A GUIDE TO UNDERSTANDING THE ECONOMIC LOSS DOCTRINE

Jeffrey L. Goodman, Daniel R. Peacock** & Kevin J. Rutan****

ABSTRACT[1]

The economic loss doctrine prevents a party who suffers only economic damages from recovering those damages in tort. The doctrine reasons that contract law—not tort law—provides the appropriate avenue for recovery when there is no personal injury or physical injury to property. Accordingly, the doctrine serves to define the boundaries between tort and contract law. It also acts as a powerful tool for limiting a defendant's liability and reducing the avenues of recovery for a plaintiff.

The doctrine is recognized and applied in various fashions across the United States. However, the doctrine's application is not uniform, with different jurisdictions adopting different approaches, exceptions, and limitations. As a result, judges, lawyers, and legal scholars struggle to track the doctrine's meaning, application, and scope within their jurisdiction. This Article seeks to provide a

* Jeffrey L. Goodman is the founder of Goodman Law, P.C. in West Des Moines, Iowa and a 1985 graduate of Drake Law School. Mr. Goodman is a National Board of Trial Advocacy Certified Civil Trial Advocate and a member of the American Board of Trial Advocates. Mr. Goodman has over 30 years of experience litigating cases ranging from $20,000 to $40 million. Mr. Goodman currently serves on the Federal Judicial Selection Committee, which interviews and evaluates candidates for judicial vacancies on the U.S. District Courts for the Northern and Southern Districts of Iowa and the Eighth Circuit Court of Appeals. Mr. Goodman also serves as an elected Commissioner on the State Court Judicial Nominating Commission which is responsible for nominating Justices and judges to fill the vacancies on the Iowa Supreme Court and the Iowa Court of Appeals.

** Daniel Peacock graduated from Drake Law School in 2017 with High Honors. While at Drake, Mr. Peacock served as an Articles Editor for the *Drake Law Review*, competed as a member of the ABA NAAC Moot Court Team, and co-founded the Corner of Justice.

*** Kevin Rutan graduated from Drake Law School in 2014 with High Honors and was awarded the Davis, Brown, Koehn, Shors & Roberts, P.C. Award of Excellence. Mr. Rutan is a member of the Drake Law chapter of the Order of the Coif. He is also a member of the American Homebrewers Association and the American and Polk County Bar Associations.

1. This Article is not intended to be an advocacy publication nor does it necessarily reflect the personal or professional views of the Authors, Goodman Law, P.C., or the law firm's clients. It is intended to inform lawyers, judges, scholars, and the public on an important legal issue.

practical guide for understanding the doctrine, analyzing both the function of the various approaches taken and the rationale behind each approach. First, the Article provides a brief introduction to the economic loss doctrine, discussing its basic function and key terms. Second, the Article delves into the doctrine's history and explores the reasoning behind the doctrine's creation. Lastly, the Article examines the doctrine's modern application and the various approaches utilized by different jurisdictions.

TABLE OF CONTENTS

I. The Economic Loss Doctrine: A Brief Introduction 2
II. Economic Damages 9
  A. Direct Economic Damages 9
  B. Consequential Economic Damages 10
  C. Expectation Damages 11
III. The History of the Economic Loss Doctrine 12
IV. Modern Application of the Economic Loss Doctrine 16
  A. The Majority Rule: Followed by 28 States 16
    1. Privity of Contract 21
    2. Summary of Majority Rule 25
  B. The Intermediate Rule: Followed by 17 States 27
    1. Dangerous Defect Exception 27
    2. Disappointed Expectations Test 29
    3. The Independent Duty Rule 31
    4. Summary of Intermediate Rule 32
V. The Other Property Exception to the Economic Loss Doctrine 34
VI. The Integrated System Theory 37
  A. The Integrated System Theory and Construction Defects 42
  B. Summary of the Integrated System Theory 48
VII. Exploitation Theory 49
  A. The Consumer Exception 51
VIII. Conclusion 55

I. THE ECONOMIC LOSS DOCTRINE: A BRIEF INTRODUCTION

The economic loss doctrine prevents a party who suffers only economic loss from recovering damages under a tort theory, such as negligence or strict liability.[2] Economic loss refers to the monetary damages that would be

2. *See* Annett Holdings, Inc. v. Kum & Go, L.C., 801 N.W.2d 499, 503 (Iowa 2011)

recoverable in a normal contract suit, as opposed to physical damages to person (personal injury) or property that are only recoverable in a tort suit.[3] Pecuniary damages such as lost profits, damages related to the cost of repair and replacement of a defective product, and delay damages are all examples of economic loss.[4] Personal injury and property damage are noneconomic losses, and contract law provides no basis for recovery in either.[5] Instead, tort law is the correct avenue for recovering personal injury and property damages.

The purpose of the economic loss doctrine is to delineate the boundaries between contract and tort law.[6] By preventing a plaintiff from recovering in negligence when the plaintiff suffers only economic loss, the doctrine preserves the important distinction between contract and tort law.[7]

Tort and contract claims are the two basic theories of recovery relied on by plaintiffs in the U.S. legal system.[8] Duties under tort law are created when either a legislative body or the judiciary decides that one person owes

("As a general proposition, the economic loss rule bars recovery in negligence when the plaintiff has suffered only economic loss." (citing Neb. Innkeepers, Inc. v. Pittsburgh–Des Moines, Corp., 345 N.W.2d 124, 126 (Iowa 1984))).

3. *See* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 873 (9th Cir. 2007).

4. *Id.* at 878 (quoting Calloway v. City of Reno, 993 P.2d 1259, 1263 (Nev. 2000), *overruled on other grounds by* Olson v. Richard, 89 P.3d 31 (Nev. 2004)).

5. *See Neb. Innkeepers, Inc.*, 345 N.W.2d at 126 ("The well-established general rule is that a plaintiff who has suffered only economic loss due to another's negligence has not been injured in a manner which is legally cognizable or compensable." (citing Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303, 309 (1927), *superseded by statute*, Oil Pollution Act of 1990, Pub. L. No. 101-380, 104 Stat. 484; Gen. Foods Corp. v. United States, 448 F. Supp. 111, 112 (D. Md. 1978))).

6. *See* E. River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 866–70 (1986) (illustrating the rationale behind the doctrine).

7. *See Annett Holdings, Inc.*, 801 N.W.2d at 503; *see also* RESTATEMENT (SECOND) OF TORTS § 901 (AM. LAW INST. 1979). Tort law functions to put a person in the position they would have been before the tort was committed. RESTATEMENT (SECOND) OF TORTS § 901 cmt. a. Tort law further seeks to punish wrongdoers and to deter future wrongful conduct. *Id.* § 901(c). On the other hand, contract law is designed to put a person in the place they would have been had the contract been performed. *See* Magnusson Agency v. Pub. Entity Nat'l Co.-Midwest, 560 N.W.2d 20, 27 (Iowa 1997) ("'[B]enefit-of-the-bargain' damages are intended to provide a sum of money that will put the non-breaching party in the position that he or she would have been if the contract had not been breached.").

8. *See* J. Brandon Sieg, Note, *Tort, Not Contract: An Argument for Reevaluating the Economic Loss Rule and Classifying Building Damage as "Other Property" When It Is Caused by Defective Construction Materials*, 53 WM. & MARY L. REV. 275, 282 (2011).

a duty to another person.[9] If a person breaches his or her duty to another and causes damages, then a tort may have been committed.[10] On the other hand, in contractual disputes, a legislative body or the judiciary does not generally create the duties the parties owe to one another.[11] The duties owed by the various parties—i.e. a property owner, consumer, purchaser, contractor, product manufacturer, supplier, etc.—are primarily created by contracts or warranties.[12] There are duties created by statute, common law, or industry standards that may apply to certain contracts, but generally, when a contract exists, these noncontractual duties will be excluded either by explicit language in the contract or by their implicit inclusion in the duties created by the contract.[13]

While the economic loss doctrine's general purpose is to serve as the dividing line between contract and tort law, its more narrow purpose is to prevent the "tortification" of contract law.[14] In a typical case involving the

9. John C.P. Goldberg, *Tort Law at the Founding*, 39 FLA. ST. U. L. REV. 85, 86–87 (2011) ("[T]ort law identifies *duties* that individuals owe to others.").

10. *See, e.g.*, Engstrom v. State, 461 N.W.2d 309, 315 (Iowa 1990) ("A fundamental principle of tort law is that violation of a legal right by a wrongdoer is a prerequisite to obtain redress for a claimed wrong. Thus, it is necessary to show a duty owed the injured party by the wrongdoer, and a violation of that duty." (citing Seeman v. Liberty Mut. Ins. Co., 322 N.W.2d 35, 37 (Iowa 1982); Wilson v. Nepstad, 282 N.W.2d 664, 667 (Iowa 1979))).

11. Sieg, *supra* note 8, at 279 ("Building construction often relies on a plethora of interrelated contracts, subcontracts, and sub-subcontracts, especially in the context of commercial construction projects." (citing CONSTR. SPECIFICATIONS INST., THE PROJECT RESOURCE MANUAL §§ 3.3.5 to 3.4 (5th ed. 2005))).

12. *Id.* at 279–80.

13. Parties to contracts also take on implied duties by the act of entering into a contract, as explained by the Iowa Supreme Court:

> A contract imposes upon each party a duty of good faith in its performance and enforcement. Bad faith in negotiations of a contract may result in the imposition of sanctions, such as invalidation of the contract if fraud and duress are shown. Additionally, tort remedies may be available for bad faith negotiations. We believe the Restatement position is sound in implying a duty of good faith only in the performance and enforcement of a contract.

Engstrom, 461 N.W.2d at 314 (citing RESTATEMENT (SECOND) OF CONTRACTS §§ 205, 205 cmt. c (AM. LAW INST. 1981)).

14. *See* Annett Holdings, Inc. v. Kum & Go, L.C., 801 N.W.2d 499, 503 (Iowa 2011); *see also* E. River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 866 (1986) ("It is clear, however, that if this development were allowed to progress too far, contract law would drown in a sea of tort.").

economic loss doctrine, the only obligations the parties owe to each other exist because of contract law or, in the case of products, because of an express or implied warranty.[15] However, if the contracted-for purchase or the performance of a product disappoints the purchaser, the purchaser may still seek both contract and tort remedies despite suffering no personal injury or property damage.[16] The damages the purchaser/plaintiff can legally obtain will vary depending upon the significant distinctions between the remedies available for tort and contract claims.[17] Contract claims generally limit a party's liability only to those damages that were reasonably foreseeable or actually contemplated by the parties at the time they entered into their contract or warranty, whereas a tort cause of action can provide a much broader panoply of damages.[18] A cause of action based on tortious conduct will expand a defendant's liability to include all harm proximately caused by the defendant's conduct.[19] Because of this difference in remedies, a plaintiff typically pleads contract and tort claims in borderline cases where the loss suffered is economic in nature but the facts are such that the plaintiff

15. *See* Lesiak v. Cent. Valley Ag Coop., Inc., 808 N.W.2d 67, 81 (Neb. 2012); *see also E. River S.S. Corp.*, 476 U.S. at 868–70; Seely v. White Motor Co., 403 P.2d 145, 151–52 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014).

16. For example, in *Determan v. Johnson*, the plaintiff purchased a home and signed a contract, acknowledging that she had inspected the home and was buying the home "in its existing condition." 613 N.W.2d 259, 260 (Iowa 2000). Five years later, the plaintiff discovered that the roof was sagging and sued the seller of the home in tort, asking for "repair costs, loss of use, inconvenience, emotional distress, and mental pain and suffering." *Id.* at 260–61.

17. *See* Kuehl v. Freeman Bros. Agency, Inc., 521 N.W.2d 714, 718 (Iowa 1994) ("Distinct from the general rule for damages based on commitment of a tort, damages based on breach of a contract must have been foreseeable or have been contemplated by the parties when the parties entered into the agreement." (citing Meyer v. Nottger, 241 N.W.2d 911, 920 (Iowa 1976); Hadley v. Baxendale (1854) 156 Eng. Rep. 145; 25 C.J.S. *Damages* § 80 (1966))); R.E.T. Corp. v. Frank Paxton Co., 329 N.W.2d 416, 420–21 (Iowa 1983) ("[D]amages [that] were reasonably contemplated by the parties at the time of entering into the agreement are recoverable for a breach . . . ." (quoting 25 C.J.S. *Damages* § 80)).

18. *See* Alejandre v. Bull, 153 P.3d 864, 874 (Wash. 2007) (Chambers, J., concurring) ("Tort remedies are often, perhaps always, significantly larger than contract remedies."); Grams v. Milk Prods., Inc., 699 N.W.2d 167, 171 (Wis. 2005) ("Tort law generally offers a 'broader array' of damages than contract.").

19. Banks McDowell, *Foreseeability in Contract and Tort: The Problems of Responsibility and Remoteness*, 36 CASE W. RES. L. REV. 286, 286–88 (1985–1986).

can argue a tort has been committed.[20] The plaintiff's goal is to obtain the expanded remedies available through torts.[21]

Contracts solely provide the limited remedies spelled out in their terms and conditions.[22] Tort causes of action can provide more remedies or, in some circumstances, a lower burden of proof. A claim for tort damages in a contractual dispute can also surprise a defendant who likely thought he or she had entered into a relationship with a limited amount of liability governed solely by the terms of a contract or warranty. In certain cases, this surprise, or fear of incurring more liability than what was initially bargained for, can be used to leverage a better settlement for the consumer. Even if the defendant is confident the consumer's tort claim would not survive summary judgment, the defendant knows it will cost a substantial amount of money to get to the summary judgment stage of litigation. Therefore, the defendant might be willing to pay to avoid litigating such time-consuming and expensive allegations.[23]

Whether a plaintiff is justified in pleading contract and tort claims together is an issue to be decided on a case-by-case basis, but the fact is, there are plaintiffs who plead tort claims when they have only suffered economic damages. Courts devised the economic loss doctrine to prevent the litigation of tort claims when the only losses suffered are economic in nature.[24] By preventing a plaintiff from recovering in tort for purely economic loss, the doctrine protects the right to allocate economic risks in contract.[25] In other

20. *See Determan*, 613 N.W.2d at 262 (quoting Nelson v. Todd's Ltd., 426 N.W.2d 120, 123 (Iowa 1988)) ("The line between tort and contract must be drawn 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.").

21. *See* Sieg, *supra* note 8, at 293–94.

22. *See* All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 866 (7th Cir. 1999) ("The function of the economic-loss doctrine in confining contract parties to their contractual remedies is particularly well illustrated by cases involving product warranties . . . .").

23. *See, e.g.*, Lawrence M. Spizman, *The Defense Economist's Role in Litigation Settlement Negotiations*, J. LEGAL ECON., Fall 1995, at 57, 57–65 (discussing how the expense of litigation and the inherent risks associated therewith can influence a defendant's willingness to settle).

24. *See* Annett Holdings, Inc. v. Kum & Go, L.C., 801 N.W.2d 499, 503–04 (Iowa 2011).

25. *See id.* at 504.

words, transacting parties are limited to pursuing only the contractual remedies they bargained for in their contracts.[26] This encourages the contracting parties to "assess the risk of economic loss . . . to assume, allocate, or insure against that risk."[27] The parties' rights and duties are controlled by the contract, and when purely economic loss occurs, no tort duty is breached.[28] Simply put, the economic loss doctrine prevents parties from subverting their contract and recovering in tort what they could not obtain through their contractual remedies.[29] Accordingly, the burden falls squarely on the transacting parties to bargain for adequate contract remedies in case of a breach or disappointed expectation.[30]

While the economic loss doctrine is recognized and applied in various fashions throughout the United States, its application is not uniform, and as a result, it does not produce clear and consistent results.[31] Historically, application of the economic loss doctrine was simple, but the results the doctrine produced were considered harsh.[32] Straightforward applications of the doctrine resulted in the outright dismissal of plaintiffs' tort claims or an

26. Digicorp, Inc. v. Ameritech Corp., 662 N.W.2d 652, 659 (Wis. 2003).

27. *Id.*

28. *See* E. River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 871 (1986) ("When a product injures only itself the reasons for imposing a tort duty are weak those for leaving the party to its contractual remedies are strong."); *Annett Holdings, Inc.*, 801 N.W.2d at 503–04.

29. *See In re* Starlink Corn Prods. Liab. Litig., 212 F. Supp. 2d 828, 840 (N.D. Ill. 2002) (noting the absence of a contractual remedy does not entitle a plaintiff to recover in tort); Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1230 (W.D. Wis. 1997); Kailin v. Armstrong, 643 N.W.2d 132, 144 (Wis. Ct. App. 2002).

30. *See* Wausau Tile, Inc. v. Cty. Concrete Corp., 593 N.W.2d 445, 459 (Wis. 1999) ("We refuse to pass on to society the economic loss of a purchaser . . . who may have failed to bargain for adequate contract remedies.").

31. *See E. River S.S. Corp.*, 476 U.S. at 868–71 (discussing the minority, majority, and intermediate approach to the economic loss doctrine); *see, e.g.*, Casa Clara Condo. Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1246 n.2 (Fla. 1993) ("The economic loss rule has been adopted in a majority of jurisdictions."). See the cases collected in the appendix to William K. Jones, *Product Defects Causing Commercial Loss: The Ascendency of Contract over Tort*, 44 U. MIAMI L. REV. 731, 799 (1990). *See also* Christopher Scott D'Angelo, *The Economic Loss Doctrine: Saving Contract Warranty Law from Drowning in a Sea of Torts*, 26 U. TOL. L. REV. 591, 601–08 (1995).

32. *See* Gennady A. Gorel, Note, *The Economic Loss Doctrine: Arguing for the Intermediate Rule and Taming the Tort-Eating Monster*, 37 RUTGERS L.J. 517, 541–48 (2006).

award of summary judgment to defendants.[33] In order to avoid some of these harsh results, courts carved out many exceptions, drastically limited the doctrine's scope, or eliminated the doctrine completely.[34] As a result, the economic loss doctrine is no longer simple to apply and no longer produces consistent and clear results. Instead, application of the doctrine now involves applying copious exceptions, numerous tests, and exhaustive mental gymnastics.[35]

This Article offers practitioners, judges, and law students alike a usable guide for navigating all of the economic loss doctrine's complexities and nuances. Part II defines economic damages and their importance in relation to the doctrine. Part III examines the history of the economic loss doctrine, its origin, and its evolution. Part IV analyzes the doctrine's current application, specifically looking at the majority approach, intermediary approach, and minority approach applied by different jurisdictions. Part V reviews the other property exception to the economic loss doctrine. Part VI explores the integrated system theory and its impact on the economic loss doctrine, with a particular focus toward its application in construction-defect cases. Part VII examines exploitation theory's role in developing the consumer exception to the economic loss doctrine. Finally, Part VIII concludes the Article.

---

33. *See E. River S.S. Corp.*, 476 U.S. at 875–76 (affirming the district court's grant of summary judgment for defendants since defendants "owed no duty under a products-liability theory based on negligence to avoid causing purely economic loss"); Danforth v. Acorn Structures, Inc., 608 A.2d 1194, 1201 (Del. 1992) (affirming grant of summary judgment in favor of defendant on grounds that purely economic loss was not recoverable), *superseded by statute*, Home Owner's Protection Act, 70 Del. Laws ch. 419 (1996); *Casa Clara Condo. Ass'n*, 620 So. 2d at 1248 (affirming the dismissal of homeowners' tort claims brought against the company that supplied concrete used in their homes); Copenhaver v. Rogers, 384 S.E.2d 593, 595 (Va. 1989) (affirming dismissal of tort claims against an attorney who was allegedly negligent in drafting a will).

34. *See infra* Parts IV.A, IV.B.

35. *See* Paul J. Schwiep, *The Economic Loss Rule Outbreak: The Monster that Ate Commercial Torts*, FLA. B.J., Nov. 1995, at 34, 34 ("[J]udges, lawyers, and commercial clients alike are all desperately struggling to define the parameters of the economic loss doctrine."); *see also* R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1789 (2000) ("The economic loss rule is one of the most confusing doctrines in tort law.").

II. ECONOMIC DAMAGES

Before delving into the history and application of the economic loss doctrine, it is important to define the doctrine's relevant terms. As stated above, the doctrine bars a party who suffers only economic loss from recovering damages under a tort theory, such as negligence or strict liability.[36] "Economic damages" is a term of art and may include direct and consequential damages.[37] It is used interchangeably with the terms "economic loss," "pure economic loss," and "commercial loss."[38]

A. *Direct Economic Damages*

Direct economic damages include damage to a product itself, the product's diminished value from being defective, and the costs of repair or replacement of the defective product.[39] Direct economic damage is described as "the difference between the actual value of the goods accepted and the value they would have had if they had been as warranted."[40] Further, direct economic damages can include a product's diminished value caused by its inferiority in quality or caused by its failure to work for the general purposes for which it was manufactured.[41]

36. Annett Holdings, Inc. v. Kum & Go, L.C., 801 N.W.2d 499, 503 (Iowa 2011) ("As a general proposition, the economic loss rule bars recovery in negligence when the plaintiff has suffered only economic loss." (citing Neb. Innkeepers, Inc. v. Pittsburgh–Des Moines Corp., 345 N.W.2d 124, 126 (Iowa 1984))).

37. *See, e.g.*, *id.* at 504.

38. *See, e.g.*, Seely v. White Motor Co., 403 P.2d 145, 150–51 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014) (using the term "commercial losses" interchangeably with "economic losses").

39. *See* Tomka v. Hoechst Celanese Corp., 528 N.W.2d 103, 107–08 (Iowa 1995) (citing Beyond the Garden Gate, Inc. v. Northstar Freeze-Dry Mfg., Inc., 526 N.W.2d 305, 309 (Iowa 1995)); *see also* Daigle v. Ford Motor Co., 713 F. Supp. 2d 822, 829 (D. Minn. 2010); Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 449 (Ill. 1982) (citing Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 918 (1966)); State Farm Mut. Auto. Ins. Co. v. Ford Motor Co., 592 N.W.2d 201, 206 (Wis. 1999). *See generally* 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 11–5, at 592 (4th ed. 1995).

40. *Tomka*, 528 N.W.2d at 107–08 (quoting *Beyond the Garden Gate, Inc.*, 526 N.W.2d at 309).

41. *Id.* (citations omitted).

B. *Consequential Economic Damages*

Consequential damages are those damages that proximately flow from the incident that caused the initial damage to the product.[42] Simply put, consequential damages are all other economic losses "attributable to the product defect."[43] These include such damages as lost profits, loss of operating revenue, loss of product, loss of goodwill, and loss of business reputation.[44]

The case of *Tomka v. Hoescht Celanese Corp.* provides a useful framework for evaluating what constitutes direct economic damages and what constitutes consequential economic damages.[45] In *Tomka*, the plaintiff sued a manufacturer of synthetic growth hormones, alleging the growth hormones did not cause the plaintiff's cows to gain as much weight as promised.[46] The plaintiff claimed damages for lost profits and for loss of goodwill under both contract and tort (strict liability and negligence) causes of action.[47] The lost profits and loss of goodwill are consequential damages stemming from the product's defect.[48] In other words, because the product did not perform as expected, the plaintiff lost money. The plaintiff's direct damages would have been the difference between the actual value of the goods accepted—meaning the value of defective growth hormones—compared to the value the goods would have had if they had performed as warranted.[49]

In *Tomka*, the trial court directed a verdict in favor of the defendant on the tort claims.[50] On appeal, the Iowa Supreme Court ruled the economic

---

42. *See* Steven R. Swanson, *The Citadel Survives a Naval Bombardment: A Policy Analysis of the Economic Loss Doctrine*, 12 TUL. MAR. L.J. 135, 140 (1987).

43. *Id.*

44. *Id.*; *see also* Lloyd F. Smith Co. v. Den–Tal–Ez, Inc., 491 N.W.2d 11, 15 (Minn. 1992) (noting damage to the defective product itself includes "consequential damages for repair and loss of profits resulting from inability to use the defective product during the period of its replacement or repair"); Minneapolis Soc'y of Fine Arts v. Parker–Klein Assocs. Architects, Inc., 354 N.W.2d 816, 820–21 (Minn. 1984), *overruled on other grounds by* Hapka v. Paquin Farms, 458 N.W.2d 683 (Minn. 1990).

45. *See Tomka*, 528 N.W.2d at 107–08 (citing *Beyond the Garden Gate, Inc.*, 526 N.W.2d at 309).

46. *Id.* at 105.

47. *Id.*

48. *Beyond the Garden Gate, Inc.*, 526 N.W.2d at 309.

49. *See Tomka*, 528 N.W.2d at 108–09.

50. *Id.* at 106.

loss doctrine prohibits recovery of economic damages through a tort cause of action and focused on the fact that the plaintiff sued because he was disappointed in the product's performance, not because of alleged injury to his property—he just thought his cows should have grown more than they did.[51] In other words, the plaintiff suffered purely economic damages because the product did not perform as expected.[52] Contract law, rather than tort law, protects a consumer's expectation interests, and under the purview of the economic loss doctrine, disappointed expectations are properly redressed through contractual remedies only.[53]

C. *Expectation Damages*

Damages under a contract are limited to "expectation damages," which means the aggrieved party is entitled to get what he or she expected—no more and no less.[54] By pleading contract and tort claims together, plaintiffs often attempt to make a "tort end run" around the terms and limits of the contract to receive something other than what was bargained for.[55] A Wisconsin federal court expressed this sentiment in *Coach USA, Inc. v. Van Hool N.V.* wherein the court explained the economic loss doctrine "prevents 'end runs' around a contract by prohibiting parties from reworking a

51. *Id.* at 107 ("As Tomka's own attorney said, '[T]his product is designed here to promote growth in cattle and yet we are alleging that the product failed to do that.' Tort law does not encompass this type of damage and therefore, the trial court properly directed a verdict on Tomka's strict liability and negligence theories." (citing G&M Farms v. Funk Irrigation Co., 808 P.2d 851, 864 (Idaho 1991))).

52. *See id.*

53. *Id.* (noting contract law protects a purchaser's expectation interest that the product received will be fit for its intended use); *see also* Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 448 (Ill. 1982); Northridge Co. v. W.R. Grace & Co., 471 N.W.2d 179, 185 (Wis. 1991).

54. Am. Fire & Cas. Co. v. Ford Motor Co., 588 N.W.2d 437, 439 (Iowa 1999); *see also* McDowell, *supra* note 19, at 287–88.

55. *See* Ralph A. Anzivino, *The False Dilemma of the Economic Loss Doctrine*, 93 MARQ. L. REV. 1121, 1130, 1148 (2010) [hereinafter Anzivino, *The False Dilemma*]. In his article on simplifying the economic loss doctrine, Anzivino argues, "Courts should not permit a tort end run around the contract." *Id.* at 1130. Anzivino focuses on the economic loss doctrine in Wisconsin and discusses removing the disappointed expectations test in favor of a contract-first approach in which the courts begin their analysis with the language of the contract. *Id.* at 1132 ("Once attorneys realize that the parties' contract will be the starting point in resolving disputes over contract and tort claims for consequential damages, there will be much greater use of and focus on bargaining for these protections. As a result, there are likely to be fewer cases where the parties have not bargained over these important matters.").

disclaimed contract warranty into a legitimate tort claim, when the underlying complaint is the same: a product was defective."[56]

III. THE HISTORY OF THE ECONOMIC LOSS DOCTRINE

In 1965, California State Supreme Court Justice Roger Traynor judicially created the economic loss doctrine in *Seely v. White Motor Co.*[57] In *Seely*, the plaintiff purchased a truck for his hauling business.[58] White Motor Co. manufactured the truck and offered an express warranty with it.[59] The truck "galloped" (a technical term to describe violent bouncing), and the brakes later failed, causing the truck to overturn.[60] The plaintiff suffered no injuries as a result of the accident.[61] The total cost of repairs to the plaintiff's truck was $5,466.09.[62]

The plaintiff sued White Motor Co., the truck manufacturer, and the dealership that sold him the truck for the repair costs, the purchase price, and his business's lost profits.[63] The court denied the plaintiff's claims for damages beyond those allowed under the express warranty.[64] In his frequently quoted opinion, Chief Justice Roger Traynor[65] explained:

56. Coach USA, Inc. v. Van Hool N.V., No. 06-C-457-C, 2006 WL 3523102, at *3 (W.D. Wis. Dec. 5, 2006).

57. Seely v. White Motor Co., 403 P.2d 145, 147 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014).

58. *Id.*

59. *Id.* at 147–48.

60. *Id.* at 147.

61. *Id.*

62. *Id.* at 148.

63. *Id.* at 147–48.

64. *Id.* at 148, 152.

65. Chief Justice Traynor is considered one of the greatest judges in the history of the California courts and, in fact, one of the greatest judges in the history of the United States. *See* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 688 (2d ed. 1985). Traynor is credited with developing the causes of action for strict liability, intentional infliction of emotional distress, the "moderate and restrained interpretation" doctrine for resolving conflict-of-laws problems, and the rule that majority shareholders of closely held corporations have a duty to not destroy the value of minority shares. *See* 2 J. EDWARD JOHNSON, HISTORY OF THE SUPREME COURT JUSTICES OF CALIFORNIA, 1900–1950, at 182 (1966); Page Keeton, *Roger Traynor and the Law of Torts*, 44 S. CAL. L. REV. 1045, 1045 (1971); *see also* Henry J. Friendly, *Ablest Judge of His Generation*, 71 CAL. L. REV. 1039, 1039 (1983) ("Roger Traynor was the ablest judge of his generation in the United States. I say this without hesitation, qualification, limitation, or fear of successful contradiction."). It is worth noting that the judge who paid such high compliments to

> 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 consumer's demands.[66]

Chief Justice Traynor reasoned it was fair to prevent the consumer from receiving more than he or she bargained for in initially purchasing the product when the consumer did not suffer a personal injury or "physical injury to [the] plaintiff's [other] property" because of the product's defect.[67] Chief Justice Traynor further explained the consuming public should not bear the burden of ensuring that every product meets the unique business needs of each purchaser.[68] He stated, "Th[e] 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."[69]

Chief Justice Traynor's *Seely* opinion drew from his earlier concurring opinion in *Escola v. Coca Cola Bottling Co.*[70]—where he reasoned strict liability provided a more efficient and fairer recovery scheme than negligence when a defective item a manufacturer places on the market injures a person.[71] Additionally, his opinion drew from the warranty

---

Chief Justice Traynor was no slouch himself. *See* Tory L. Lucas, *Henry J. Friendly: Designed to Be a Great Federal Judge*, 65 DRAKE L. REV. 421, 422 (2017).

66. *Seely*, 403 P.2d at 151.

67. *Id.* at 152 (holding that though the court agreed with the plaintiff that damage to property could be treated like injury to the person as a matter of strict tort liability, the facts pleaded failed to establish the causation required by law).

68. *Id.* at 151.

69. *Id.*

70. *Id.* (quoting Escola v. Coca Cola Bottling Co. of Fresno, 150 P.2d 436, 441 (Cal. 1944) (Traynor, J., concurring)).

71. *Escola*, 150 P.2d at 440 ("[I]t should now be recognized that a manufacturer incurs an absolute liability when an article that he has placed on the market, knowing that it is to be used without inspection, proves to have a defect that causes injury to human beings.").

provisions of the Uniform Commercial Code (UCC)—which expressly recognize that limitations to damages are prima facie unconscionable when personal injury is involved.[72] The UCC otherwise allows parties to freely allocate risks through warranty and contract in cases of commercial loss.[73] Recognizing these two legal principles, Chief Justice Traynor determined contract law and its remedies should govern the economic relations between parties unless a manufacturer's product caused personal injury or physical injury to the plaintiff's property.[74] Since manufacturers have a responsibility to create products that do not create unreasonable harm, Chief Justice Traynor posited that their liability should be limited to damages for physical injuries and that there is no tort recovery for economic loss alone.[75]

Over the next 20 years, numerous courts throughout the country adopted the economic loss doctrine from Chief Justice Traynor's *Seely* decision.[76] The United States Supreme Court placed its stamp of approval on Traynor's economic loss doctrine in 1986 when the Court applied the doctrine in *East River Steamship Corp. v. Transamerica Delaval, Inc.*[77] In *East River Steamship Corp.*, a shipping transport company sued a ship manufacturer—who was responsible for the design, manufacture, and installation of the turbine engines for the contracted ship—when a design defect in a turbine engine caused damage to other parts of the turbine.[78] Importantly, the shipping transport company sued under a strict liability theory, seeking damages for the alleged design and manufacturing defect that caused the malfunction.[79] The defect did not cause any personal injury or physical damage to the transport company's other property.[80] Only the turbine itself suffered damages.[81]

72. *Seely*, 403 P.2d at 152 (citing CAL. COM. CODE § 2719 (West 2018)).

73. *Id.* (citing CAL. COM. CODE § 2719).

74. *Id.* at 151–52 ("Physical injury to property is so akin to personal injury that there is no reason for distinguishing them.").

75. *Id.* at 151.

76. *See, e.g.*, Casa Clara Condo. Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1246 n.2 (Fla. 1993) ("The economic loss rule has been adopted in a majority of jurisdictions.").

77. E. River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 871 (1986).

78. *Id.* at 859–60.

79. *Id.* at 861–62.

80. *Id.* at 860.

81. *Id.*

Adopting Chief Justice Traynor's approach in *Seely*, a unanimous Supreme Court held, "[A] manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself."[82] The Court concluded economic losses are only recoverable under contract law and not tort.[83]

The Court's reasoning in *East River Steamship Corp.* mirrored that of Chief Justice Traynor's in *Seely*.[84] Specifically, the Court analyzed the distinction between the recovery theories underlying tort and contract law and concluded each theory must remain separate; otherwise, "contract law would drown in a sea of tort."[85] Tort law is designed to protect people and their property from unsafe conditions and behavior, such as unexpectedly dangerous and defective products.[86] Accordingly, the Court reasoned that "[t]he tort concern with safety" is diminished or nonexistent in cases where the injury is only to the product itself.[87] On the other hand, the Court recognized that contract law is better suited to deal with purely economic losses because "the parties may set the terms of their own agreements," and so, the parties can allocate the risk of loss before undertaking any transaction.[88] In other words, if consumers want to ensure a product they purchase meets their performance or business needs, their remedy is bargaining for a warranty that permits them to recover the costs of repair/ replacement of the product and any consequent loss of profits.[89] The Court provided, "Since a commercial situation generally does not involve large disparities in bargaining power, we see no reason to intrude into the parties' allocation of the risk."[90] Lastly, the Court concluded the remedies available

82. *Id.* at 871 ("[W]e adopt an approach similar to *Seely* . . . .").

83. *See id.* at 872–73.

84. *Id.* at 871 (quoting Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014)). Just as Chief Justice Traynor's decision rested on the distinction between tort and contract law, so too did the Supreme Court's decision. *Id.* at 871–82.

85. *Id.* at 866 (citing GRANT GILMORE, THE DEATH OF CONTRACT 87–94 (1974)).

86. *See* RESTATEMENT (SECOND) OF TORTS § 901 (AM. LAW INST. 1979).

87. *E. River S.S. Corp.*, 476 U.S. at 871.

88. *Id.* at 872–73.

89. *See id.* at 873.

90. *Id.*

in contract law—expectation damages—gave the transport company the full benefit of their bargain with the manufacturer.[91]

In choosing to adopt the *Seely* approach to the economic loss doctrine—which is also the majority approach taken by the states—the Court also expressly rejected the "intermediate" approach and "minority" approach taken by the remaining jurisdictions who chose not to follow *Seely*.[92] Despite the Supreme Court's adoption of the *Seely* approach, numerous jurisdictions continue to adhere to the intermediate approach, minority approach, and other versions of the economic loss doctrine.[93]

Chief Justice Traynor's *Seely* decision spawned the economic loss doctrine, which prohibits consumers from suing in tort solely for the recovery of economic damages, unless an exception applies.[94] A majority of U.S. jurisdictions follow the economic loss doctrine in some form.[95] Part IV explores the modern application of the doctrine.

IV. Modern Application of the Economic Loss Doctrine

A. *The Majority Rule: Followed by 28 States*[96]

A majority of states follow the *Seely* approach to the economic loss doctrine, which prohibits a plaintiff from recovering purely economic damages in tort without exception.[97] Under this rule, a plaintiff may only recover under a tort theory when there is a personal injury or damage to other property.[98] If the plaintiff suffers purely economic damages, the

91. *Id.* at 873–74 ("Recovery on a warranty theory would give the charterers their repair costs and lost profits, and would place them in the position they would have been in had the turbines functioned properly.").

92. *Id.* at 869–70. The intermediate approach and minority approach are discussed more thoroughly in Part IV.B.

93. *See infra* Part IV.B.

94. *See* Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014).

95. D'Angelo, *supra* note 31, at 592.

96. *See infra* notes 100–27. The Supreme Court adopted the *Seely* approach (the majority approach) in *East River Steamship Corp.* 476 U.S. at 871.

97. *See infra* notes 100–27; *see, e.g.*, Indemnity Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 539–40 (Fla. 2004) (citing the rationale from *Seely* with approval); David v. Hett, 270 P.3d 1102, 1105 (Kan. 2011) (noting the different variations of the economic loss doctrine).

98. *Indemnity Ins. Co. of N. Am.*, 891 So. 2d at 536 ("The prohibition against tort actions to recover solely economic damages for those in contractual privity is designed

plaintiff's only avenue of recovery is through contract.[99] The majority rule is followed in Alabama,[100] Delaware,[101] Florida,[102] Hawaii,[103] Idaho,[104] Indiana,[105] Kentucky,[106] Maine,[107] Minnesota,[108] Mississippi,[109] Missouri,[110] Nebraska,[111] Nevada,[112] New Jersey,[113] New Mexico,[114] New York,[115]

to prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort."); *see also* Ginsberg v. Lennar Fla. Holdings, Inc., 645 So. 2d 490, 494 (Fla. Dist. Ct. App. 1994) ("Where damages sought in tort are the same as those for breach of contract a plaintiff may not circumvent the contractual relationship by bringing an action in tort.").

99. *Indemnity Ins. Co. of N. Am.*, 891 So. 2d at 536 ("A party to a contract who attempts to circumvent the contractual agreement by making a claim for economic loss in tort is, in effect, seeking to obtain a better bargain than originally made. Thus, when the parties are in privity, contract principles are generally more appropriate for determining remedies for consequential damages that the parties have, or could have, addressed through their contractual agreement.").

100. *See* Lloyd Wood Coal Co. v. Clark Equip. Co., 543 So. 2d 671, 674 (Ala. 1989).

101. *See* Danforth v. Acorn Structures, Inc., 608 A.2d 1194, 1198 (Del. 1992), *superseded by statute*, Home Owner's Protection Act, 70 Del. Laws ch. 419 (1996).

102. *See Indemnity Ins. Co. of N. Am.*, 891 So. 2d at 540–41.

103. *See* Bronster *ex rel.* State v. U.S. Steel Corp., 919 P.2d 294, 302 (Haw. 1996).

104. *See* Duffin v. Idaho Crop Improvement Ass'n, 895 P.2d 1195, 1200–01 (Idaho 1995).

105. *See* Bamberger & Feibleman v. Indianapolis Power & Light Co., 665 N.E.2d 933, 939 (Ind. Ct. App. 1996).

106. *See* Giddings & Lewis, Inc. v. Indus. Risk Insurers, 348 S.W.3d 729, 736–38 (Ky. 2011).

107. *See* Order on Defendant's Motion for Summary Judgment at 9–11, Arundel Valley, LLC v. Branch River Plastics, Inc., No. BCD-CV-13-15 (Me. Super. Ct. Nov. 6, 2014).

108. *See* MINN. STAT. ANN. § 604.101 (West 2018).

109. *See* State Farm Mut. Auto. Ins. Co. v. Ford Motor Co., 736 So. 2d 384, 387 (Miss. Ct. App. 1999).

110. *See* Sharp Bros. Contracting Co. v. Am. Hoist & Derrick Co., 703 S.W.2d 901, 903 (Mo. 1986).

111. *See* Nat'l Crane Corp. v. Ohio Steel Tube Co., 332 N.W.2d 39, 44 (Neb. 1983).

112. *See* Terracon Consultants W., Inc. v. Mandalay Resort Grp., 206 P.3d 81, 86–88 (Nev. 2009).

113. *See* Alloway v. Gen. Marine Indus., L.P., 695 A.2d 264, 275 (N.J. 1997).

114. *See* Utah Int'l, Inc. v. Caterpillar Tractor Co., 775 P.2d 741, 744 (N.M. Ct. App. 1989).

115. *See* Bocre Leasing Corp. v. Gen. Motors Corp., 645 N.E.2d 1195, 1199 (N.Y. 1995).

North Carolina,[116] North Dakota,[117] Ohio,[118] Oklahoma,[119] Pennsylvania,[120] South Carolina,[121] South Dakota,[122] Tennessee,[123] Texas,[124] Vermont,[125] Wisconsin,[126] and Wyoming.[127] However, even some states that adhere to the majority approach have carved out narrow exceptions for specific causes of action that enable recovery in tort for purely economic losses.[128] These exceptions include "negligent misrepresentation, defamation, [asbestos,] professional malpractice, breach of fiduciary duty, nuisance, loss of consortium, wrongful death, spoliation of evidence, and unreasonable failure to settle a claim within insurance policy limits, all of which may afford recovery for negligence causing purely economic losses."[129]

Proponents of the majority rule argue that a bright-line prohibition on recovering economic loss in tort preserves the important distinctions

---

116. *See* Moore v. Coachmen Indus., Inc., 499 S.E.2d 772, 780 (N.C. Ct. App. 1998).

117. *See* Hagert v. Hatton Commodities, Inc., 350 N.W.2d 591, 595 (N.D. 1984) ("We conclude that economic loss, as distinguished from injury to property, may be recovered under express or implied warranty under the Uniform Commercial Code but not under § 402A, strict liability in tort.").

118. *See* Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n, 560 N.E.2d 206, 208 (Ohio 1990) ("For actions sounding in negligence, '[t]he well established general rule is that a plaintiff who has suffered only economic loss due to another's negligence has not been injured in a manner which is legally cognizable or compensable.'" (quoting Neb. Innkeepers, Inc. v. Pittsburgh–Des Moines Corp., 345 N.W.2d 124, 126 (Iowa 1984))).

119. *See* Waggoner v. Town & Country Mobile Homes, Inc., 808 P.2d 649, 653 (Okla. 1990).

120. *See* REM Coal Co. v. Clark Equip. Co., 563 A.2d 128, 132–33 (Pa. Super. Ct. 1989).

121. *See* Sapp v. Ford Motor Co., 687 S.E.2d 47, 51 (S.C. 2009).

122. *See* Diamond Surface, Inc. v. State Cement Plant Comm'n, 583 N.W.2d 155, 161 (S.D. 1998) (citing City of Lennox v. Mitek Indus., Inc., 519 N.W.2d 330, 333 (S.D. 1994)).

123. *See* Trinity Indus., Inc. v. McKinnon Bridge Co., 77 S.W.3d 159, 173 (Tenn. Ct. App. 2001), *abrogated by* Bowen *ex rel.* Doe v. Arnold, 502 S.W.3d 102 (Tenn. 2016).

124. *See* Nobility Homes of Tex., Inc. v. Shivers, 557 S.W.2d 77, 80 (Tex. 1977).

125. *See* Paquette v. Deere & Co., 719 A.2d 410, 414 (Vt. 1998).

126. *See* Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc., 437 N.W.2d 213, 217–18 (Wis. 1989); Acuity v. Soc'y Ins., 810 N.W.2d 812, 825 (Wis. Ct. App. 2012).

127. *See* Continental Ins. Co. v. Page Eng'g Co., 783 P.2d 641, 649 (Wyo. 1983).

128. Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 530–34 (2009).

129. *Id.*

between contract and tort law.[130] Allowing otherwise would permit tort law to "trump contract law and render the parties' bargains and the careful allocation of duties and risks in the U.C.C. meaningless."[131] Furthermore, even in those situations where the plaintiff and defendant lack a contract and the party bringing the tort action seeks purely economic damages, the plaintiff's economic losses are usually too remote and unforeseeable to outweigh the important policy considerations safeguarded by the economic loss doctrine—namely preserving the distinction between tort and contract law—to allow recovery for indirect economic damages.[132] Finally, the bright-line rule also prevents a "flood of litigation" while providing clear, consistent, and predictable results.[133]

Critics of the majority rule, on the other hand, decry its strict prohibition on recovering economic damages under a tort theory of recovery as unfair because it applies even when there is no contractual remedy available to the plaintiff.[134] For example, in cases where a contract does not exist or cases where the existing contract does not fairly allocate the risk of loss or include the plaintiff as a party, the majority rule still bars recovery in tort under the theory that the judicial system prefers to compensate economic loss solely through contractual remedies.[135] This means a tort

130. *See* D'Angelo, *supra* note 31, at 599.

131. *Id.*

132. *See* Trinity Indus., Inc. v. McKinnon Bridge Co., 77 S.W.3d 159, 182 (Tenn. Ct. App. 2001), *abrogated by* Bowen *ex rel.* Doe v. Arnold, 502 S.W.3d 102 (Tenn. 2016); United Textile Workers of Am., AFL-CIO v. Lear Siegler Seating Corp., 825 S.W.2d 83, 85–86 (Tenn. Ct. App. 1990) (rejecting the plaintiff's contention that the rule should be abandoned and prohibiting recovery for indirect economic loss). *See generally* Eileen Silverstein, *On Recovery in Tort for Pure Economic Loss*, 32 U. MICH. J.L. REFORM 403 (1999).

133. Stevenson v. E. Ohio Gas Co., 73 N.E.2d 200, 203 (Ohio Ct. App. 1946) ("While the reason usually given for the refusal to permit recovery in this class of cases is that the damages are 'indirect' or are 'too remote' it is our opinion that the principal reason that has motivated the courts in denying recovery in this class of cases is that to permit recovery of damages in such cases would open the door to a mass of litigation which [m]ight very well overwhelm the courts . . . .").

134. Johnson, *supra* note 128, at 553–54; *see, e.g.*, Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 534 (Fla. 2004) (requiring privity of contract for the economic loss rule to apply); Biscayne Inv. Grp., Ltd. v. Guarantee Mgmt. Servs., Inc., 903 So. 2d 251, 255–56 (Fla. Dist. Ct. App. 2005).

135. Johnson, *supra* note 128, at 547–48 n.111 ("A bright line distinction between the remedies offered in contract and tort with respect to economic damages . . . encourages parties to negotiate toward the risk distribution that is desired or customary." (quoting Alejandre v. Bull, 153 P.3d 864, 868 (Wash. 2007))).

cause of action can be dismissed even when the plaintiff does not have a contract, let alone a contractual remedy.[136]

The United States Court of Appeals for the Tenth Circuit case of *Rocky Mountain Helicopters, Inc. v. Bell Helicopter Textron, Inc.* provides an example of the harsh results that strict adherence to the majority rule may potentially produce.[137] In *Rocky Mountain Helicopters, Inc.*, a helicopter purchaser sued the original manufacturer of defective rotor blades in tort for the repair and replacement of the defective blades.[138] The helicopter purchaser bought the helicopter used and without any warranties from its seller, who was not the manufacturer.[139] No contractual relationship existed between the helicopter purchaser and the manufacturer.[140] The Tenth Circuit applied the majority rule and affirmed the dismissal of the helicopter purchaser's tort claims despite the lack of privity between the helicopter purchaser and the manufacturer.[141] The Tenth Circuit reasoned that the helicopter purchaser could have bargained for warranties with the seller, but since the purchaser failed to do so, "[it] cannot fall back on tort when it has failed to preserve its UCC remedies."[142] Accordingly, under the majority approach, the rule bars the recovery of economic losses in tort even when there is no contractual privity between the parties, and thus no contractual remedy exists for the aggrieved party.[143]

The majority rule undoubtedly presents the broadest application of the economic loss doctrine. Several courts and scholars have rejected the majority rule's premise that "contract principles [should] define the extent

136. Midwest Helicopter Airways, Inc. v. Sikorsky Aircraft, 849 F. Supp. 666, 671 (E.D. Wis. 1994) (barring recovery for economic loss in tort even when the purchaser is without contractual remedies), *aff'd*, 42 F.3d 1391 (7th Cir. 1994); N.Y. State Elec. & Gas Corp. v. Westinghouse Elec. Corp., 564 A.2d 919, 925 (Pa. Super. Ct. 1989) ("Moreover, even in the absence of the parties' agreements, we would nevertheless hold that NYSEG's recovery for damages pleaded in the negligence and strict liability counts is barred as a matter of law *because the losses alleged are purely economic in nature and cannot be recovered in negligence or strict liability*." (emphasis added) (citing REM Coal Co. v. Clark Equip. Co., 563 A.2d 128 (Pa. Super. Ct. 1989))).

137. Rocky Mountain Helicopters, Inc. v. Bell Helicopter Textron, Inc., 24 F.3d 125, 130 (10th Cir. 1994).

138. *Id.* at 127.

139. *Id.*

140. *Id.* at 129.

141. *Id.* at 133.

142. *Id.* at 130.

143. *See, e.g.*, *id.* at 133.

of the [parties'] dut[ies] where the economic injurer and victim were not in privity."[144] Critics argue the majority rule's broad application does not serve the rule's main purpose of acting as a boundary line between tort law and contract law:

> If there is no agreement between the parties to a lawsuit, there is no risk that recognizing tort obligations will violate the parties' freedom to contract, because there never was an effort to exercise such freedom. If the parties are not in privity, contract law does not potentially afford a remedy, except in the relatively rare case of a third-party beneficiary. Thus, respect for contract principles . . . does not require that the economic loss rule bar the claims of persons not standing in a contractual relationship.[145]

Thus, instead of contract law drowning in a "sea of tort,"[146] critics contend that an overly broad application of the economic loss doctrine puts tort law at risk of drowning in a "sea of contract."[147] This seems especially true if tort theories can be dismissed even when there is no contractual relationship between the parties.[148] Moreover, the practice of enforcing the economic loss doctrine even when no contract exists is problematic because it allows defendants to avoid liability for their conduct even if their conduct is governed by independent duties owed under tort law.[149]

1. *Privity of Contract*

When a contract or a warranty exists, the majority rule functions to enforce the parties' expectations.[150] Parties to a commercial transaction are free to enter into agreements and craft the agreements to include specific terms and conditions. For example, a purchaser can bargain for specific remedies—such as a money-back guarantee, refund, or lower purchase price—to ensure that the bargained-for product or service meets their business needs.[151] Parties can even negotiate to waive the application of the

144. Johnson, *supra* note 128, at 553.

145. *Id.* at 555.

146. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986) (citing GILMORE, *supra* note 85, at 87–94).

147. Johnson, *supra* note 128, at 584.

148. *Rocky Mountain Helicopters, Inc.*, 24 F.3d at 130.

149. Johnson, *supra* note 128, at 584.

150. *Id.* at 551.

151. *Cf.* Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 880 (1997) ("The commercial buyer and commercial seller can negotiate a contract—a warranty—that will

economic loss doctrine.[152] While there are circumstances when the parties' expectations are not enforced through application of the economic loss doctrine—such as with contracts of adhesion in which the terms and conditions of the contract are set by only one of the parties and the other party has little or no ability to negotiate more favorable terms—generally speaking, the doctrine ensures that parties to a contract negotiated at arm's length receive exactly what they bargained for and nothing more. While consumers are free to demand warranties that protect against economic loss, consumers rarely do so, instead choosing to rely on the manufacturer's warranty or the default warranty terms and conditions set out in the UCC.[153]

Manufacturers favor warranties because they limit the manufacturer's liability to the terms of the warranty and enable the manufacturer to provide the product at a price that reflects the strength of the warranty.[154] For products produced at an inexpensive cost that are sold for limited use or for products that are inherently fragile, manufacturers rarely offer any type of warranty.[155] Instead, the product is sold at a relatively inexpensive cost, and the consumer will simply have to buy another one if the product breaks. For instance, a light-bulb manufacturer does not warrant a light bulb for breakage. If the consumer drops the light bulb and it shatters, there is no warranty that would allow a consumer to obtain a replacement bulb from the manufacturer. The consumer simply goes to the store and purchases a new light bulb. The cost falls squarely on the consumer, but the light bulb's cost is inexpensive to begin with because there is no warranty.

---

set the terms of compensation for product failure. If the buyer obtains a warranty, [s]he will receive compensation for the product's loss, whether the product explodes or just refuses to start. If the buyer does not obtain a warranty, [s]he will likely receive a lower price in return. Given the availability of warranties, the courts should not ask tort law to perform a job that contract law might perform better." (citing Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014))).

152. *See* Johnson, *supra* note 128, at 583.

153. *See id.* at 551; *see also* U.C.C. §§ 2-314, 2-315 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

154. *See* Lipps v. Hjelmeland Builders, Inc., No. 07-1410, 2008 WL 4877458, at *1 (Iowa Ct. App. Nov. 13, 2008) (quoting Richards v. Midland Brick Sales Co., 551 N.W.2d 649, 650 (Iowa Ct. App. 1996)).

155. For example, a purchaser would be hard-pressed to find a paperclip company that offers a lifetime warranty on its paperclips. The cost of providing such a warranty would skyrocket the product's sale price, and the company would likely lose sales to the lower cost paperclips sold without the lifetime warranty.

Warranties are generally written by manufacturers, and as a result, critics claim warranties provide favorable terms to the manufacturer at the expense of the average consumer.[156] While there is statistical evidence suggesting manufacturers do not exploit consumers, as discussed further in Part VII, there is no doubt that a party drafting a contract—whether that party is a manufacturer or an individual—is going to draft the contract to protect its interests.[157] Protecting one's interests by attempting to secure a favorable bargain does not mean a party is seeking to take advantage of another.[158] Society assumes that manufacturers are doing this, and there is anecdotal evidence to support this assumption;[159] however, there is an equal amount of anecdotal evidence that certain manufacturers provide good warranties and endeavor to sell their product at a fair price.[160]

In the absence of a bargained-for warranty, parties may fall back on the default terms provided in the UCC.[161] The UCC, which has been adopted by all 50 states, "provides a comprehensive system for compensating consumers for economic loss arising from the purchase of defective products."[162] Courts enforcing the economic loss doctrine in the arena of defective products reason that failing to do so would essentially override and render useless the provisions of the UCC explicitly designed to deal with these issues.[163]

156. George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1299–1302 (1981) (discussing exploitation theory, which posits that manufacturers wield their power to enforce terms and conditions that protect their own interest).

157. *Id.* at 1321–22.

158. *See id.*

159. *Id.* at 1302; *see also* D'Angelo, *supra* note 31, at 599.

160. *See, e.g.*, Lisa Poisso, *32 Brands with Lifetime Warranties*, HUFFPOST (May 19, 2016), https://www.huffingtonpost.com/gobankingrates/32-brands-with-lifetime-w_b_10052518.html.

161. U.C.C. § 2-314 (AM. LAW INST. & UNIF. LAW COMM'N 1977) ("Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale."); *id.* § 2-315 ("Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.").

162. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 171 (Wis. 2005) (citations omitted).

163. *Id.* at 172.

The UCC asserts that a manufacturer should not be liable for consequential damages if they are not in privity with the buyer.[164] For instance, imagine if a buyer purchased a manufacturer's product from an unauthorized retailer, suffered economic loss such as lost profits, and then sued the manufacturer for said damages. The buyer is not in privity with the manufacturer in this situation, yet the buyer is still attempting to sue the manufacturer for economic damages. According to White & Summers, *Uniform Commercial Code* § 11–6, the manufacturer is not subject to liability for consequential damages if it lacks privity with the buyer because it could wrongfully be subject to "enormous losses."[165] This theory posits that the manufacturer has no way to "predict the purposes for which the goods will be used" by some remote purchaser who buys the product from a third party and might misuse the product.[166] The manufacturer would face unknown, inestimable liability for which it might be incapable of insuring against because insurers cannot insure against immeasurable risk.[167]

A buyer is well suited to assess the risk of economic damages and can likewise evaluate the product and warranty and weigh the factors that constitute the risk and reward of purchasing the product.[168] The buyer can also evaluate the price and the manufacturer's reputation. Whether the buyer actually compares and evaluates the warranties is immaterial. Like any contract, the buyer merely needs the *opportunity* to evaluate the terms of the warranty.[169] The buyer makes the decision to enter into the transaction, and the economic loss doctrine exists to enforce the terms of the

164. Beyond the Garden Gate, Inc. v. Northstar Freeze-Dry Mfg., Inc., 526 N.W.2d 305, 309 (Iowa 1995) (discussing and quoting 1 WHITE & SUMMERS, *supra* note 39, § 11–2, at 539).

165. *Id.* (citing 1 WHITE & SUMMERS, *supra* note 39, § 11–6, at 539–40).

166. *Id.*

167. *Id.*

168. *See* Tomka v. Hoechst Celanese Corp., 528 N.W.2d 103, 107 (Iowa 1995); *see also* Tapestry Vill. Place Indep. Living, L.L.C. v. Vill. Place at Marion, L.P., No. 08-1018, 2009 WL 1212234, at *7 (Iowa Ct. App. May 6, 2009).

169. *See, e.g.*, Peak v. Adams, 799 N.W.2d 535, 543 (Iowa 2011) ("[I]t is well-settled that failure to read a contract before signing it will not invalidate a contract." (quoting Huber v. Hovey, 501 N.W.2d 53, 55 (Iowa 1993))).

warranty.[170] The economic loss doctrine helps the manufacturer keep costs down so the average consumer does not have to pay a higher price.[171]

This is not an unfair result because it only prohibits the nonprivity buyers from recovering economic damages in tort.[172] The nonprivity buyer can bring tort claims under strict products liability law if the product is defective and causes noneconomic damages, such as personal injury.[173] Privity is not required for strict products liability claims because the manufacturer or distributor is liable to remote buyers if they introduce a dangerous product into the marketplace.[174] The manufacturer charges a premium because of strict products liability and should be able to ensure against losses caused by strict products liability.

While the UCC provides a statutory mechanism for recovering economic loss in the sale of goods, the relief is limited in that it only covers specific transactions.[175] The UCC covers contracts related to the sale of goods, leasing of goods, and secured transactions, but it does not cover contracts for services, real estate contracts, or employment contracts.[176] Consequently, the UCC does not provide parties with a remedy when no privity of contract exists or when there is no sale of goods.[177]

2. *Summary of Majority Rule*

Some critics of the majority rule denounce the strict application of the economic loss doctrine as harsh and unfair.[178] One scholar argues courts should abandon the majority rule and instead look to the "actual conduct of the parties viewed in the context of the obligations tort law sometimes imposes."[179] In other words, "[i]f the defendant has breached a tort duty that

170. Thunander v. Uponor, Inc., 887 F. Supp. 2d 850, 871 (D. Minn. 2012). The doctrine acknowledges that commercial law and contracts possess the appropriate remedies for pure economic loss.

171. *See* Lipps v. Hjelmeland Builders, Inc., No. 07-1410, 2008 WL 4877458, at *1 (Iowa Ct. App. Nov. 13, 2008) (quoting Richards v. Midland Brick Sales Co., 551 N.W.2d 649, 651 (Iowa Ct. App. 1996)).

172. *See id.*

173. *See id.*

174. Colvin v. FMC Corp., 604 P.2d 157, 162 (Or. Ct. App. 1979).

175. *Id.*

176. *See id.*

177. *See id.*

178. *See* Gorel, *supra* note 32, at 541–48.

179. Johnson, *supra* note 128, at 584.

arises independent of contractual obligations, that breach should be actionable unless the parties' contract expressly or by necessary implication preempts such relief."[180] This method would require an ad hoc or case-by-case approach. The parties would present their arguments and have a judge decide whether contract or tort law governs their behavior. In some circumstances, this process might render a fair result because of the complex nature of the parties' dealings. It would also prevent a defendant who deliberately and tortiously inflicts economic losses on a plaintiff from escaping liability under the strict application of the majority rule.[181]

For the more typical cases where there is a contract and a party is simply trying to expand its recovery by pleading tort causes of action in addition to their contract or warranty claims, the case-by-case approach may be inefficient and produce incongruent results. Further, a case-by-case approach essentially reverts the courts to the same position they were in before Chief Justice Traynor penned his famous *Seely* opinion in 1965.[182] Even with all of its criticisms, the majority rule is still what its name implies: the rule utilized by a majority of jurisdictions as the best approach for applying the economic loss doctrine.[183]

Despite the majority rule's effectiveness at separating tort theories of recovery from contract and the consistent results it produces, a number of jurisdictions reject the majority rule in favor of rules that either partially allow for the recovery of purely economic loss in tort causes of action (the intermediate approach) or allow for such recovery without limitation (the minority approach).[184]

Part IV.B discusses the economic loss doctrine's intermediate rule and its variations and provides a case-by-case analysis. Part IV.B further explores the limitations and benefits of such an approach.

---

180. *Id.*

181. *See, e.g.*, David Gruning, *Pure Economic Loss in American Tort Law: An Unstable Consensus*, 54 AM. J. COMP. L. SUPP. 187, 188–208 (2006).

182. *See* Seely v. White Motor Co., 403 P.2d 145, 147–52 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014).

183. *See supra* notes 100–27 and accompanying text.

184. *See infra* Part IV.B.

B. *The Intermediate Rule: Followed by 17 States*[185]

The intermediate rule allows tort recovery for economic loss under certain limited circumstances.[186] While it operates in a manner substantially similar to the majority rule—in that it bars recovery of economic loss in tort in most circumstances—it is different in that its application of the economic loss doctrine is not absolute. The form of the intermediate rule varies from jurisdiction to jurisdiction, but most applications are conceptually similar. At least 17 states apply some variation of the intermediate rule.[187] Discussed below are three of the most utilized variations of the intermediate rule.

1. *Dangerous Defect Exception*

The dangerous defect variation of the intermediate rule allows recovery of economic damages under tort causes of action when a product

185. *See* Pa. Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165, 1169–76 (3d Cir. 1981) (allowing for the recovery of economic damages under a tort theory of action); *see also* Fireman's Fund Am. Ins. Cos. v. Burns Elec. Sec. Servs., 417 N.E.2d 131, 133 (Ill. App. Ct. 1980); Am. Fire & Cas. Co. v. Ford Motor Co., 588 N.W.2d 437, 439 (Iowa 1999). The fire alarm example discussed in *Fireman's Fund American Insurance Companies v. Burns Electronic Security Services* has been cited in many Iowa opinions, including the landmark case of *Nebraska Innkeepers, Inc. v. Pittsburgh–Des Moines Corp.*, 345 N.W.2d 124 (Iowa 1984).

The U.S. Supreme Court rejected the use of the intermediate rule in favor of the majority rule in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 871 (1986). However, Alaska, California, Colorado, Georgia, Illinois, Iowa, Kansas, Maryland, Massachusetts, Michigan, Montana, New Hampshire, Oregon, Rhode Island, Utah, Washington, and West Virginia all apply some variation of the intermediate rule. *See* Progressive N. Ins. Co. of Ill. v. Ford Motor Co., 259 F. Supp. 3d 887, 891 (S.D. Ill. 2017); Sebago, Inc. v. Beazer E., Inc., 18 F. Supp. 2d 70, 89–90 (D. Mass. 1998); N. Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324, 327–29 (Alaska 1981); Jimenez v. Superior Court, 58 P.3d 450, 456 (Cal. 2002); Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1264 (Colo. 2000); Vulcan Materials Co. v. Driltech, Inc., 306 S.E.2d 253, 256–57 (Ga. 1983); *Am. Fire & Cas. Co.*, 588 N.W.2d at 439; Coker v. Siler, 304 P.3d 689, 693–94 (Kan. Ct. App. 2013); Pulte Home Corp. v. Parex, Inc., 923 A.2d 971, 1000–02 (Md. Ct. Spec. App. 2007), *aff'd*, 942 A.2d 722 (Md. 2008); State Farm Fire & Cas. Co. v. Ford Motor Co., No. 287512, 2010 WL 866149, at *3 (Mich. Ct. App. Mar. 11, 2010); Streich v. Hilton–Davis, 692 P.2d 440, 445 (Mont. 1992); Lempke v. Dagenais, 547 A.2d 290, 297 (N.H. 1988); Russell v. Ford Motor Co., 575 P.2d 1383, 1387 (Or. 1978); Rousseau v. K.N. Constr., Inc., 727 A.2d 190, 193 (R.I. 1999); Grynberg v. Questar Pipeline Co., 70 P.3d 1, 11 (Utah 2003); Affiliated FM Ins. Co. v. LTK Consulting Servs., Inc., 243 P.3d 521, 533 (Wash. 2010); Anderson v. Chrysler Corp., 403 S.E.2d 189, 192–93 (W. Va. 1991).

186. *See, e.g.*, Moorman Mfg. Co. v. Nat'l Tanking Co., 435 N.E.2d 443, 448 (Ill. 1982) (applying the intermediate rule).

187. *See generally supra* note 185.

defect creates an unreasonable danger or damages itself in a sudden and unforeseeable manner.[188] If the product defect causes damage that is neither dangerous, unforeseeable, nor "sudden and calamitous,"[189] the rule bars recovery of economic losses under a tort theory of recovery in the same manner and to the same extent as the majority rule.[190] The focus of the dangerous defect rule is not on the type of damages (i.e. economic versus physical) but rather the nature of the defect.[191] Under this rule, a tort theory of recovery is available when a defective product presents a hazard and danger to the consumer, even if the damages suffered are ultimately only economic in nature.[192]

The dangerous defect exception distinguishes between disappointed consumers—those who only suffer economic losses because the purchased product did not meet their expectations—and endangered consumers—those who are exposed to a potential danger when the economic damage occurred.[193] A disappointed consumer's "losses are encompassed by contract law principles," while an endangered consumer's losses are governed by tort principles.[194] Consequently, the endangered consumer may recover economic losses in tort since the purchased product "does not meet the reasonable expectations of the ordinary consumer as to its safety."[195]

Courts consider the following factors when determining whether a consumer merely suffered disappointed expectations or was endangered by the product's defect: (1) the nature of the defect; (2) the type of risk; and (3) the manner in which the injury arose.[196] The third factor considered by the courts, the manner in which the injury arose, evaluates injury to both the

188. *Am. Fire & Cas. Co.*, 588 N.W.2d at 439 ("[T]ort theory is generally available when the harm results from 'a sudden or dangerous occurrence, frequently involving some violence or collision with external objects, resulting from a *genuine hazard in the nature of the product defect*.'" (quoting Nelson v. Todd's Ltd., 426 N.W.2d 120, 125 (Iowa 1988))).

189. D'Angelo, *supra* note 31, at 601.

190. Gorel, *supra* note 32, at 540.

191. *Id.*

192. *See Am. Fire & Cas. Co.*, 588 N.W.2d at 439–40.

193. *See id.*

194. Nelson v. Todd's Ltd., 426 N.W.2d 120, 124 (Iowa 1988).

195. Lobianco v. Prop. Prot., Inc., 437 A.2d 417, 426 (Pa. Super. Ct. 1981) (quoting WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS 659 (4th ed. 1971)).

196. *See Am. Fire & Cas. Co.*, 588 N.W.2d at 439 (citing *Nelson*, 426 N.W.2d at 124); *see also Nelson*, 426 N.W.2d at 124–25 (quoting Pa. Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165, 1173 (3d Cir. 1981)).

property and any potential injury to the consumer, but the presence or absence of physical harm to the consumer or the consumer's property is not the determining factor for finding a product dangerous.[197] Instead, courts consider "what the product was supposed to accomplish."[198] If the damage caused by a product's failure is reasonably foreseeable, the damage is considered an economic loss even if there is physical damage.[199] The Illinois Supreme Court famously explained this concept using a fire alarm: "For example, if a fire alarm fails to work and a building burns down, that is considered an 'economic loss' even though the building was physically harmed . . . ."[200] The damage from the fire would be a foreseeable consequence from the failure of the product to work properly. The court continued the explanation, stating, "[B]ut if the fire was caused by a short circuit in the fire alarm itself, it is not economic loss."[201]

The result is substantially the same in both instances: the fire alarm fails to work in some manner, and the building burns down. In the first situation, the alarm fails to do what it was supposed to do by failing to alarm the building's inhabitants so they can put the fire out. Thus, the building's inhabitants are disappointed in the fire alarm's performance. The consequences of the fire alarm's failure to perform are foreseeable. In the latter situation, in which the alarm short-circuits and causes a fire, the building's inhabitants are actively endangered by the alarm. This is not a foreseeable consequence of the fire alarm's failure to function properly. Under the dangerous defect variation of the intermediate rule, the distinction between disappointment and danger is the determinative factor for whether the economic loss doctrine bars recovery of economic losses in tort. If the consumer is disappointed but not endangered, he or she is expected to pursue contract or warranty remedies, and recovery in tort is prohibited.

2. *Disappointed Expectations Test*

Wisconsin adheres to the disappointed expectations variation of the intermediate rule.[202] The disappointed expectations test asks "whether the

197. *See Nelson*, 426 N.W.2d at 124 (citing Fireman's Fund Am. Ins. Cos. v. Burns Elec. Sec. Serv., 417 N.E.2d 131, 133 (Ill. App. Ct. 1980)).

198. *Id.*

199. *Id.*

200. *Fireman's Fund Am. Ins. Cos.*, 417 N.E.2d at 133.

201. *Id.*

202. *See* State Farm Fire & Cas. Co. v. Hague Quality Water, Int'l, 826 N.W.2d 412,

purchaser should have foreseen . . . the damage at issue."[203] If the answer is yes, then the economic loss doctrine will prohibit recovery of economic damages in tort. The analysis is similar to the dangerous defect exception discussed above, but different in that it does not require the damage suffered to be dangerous. Instead, the damage must only be unforeseeable. For example, in *Selzer v. Brunsell Bros.*, a homeowner purchased and installed windows advertised by the manufacturer as specifically treated to permanently prevent against rot and decay.[204] The windows' product warranty guaranteed the windows to be free from defect for one year.[205] Several years after the windows' installation was completed, the windows and the surrounding siding rotted.[206] The homeowner brought a variety of claims against the window manufacturer, including breach of express and implied warranties, fraudulent misrepresentation, and negligent misrepresentation.[207]

The Wisconsin Court of Appeals barred the homeowner from recovering the cost of the windows under tort causes of action.[208] The court reasoned that because the homeowner expected the purchased windows to resist rot and they failed to do so, any "tort claim based on these losses stem[med] directly from the failure of the windows to perform as expected."[209] In other words, it is foreseeable that when rot-resistant windows fail to perform as expected, rot will occur. Under the disappointed expectations test, the homeowner could only recover economic damages in tort if the windows caused unforeseeable damage: "Had the windows resisted rot but spontaneously shattered, spewing shards of glass into an adjacent Picasso, [plaintiff] might well argue that the defective windows damaged his painting in an entirely unanticipated manner, going well beyond a failure to perform as expected and entitling him to pursue a tort

415 (Wis. Ct. App. 2012), *aff'd*, 841 N.W.2d 819 (Wis. 2014) (mem.) (per curiam).

203. *Id.*

204. Selzer v. Brunsell Bros., Ltd., 652 N.W.2d 806, 809 (Wis. Ct. App. 2002).

205. *Id.* at 809–10.

206. *Id.* at 810.

207. *Id.*

208. *Id.* at 817 ("Applying the economic loss doctrine to the facts at hand, we conclude that Selzer may not recover in tort for the cost to repair or replace his rotting windows. These damages are purely economic losses: the windows were not as rot-resistant as Selzer claims to have expected them to be, and the failure caused damage to the windows themselves.").

209. *Id.* ("Because Selzer has not proved any harm beyond disappointed expectations, he is precluded from pursuing a recovery in tort.").

remedy."[210] The court also dismissed the plaintiff's warranty claim since the windows' warranty only guaranteed that the windows would be free from defect for one year after sale.[211]

3. *The Independent Duty Rule*

The independent duty rule is another variation or adaptation of the intermediate rule. For a plaintiff to successfully bring a tort claim, the independent duty rule requires a duty to exist independent of the contract.[212] For example, in California's *Robinson Helicopter Co. v. Dana Corp.*, the court allowed the plaintiff to plead and prove fraud and intentional misrepresentation claims in addition to breach of contract claims under the independent duty rule.[213] In *Robinson Helicopter Co.*, the parties had a contractual relationship in which the defendant provided helicopter clutches for the plaintiff's helicopter manufacturing business.[214] The Federal Aviation Administration (FAA) approved the design for the clutch, and any modifications required further FAA inspection and approval.[215] The defendant agreed to deliver the clutches to the plaintiff, along with a written certification that the clutches were designed pursuant to the FAA-approved design.[216] Without informing the plaintiff, the defendant modified the clutches but still represented that they were manufactured according to the original FAA-approved design.[217] The defendant did not notify anyone of the modification, and the plaintiff only learned of the modification when the clutch's failure rates climbed from 0.03 percent to 9.86 percent.[218]

210. *Id.*

211. *Id.*

212. Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 273 (Cal. 2004) ("[C]onduct amounting to a breach of contract becomes tortious only when it also violates a duty independent of the contract arising from principles of tort law." (quoting Aas v. Superior Court, 12 P.3d 1125, 1136 (Cal. 2000), *superseded by statute*, CAL. CIV. CODE §§ 895–945.5 (West 2014), *as recognized in* McMillin Albany LLC v. Superior Court, 408 P.3d 797 (Cal. 2018))).

213. *Id.* at 275–76.

214. *Id.* at 270. ("A sprag clutch is primarily a safety mechanism. If a helicopter loses power during flight, the sprag clutch allows the rotor blades to continue turning and permits the pilot to maintain control and land safely by the 'autorotating' of the rotor blades.").

215. *Id.*

216. *Id.* at 270–71.

217. *Id.* at 271.

218. *Id.*

The plaintiff's claims of fraud and intentional misrepresentation were tort claims, which the defendant argued were barred by the economic loss doctrine.[219] The court disagreed, holding that the economic loss rule did not bar the plaintiff's fraud and intentional misrepresentation claims "because they were independent of [defendant's] breach of contract."[220] The court also determined public policy supported the holding: "Courts will generally enforce the breach of a contractual promise through contract law, except when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies."[221] The court further reasoned that a contract sets forth terms and conditions governing the relationship between the parties; thus, damage caused by deliberate misrepresentation of material terms of the contract is not foreseeable because "[n]o rational party would enter into a contract anticipating that they are or will be lied to."[222]

4. *Summary of Intermediate Rule*

The intermediate rule and its various applications confound application of the economic loss doctrine. The exceptions ensure that the economic loss doctrine does not act as a bright-line rule or apply consistently.[223] The unpredictable outcomes produced by the intermediate rule, which depend on a court's subjective interpretation of whether a product was dangerous or damage was foreseeable, complicates a doctrine designed to clearly demarcate the boundaries of tort and contract law.[224] It also requires a case-by-case analysis, which eliminates the efficient manner in which the majority approach disposes of tort causes of action when there is only economic damage.[225] Some academics have argued for the abolition

219. *Id.* at 275.

220. *Id.* at 274. Defendants should keep in mind that fraud or intentional misrepresentation claims are subject to an enhanced burden of proof of clear, convincing, and satisfactory evidence, as well as proof of intent to deceive and scienter. In most cases fraud should be easier to defend against than breach of contract. Yet, fraud or an intentional tort giving rise to an independent duty might support a claim for punitive damages as well.

221. *Id.* at 275 (quoting Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 683 (Cal. 1995) (Mosk, J., concurring in part, dissenting in part)).

222. *Id.* at 275–76.

223. *See* Anzivino, *The False Dilemma*, *supra* note 55, at 1129 (discussing how the disappointed expectations test "compounds" the economic loss doctrine and narrows other property rules).

224. *See id.* at 1133.

225. *See, e.g.*, *Robinson Helicopter Co.*, 102 P.3d at 273–76.

of at least one of the variations of the intermediate rule.[226] Furthermore, the United States Supreme Court expressly rejected the Third Circuit's original version of the intermediate test in its *East River Steamship Corp.* decision.[227]

Nonetheless, 17 states still follow some variation of the intermediate test.[228] Advocates for the intermediate approach argue that the rule provides more protection for consumers, reinforces tort principles by deterring manufacturers from producing dangerous products, and provides courts with more discretion to decide whether certain circumstances may warrant allowing recovery of economic losses in tort.[229] Additionally, the intermediate approach still largely functions in the same manner as the majority approach and preserves the important distinction between tort and contract law; however, the intermediate rule is not absolute and does allow for the recovery of economic damages in tort under the limited circumstances discussed above.[230]

States that do not follow the intermediate rule or majority rule adopt what is known as the minority rule.[231] Under the minority rule, there is no economic loss rule which bars recovery of economic loss under tort.[232] The minority rule allows a plaintiff to recover in tort for economic loss without

226. *See* Anzivino, *The False Dilemma*, *supra* note 55, at 1129 (discussing how the disappointed expectations test "compounds" the economic loss doctrine and how it narrows the other property exception).

227. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 870 (1986) ("We find the intermediate and minority land-based positions unsatisfactory. The intermediate positions, which essentially turn on the degree of risk, are too indeterminate to enable manufacturers easily to structure their business behavior. Nor do we find persuasive a distinction that rests on the manner in which the product is injured. We realize that the damage may be qualitative, occurring through gradual deterioration or internal breakage. Or it may be calamitous.").

228. *See supra* note 185 (listing all the states that utilize the intermediate approach). Additionally, following *Santor v. A & M Karagheusian, Inc.*, 207 A.2d 305, 312–13 (N.J. 1965), *abrogated by Alloway v. General Marine Industries, L.P.*, 695 A.2d 264 (N.J. 1997), approximately five states follow what is called the minority rule of the economic loss doctrine, which means they do not follow the economic loss doctrine at all. *See* Gorel, *supra* note 32, at 529 nn.80–82. The minority rule has been rejected in the majority of states and by the Supreme Court in *East River Steamship Corp.* because it fails to acknowledge the boundary problem between contract and tort law. 476 U.S. at 870.

229. Gorel, *supra* note 32, at 540–48.

230. *Id.* at 550.

231. *Id.* at 519.

232. *Id.*

limitation.[233] For example, if a buyer purchases a product from a manufacturer and the product is defective but solely damages itself, a recovery under tort can still be pursued by the buyer under the minority rule regardless of how the product damaged itself.[234]

Accordingly, there are three approaches to the economic loss doctrine: the majority rule, the intermediate rule (with its various applications), and the minority rule.[235] Unfortunately, the analysis does not end there. The following Parts address the application of the economic loss doctrine to specific scenarios, which have developed their own rules and exceptions separate and apart from the majority, intermediate, and minority views.

V. THE OTHER PROPERTY EXCEPTION TO THE ECONOMIC LOSS DOCTRINE[236]

Under the economic loss doctrine, tort claims are prohibited unless the plaintiff proves he or she suffered damage to "other property."[237] If there is damage to other property, a plaintiff may then plead tort claims to recover economic damages, which may include consequential damages like lost profits or wages and the damage caused to the other property.[238]

The definition of other property varies by jurisdiction, but the basic concept is simple.[239] If a defective product goes beyond damaging itself and causes damage to other property, then the plaintiff's claim is not barred by

233. *See id.* at 531–33.

234. *See* Farm Bureau Ins. Co. v. Case Corp., 878 S.W.2d 741, 743 (Ark. 1994) (allowing recovery under a strict liability theory despite the fact that there was no personal injury or damage to other property caused by the defective product); *see also* LA. STAT. ANN. § 9:2800.53(5) (2018). The Louisiana Products Liability Act defines the damages recoverable for a product defect to include damages to the product itself, making purely economic loss recoverable under tort. *Id.*

235. Gorel, *supra* note 32, at 526.

236. *See* Jimenez v. Superior Court, 58 P.3d 450, 483 (Cal. 2002) ("[T]he economic loss rule allows a plaintiff to recover in strict products liability in tort when a product defect causes damage to 'other property,' that is, property other than the product itself. The law of contractual warranty governs damage to the product itself.").

237. *See* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 867–72 (1986) (adopting the majority approach and noting the "need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages").

238. *See* Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 273 (Cal. 2004).

239. *See, e.g.*, Lloyd F. Smith Co. v. Den–Tal–Ez, Inc., 491 N.W.2d 11, 13 (Minn. 1992) (defining "other property" as "property other than the defective product itself").

the economic loss doctrine.[240] The Supreme Court of Minnesota effectively illustrated the other property exception through the example of a defective coffee pot: "For example, if a defective coffee pot starts a fire which burns down a building, the coffee pot purchaser could sue in tort as well as in breach of warranty for damages to the building."[241] While the coffee-pot purchaser would be barred from recovering any economic damages under a tort theory for the damage done to the coffee pot itself, the purchaser would be free to pursue tort theories for damage done to the building, which constitutes damage to other property.

The Minnesota case of *Lloyd F. Smith Co. v. Den–Tal–Ez, Inc.* further illustrates the concept of the other property exception. [242] In *Lloyd F. Smith Co.*, a defective dental chair caused a fire that substantially damaged the dental office in which the chair was used.[243] The fire also damaged other areas of the building in which the dental office was located.[244] The dentist who owned the chair, the building owner, and the other tenants brought suit against the defendant dental-chair manufacturer, suing under tort and breach of warranty theories.[245] The defendant dental-chair manufacturer sought to bar recovery in tort by asserting the economic loss doctrine.[246] However, the Supreme Court of Minnesota held "[t]he damages sought by plaintiffs in this case are indisputably 'other property.' In the fire plaintiffs lost computer equipment, records, machinery, furniture, plus other tangible items, and the building itself was damaged, all property separate from the allegedly defective dental chair."[247] Consequently, the court allowed the plaintiffs to pursue tort remedies in seeking to recover the damages done to their other property.[248]

240. *See id.*; *see also* Marshall v. Wellcraft Marine, Inc., 103 F. Supp. 2d 1099, 1111 (S.D. Ind. 1999) (holding a boat owner's tools, towels, canvas, pillows, various electronics, spare parts, photographs, food, supplies, and clothing constituted other property separate and distinct from the boat); Doty v. Parkway Homes Co., 368 S.E.2d 670, 671 (S.C. 1988); Northridge Co. v. W.R. Grace & Co., 471 N.W.2d 179, 180 (Wis. 1991) (holding a fireproofing product containing asbestos damaged other property by contaminating the owner's building with asbestos).

241. *Lloyd F. Smith Co.*, 491 N.W.2d at 15.

242. *Id.* at 13.

243. *Id.*

244. *Id.*

245. *Id.*

246. *See id.*

247. *Id.*

248. *Id.* at 17.

The other property exception allows plaintiffs to circumvent the economic loss doctrine's strict bar to recovery while still preserving the rationale behind the doctrine. In *East River Steamship Corp.*, the Supreme Court sought to preserve the distinction between claims arising from tort law and contract law.[249] It reasoned that the cost of a personal injury or injury to property "may be an overwhelming misfortune" properly addressed by tort law;[250] whereas, when a product injures only itself and does not damage other property, the commercial user stands to lose only the value of the product, which is the type of loss that can be insured against.[251] In other words, the other property exception still ensures the economic loss doctrine only allows recovery under tort in those cases supported by tort principles of recovery.[252]

The *Restatement (Second) of Torts* encapsulates the rationale behind the other property exception stating, "One who sells any product in a defective condition unreasonably dangerous to the user or consumer *or to his property* is subject to liability for physical harm thereby caused to the ultimate user or consumer, *or to his property* . . . ."[253] Thus, tort theories of recovery are appropriate when a defective product causes damage to a person or a person's *property*.[254] This approach ensures manufacturers and sellers are responsible for physical harm caused by their defective products, encourages manufacturers and sellers to make safe products, and places the responsibility for personal and physical damages on the person most able to remedy future defects.[255]

While the cases above illustrate a straightforward application of the other property exception, additional caveats, limitations, and intricacies exist that affect the application of this exception. For instance, Illinois requires a sudden and calamitous event to cause the damage to other property; otherwise, a plaintiff cannot bring tort claims and is limited

249. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 871–72 (1986).

250. *Id.* (quoting Escola v. Coca Cola Bottling Co., 150 P.2d 436, 441 (Cal. 1944) (Traynor, J., concurring)).

251. *Id.*

252. *Id.* at 871.

253. RESTATEMENT (SECOND) OF TORTS § 402A cmt. c (AM. LAW INST. 1965) (emphasis added).

254. *See id.*

255. *See id.*

to recovering solely through contract.[256] In jurisdictions that have adopted the integrated system theory—which is discussed more in Part VI—a plaintiff must show the defective product caused damage to something other than the machine or system of which it is a part.[257]

VI. THE INTEGRATED SYSTEM THEORY

Under the integrated system theory of the economic loss doctrine, a buyer is prohibited from bringing tort claims to recover for damages to a product—said to be an integrated system—if the damage is caused by a defective component part of the product.[258] The rule conceptualizes a final product as the sum of all of its parts and therefore a single unit or system. Since it is foreseeable that a component part could damage the finished product, the risks associated with these foreseeable damages are contractual in nature.[259] Because these risks are foreseeable, the integrated system theory places the burden on the consumer to purchase a warranty or otherwise insure against the risk.[260] The parties are responsible for evaluating the risks at the time the contract is negotiated, and if they choose, they can agree to shift that risk of loss.[261]

Integrated systems are products composed of many smaller individual parts but sold as a single package that works all together.[262] For example, a

256. *See* Trans States Airlines v. Pratt & Whitney Can., Inc., 682 N.E.2d 45, 48, 55 (Ill. 1997) ("[T]he event, by itself, does not constitute an exception to the economic loss rule. Rather, the exception is composed of a sudden, dangerous, or calamitous event coupled with personal injury or property damage." (quoting *In re* Chi. Flood Litig., 680 N.E.2d 265, 275 (Ill. 1997))).

257. *See infra* Part VI.

258. *See* Ralph C. Anzivino, *The Disappointed Expectations Test and the Economic Loss Doctrine*, 92 MARQ. L. REV. 749, 755 (2009) [hereinafter Anzivino, *The Disappointed Expectations Test*].

259. *See id.*

260. *See id.* at 754.

261. *See id.*

262. *See, e.g.*, Midwest Helicopter Airways, Inc. v. Sikorsky Aircraft, 849 F. Supp. 666, 672 (E.D. Wis.) ("[T]his case involves a single piece of machinery with component parts. Although Midwest now contends that the defective tail rotor drive system was separate property, I do not find that argument persuasive. This is especially true given that Midwest's tort claims concern both the tail rotor drive system and the helicopter. Sikorsky provided the whole helicopter. The helicopter functions as an integral system."), *aff'd*, 42 F.3d 1391 (7th Cir. 1994); *see also* King v. Hilton–Davis, 855 F.2d 1047, 1051 (3d Cir. 1988).

single car is made up of about 30,000 parts.[263] A car manufacturer produces the car, but the components of the vehicle may be—and often are—manufactured by other suppliers.[264] Out of those 30,000 parts, many make up distinct subsystems of the vehicle, such as power and propulsion, steering, safety, and electronics.[265] Once assembled, the car is sold to a consumer as a single integrated system.[266] Few people, if any, think of a car in terms of separate components and systems. When a car breaks down, the owner generally takes it to an automotive repair shop and complains that "the car" is not functioning properly, viewing the car as a complete integrated system; although, the problem with the car is related to a specific component part, such as a water pump, radiator, engine, or filter. It would be absurd to sell a car with a warranty for each component part (30,000 separate warranties for a Toyota) instead of a warranty for the car as a single system.

The integrated system rule "expand[s] the domain of contract law by shrinking those cases that qualify as 'other property' damage under tort law."[267] By viewing products as a single integrated system, a defective product that damages itself or its system "has not caused sufficient property damage to engender tort remedies."[268] Instead, the product must cause damage outside of the system to trigger the other property exception.[269] For instance, it would not be enough for a faulty radiator to damage the hood or paint of a car because the radiator is a component part of the car, which is an integrated system.[270] In order for the other property exception to apply,

263. *See How Many Parts Is Each Car Made of?*, TOYOTA, http://www.toyota.co.jp/en/kids/faq/d/01/04/ (last visited Dec. 16, 2018).

264. *See id.* (noting that Toyota's suppliers make the wheels, seats, steering wheels, windshields, headlights, and meters). For example, tires placed on a car by a car manufacturer may consist of tire valve assemblies manufactured by a separate entity who then sells the tire valve assemblies to a tire manufacturer, who incorporates the tire valve assemblies into the tires, and then finally sells the finished tires to a car manufacturer. *See* Asahi Metal Indus. Co. v. Superior Court, 480 U.S. 102, 105–07 (1987).

265. *See How Many Parts Is Each Car Made of?*, *supra* note 263.

266. *See King*, 855 F.2d at 1052 ("The Kings contracted to buy a single integrated product, seed potatoes. Like many agricultural products, seed potatoes may be treated with a multitude of chemicals for a multitude of purposes; the end result of this treatment is intended to be a single product-in this case a disease-free, pest-free seed potato that is capable of producing healthy plants."); *Midwest Helicopter Airways, Inc.*, 849 F. Supp. at 672.

267. Anzivino, *The Disappointed Expectations Test*, *supra* note 258, at 751.

268. *Id.*

269. *Id.*

270. *See id.*

the radiator would have to cause damage outside of the car (i.e. damage to a garage, a separate car, or other property distinct from the car itself).[271]

The Supreme Court endorsed the integrated system theory in its *East River Steamship Corp.* decision, which is also the decision where the Court adopted the economic loss doctrine.[272] In *East River Steamship Corp.*, the defendant manufactured and installed $1.4 million dollar turbines into supertankers (large ocean traveling ships) chartered by the plaintiff.[273] Steam reversing rings, which were components inside of the turbine engines, malfunctioned and caused the turbine engines to fail.[274] The plaintiff sued the defendant manufacturer, alleging five counts of tortious conduct and claiming $8 million dollars in damages, which included the cost of repairing the ships and the income lost while the ships were unusable.[275] The plaintiff's tort claims included strict liability for design defects and negligent supervision of the installation of one of the turbines during the manufacturing process.[276] The Supreme Court held as a matter of law that no damage to other property occurred because the turbines only damaged themselves, and the defendant manufactured each turbine as a single unit.[277] The Supreme Court cited *Northern Power & Engineering Corp. v. Caterpillar Tractor Co.*, a decision by the Alaska Supreme Court, to support its holding: "Since all but the very simplest of machines have component parts, [a contrary] holding would require a finding of 'property damage' in virtually every case where a product damages itself. Such a holding would eliminate the distinction between warranty and strict products liability."[278]

Since the Supreme Court's endorsement of the integrated system theory and its adoption by the *Restatement (Third) of Torts: Products Liability*, section 21,[279] most jurisdictions (roughly 34) recognize some form

---

271. *See id.*
272. *Id.* at 754.
273. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 859–60 (1986).
274. *Id.* at 860.
275. *Id.* at 861.
276. *Id.*
277. *Id.* at 867–68.
278. *Id.* at 867 (citing N. Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324, 330 (Alaska 1981)).
279. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. e (AM. LAW INST. 1998).

of this theory.[280] Proponents of the theory argue it is illogical to adopt the

---

280. *See, e.g.*, GARY WICKERT, MATTHIESEN, WICKERT & LEHRER, ECONOMIC LOSS DOCTRINE IN ALL 50 STATES (2018), https://www.mwl-law.com/wp-content/uploads/2013/03/economic-loss-doctrine-in-all-50-states.pdf; Ralph C. Anzivinio, *The Economic Loss Doctrine: Distinguishing Economic Loss from Non-Economic Loss*, 91 MARQ. L. REV. 1081, 1090 n.66 (2008) (noting Alabama, Alaska, Arizona, California, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Hampshire, New York, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, and Wisconsin all recognize some variation of the integrated system rule); *see also* Lockheed Martin Corp. v. RFI Supply, Inc., 440 F.3d 549, 555 (1st Cir. 2006) (applying New Hampshire law); HDM Flugservice GMBH v. Parker Hannifin Corp., 332 F.3d 1025, 1031 (6th Cir. 2003) (applying Ohio law); Rockport Pharmacy, Inc. v. Dig. Simplistics, Inc., 53 F.3d 195, 198–99 (8th Cir. 1995) (applying Missouri law); Laurens Elec. Coop., Inc. v. Altec Indus., Inc., 889 F.2d 1323, 1324–25 (4th Cir. 1989) (predicting South Carolina law); King v. Hilton–Davis, 855 F.2d 1047, 1050–53 (3d Cir. 1988) (predicting Pennsylvania law); Flintkote Co. v. Dravo Corp., 678 F.2d 942, 951 (11th Cir. 1982) (applying Georgia law); Moffitt v. Icynene, Inc., 407 F. Supp. 2d 591, 601 (D. Vt. 2005); Superior Kitchen Designs, Inc. v. Valspar Indus. (U.S.A.), Inc., 263 F. Supp. 2d 140, 145–46 (D. Mass. 2003); Delmarva Power & Light v. Meter-Treater Inc., 218 F. Supp. 2d 564, 569–70 (D. Del. 2002); Alcan Aluminum Corp. v. BASF Corp., 133 F. Supp. 2d 482, 505 (N.D. Tex. 2001); Va. Sur. Co. v. Am. Eurocopter Corp., 955 F. Supp. 1213, 1216 (D. Haw. 1996); ERA Helicopters, Inc. v. Bell Helicopter Textron, Inc., 696 F. Supp. 1096, 1097–98 (E.D. La. 1987); Carrell v. Masonite Corp., 775 So. 2d 121, 126 (Ala. 2000); N. Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324, 330 (Alaska 1981); Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc., 666 P.2d 544, 548–49 (Ariz. Ct. App. 1983); Jimenez v. Superior Court, 58 P.3d 450, 458 (Cal. 2002); Casa Clara Condo. Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1247 (Fla. 1993); Blahd v. Richard B. Smith, Inc., 108 P.3d 996, 1000–01 (Idaho 2005); Trans State Airlines v. Pratt & Whitney Can., Inc., 682 N.E.2d 45, 58–59 (Ill. 1997); Progressive Ins. Co. v. Gen. Motors Corp., 749 N.E.2d 484, 490 (Ind. 2001); Richards v. Midland Brick Sales Co., 551 N.W.2d 649, 650–51 (Iowa Ct. App. 1996); Nw. Ark. Masonry, Inc. v. Summit Specialty Prods., Inc., 31 P.3d 982, 988 (Kan. Ct. App. 2001); Oceanside at Pine Point Condo. Owners Ass'n v. Peachtree Doors, Inc., 659 A.2d 267, 271 (Me. 1995); Pulte Home Corp. v. Parex, Inc., 923 A.2d 971, 1004–05 (Md. Ct. Spec. App. 2007), *aff'd*, 942 A.2d 722 (Md. 2008); Sullivan Indus., Inc. v. Double Seal Glass Co., 480 N.W.2d 623, 629–30 (Mich. Ct. App. 1991); Minneapolis Soc'y of Fine Arts v. Parker–Klein Assocs. Architects, Inc., 354 N.W.2d 816, 819–21 (Minn. 1984), *overruled on other grounds by* Hapka v. Paquin Farms, 458 N.W.2d 683 (Minn. 1990); State Farm Mut. Auto. Ins. Co. v. Ford Motor Co., 736 So. 2d 384, 388 (Miss. Ct. App. 1999); Nat'l Union Fire Ins. Co. of Pittsburgh v. Pratt & Whitney Can., Inc., 815 P.2d 601, 604 (Nev. 1991); AKV Auto Transp., Inc. v. Syosset Truck Sales, Inc., 806 N.Y.S.2d 254, 256 (App. Div. 2005); Atl. Coast Mech., Inc. v. Arcadis, Geraghty & Miller of N.C., Inc., 623 S.E.2d 334, 340 (N.C. Ct. App. 2006); Coop. Power Ass'n v. Westinghouse Elec. Corp., 493 N.W.2d 661, 667 (N.D. 1992); City of Lennox v. Mitek Indus., Inc., 519 N.W.2d 330, 333–34 (S.D. 1994); Messer Griesheim

economic loss doctrine without also adopting the integrated system theory, noting the nature of the modern machine—and all of its component parts—makes the integrated system theory a necessity for the doctrine to function properly.[281] However, some scholars and courts are critical of the integrated system theory because it expands the application of contract law at the expense of the other property exception to the economic loss doctrine, which in turn further limits what a consumer can recover in tort under the other property exception.[282]

The case of *Fishman v. Boldt* provides a useful example of the integrated system theory in action. In *Fishman*, a Florida court applying the integrated system theory held that a defective seawall was an integrated component part of a house, pool, and patio, despite the fact that the seawall was physically distinctive and geographically separate from the other parts of the house.[283] The court reasoned "the 'product' purchased by the appellants was the home with all of its component parts, including the seawall, pool, and patio," and thus the "pool, patio, and home were not 'other property'" under the integrated system theory.[284]

The integrated system theory limits a plaintiff's ability to recover under the other property exception; however, the theory does not prevent recovery in every situation, as is evidenced by the Supreme Court's decision in *Saratoga Fishing Co. v. J.M. Martinac & Co.*[285] In *Saratoga Fishing Co.*, the purchaser of a ship from a manufacturer added miscellaneous equipment—a skiff, a seine net, and various other spare parts—to the ship after his initial purchase.[286] After using the ship for a number of years, the first owner

Indus., Inc. v. Cryotech of Kingsport, Inc., 131 S.W.3d 457, 466 (Tenn. Ct. App. 2003); Am. Towers Owners Ass'n v. CCI Mech., Inc., 930 P.2d 1182, 1191 (Utah 1996), *abrogated by* Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, LC, 221 P.3d 234 (Utah 2009); Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 374 S.E.2d 55, 57–58 (Va. 1988); Wausau Tile, Inc. v. Cty. Concrete Corp., 593 N.W.2d 445, 452 (Wis. 1999).

281. *See E. River S.S. Corp.*, 476 U.S. at 867 (citing *N. Power & Eng'g Corp.*, 623 P.2d at 330); Anzivino, *The Disappointed Expectations Test*, *supra* note 258, at 755, 757.

282. *See* Grams v. Milk Prods., Inc., 699 N.W.2d 167, 175 (Wis. 2005) ("The 'integrated system' concept does not translate well to all situations involving property damage to which the economic loss doctrine logically applies."); Anzivino, *The Disappointed Expectations Test*, *supra* note 258, at 760.

283. Fishman v. Boldt, 666 So. 2d 273, 274 (Fla. Dist. Ct. App. 1996).

284. *Id.*

285. Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 884–85 (1997).

286. *Id.* at 877.

subsequently sold the ship.[287] The boat sank shortly after the first owner sold the ship due to a fire caused by a defectively designed hydraulic system originally installed by the ship's manufacturer.[288] The second owner of the ship brought a defective-design action against the manufacturer and sought to recover the costs of the miscellaneous equipment added by the first owner.[289] The Supreme Court allowed the second owner to recover damages for the miscellaneous equipment added by the first owner, finding that:

> [E]quipment added to a product after the Manufacturer (or distributor selling in the initial distribution chain) has sold the product to an Initial User is not part of the product that itself caused physical harm. Rather, in *East River*'s language, it is "other property." (We are speaking, of course, of added equipment that itself played no causal role in the accident that caused the physical harm.) Thus the extra skiff, nets, spare parts, and miscellaneous equipment at issue here, added to the ship by a user after an initial sale to that Initial User, are not part of the product (the original ship with the defective hydraulic system) that itself caused the harm.[290]

The Supreme Court's decision in *Saratoga Fishing Co.* provides clear guidance in defining what constitutes other property under the integrated system theory.[291] While *East River Steamship Corp.* and *Saratoga Fishing Co.* are both notable Supreme Court cases delineating the boundaries of the economic loss doctrine, it is worth noting that both cases are admiralty law decisions, which means they are only binding in cases applying admiralty law. However, in recent years, product manufacturers have successfully asserted the integrated system concept in nonadmiralty-law cases to dismiss tort claims in favor of enforcing the terms of written warranties.[292]

A. *The Integrated System Theory and Construction Defects*

The integrated system theory is prevalent in construction-defect cases.[293] Manufacturers, design professionals, and contractors frequently

287. *Id.*
288. *Id.*
289. *Id.* at 878.
290. *Id.* at 884–85.
291. Sieg, *supra* note 8, at 298–300 (discussing the limitations of *Saratoga Fishing Co.* as compared to *East River Steamship Corp.*).
292. *See* Bay Breeze Condo. Ass'n v. Norco Windows, Inc., 651 N.W.2d 738, 741 (Wis. Ct. App. 2002).
293. *See, e.g.*, *id.* at 746.

raise the theory as a bar to tort liability.[294] For example, when a window manufacturer is sued because its product allegedly caused water damage, plaintiffs routinely claim that the window allowed water to damage portions of the structure beyond the window.[295] The window manufacturer will routinely argue that once the window is installed and the wall is fully constructed, the window and the wall are an "integrated system."[296] The window manufacturer's position is supported by the common definition of an integrated system, which states a system is integrated when its "component materials become indistinguishable parts of a final product."[297] Thus, when the component parts that make up a wall—or an entire house—become indistinguishable from the final product, the economic loss doctrine will prohibit tort causes of action alleging a window damaged the wall because the whole wall or house is considered an integrated piece of property.[298] Damage to a window, drywall, or any other part of this integrated system is considered damage to the product itself (rather than damage to other property), and any claim for economic damages against the window manufacturer would be barred by the economic loss doctrine.[299]

The window manufacturer clearly favors this result because it ensures its warranty, if one was provided, is the plaintiff's sole remedy. The buyer, on the other hand, may disagree with this result, depending on the terms of the warranty and on the buyer's understanding of the warranty.[300] In crafting warranties, manufacturers attempt to provide fair remedies for the buyer while also restricting the manufacturer's liability to what fits their pricing scheme and their service capabilities.[301] Often times, in pursuit of this goal, manufacturers may create intricate warranties that average buyers do not take the time to read or understand.[302] An effective warranty should both protect the interests of the manufacturer and fully inform the buyer of the product's risks, what the warranty covers, and what the warranty does not

294. *See, e.g.*, E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 859 (1986); *Bay Breeze Condo. Ass'n*, 651 N.W.2d at 739.

295. *See Bay Breeze Condo. Ass'n*, 651 N.W.2d at 740.

296. *See id.*

297. *See* Nw. Ark. Masonry, Inc. v. Summit Specialty Prods., Inc., 31 P.3d 982, 988 (Kan. Ct. App. 2001).

298. *Bay Breeze Condo. Ass'n*, 651 N.W.2d at 743.

299. *See id.*

300. Priest, *supra* note 156, at 1303 (discussing the signal theory and the information that a consumer is likely to obtain or to perceive from a warranty).

301. *See id.* at 1304.

302. *Id.*

cover.[303] Staying with the window manufacturer example, the following excerpts illustrate effective warranty provisions:

> WHAT THIS WARRANTY COVERS
>
> Except as set forth in the Special Coverages section below, we warrant that if your Product exhibits a defect in material or workmanship within the time periods from the manufacture date as specified below, we will, at our option, *repair, replace, or refund the purchase price of the Product or component part*.
>
> [Generally, a warranty will then list the specific-coverage length for specific products and identify any products that require special coverages.][304]
>
> WHAT THIS WARRANTY DOES NOT COVER
>
> The Manufacturer is Not Liable for: Damage or distortion to other property, including but not limited to vinyl siding, building components or landscaping, caused in whole or in part by reflection of light or heat from the Manufacturer's windows.
>
> [Other examples of what a window warranty may not cover includes normal wear-and-tear, misuse of the product, alteration or modification of the product, improper installation, damages caused by conditions that exceed product design standards, etc.][305]

The warranty provisions above clearly identify what is covered and what is not under the terms of the warranty. In addition to the information listed above, an effective warranty should also state how long the warranty is effective for, explain how to get assistance when making a claim, and inform the buyer of their rights under the warranty—which is generally done through a legal disclaimer.[306] If a manufacturer plans to rely on the economic loss doctrine as a defense, its warranty should clearly address what remedies are available to the buyer.[307] For example, an effective legal disclaimer identifies what actions are available to the buyer, what damages are available

303. *See generally id.* at 1333–35, 1338–39.
304. *See generally id.* at 1339.
305. *See generally id.* at 1333–35.
306. *See generally id.* at 1328–46.
307. *See* Bay Breeze Condo. Ass'n, Inc. v. Norco Windows, Inc., 651 N.W.2d 738, 741 (Wis. Ct. App. 2002).

in those actions, and what actions and damages are not available under the warranty:[308]

> IMPORTANT LEGAL INFORMATION
>
> Please read this carefully. It affects your rights.
>
> This Limited Warranty document sets forth our maximum liability for our products. We shall not be liable for special, indirect, consequential, or incidental damages. Your sole and exclusive remedy with respect to any and all losses or damages resulting from any cause whatsoever shall be as specified above. We make no other warranty or guarantee, either express or implied, including implied warranties of merchantability and fitness for a particular purpose to the original purchaser or to any subsequent user of the Product, except as expressly contained herein. In the event state or provincial law precludes exclusion or limitation of implied warranties, the duration of any such warranties shall be no longer than, and the time and manner of presenting any claim thereon shall be the same as, that provided in the express warranty stated herein. This Limited Warranty document gives you specific legal rights, and you may have other rights that vary from state/province to state/province.

This legal disclaimer effectively conveys the principles of the economic loss doctrine: that the buyers' rights are limited to the remedies available under the warranty.

Manufacturers have successfully asserted the economic loss doctrine to foil tort claims and enforce the terms of written warranties in recent years.[309] For example, in *Bay Breeze Condominium Ass'n v. Norco Windows, Inc.*, a condo association installed windows with a two-year replacement warranty in four of its condominiums.[310] The condo association sued the window manufacturer after water infiltrated the windows and caused "excessive peeling of paint," "rotting, and deterioration of wood window casements and frames and of certain portions of the building," and "water damage to the interior of the condominium units and structural components of the walls of certain buildings."[311]

308. *See id.* at 741–43, 746.
309. *See, e.g.*, *id.* at 740.
310. *Id.*
311. *Id.* at 740–41.

The association alleged strict product liability, negligence (i.e., tort), and breach of warranty against the window manufacturer.[312] The window manufacturer prevailed on all claims in a summary judgment motion through the integrated system theory.[313] The district court held that the materials comprising the wall, including the windows, were merely component parts of an integrated system—the condominium.[314] The court reasoned, "Because of the integral relationship between the windows, the casements and the surrounding walls, the windows are simply a part of a single system or structure, having no function apart from the buildings for which they were manufactured."[315] Consequently, since no damage occurred to property other than the condominiums, the court determined the association's tort claims were barred by the economic loss doctrine.[316]

In *Bay Breeze*, the window manufacturer also prevailed on the warranty claim on summary judgment.[317] The limited warranty on the windows did not provide any recovery for incidental or consequential damages when a wall was damaged; the warranty only covered damage done to the window itself.[318] The Wisconsin Court of Appeals affirmed the district court's decision, upholding the application of the integrated system theory and barring recovery under the terms of the warranty.[319]

The *Bay Breeze Condominium Ass'n* court relied heavily on *Wausau Tile, Inc. v. County Concrete Corp.* in reaching its conclusion that windows were an integrated component part of the condominium.[320] In *Wausau Tile*, a manufacturer of concrete blocks sued the manufacturer of the cement used to create these blocks.[321] The manufacturer of the concrete blocks alleged the cement had too much alkalinity, which caused many of the blocks to split and crack, subjecting the manufacturer of the concrete to liability.[322] The

312. *Id.*

313. *Id.* at 742.

314. *Id.* at 746.

315. *Id.*

316. *Id.*

317. *Id.*

318. *Id.* The warranty covered the "wood components, hardware, weather stripping, insect screens, and glazing beads that accompany its products ('components')." *Id.* at 740.

319. *Id.*

320. *See id.* at 742.

321. Wausau Tile, Inc. v. Cty. Concrete Corp., 593 N.W.2d 445, 449 (Wis. 1999).

322. *Id.*

plaintiff pleaded multiple theories of recovery, including breach of warranty, negligence, contribution, and strict liability.[323] The court applied the economic loss doctrine and refused to find damage to other property, reasoning that the cement was merely part of an integrated system—the block—and this finding precluded recovery for a claim for damage to other property.[324] The court's analysis turned on whether the defective product was an "integral" part of the larger system.[325] Since the defective product, the cement, was integral to the function of the damaged property—i.e. there would be no block without the cement—the cement constituted part of the same integrated system.[326]

Although the integrated system theory shrinks what constitutes other property in construction-defect cases, plaintiffs are still able to recover for damage to other property under certain circumstances.[327] For example, in *Selzer v. Brunsell*, the Wisconsin Court of Appeals held that defective windows were an integral part of a house and damage to the siding of the house caused by the windows was not considered damage to other property.[328] However, the court pointed out that if the windows would have damaged a painting inside the house, rather than just the siding, recovery under tort may have been permitted.[329] This example is consistent with the Supreme Court's decision in *Saratoga Fishing Co. v. J.M. Martinac & Co.*, which allowed the plaintiff to recover in tort for damages to miscellaneous property added to a boat after the manufacturer sold it to the purchaser.[330] In both scenarios, the items that constituted other property were added after the initial purchase of the integrated system, and both items were physically distinct from the integrated system.[331]

323. *Id.*

324. *Id.* at 453.

325. *Id.*

326. *Id.* at 453–54.

327. *See* Selzer v. Brunsell Bros., Ltd., 652 N.W.2d 806, 834 (Wis. Ct. App. 2002).

328. *Id.*

329. *Id.* at 817, 834.

330. *See* Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 884–85 (1997); *see also* RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. e, illus. 4 (AM. LAW INST. 1998). The *Restatement (Third) of Torts* uses the example of a defective forklift in a manufacturing plant to show when recovery is permitted under the other property exception. If the forklift is defective and loses control—damaging an assembly line—the damages from the defective forklift are considered to be damage to other property actionable under tort. The forklift and the plant are not an integrated system.

331. *Compare Saratoga Fishing Co.*, 520 U.S. at 884–85, *with Selzer*, 652 N.W.2d at

B. *Summary of the Integrated System Theory*

The economic loss doctrine, coupled with the integrated system theory, expands the scope of what constitutes a single product.[332] Instead of viewing all of the component parts of a finished product, such as a house, as distinct and separate smaller products (i.e. windows, doors, cabinets, etc.), the integrated system theory contextualizes all of the component parts as a single integrated system.[333] As the definition of what constitutes a single product expands, the "other property" exception shrinks.[334] The resulting application of this theory means fewer plaintiffs prevail when suing in tort under the other property exception to the economic loss doctrine.[335]

When the Wisconsin Supreme Court adopted the integrated system theory, it reasoned that the theory encourages the buyer—often considered to be the party best situated to assess the risk of loss—to assume, allocate, or insure against the risk of loss.[336] The buyer is thought to be in the best position to assess and insure against risk because a product manufacturer does not know how well a product will be installed, if the product will be misused or left out in the rain, or if the product will be otherwise damaged prior to installation.[337] During the purchasing process, a buyer can purchase insurance or bargain for a better price or a better warranty from the product seller, whether through a third party, such as a distributor, or directly from

834. Conceptually, this distinction makes sense as well. For instance, it is easy to see a window, door, and wall as a single unit. The analysis becomes strained when a TV, couch, or other property (pun not intended) inside the house is viewed as a component part of the house, since these items are rarely purchased as a part of the integrated system.

332. *See, e.g.*, *Selzer*, 652 N.W.2d at 817, 834.

333. *See* Bay Breeze Condo. Ass'n v. Norco Windows, Inc., 651 N.W.2d 738, 746 (Wis. Ct. App. 2002).

334. *See id.*

335. *See* Anzivino, *The False Dilemma*, *supra* note 55, at 1144–45 (discussing the difficulty of applying the integrated system test and arguing for application of the contracts-first approach instead). There is some merit to Anzivino's suggestion because of the great variance in the integrated system approach and the ad hoc, case-by-case analysis required by its application. *See id.* at 1144. As an alternative to Anzivino's suggestion, one could also see value in a simplification of the integrated system theory to make it less confusing and easier to apply. How to simplify it might be a complicated matter and the drafters of the inevitable *Restatement (Fourth) of Torts* will hopefully address the problem.

336. *See* Daanen & Janssen, Inc. v. Cedarapids, Inc., 573 N.W.2d 842, 849 (Wis. 1998).

337. *Id.*

the product manufacturer.[338] The application of the integrated system theory allows a manufacturer to price each of its products at the lowest price possible and eliminates the need for the manufacturer to have to speculate how the product may be misused, improperly installed, or damaged in the future when setting the product's price.[339]

Critics of the integrated system theory contend that application of the theory may completely swallow the other property exception.[340] In most cases involving a product, an argument exists that there is an integrated system, and it is difficult to know where a court may draw the line. Much like a proximate cause analysis, there must be a certain logical cutoff where a product ends and other property begins. There is likely no functional bright-line rule for determining where one product ends and another begins, but there is no reason this analysis cannot be done on a case-by-case basis.

VII. EXPLOITATION THEORY

Some jurisdictions only allow the economic loss doctrine to be asserted in transactions between merchants, as opposed to individual consumers.[341] This result is based on exploitation theory, which reasons that ordinary consumers lack bargaining power when they buy a product from a manufacturer.[342] Because the average buyer lacks bargaining power,

338. *See* Beyond the Garden Gate, Inc. v. Northstar Freeze-Dry Mfg., Inc., 526 N.W.2d 305, 309–10 (Iowa 1995) ("In short, we believe that a buyer should pick his seller with care and recover any economic loss from that seller and not from parties remote from the transaction. Put another way, we believe the user is often the 'least cost avoider.' By placing the loss on him or by forcing him to bargain with his immediate seller about the loss, we may minimize the total loss to society. If the manufacturer is not the least cost risk avoider, but must nevertheless bear the loss, we may cause him to spend more of society's resources than are optimal to avoid the loss and may unnecessarily increase the cost of the commodity sold." (quoting 1 WHITE & SUMMERS, *supra* note 39, § 11–5, at 539–40)). Whether the consumer can realistically bargain with a manufacturer is certainly going to vary by manufacturer and may not always be a realistic option.

339. *See id.* at 310; *see also* Priest, *supra* note 156, at 1331 n.140 (emphasizing how warranties universally exclude damage or defects caused by consumer misuse).

340. *See* Anzivino, *The False Dilemma*, *supra* note 55, at 1146 ("Currently, with the integrated system rule and the disappointed expectations test, an other property damage case is virtually always a contract case.").

341. *See, e.g.*, Franklin Grove Corp. v. Drexel, 936 A.2d 1272, 1277 (R.I. 2007); *see also* Rousseau v. K.N. Constr., Inc., 727 A.2d 190, 193 (R.I. 1999).

342. *See* Priest, *supra* note 156, at 1301.

the buyer should not be limited to contract remedies for which they had no meaningful input.[343]

The New Jersey Supreme Court succinctly explained the concept of exploitation theory in the case of *Henningsen v. Bloomfield Motors, Inc.*, wherein Chrysler sold a defective car that caused severe personal injuries.[344] The car warranty limited the manufacturer's liability by excluding the consumer's right to bring claims for breach of implied warranties or personal injury.[345] The court found Chrysler's exclusions "violative of public policy and void,"[346] reasoning that allowing an "automobile manufacturer to use its grossly disproportionate bargaining power to relieve itself from liability" would be "inimical to the public good."[347] The court noted it would be wrong to impose the risk of personal injury caused by an automobile onto the ordinary buyer because the ordinary buyer "has no real freedom of choice."[348] The court further recognized that while theoretically the consumer could have purchased the car from someone else, because manufacturers tend to offer the same or substantially similar warranties, "freedom of choice" in this context was merely a fiction.[349]

The average buyer's absence of choice in bargaining with manufacturers is the underpinning to exploitation theory.[350] Exploitation theory assumes that manufacturers attempt to exploit consumers for all they are worth while limiting their own liability as much as legally possible.[351] This perspective is like something out of an Ayn Rand novel, in that it objectifies the manufacturer's motivations as rationally selfish and assumes they are purely economic.[352] George Priest, distinguished research scholar and

343. *See id.* at 1301–02.

344. Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69, 73 (N.J. 1960).

345. *Id.* at 88–89.

346. *Id.* at 97.

347. *Id.* at 95.

348. *Id.* (supporting strict products liability in favor of the consumer, who is said to have no bargaining power when he must own a product, such as a car, and the manufacturer and all the manufacturer's competitors offer their cars with the same or substantially the same warranties and the consumer must take the product or leave it, but cannot leave it because it is a necessity). This reasoning, as it relates to strict products liability, has been adopted in virtually all jurisdictions.

349. *Id.*

350. Priest, *supra* note 156, at 1299–1302 (discussing the exploitation theory's history and milestones).

351. *See id.*

352. *See, e.g.*, AYN RAND, ATLAS SHRUGGED (1957).

Professor at Yale University, criticizes exploitation theory because it "provides no theoretical link between market power and product warranty terms."[353] If the exploitation theory is correct, the biggest manufacturers should exploit their large market share to issue one-sided warranties to the consumer and thus make more money.[354] Priest's criticism demonstrates this theory is likely false and that not all manufacturers exploit their market power to issue one-sided warranties.[355] Priest's criticism is based upon numerous statistics and comparisons of warranties issued by corporations like General Electric.[356] He suggests exploitation theory is not supported merely by the size of a manufacturer and posits that both small and large manufacturers tend to offer fairly similar warranties—whether it is for coverage of basic parts, extended parts, basic labor, original purchaser limitations, etc.[357]

A. *The Consumer Exception*

The consumer exception applies exploitation theory's rationale to the economic loss doctrine. Under the consumer exception, the economic loss doctrine only applies in commercial transactions between merchants and "not to a consumer who purchases goods for personal [or] residential use."[358] Thus, because consumers lack bargaining power, they are not limited to the contractual remedies provided by the manufacturer.[359] Instead, the consumer exception allows dissatisfied consumers to pursue remedies in tort since the consumer had no real input in bargaining for the contractual remedies provided by the manufacturer.[360] While the consumer exception detracts from the pure application of the economic loss doctrine and further complicates application of the doctrine in certain jurisdictions, proponents

353. Priest, *supra* note 156, at 1321.

354. *See id.*

355. *See id.* at 1320–25.

356. *Id.*

357. *Id.* at 1320–27.

358. Richards v. Midland Brick Sales Co., 551 N.W.2d 649, 651 n.2 (Iowa Ct. App. 1996) (citing Bowling Green Mun. Utils. v. Thomasson Lumber Co., 902 F. Supp. 134, 136 (W.D. Ky. 1995); Frankenmuth Mut. Ins. Co. v. Ace Hardware Corp., 899 F. Supp. 348, 351 (W.D. Mich. 1995)) (noting that some courts only apply the economic loss rule in a commercial context and "not to a consumer who purchases goods for personal, residential use").

359. *See* Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69, 94–96 (N.J. 1960).

360. *See id.* at 100.

argue it provides a more fair result based on the parties' respective bargaining powers.[361]

The economic loss doctrine applies equally to consumers and merchants in Kansas,[362] Michigan,[363] North Dakota,[364] Tennessee,[365] and Wisconsin.[366] Other jurisdictions do not apply the doctrine to the consumer at all (e.g. Rhode Island[367]), and there are still other jurisdictions that protect consumers only in certain situations. Then there are courts, such as Iowa,[368] that have acknowledged the existence of the consumer exception outside of their own jurisdiction but have not yet decided whether the exception applies in their jurisdiction.

Whether a state adopts the consumer exception to the economic loss doctrine depends on whether the state sees value in applying exploitation theory to all products.[369] Exploitation theory is uniquely designed to address strict products liability and dangerous products, such as automobiles; it is less suited for cases not involving strict products liability principles.[370] For example, strict products liability is not particularly relevant to construction-defect cases involving general construction materials, such as windows, which are not inherently dangerous products. However, plaintiffs still allege strict products liability in such cases.[371] Pleading strict products liability in

361. *See generally* Priest, *supra* note 156, at 1299–1302 (discussing the exploitation theory's history and milestones).

362. *See* Jordan v. Case Corp., 993 P.2d 650, 652 (Kan. Ct. App. 1999).

363. *See* Sherman v. Sea Ray Boats, Inc., 649 N.W.2d 783, 786–88 (Mich. Ct. App. 2002).

364. *See* Clarys v. Ford Motor Co., 592 N.W.2d 573, 578 (N.D. 1999).

365. *See* Ritter v. Custom Chemicides, Inc., 912 S.W.2d 128, 133 (Tenn. 1995).

366. *See* State Farm Mut. Auto. Ins. Co. v. Ford Motor Co., 592 N.W.2d 201, 205 (Wis. 1999); Selzer v. Brunsell Bros., Ltd., 652 N.W.2d 806, 817 (Wis. Ct. App. 2002).

367. *See* Franklin Grove Corp. v. Drexel, 936 A.2d 1272, 1275–77 (R.I. 2007).

368. Richards v. Midland Brick Sales Co., 551 N.W.2d 649, 651 n.2 (Iowa Ct. App. 1996). The Iowa Court of Appeals states the plaintiff failed to raise the consumer exception argument. *Id.* From the court's conclusory tone regarding the consumer exception, it sounds like the plaintiff's failure to raise the argument was a mistake.

369. *See* Priest, *supra* note 156, at 1299–1302.

370. *See id.* at 1324 ("The evidence most persuasive to judicial acceptance of the exploitation theory, however, was the correspondence between the high level of concentration in the automobile industry and the restrictive content of automobile warranties, in particular, the prevalence of disclaimers and exclusions of liability.").

371. *See* Bay Breeze Condo. Ass'n v. Norco Windows, Inc., 651 N.W.2d 738, 740 (Wis. Ct. App. 2002) (raising strict products liability claims against a window manufacturer).

construction-defect cases without personal injury is contrary to the core purpose of strict products liability, which is "to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves."[372] Instead, a consumer's appropriate action in a construction-defect case without personal injury or damage to other property lies in contract.[373]

Rousseau v. K.N. Construction, Inc. provides a useful example of the consumer exception in action.[374] In *Rosseau*, plaintiffs purchased a parcel of land from the defendant, intending to build a home.[375] The defendant hired an engineer who performed tests confirming the lot would be suitable for a septic system.[376] However, when the plaintiffs attempted to build a home several years later, these tests turned out to be incorrect.[377] As a result, "[t]he plaintiffs brought several contract claims against [defendant] and an action based on negligence and fraud against [the engineer], seeking economic damages only."[378] The engineer argued the parties lacked privity of contract; therefore, the plaintiffs could not pursue tort claims against him because his duties arose from his contract with the defendant.[379]Alternatively, the engineer argued the economic loss doctrine prohibited plaintiffs' negligence and fraud claims because the plaintiffs only sought economic damages.[380] The plaintiffs argued that the economic loss doctrine did not apply to them because they were consumers, not merchants, and the economic loss doctrine is only applicable to merchants under Rhode Island law.[381]

372. *See* Passwaters v. Gen. Motors Corp., 454 F.2d 1270, 1277 (8th Cir. 1972) (quoting Hawkeye–Sec. Ins. Co. v. Ford Motor Co., 174 N.W.2d 672, 683 (Iowa 1970)) (discussing the history of strict products liability which shows that it is basically a tort doctrine that mimics the tort concept of implied warranty without need to apply privity, notice, disclaimer, or reliance); *see also* RESTATEMENT (SECOND) OF TORTS § 402A (AM. LAW INST. 1965).

373. *See* Rousseau v. K.N. Constr., Inc., 727 A.2d 190, 192–93 (R.I. 1999).

374. *Id.* at 191–92.

375. *Id.*

376. *Id.* at 191.

377. *Id.* at 192.

378. *Id.*

379. *See id.* at 192–93.

380. *Id.* at 192.

381. *Id.* The plaintiff's argument is based on the origination of the economic loss doctrine from the UCC, which does in fact govern transactions between merchants. *See* U.C.C. § 2-102 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

The Supreme Court of Rhode Island held (1) privity was no longer required for tort actions in Rhode Island, which meant that "architects, engineers, and other improvers of real property" were exposed to "unlimited potential liability to third parties,"[382] and (2) Rhode Island recognized the consumer exception to the economic loss doctrine, which meant that the doctrine did not apply to the plaintiffs' tort claims against the engineer because the plaintiffs were consumers.[383] The court determined that when "a cause of action arises under a contract and a consumer lacks privity of contract with the offending party, an action in tort remains available, even if the damages are purely economic."[384] As a matter of public policy, the court reasoned that consumers in Rhode Island have been traditionally entitled to special protections when they deal with commercial entities, so it was sensible to extend these protections to the application of the economic loss doctrine.[385]

The *Rousseau* opinion did not expressly refer to exploitation theory, but it embraced the theory in its result by relying on Rhode Island's history and tradition of protecting consumers in their transactions with merchants.[386] However, the court stopped short of explaining why that history and tradition exists or why consumers need additional protections when dealing with commercial entities.[387] While there are transactions in which consumers arguably need added protections, there are also plenty of situations where such added protections are not necessary or rational.[388] For instance, what if the defendant in *Rousseau* was a small company with a single manager? What if the plaintiffs drafted the contract? What if the plaintiffs had more income than the defendant? Under exploitation theory, the answer to each of these questions is based on the relative bargaining powers of the parties, meaning the consumer exception only applies in situations in which the consumer lacks bargaining power.[389] Thus, if a consumer is on equal grounds

382. *Rousseau*, 727 A.2d at 192 (quoting Walsh v. Gowing, 494 A.2d 543, 548 (R.I. 1985)).

383. *Id.* at 193.

384. *Id.*

385. *Id.*

386. *See id.* ("This Court has long adhered to a tradition of providing increased protection and an opportunity for recovery in cases in which consumers deal with commercial entities.").

387. *See id.*

388. *See generally id.*

389. *See generally* Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69, 94–96 (N.J. 1960) ("But quite obviously the Legislature contemplated lawful stipulations (which are

with a manufacturer or a business when buying a product or drafting a contract, the consumer exception will not apply.[390]

The consumer exception to the economic loss doctrine applies broadly and, in some transactions, results in seemingly unfair outcomes. Applying the exception to every consumer—regardless of their bargaining power—delivers predictable and consistent results at the expense of the rationale behind exploitation theory. While it is generally true that consumers lack bargaining power with commercial entities and can, at times, be seen as a class of persons who need special protections, there are also situations where consumers stand in the same, if not better, bargaining position as commercial entities.[391] *Rousseau*'s almost blind support of the consumer over commercial entities is arguably broader than it needs to be and should be subject to scrutiny in situations where the consumer possesses adequate bargaining power. While modifying the exception to account for the parties' relative bargaining power would make it less predictable, such changes may be necessary in order to produce fair and equitable results that reflect the respective parties' bargaining powers. Additional research evaluating the actual bargaining power between the consumer and the commercial entity should be done to best craft an efficient, but fair, consumer exception.

VIII. CONCLUSION

The premise of the economic loss doctrine is simple: contract and tort are separate and distinct areas of the law that provide separate and distinct remedies.[392] A party who enters into a contract which contains terms that limit recovery in the event of a breach are typically unable to circumvent such provisions by alleging a tort occurred as well.[393] The warranty or contract's terms and conditions set forth the rules governing the relationship,

determined by the circumstances of a particular case) arrived at freely by parties of relatively equal bargaining strength. The lawmakers did not authorize the automobile manufacturer to use its grossly disproportionate bargaining power to relieve itself from liability and to impose on the ordinary buyer, who in effect has no real freedom of choice, the grave danger of injury to himself and others that attends the sale of such a dangerous instrumentality as a defectively made automobile.").

390. *See id.*

391. *Compare id.*, *with* Sherman v. Sea Ray Boats, Inc., 649 N.W.2d 783, 786–88 (Mich. Ct. App. 2002).

392. *See, e.g.*, Giles v. Giles Motors Acceptance Corp., 494 F.3d 865, 873 (9th Cir. 2007).

393. *See, e.g.*, Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1230 (W.D. Wis. 1997).

and tort law does not expand the remedies of the contract beyond the agreed-to terms.[394] Absent personal injury or damage to other property, the sole remedy lies in contract.[395]

Nearly every state utilizes some form of the economic loss doctrine, whether it be the majority approach outlined in *Seely*, a variance of the intermediate approach, or a combination of different approaches.[396] Unfortunately, the numerous approaches taken by the different jurisdictions make the doctrine a "confusing morass."[397] The doctrine no longer produces clear and consistent results across state lines, instead results vary depending on the fact pattern of the particular case and the variation of the doctrine utilized by the jurisdiction.[398]

Through examining the doctrine's history, modern application, and various forms, this Article endeavors to provide practitioners, judges, and scholars with a practical guide to navigate the economic loss doctrine. Although almost every jurisdiction has a uniquely crafted doctrine, the definitions, variations of the doctrine, and concepts discussed in this Article provide workable definitions and examples supported by case law, the UCC, and academic scholarship.

The integrated system theory and the consumer exception substantially impact how the doctrine functions in jurisdictions that have adopted either approach. The integrated system theory greatly impacts a plaintiff's ability to recover tort damages under the other property exception. This theory conceptualizes a product and all of its components as a single integrated product, which drastically shrinks what constitutes other property under the economic loss doctrine. On the other hand, the consumer exception broadens the remedies available to a plaintiff by barring the doctrine's application in transactions between consumers and merchants. Under this exception, the doctrine only applies in commercial transactions between

394. *See* Digicorp, Inc. v. Ameritech Corp., 662 N.W.2d 652, 659 (Wis. 2003).

395. *See id.* at 661.

396. *See* Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014); David v. Hett, 270 P.3d 1102, 1105 (Kan. 2011).

397. Lesiak v. Cent. Valley Ag Coop., Inc., 808 N.W.2d 67, 80 (Neb. 2012); *see also* Schwiep, *supra* note 35, at 34 ("[I]t is clear that judges, lawyers, and commercial clients alike are all desperately struggling to define the parameters of the economic loss doctrine.").

398. *See David*, 270 P.3d at 1105.

sophisticated parties, meaning consumers are free to bring tort claims against merchants for economic damages.

The economic loss doctrine is a powerful tool for defendants that impacts the way plaintiffs are able to bring causes of action. Some jurisdictions have extensive case law devoted to the economic loss doctrine[399] —requiring attorneys and judges to wade through volumes of cases to figure out how the doctrine works—while others still fail to delineate the doctrine's parameters or define its essential terms.[400] Other states have acknowledged that some of the exceptions exist, but have dodged deciding if the exceptions should apply in their state because parties either lacked standing or failed to properly present the issue for review.[401] Because of this, the economic loss doctrine has rightfully been dubbed a "confusing morass." [402]

The economic loss doctrine preserves the important distinction between contracts and torts.[403] As the doctrine continues to evolve, it is more important than ever for practitioners, judges, and scholars to understand how the doctrine works and the rationale behind its application.

399. *See* WICKERT, *supra* note 280, at 8. ("Wisconsin has been a hotbed of ELD litigation and development, resulting in perhaps more [economic loss doctrine] decisions in the past 20 years than any other state.").

400. *See* MINN. STAT. ANN. § 604.101 (West 2018). Minnesota's statute on the economic loss doctrine fails to define "other property" under the statute.

401. *See* Richards v. Midland Brick Sales Co., 551 N.W.2d 649, 651 n.2 (Iowa Ct. App. 1996) ("Some courts have pointed out the economic loss rule applies only in a commercial context, not to a consumer who purchases goods for personal, residential use. The plaintiff in this case does not argue the doctrine is inapplicable because the sale of the bricks was not a commercial transaction." (citations omitted)). Iowa has acknowledged the "consumer transaction exception," but has not adopted or rejected it. *See id.* at 651.

402. *Lesiak*, 808 N.W.2d at 80; *see also* Schwiep, *supra* note 35, at 34 ("[I]t is clear that judges, lawyers, and commercial clients alike are all desperately struggling to define the parameters of the economic loss doctrine.").

403. *Lesiak*, 808 N.W.2d at 81; *see also* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 871 (1986) (adopting the economic loss doctrine as outlined in *Seely* and causing it to become the majority approach taken by the states); Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965), *superseded by statute on other grounds*, CAL. CIV. CODE §§ 895–945.5 (West 2014).