significant number of the courts have held that when a contractor or owner/developer suffers damages as a result of errors by a design professional, the economic loss doctrine bars negligence claims, unless such negligence causes either personal injury or damage to “other property.” What constitutes “other property” is often the central issue analyzed by the courts in these types of cases. “Economic loss” is the result of the failure of the product to perform to the level expected by the buyer, which is the core concern of traditional contract law.

Two recent court decisions in Nevada and Arizona, both involving professional soils engineering services, examine situations involving claims for purely economic damages resulting from the delivery of professional services. In Nevada, the Court refused to allow the owner to make a negligence claim against a design professional for economic losses in the absence of physical injury or damage to “other property.” In the more recent Arizona case, the Court allowed the owner to assert a claim for negligent design services and
concluded that the economic loss doctrine did not apply where the design professional’s services resulted in physical damage to “other property.”

NEVADA UPDATE:
ECONOMIC LOSS RULE BARS NEGLIGENCE CLAIM AGAINST ENGINEERING FIRM

In *Terracon Consultants Western, Inc. et al. v. Mandalay Resort Group, et al.*, the Nevada Supreme Court applied the economic loss doctrine to bar a negligence claim against a design professional that provided engineering services for the development of a casino resort where the plaintiffs’ damages were purely financial. Terracon provided geotechnical engineering advice about the subsurface soil conditions and recommended a foundation design for the property but was not involved in constructing the property. During construction, the soil settled more than Terracon’s predictions and the municipal building inspector required the developer to repair and reinforce the foundation before proceeding with construction.

The developer then sued Terracon for damages, alleging breach of contract and professional negligence. Terracon argued that the economic loss doctrine barred the developer’s negligence claim for purely economic losses in the absence of physical injury or damage to “other property.” Terracon urged the Court to limit the developer to damages available under the contract: that is, damages within the contemplation of the parties. The economic loss doctrine draws a legal line between contract and tort liability that forbids tort compensation for “certain types of foreseeable, negligently caused, financial injury.”

The developer on the other hand, urged the Court to extend an exception to the economic loss doctrine, created in cases concerning professional negligence against attorneys, accountants and insurance brokers. The Court distinguished those cases, however, because those cases involved professionals that owed duties beyond the terms of the contract. In this case, however, the Court did not find any reason to create a new exception for the design professional. Instead, the Court maintained its previous pronouncement that the economic loss doctrine bars unintentional tort actions when the plaintiff seeks to recover purely economic losses. The Nevada Supreme Court relied on the underlying purpose behind the economic loss doctrine—to shield defendants from unlimited liability for all of the economic consequences of a negligent act, particularly in a commercial or professional setting, and thus to keep the risk of liability reasonably calculable. The Court concluded that contract law is more appropriately invoked to enforce the quality expectations derived from the parties’ agreement than tort law.
**Arizona Update:**

Economic Loss Rule Not a Bar to Negligence Claim Against Engineer Because Negligent Act Damaged “Other Property”

In *Hughes Custom Building, LLC v. Davey*, the Arizona supreme Court recently declined to apply the economic loss doctrine to bar a negligence claim against a design professional that provided soils engineering services, based on facts distinct from those in the *Terracon* case. In *Hughes Custom Building*, the developer of a residential subdivision engaged a civil engineering firm to perform various engineering services, including the preparation of a grading and drainage plan. After construction of the residences, the soil under the houses subsided and resulted in structural damage. The developer then asserted a claim against the engineer for financial damages that it alleged resulted from the engineer’s negligence.

The developer argued that the engineer had breached its duty to ensure that the lots could be used for the construction of single-family residences and also breached its duty to advise the public of any conditions that would prevent the development of the lots as intended. In other words, the developer argued that the engineer had a duty to determine whether the lots were *suitable* for the intended use. The developer sought for damages for past and future income, expenses incurred to prevent further subsidence, and for damages sustained by the purchasers of the houses. In asserting its claim, the developer argued that the economic loss doctrine did not bar its tort-based claims because the engineer’s defect design *did* result in damage to “other property” that is: residences.

The Court agreed and held that the theory underlying economic loss is that the law should permit the parties to a transaction to allocate the risk that an item sold or a service performed does not live up to expectations. Damage to the product itself is recoverable only in contract, but damage to other property (in this case, the homes) is recoverable in tort. The engineer's contract required it to plan and inspect the fill dirt used in the lots. The engineer's failure to perform its contractual duty to inspect the adequacy of the dirt led to the damage to other property—the houses. Since the damages sought were for costs to repair the houses, the court concluded that the economic loss doctrine did not bar the negligence claim for separate property damage.

OTHER STATE LAW DISCUSSING THE ECONOMIC LOSS RULE


KANSAS UPDATE


ILLINOIS UPDATE

In *2314 Lincoln Park West Condominium Association v. Mann, Gin, Ebel and Frazier Lmtd.*, 555 N.E. 2d 346 (1990) the Supreme Court of Illinois held that the economic loss rule barred malpractice and negligence claims against an architect who had provided certain work, labor and services for the construction of condominium building.

MISSOURI UPDATE

In *Businessmen’s Assurance Company of America v. Graham*, 891 S.W. 2d 438 (Mo.Ct. App. W.Dist. 1994), the Missouri Court of Appeals refused to apply the economic loss rule and allowed the owner to assert tort claims for strict liability and negligence against an architect. The court reasoned that the architect had a duty to provide professional architectural services that arose apart and was separate, from the architect’s contractual obligation to the building owner. Missouri is among a minority of states that has been slow to recognize and apply the economic loss rule.
COLORADO UPDATE

The Colorado Supreme Court adopted the economic loss rule in *Town of Alma v. AZCO Constr. Co., Inc.*, 10 P.3d 1256 (Colo. 2000). In *AZCO*, the Town of Alma alleged damages resulting from a faulty installation of a pipe. Instead of focusing on whether the damage was to the project or to "other property" the Court focused on the nature of the duty owed by the contractor and determined that the duty arose from the contract, thus limiting the City to contract damages.

The Colorado Supreme Court expanded the application of the economic loss rule in *BRW, Inc. v. Dufficy & Sons, Inc.*, 99 P.3d 66 (Colo. 2004), when it held that the rule barred both negligence and negligent misrepresentation claims asserted against an engineering firm and inspector. But see, *AC Escavating v. Yacht Club II HOA*, 114 P.3d 862 (Colo. 2005) (subcontractor owed independent duty to homeowner even though subcontractor did not have contract with homeowner, thus, the economic loss rule does not apply).

In *Hamon Contractors, Inc. v. Carter & Burgess, Inc.*, 2009 WL 1152160 (Colo. Ct. App. 2009), the Court applied the economic loss rule to bar post-contractual claims for fraud and negligent misrepresentation. Colorado is one of the few states that has extended the economic loss rule to bar fraud claims.

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