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THE ECONOMIC LOSS RULE AND DAMAGE ASSESSMENT

By Brad C. Friend

Understanding the Economic Loss Rule is essential for contractors and their lawyers. Although the legal doctrine has gone through many adaptations and is riddled with exceptions among various jurisdictions, the Economic Loss Rule is a very common defense used by Owners, Architects and Contractors in litigation. At its core, the Economic Loss Rule stands for the principle that a party cannot recover in tort for solely economic loss (*i.e.* pecuniary or contract expectation losses).

The doctrine is often raised as a defense where a plaintiff attempts to turn a simple breach of contract cause of action into a tort cause of action. Indeed, one of the underlying purposes of the Economic Loss Rule is to keep the legal spheres of contracts and torts distinct. In many cases, the applicability of the Economic Loss Rule is critical because parties involved in a construction project may not be in contractual privity and, thus, a party's only possible remedy is a tort cause of action.

The Economic Loss Rule focuses on the damages/losses at issue (although some courts have engaged in a contract duty vs. tort duty analysis). If a plaintiff's damages are solely economic loss, as opposed to personal injury or property damage, then the Economic Loss Rule would prevent the plaintiff from recovering in a tort cause of action such as negligence. Accordingly, a "damage assessment" – in terms of understanding what kind of damages are stricken by the Economic Loss Rule – is crucial in determining if a contractor has a viable tort claim.

The recent case of *AIU Insurance Co. v. Omega Flex, Inc.*, 2011 WL 2295270 (W.D.Va. June 9, 2011) is a good illustration of the parameters of the Economic Loss Rule. In *AIU*, the plaintiff insurer sued a manufacturer of steel tubing used for natural gas lines. The manufacturer's steel tubing was installed in the insured's residence by a contractor hired by the insured. One evening, lightning struck near the residence causing an electricity arc and hole in the steel tubing. The natural gas escaped from the steel tubing and ignited a fire which caused significant damage to the insured's real and personal property.

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In *AIU*, the manufacturer raised the Economic Loss Rule as a defense to the plaintiff insurer's negligence claim. However, the court held that the Economic Loss Rule was inapplicable because the damages at issue were "property damage" – not solely economic loss. The court noted that the plaintiff did not merely complain about the inability of the steel tubing to attain some preconceived notion of performance or quality, but rather the plaintiff alleged substantial consequential damage to other property. The court reasoned that the Economic Loss Rule was not applicable because the plaintiff's damages were for injury to property that was not the subject of any contractual obligation. The only economic loss that was unrecoverable in tort was the damage to the steel tubing itself.

Pursuant to the Economic Loss Rule, owners, contractors, and their lawyers should assess the damages at issue prior to initiating litigation to determine if a viable tort claim exists. Depending upon what side of the Economic Loss Rule a party is on, a party will want to characterize the damages at issue as being the defective work/product itself or being damage to *other* property.

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