Minnesota Supreme Court did not apply the economic loss rule in negligence cases. *Id.* at 377.

51. 827 F.2d 975 (4th Cir. 1987).

52. First, the court noted that the plaintiff in *City of Greenville* owned the damaged property, whereas Myrtle Beach did not own the air strips. Second, the defendant in *City of Greenville*

Cooley and *Held* rely heavily on the *Restatement*, which has been interpreted by the courts as barring recovery of economic loss in strict liability. Courts rely on the *Restatement* language permitting recovery in strict liability for damage to the plaintiff or to the plaintiff's property.[53] The courts interpret this language as precluding recovery for damage to the product itself.[54] However, the comments to the *Restatement,* which have been enacted by the South Carolina Legislature,[55] do not necessarily dictate this result:

> The rule stated in this Section is not governed by the provisions of . . . the Uniform Commercial Code, as to warranties; and it is not affected by limitations on the scope and content of warranties, or by limitation to 'buyer' and 'seller' in those statutes . . . The consumer's cause of action . . . is not affected by any disclaimer or other agreement . . . .[56]

Thus, the conclusion by the *Myrtle Beach Pipeline* and other courts that the *Restatement* dictates the economic loss rule's bar does not necessarily follow from the section.

Although the court's holding may not square with the comments to the *Restatement (Second) of Torts* § 402A, it does conform to prior courts' interpretations of the section. Further, the court's more restrictive dicta definition of other property is theoretically sound. *Myrtle Beach Pipeline* adopted the economic loss rule in the commercial context to protect commer-

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knowingly sold a dangerous product. Third, asbestos is an inherently dangerous product, but an air eliminator is not. Fourth, in *City of Greenville* grave personal injury was involved, and in the present case only property damage occurred. Fifth, the court in *City of Greenville* concluded that the parties would not have shifted the loss onto the plaintiff, as application of the economic loss rule would have done. Finally, *City of Greenville* was decided on its particular facts. *Myrtle Beach Pipeline*, 843 F.Supp. at 1056.

Without discussing the sufficiency of the court's distinctions, it should be noted that courts often apply the economic loss rule differently in asbestos litigation. *East Mississippi Electric Power Ass'n v. Porcelain Products Co.*, 729 F. Supp. 512 (D.D. Miss. 1990), noted the tendency of courts to apply the economic loss rule sparingly in asbestos cases. The court then held the economic loss rule barred plaintiff's tort claims. Other cases have permitted plaintiffs to assert tort claims. *E.g.*, Tioga Pub. Sch. Dist. No. 15 v. United States Gypsum Co., 984 F.2d 915 (8th Cir. 1993); Hebron Pub. Sch. Dist. No. 13 v. United States Gypsum Co., 690 F. Supp. 866 (D.N.D. 1988); Town of Hooksett Sch. Dist. v. W.R. Grace & co., 617 F. Supp. 126 (D.N.H. 1984).

53. The *Restatement* provides: "One who sells any product in a defective condition . . . is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property . . . ." RESTATEMENT (SECOND) OF TORTS § 402A (1965).

54. *E.g. Held*, 672 F.Supp. at 377.

55. S.C. CODE ANN. § 15-73-30 (Law. Co-op. 1976).

56. RESTATEMENT (SECOND) OF TORTS § 402A cmt. m (1965).

cial parties' allocation of risk and to recognize the commercial sophistication of the parties.

Other courts also have emphasized a need to respect the legislature's adoption of the Uniform Commercial Code and its limited warranty provisions. For example, *Neibarger v. Universal Coops.*[57] discussed these benefits of the economic loss rule. In *Neibarger*, the plaintiff sued in tort to recover for damages to his cows resulting from a defect in a milking system designed and sold by the defendants. The court denied tort recovery because "[a] contrary holding would not only serve to blur the distinction between tort and contract, but would undermine the purpose of the Legislature in adopting the [Uniform Commercial Code]."[58] The court further recognized that the "adoption of the economic loss doctrine will allow sellers to predict with greater certainty their potential liability for product failure and to incorporate those predictions into the price or terms of the sale."[59]

Ringer v. Agway, Inc.[60] addressed similar issues. *Ringer* denied recovery to a plaintiff whose farmland, crop, and farm machinery were injured by defective seeds purchased from defendant. The court denied recovery because plaintiff suffered only "disappointed commercial expectations."[61] The court emphasized that permitting a plaintiff to recover would "disrupt the expectations of the parties by supplanting their agreement by allowance of tort recovery, which raises the possibility of potentially unlimited liability."[62]

The federal court's decision in *Myrtle Beach Pipeline* recognizes the South Carolina courts' limited adoption of the economic loss rule[63] and anticipates the South Carolina court's expansion of that rule in a way that respects the South Carolina Legislature's enactment of the Uniform Commercial Code.

In *Myrtle Beach Pipeline*, the court restrictively defined other property, damage to which bars application of the economic loss rule and permits recovery in tort. The court correctly respected the parties' rights to contract

57. 486 N.W.2d 612 (Mich. 1992).

58. *Neibarger*, 486 N.W.2d at 618.

59. *Id.* at 619.

60. 13 U.C.C. Rep. Serv. 2d (Callaghan) 114 (E.D. Pa. 1990).

61. *Id.* at 121.

62. *Id.* (quoting *Public Serv. Ent. Group., Inc.* 722 F. Supp. at 196).

63. In *Carolina Winds Owners' Ass'n*, the South Carolina Court of Appeals adopted the economic loss rule, noting that the rule "simply observes the traditional distinction between recovery in contract and recovery in negligence in those cases where the damage consists of a diminution in the expected value of a product." *Carolina Winds Owners' Ass'n*, 297 S.C. at 82, 374 S.E.2d at 902. The court also observed that "the risk to the expectancy interest can be fairly allocated by agreement of the parties to the sale. To protect himself, the purchaser may either take warranties, bargain for a lower price, or insure the risk." *Id.* Later, in *Kennedy*, the court restricted the rule's use to situations "where duties are created *solely* by contract." *Kennedy*, 299 S.C. at 347, 384 S.E.2d at 737. That case, however, involved the negligence of a builder where other legal duties, besides contractual, may have been breached.

freely and the legislature's actions to facilitate free agreement through the enactment of the Uniform Commercial Code. Both concerns previously encouraged the South Carolina courts to adopt the economic loss rule in *Carolina Winds Owners' Ass'n.*[64]

Rachel Scott Decker

64. *Carolina Winds Owners' Ass'n,* 297 S.C. at 74, 374 S.E.2d at 897.