

# The Economic Loss Rule: Easier to State Than to Apply

By Kurtis B. Reeg and Marshall S. Shapo

**S**UITS FOR economic loss in product liability cases present a recurrent set of slippery issues. Company officials may find the distinctions bewildering, and corporate and outside counsel frequently will find them costly to research and litigate. Enterprises are likely to wind up on both sides of these suits — not only as defendants in consumer litigation, but as claimants against other business firms.

The general rule, although one that has a lot of leakage around its edges, is that economic loss is not recoverable under tort theories of negligence and strict liability. The principal bar to recovery in such litigation emanates from the idea that contract, rather than tort, law governs liability for economic loss in cases involving sales of goods.

The rationale for the rule was well stated by California's famous — or infamous — Justice Roger J. Traynor, who, in a notable dictum, strenuously opposed tort liability for economic loss. He said that a manufacturer should not be liable "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." *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

A leading decision by the Illinois Supreme Court put a sharp point on

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the view that there should be no tort liability for economic loss in product cases. The court did so by distinguishing calamitous conduct-related occurrences posing physical hazards from products that simply exhibit defects that make them inadequate for the tasks for which they were designed. The occasion was a case in which a crack developed in the ring of a bolted steel grain storage tank. The court said that to apply tort theories in such a case, where the tank had not suddenly failed, "would, in effect, make a manufacturer the guarantor that all of its products would continue to perform satisfactorily throughout their reasonably productive life." *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 91, 435 N.E.2d 443, 453 (1982).

Thus, claimants suing under a tort theory for losses that are essentially economic have to find a way to circumvent the general rule. One avenue invokes the major distinction in the law between economic loss, for which tort recovery is denied, and property damage, for which liability will be imposed. This dichotomy has led to considerable disagreement over what constitutes "property damage." Some courts have construed the concept broadly, as in one decision that applied strict liability to the manufacturer of a mobile home that had a number of defects — for example, a sag in the living room ceiling and shingles that blew off the roof — even though many other courts would view these items as falling under the umbrella of economic loss. *Thompson v. Nebraska Mobile Home Corp.*, 198 Mont. 461, 647 P.2d 334 (1982).

## The Nonrecovery View

On the nonrecovery side of this issue, the U.S. Supreme Court has

weighed in with an influential opinion that denied recovery for a product that, because of its defects, effectively destroyed itself.

The case involved defective components in turbines that allegedly caused damage to the turbines themselves. In rejecting a tort claim in admiralty, the Court said, "The tort concern with safety is reduced when an injury is only to the product itself," which it said "is most naturally understood as a warranty claim." *East River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 871-72 (1986).

## Some State Courts Swayed

While state courts are not directly governed by this federal decision, many have found it persuasive nonetheless. Among the recent state

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decisions that have applied this type of thinking and denied recovery is a case involving deterioration of roofs brought against makers of plywood treated with fire retardant. *Morris v. Osmose Wood Preserving*, 340 Md. 519, 667 A.2d 624 (1995).

The strength of the economic loss rule is also evident in an opinion by the Florida Supreme Court (answering certified questions from a federal appellate court) that opposed recovery in tort for school buses that caught fire and were destroyed. *Airport Rent-A-Car Inc. v. Prevost Car Inc.*, 660 So. 2d 628, 631 (Fla. 1995).

The Michigan Supreme Court has also denied recovery on the basis of the economic loss rule when dairy farmers claimed that milking equipment was so defective that it made their cattle ill — some so sick that they died. *Niebarger v. Universal Cooperatives Inc.*, 439 Mich. 512, 486 N.W.2d 612 (1992).

Yet, as courts are sometimes wont to do, the Supreme Court distinguished its own opinion in the turbines case in a suit involving equipment that was added to a defective ship. In the Court's view, this equipment — a skiff, a fishing net and spare parts — qualified as "other property" — that is, other than the ship, so that tort recovery could be had for property damage to the added equipment. *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875 (1997).

### Distinction Hard to Define

This combination of Supreme Court decisions shows that the distinction between economic loss and property damage is fluid, if not elusive. It appears that what the courts are grappling with is a way to divine and segregate those cases in which there is a real possibility of identifying and addressing potential disputes in advance through contract. Most

judges appear to hold claimants' feet to the fire when they sue after the fact for consequences and damages that they could have bargained about and solved (or at least addressed) in advance.

This explanation is borne out by the case law. Courts have frequently denied tort recovery to ordinary consumers when the claims are essentially for pocketbook loss. However, they have been downright hostile to commercial parties that bring tort suits merely because a product disappointed them.

Illustrative of a case that yields this result is a decision that denied recovery to a manufacturer of a power generating system that operated in a faulty manner. In this instance, the court emphasized that both parties were "commercial enterprises contracting from positions of relatively equal bargaining power for a product designed to negotiable specifications and not furnished off the shelf." *General Public Utilities Corp. v. Babcock & Wilcox Co.*, 547 F. Supp. 842, 845 (S.D.N.Y. 1982).

### Caveat Emptor

Accordingly, the buyer should beware. Those who purchase products by methods other than over-the-counter, for which a written purchase order or contract is involved, would be well served by considering and addressing their potential losses in advance. When businesses do this, future claims can be adjudicated as a matter of contract law, and the gamble over tort recovery can thereby be avoided. Otherwise, most of the current case law indicates that the hope of recovering economic damages related to failure may prove elusive. Finally, because some uncertainty in the law remains, sellers themselves are well advised to use care when allocating losses by contract. ■

## CASE NOTES

### ASBESTOS

➤ **Court Finds That Defendants Conspired to Hide Information.** An Illinois appellate court has upheld the award of \$700,000 to the estate of a security guard who died of mesothelioma, finding that two manufacturers of asbestos products conspired to suppress information about asbestos-related hazards. *Burgess v. Abex Corp.*, No. 95L93 (Ill. Ct. App. 4th Dist. June 17). The decedent had worked for nine years as a guard at a plant that manufactured asbestos products; he later developed mesothelioma. His estate, represented by James Wylder of Walker & Wylder in Bloomington, Ill., sued a number of asbestos manufacturers; all but two settled. A jury returned a verdict against the remaining two companies (which was reduced by the amount of the settlements), finding that sufficient evidence existed to show that the companies — which were represented by Jerold S. Solovy, Donald R. Harris and Barry Levenstam of Chicago's Jenner & Block and by Dennis J. Dobbels and Brian W. Fields of Kansas City, Mo.'s Polsinelli, White, Vardeman & Shalton — had conspired to conceal information about the harmful effects of asbestos exposure.

### EVIDENCE

➤ **Spoliation Suit Allowed if It Has 'Significant Possibility' of Success.** Relying on the answer to a certified question from a federal district court, a federal appellate court has reversed the award of summary judgment to a rental car company, ruling that the plaintiff's spoliation-of-evidence case could proceed if his crash-worthiness claim demonstrated a "significant possibility" of succeeding. *Holmes v. Amerex Rent-a-Car*, No. 9607182 (D.C. Cir. June 18). The plaintiff had been injured in a car rented from the defendant; he asked the defendant to keep the car until he could have it inspected by an expert. The defendant agreed, but when a claims representative arranged to sell the car to the plaintiff, it was discovered that the defendant had already sold the car to a salvage company and the engine had been destroyed. Represented by Jonathan E. Halperin of Washington, D.C.'s Regan, Halperin & Long, the plaintiff sued the defendant for negligent spoliation of evidence and tortious interference in his claim against the vehicle's manufacturer. He presented an accident reconstruction expert who testified that if the vehicle had been saved in the