

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

TABLE OF CONTENTS

INTRODUCTION .....	276
I. THE CONSTRUCTION CONTRACT .....	279
A. <i>The Owner-Architect Agreement</i> .....	280
B. <i>The Owner-Contractor Agreement</i> .....	281
C. <i>The Important Role of the Supply Team</i> .....	281
II. THE ECONOMIC LOSS RULE .....	282
A. <i>MacPherson v. Buick Motor Co.</i> .....	283
B. <i>Seely v. White Motor Co.</i> .....	284
C. <i>East River Steamship Corp. v. Transamerica</i> <i>Delaval Inc.</i> .....	286
D. <i>Saratoga Fishing Co. v. J.M. Martinac &amp; Co.</i> .....	288
III. THE ECONOMIC LOSS RULE IN CONSTRUCTION	
MATERIAL DEFECT CASES .....	289
A. <i>Application of the Economic Loss Rule in</i> <i>Construction Cases</i> .....	290
B. <i>The Problem with Applying the Economic</i> <i>Loss Rule to Construction Material Defect Cases</i> .....	292
IV. PROPOSED SOLUTION .....	296
A. <i>Building Construction Should Be</i> <i>Distinguished from Product Manufacturing</i> .....	296
B. <i>Saratoga, not East River, Provides the Ideal</i> <i>Framework for Construction Material</i> <i>Defect Claims</i> .....	298
C. <i>There Is Precedent for Reevaluating the East River</i> <i>Analysis in Construction Cases</i> .....	300
D. <i>This Proposed Solution Does Not Unfairly</i> <i>Burden the Supply Team</i> .....	301
CONCLUSION .....	302

## INTRODUCTION

A window and a lawnmower have one thing in common—you can buy both of them at Home Depot.<sup>1</sup> Each is a product that is widely available in the market. Yet, if a defect in either product damages another piece of your property, you will likely have very different options for recovery. Under the economic loss rule (ELR), a defendant window manufacturer, unlike the lawnmower manufacturer, may ask the court to find a contractual relationship linking the defective window with your damaged property to preclude your tort cause of action.<sup>2</sup>

Traditional concepts of products liability suggest that if the lawnmower blade flew off and broke your window, then you may sue the lawnmower manufacturer for this damage to your property.<sup>3</sup> The law will recognize a clear distinction between the lawnmower and your house as separate pieces of property.<sup>4</sup> The damage that the lawnmower caused to your house will likely support a tort cause of action against the lawnmower manufacturer.<sup>5</sup>

This analysis changes if your house were to be damaged by the window itself. Perhaps the seals within the window were defective, allowing water to penetrate into the wall cavity and ultimately causing your exterior wall to rot from within. In this situation, a court will likely consider whether there was any contract linking the window purchase and installation with the overall construction of the surrounding wall before evaluating the merits of your tort claim against the window manufacturer.<sup>6</sup>

For example, you might have spent the summer converting your garage into a new home office. You began by replacing your double-hung windows with some modern casement windows. After week-

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1. THE HOME DEPOT, <http://www.homedepot.com> (last visited Sept. 20, 2011) (advertising windows and lawnmowers).

2. See *infra* Part III.

3. See W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 99, at 694-96 (5th ed. 1984).

4. *Id.* § 99, at 695 (“[T]he product must be defective in the kind of way that subjects persons or tangible property to an unreasonable risk of harm.”).

5. See *infra* Part II.A.

6. See *infra* Part III.

ends of hanging drywall, leveling floors, and mitering trim, the room finally smells like fresh paint and is filled with new furniture.

Your neighbor was so impressed with your work that he hired a contractor to give his garage the same transformation. Amazingly, his renovation meticulously copied each of your construction details, even the make and model of your windows. Unfortunately, that window model was defective; the seals were not designed properly. After a few hard rains you both noticed water stains on your walls and carpet. The defective windows have thus ruined both renovations.

Fortunately for you, each of your construction materials was purchased separately as needed. Because no single contract governed your entire renovation or your expectations of the project, the law will likely recognize the damage caused to your walls by the leaking windows as property damage.<sup>7</sup> Because the windows damaged your other property, which is distinguishable from the windows, you will be permitted to bring a tort action against the window manufacturer.<sup>8</sup>

Your neighbor, on the other hand, having contracted for the entire renovation, will not be so lucky. Under the ELR, the law will look to this contract and interpret the completed renovation as a single product because the construction contract should have protected his expectations in the project.<sup>9</sup> The water damage to his walls will likely be categorized as disappointed expectations in the renovation rather than as damage to a separate, distinguishable piece of property. The ELR, then, will likely preclude your neighbor from suing the window manufacturer in tort for this economic loss.<sup>10</sup> If a warranty from the manufacturer does not cover the damage, then your neighbor's recovery will be limited to claims arising under his contract with the builder. The ELR will therefore force your neighbor to initiate a series of liability and indemnity actions, which will drag the contractor, subcontractor, and all other related

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7. *See infra* Part III.

8. *See infra* Part III.

9. *See infra* Part III.

10. *See infra* Part III.A.

parties into litigation before the claim eventually, if ever, reaches the negligent manufacturer.<sup>11</sup>

This Note will make two primary arguments. The first is that the mere presence of a construction contract should not preclude tort recovery against a remote manufacturer. For practical reasons beyond products liability law, construction projects require a complex series of interrelated contracts.<sup>12</sup> This arrangement prevents building owners from negotiating sales contracts directly with construction material manufacturers or suppliers.<sup>13</sup> Although warranty law might effectively shift the cost of damages caused by defective construction materials away from the building owner,<sup>14</sup> the net effect of the ensuing litigation tends to shield negligent manufacturers and suppliers from liability.<sup>15</sup>

The second argument is that, rather than stretching the product-component analysis discussed in *East River Steamship Corp. v. Transamerica Delaval Inc.*,<sup>16</sup> the courts should look to *Saratoga Fishing Co. v. J.M. Martinac & Co.*<sup>17</sup> for guidance in construction material defect cases.<sup>18</sup> By characterizing the purchase of a product from the marketplace as a transition from manufacturing to the use of a product, *Saratoga* provides a framework that can appropriately distinguish between the sales contracts and the service contracts of a construction project.<sup>19</sup> This distinction will permit a building owner to pursue a tort claim directly against a construction material manufacturer or supplier without unnecessarily entangling the remaining project team in litigation. This approach focuses on the substance of construction contracts and the service that contractors provide rather than a common, but misguided, notion that contractors sell a discrete product, which they unilaterally created. While permitting tort claims against construction material manufacturers

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11. See *infra* Part III. Insurance adds an additional layer of complexity and is addressed briefly in Part IV.C.

12. See Carl J. Circo, *Placing the Commercial and Economic Loss Problem in the Construction Industry Context*, 41 J. MARSHALL L. REV. 39, 96-97 (2007).

13. See *infra* Part III.B.

14. See *infra* note 150 and accompanying text.

15. See *infra* Part IV.D.

16. 476 U.S. 858 (1986).

17. 520 U.S. 875 (1997).

18. See *infra* Part IV.B.

19. See *infra* Part IV.B.

and suppliers, the *Saratoga* framework preserves the ELR as it pertains to risks that construction contracts can properly manage—such as defective construction or design.<sup>20</sup>

## I. THE CONSTRUCTION CONTRACT

A brief introduction to construction contracts is necessary to show why they do not effectively negotiate the risk of product defects. Building construction often relies on a plethora of interrelated contracts, subcontracts, and sub-subcontracts, especially in the context of commercial construction projects.<sup>21</sup> Despite this multitude of contracts, the building owner (Owner) rarely negotiates directly with more than a few of the numerous parties required to complete the construction project (Project Team).<sup>22</sup>

The Owner typically negotiates and contracts with only two distinct parties<sup>23</sup>: (1) the architect (Architect),<sup>24</sup> who is responsible for designing the project, and (2) the prime contractor (Contractor), who is responsible for building the proposed design according to the Architect's drawings and specifications. Each of these parties subsequently delegates responsibility for design and construction

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20. A recent article argues that the ELR should not protect a negligent subcontractor. Thomas J. Craven, Comment, *The Fourth Circuit Sinks Admiral Dur's Boat and Virginia's Economic Loss Rule Insulates a Negligent Subcontractor from Tort Liability*, 16 GEO. MASON L. REV. 747, 757, 764-65 (2009). This Note does not challenge the application of the ELR to subcontracted services within the construction industry. It addresses the unique problem of how the ELR channels defective construction materials claims into contract law, despite the inadequacy of construction contracts to accommodate this risk.

21. CONSTR. SPECIFICATIONS INST., THE PROJECT RESOURCE MANUAL §§ 3.3.5 to 3.4 (5th ed. 2005) [hereinafter CSI] (describing various possible project delivery methods and the contractual structure for each). Consider, for example, the contractual relationships in a multiple-prime contract, a variation of the common single-prime contract. *Id.* § 3.3.5.2 fig.3.3-D; see also *id.* § 3.3.5.1.

22. *Id.* §§ 3.3.5 to 3.4.

23. This arrangement is ideal, despite the problem of tracing liability for decisions such as the selection of construction materials. By contracting directly with the Owner, the interests of both the Architect and the Contractor are aligned with the Owner's interests. Consider the potential for abuse if the Contractor were subcontracted to the Architect—the Contractor might be encouraged to support all of the Architect's costly design proposals. Likewise, if the Architect were subcontracted to the Contractor, the Architect might feel pressure to maximize the efficiency, rather than the artistic quality, of design.

24. Depending on the type of project, it may be possible for an Owner to contract directly with an engineer, rather than an Architect. See CSI, *supra* note 21, § 1.3.

through a series of subcontracts. It is therefore very unlikely that the Owner will ever have the opportunity, or knowledge required, to negotiate the risk of product failure directly with the construction material manufacturer, supplier, or product representative (collectively referred to as the “Supply Team”) because these parties are so far removed from the Owner.<sup>25</sup>

#### A. *The Owner-Architect Agreement*

The construction process begins when the Owner contracts with an Architect to design the project.<sup>26</sup> The Architect may then subcontract with additional consultants such as engineers and interior designers for their specific expertise.<sup>27</sup> Collectively, these parties will form the design team (A/E),<sup>28</sup> with the Architect remaining directly liable to the Owner for the work of his consultants.<sup>29</sup>

The A/E’s ultimate purpose is to prepare the drawings and specifications to guide the Contractor’s completion of the project.<sup>30</sup> It is important to distinguish the A/E’s responsibility to provide plans and specifications from the Contractor’s responsibility to direct “means and methods” of the project.<sup>31</sup> Although the A/E provides the cumulative design of the project, means and methods

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25. *Id.* § 1.2.4 (describing the role and responsibilities of the Supply Team). Although an Owner may use a purchasing contract to purchase goods directly from a manufacturer, this process will likely be used only for purchasing freestanding pieces of equipment or furniture because the manufacturer may only participate in construction under a subcontract agreement with the construction contractor. *Id.* § 5.15.

26. This Note intentionally omits other steps in the building life cycle, such as project conception, for the purpose of clarity. *See id.* §§ 1.5, 2.1. Other project delivery methods exist, but the design-bid-build method described is most common and most relevant to this Note.

27. *Id.* §§ 1.2-1.3 & fig.1.2-A. Engineering services are often required for the structural, electrical, mechanical (primarily heating and cooling), plumbing, and civil engineering design of the building.

28. A/E is a term commonly used to represent the Architect/Engineer, but it may also be used to represent the design team generally. *Id.* §§ 1.2.2, 1.3.

29. *E.g.*, COMMONWEALTH OF VA., DEP’T OF GEN. SERVS., DIV. OF ENG’G & BLDGS., BUREAU OF CAPITAL OUTLAY MGMT. CONSTRUCTION & PROFESSIONAL SERVICES MANUAL § 313.0 (2004), available at <http://www.dgs.virginia.gov/LinkClick.aspx?link=403> (permitting an Architect to subcontract portions of his work but requiring that the Architect “remain fully liable and responsible for all Work performed by his consultants ... and shall assure that [his] Work complies with all requirements of the [Owner-Architect contract]”).

30. CSI, *supra* note 21, § 5.1.

31. *Id.* § 7.9.8.

encompass the Contractor's process of physically constructing the building.<sup>32</sup> There is, in sum, a clear distribution of authority for different roles in a construction project.

### *B. The Owner-Contractor Agreement*

The Owner-Contractor agreement governs the construction of the project.<sup>33</sup> The Contractor is responsible for a wide variety of tasks related to the daily operations of the project. Among these is a responsibility to purchase the construction materials and to warrant construction materials against defects.<sup>34</sup> This guarantee is typically limited to one year and may require the Contractor to correct any defects rather than pay liquidated damages.<sup>35</sup> Although this warranty is valuable to the Owner, especially in light of the ELR, the Contractor does not have the same capabilities to test for defects as the individual product manufacturers.<sup>36</sup>

Like the Architect, the Contractor requires help from many other parties as subcontractors.<sup>37</sup> The Contractor and all of the parties with whom he subcontracts are generally referred to as the "Construction Team."

### *C. The Important Role of the Supply Team*

The A/E cannot know enough about the seemingly infinite number of available construction materials to complete the specifications by itself.<sup>38</sup> Even if the A/E specifies a common product that it

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32. *Id.*

33. *Id.* § 7.2.3.

34. *Id.* § 7.2 fig.7.2-A.

35. See David A. Senter, *Construction Warranties and Guarantees: A Primer*, CONSTR. L., Winter 2003, at 17 (describing how the form contracts provided by the American Institute of Architects, the Associated General Contractors of America, and the Construction Owners Association of America require the Contractor to guarantee the quality of materials, usually for one year).

36. See Circo, *supra* note 12, at 98 ("[T]he risk of physical harm created by products ... is a risk uniquely within the control of manufacturers and one that is beyond any risk allocation functions that product sales transactions can achieve.").

37. CSI, *supra* note 21, § 6.6.

38. The author's personal experience in architecture has proven that specifying something as ubiquitous as gypsum wallboard can still require Supply Team assistance to meet building code requirements, such as fire-rated wall assemblies. See, e.g., NAT'L GYPSUM

has used in the past, it will still need additional information, such as product lead times, which can vary from project to project.<sup>39</sup>

The Supply Team therefore plays a critical role during the design phase by helping the A/E's select appropriate products, assisting with the preparation of specifications, and explaining detailed information about each product.<sup>40</sup> Supply Team members generally act as "technical experts" to help the A/E navigate the sea of available construction materials.<sup>41</sup> Because the contract documents do not always specify which particular products are to be used, the Construction Team must also rely on the Supply Team's expertise when purchasing construction materials.<sup>42</sup>

## II. THE ECONOMIC LOSS RULE

The ELR distinguishes personal injury and property damage, which are recoverable in tort, from mere economic loss, which is recoverable only under the terms of a contract.<sup>43</sup> Therefore, a contract action, such as breach of warranty, is the only way a building owner can recover damages that are classified as economic losses. As a matter of policy, courts generally believe that contract law risks being subsumed by tort law<sup>44</sup> and that the ELR provides an appropriate demarcation between these competing doctrines.<sup>45</sup>

The following discussion will trace the evolution of products liability and the ELR. In addition to providing historical perspec-

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CO., NATIONAL GYPSUM CONSTRUCTION GUIDE 84 (12th ed. 2008), available at <http://nationalgypsum.com/resources/gypsum-con-guide.htm> (describing and detailing fire-rated wall assemblies).

39. CSI, *supra* note 21, § 4.4.5.

40. *Id.*

41. *Id.* § 5.1.

42. Of the four methods of specifying, only propriety specifications "specif[y] actual brand names, model numbers, and other proprietary information." *Id.* § 5.7. Proprietary specification is not appropriate in many instances, particularly because "the federal government and other public authorities restrict the use of proprietary ... specifications." *Id.* § 5.7.5.

43. *See, e.g.*, *E. River S.S. Corp. v. Transamerica Deleval Inc.*, 476 U.S. 858, 876 (1986).

44. *Id.* at 866.

45. *See* *Seely v. White Motor Co.*, 403 P.2d 145, 150-52 (Cal. 1965) (providing the majority argument). *But see* *Santor v. A. & M. Karagheusian, Inc.*, 207 A.2d 305, 308-11 (N.J. 1965) (providing the minority argument for permitting recovery in tort), *abrogated by* *Alloway v. Gen. Marine Indus., L.P.*, 695 A.2d 264, 269-72 (N.J. 1997).

tive, the discussion will begin to demonstrate why courts adopting the *East River* analysis have failed to appreciate the practical realities of complex contractual agreements in their attempt to protect the conceptual integrity of contract law.

A. *MacPherson v. Buick Motor Co.*

Although the earliest traces of consumer protection date back to 1603,<sup>46</sup> *MacPherson v. Buick Motor Co.* established basic principles of modern products liability.<sup>47</sup> The plaintiff, MacPherson, was ejected from his car after defective wood spokes caused a wheel to collapse.<sup>48</sup> MacPherson suffered injuries and sued Buick, the car's manufacturer, for negligence.<sup>49</sup> Although the wheel had been manufactured by a completely different company, MacPherson argued that Buick would have discovered the defect if it had adequately inspected the wheel.<sup>50</sup> MacPherson lacked any contractual privity with Buick because he purchased the car from an intermediate dealer.<sup>51</sup> The question, therefore, became whether the defendant car manufacturer owed subsequent purchasers of the car any duty that would support such a tort claim.<sup>52</sup>

For guidance, the *MacPherson* court looked back to *Thomas v. Winchester*, which linked a remote seller's negligence to foreseeability of harm.<sup>53</sup> While considering this principle, the court distinguished situations in which a buyer was aware of a defect and

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46. Marshall S. Shapo, *A Representational Theory of Consumer Protection: Doctrine, Function and Legal Liability for Product Disappointment*, 60 VA. L. REV. 1109, 1131 & n.72 (1974) [hereinafter Shapo, *Theory*]; see also Mazetti v. Armour & Co., 135 P. 633, 634-36 (Wash. 1913) (evaluating a claim for lost reputation and lost profits); Hadley v. Baxendale, (1854) 156 Eng. Rep. 145 (Exch.) 147-48 (using foreseeability to evaluate a claim for lost profits); Chandelor v. Lopus, (1603) 79 Eng. Rep. 3 (Exch.) 3-4; MARSHALL S. SHAPO, PRODUCTS LIABILITY AND THE SEARCH FOR JUSTICE 19-24 (1993) [hereinafter SHAPO, SEARCH] (discussing important foundational products liability cases).

47. 111 N.E. 1050, 1053 (N.Y. 1916) (Cardozo, J.); Shapo, *Theory*, *supra* note 46, at 1137 (describing the opinion as "a masterpiece of judicial synthesis").

48. *MacPherson*, 111 N.E. at 1051.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.* at 1051, 1053 (citing *Thomas v. Winchester*, 6 N.Y. 397, 407-11 (1852)).

knowingly accepted the risk of harm<sup>54</sup> and situations in which the manufacturer knew that subsequent purchasers would independently test the product for defects.<sup>55</sup> The court held that, because many products are dangerous if they are negligently made, a manufacturer owes consumers a duty to make his product carefully.<sup>56</sup> Privity of contract does not limit this duty; “the source of the obligation [is] where it ought to be ... in the law.”<sup>57</sup>

Although the court touched on the relevance of this products liability principle to property damage,<sup>58</sup> its holding was limited to personal injury.<sup>59</sup> Nevertheless, Judge Cardozo’s analysis relied on two important considerations, both of which establish a theme in this Note: (1) the duty arose from the foreseeability that product defects will cause harm;<sup>60</sup> and (2) the manufacturer released his product into the marketplace, where any undisclosed defects were less likely to be discovered.<sup>61</sup>

### *B. Seely v. White Motor Co.*

Almost fifty years after *MacPherson*, the Supreme Court of California reconciled strict liability in tort for defective products with the warranty provisions of the Uniform Commercial Code (UCC) in *Seely v. White Motor Co.*<sup>62</sup> *Seely* also involved the sale of an automobile, but it presented a much more complex factual scenario than *MacPherson*.

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54. *Id.* at 1051-52 (citing *Loop v. Litchfield*, 42 N.Y. 351, 360-61 (1870)).

55. *Id.* at 1052 (citing *Losee v. Clute*, 51 N.Y. 494, 495-97 (1873)).

56. *Id.* at 1053; *see also* KEETON ET AL., *supra* note 3, § 96, at 682-83 (discussing the impact of *MacPherson*).

57. *MacPherson*, 111 N.E. at 1053. Judge Cardozo adopted broader criteria for finding negligence liability in his later opinions, such as *Palsgraf v. Long Island Railroad Co.*, 162 N.E. 99, 101 (N.Y. 1928). *See* G. EDWARD WHITE, *TORT LAW IN AMERICA: AN INTELLECTUAL HISTORY* 126 (expanded ed. 2003). This Note argues that *MacPherson* struck an appropriate balance between the foreseeability of harm to a remote purchaser and the catastrophic consequences of “unlimited [tort] liability to remote persons.” *Id.* at 125-26.

58. *MacPherson*, 111 N.E. at 1052-53 (discussing English law).

59. *Id.* at 1053. Judge Cardozo later expanded this principle to permit tort recovery for economic loss in an analogous situation. *See Glanzer v. Shepard*, 135 N.E. 275, 275-76 (N.Y. 1922).

60. *MacPherson*, 111 N.E. at 1054-55.

61. *Id.* at 1055.

62. 403 P.2d 145 (Cal. 1965).

Seely, a trucker, purchased his truck through an intermediate dealer.<sup>63</sup> The sales contract contained an express warranty by the manufacturer, White Motor Company (White).<sup>64</sup> As Seely tried to make a turn, the brakes gave out and the truck rolled over.<sup>65</sup> Although Seely was not physically injured, the truck suffered damages and Seely paid to repair it.<sup>66</sup> After the incident, Seely stopped making payments on the truck, and the dealer repossessed it.<sup>67</sup> Seely's business lost profits as a result of the repossession.<sup>68</sup>

On appeal, the court provided the following analysis to distinguish the appropriate applications of strict liability and UCC remedies in the context of products defect claims:

A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone.<sup>69</sup>

Relying on this analysis, and recognizing that White's express warranty to Seely encompassed these commercial losses,<sup>70</sup> the court affirmed the award of damages for lost profits and Seely's payments on the purchase price.<sup>71</sup>

The *Seely* court also extended the scope of Judge Cardozo's *MacPherson* analysis by equating property damage to personal injury.<sup>72</sup> *Seely* has therefore been understood to hold that the law of warranty trumps tort in the absence of personal injury or

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63. *Id.* at 147; *see also* WHITE, *supra* note 57, at 205.

64. *Seely*, 403 P.2d at 148.

65. *Id.* at 147.

66. *Id.*

67. *Id.*

68. *Id.* at 147-48.

69. *Id.* at 151.

70. *Id.* at 150.

71. *Id.* at 148, 152.

72. *Id.* at 152; *see* WHITE, *supra* note 57, at 204-07.

property damage.<sup>73</sup> In other words, economic losses are governed by contract, not tort.

*C. East River Steamship Corp. v. Transamerica Delaval Inc.*

Whereas *Seely* represented the majority view of denying recovery in tort for economic losses, *Santor v. A. & M. Karagheusian, Inc.* outlined the minority position.<sup>74</sup> *Santor* interpreted strict liability as an appropriate method of shifting the total cost of a defect from the consumer to the manufacturer.<sup>75</sup> In *East River Steamship Corp. v. Transamerica Delaval Inc.*,<sup>76</sup> the Supreme Court evaluated both competing approaches to give a unifying voice to the ELR.

The claims in *East River* arose from defective turbines on four chartered ships.<sup>77</sup> Each of the ships' turbines malfunctioned and forced the charterers not only to pay the cost of repairs but also to lose profits while the ships were restored.<sup>78</sup> Unlike the contracts at issue in *Seely*, the charterers' contracts included provisions stating that the charterers took the ships in "as is" condition and would bear the cost of any necessary repairs during the charter term.<sup>79</sup> The charterers were therefore unable to bring a contractual claim against the shipbuilder for breach of warranty.<sup>80</sup>

The charterers sued the turbine manufacturer for negligence and strict liability, arguing that the defective design of the turbines led to their repair expenses and lost profits.<sup>81</sup> The Court recognized that the broad risk of product failure, which the charterers assumed in the "as is" provision, likely lowered the contract price.<sup>82</sup> It reasoned that the charterers should not be permitted to sidestep this deliberate allocation of risk by bringing a tort claim against the manufacturer of a component of the overall product.<sup>83</sup> The economic

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73. See, e.g., WHITE, *supra* note 57, at 205.

74. 207 A.2d 305, 311-13 (N.J. 1965).

75. *Id.*

76. 476 U.S. 858 (1986).

77. *Id.* at 859-61.

78. *Id.* at 860-61.

79. *Id.* at 860, 875.

80. *Id.* at 875.

81. *Id.* at 861.

82. *Id.* at 873.

83. *Id.* at 867-68, 873.

loss rule therefore barred the tort claim for repair costs and lost profits by characterizing these losses as disappointed expectations in the product itself.<sup>84</sup>

This Note argues that *East River* was an unusual example of products liability because the “as is” provision clearly expressed the plaintiffs’ intent to accept all risk of defects. In fact, Judge Traynor’s *Seely* opinion had already suggested that “as is” sales would not support liability for economic losses.<sup>85</sup> Nevertheless, *East River* holds that when a product component damages the larger product, as opposed to other property, a plaintiff must ground his claim in contract law and look to the product’s warranty for recovery.<sup>86</sup>

The Court made a strong argument against the conceptual disaggregation of a product into its component parts. Such disaggregation would permit a plaintiff to argue that his property—the product—was harmed by a component part.<sup>87</sup> This logic would render warranty law useless because a plaintiff could continuously subdivide his product until he found a tort claim against a remote manufacturer beyond the scope of the warranty.<sup>88</sup> The problem that *East River* presented therefore became how to define the scope of “other property” in specific applications.<sup>89</sup>

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84. *Id.* at 872.

85. *Seely v. White Motor Co.*, 403 P.2d 145, 150 (Cal. 1965) (“Had defendant not warranted the truck, but sold it ‘as-is,’ it should not be liable for the failure of the truck to serve plaintiff’s business needs.”).

86. *See E. River*, 476 U.S. at 872-73; *see also, e.g.*, Steven R. Swanson, *The Citadel Survives a Naval Bombardment: A Policy Analysis of the Economic Loss Doctrine*, 12 TUL. MAR. L.J. 135, 177-78 (1987).

87. *E. River*, 476 U.S. at 867-68.

88. *Id.*

89. *Id.* at 867; *see* H. Hugh McConnell, *The “Other Property” Problem – Applying the Economic Loss Rule to Construction Contracting Claims*, 74 FLA. B.J. 87, 87-90 (2000); *see also* Michael E. Solimine, *Recovery of Economic Damages in Products Liability Actions and the Reemergence of Contractual Remedies*, 51 MO. L. REV. 977, 987-88 (1986) (arguing that *East River* superficially discarded the “fairness” to the plaintiff in favor of other considerations, such as “economic principles”).

*D. Saratoga Fishing Co. v. J.M. Martinac & Co.*

In *Saratoga Fishing Co. v. J.M. Martinac & Co.*,<sup>90</sup> the Court confronted the flaws of *East River* by looking to the practical realities of a commercial transaction. In *Saratoga*, another admiralty case, a shipbuilder, Martinac, built a fishing vessel and sold it to a fisherman.<sup>91</sup> This fisherman used the ship for several years.<sup>92</sup> During that time, the fisherman installed nets and additional fishing equipment on the ship.<sup>93</sup> He subsequently sold the ship to a fishing company, Saratoga.<sup>94</sup> After the sale, a defect in the ship's hydraulic system, which had been installed by Martinac, caused the ship to catch fire and sink.<sup>95</sup> Saratoga sued Martinac for the cost of the added fishing equipment that sank along with the ship.<sup>96</sup>

On appeal, the Ninth Circuit applied a textbook *East River* analysis, classifying Saratoga's entire ship as the "product" and finding that the equipment was merely a component of that product.<sup>97</sup> Because the ELR governs the damage a product causes to itself, the Ninth Circuit categorized all damage to the ship and its equipment as economic loss—not property damage.<sup>98</sup> The ELR, in turn, precluded tort recovery of the cost of the lost equipment because the sales contract, not tort law, should have allocated the risk of this loss.<sup>99</sup>

To reverse the Ninth Circuit, the Supreme Court critically examined *East River* and the limits of warranty law. Although the Court acknowledged that Saratoga *could* have negotiated a warranty with the fisherman to cover both the ship and the equipment, it would be unreasonable to require such a warranty for recovery.<sup>100</sup> The fisherman was distinguishable from a manufacturer or a component supplier because he lacked the ability to "systematically control the

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90. 520 U.S. 875 (1997).

91. *Id.* at 877.

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.* at 877-78.

97. *Id.* at 878.

98. *Id.*

99. *Id.* at 880, 882.

100. *Id.* at 882-83.

manufactured product's quality or ... systematically allocate responsibility for [the equipment he added] in similar ways" as those used in the manufacturing process.<sup>101</sup> The mere possibility that a reseller could have offered a warranty did not support a requirement that contract law must provide the exclusive remedy.

The Court then determined that *East River's* product-component analysis did not apply to the facts before it. Unlike the component of a larger product, the fishing vessel had been released into the marketplace before the fisherman added the equipment.<sup>102</sup> The Court explicitly held that once a buyer purchases a product from the manufacturer or distributor, any subsequently added equipment ought to be considered "other property" under the *East River* analysis.<sup>103</sup>

The *Saratoga* analysis appreciates the purchase of a product from the marketplace as a demarcation between a product's manufacture and its subsequent use. In the context of complex commercial transactions, such as building construction, this approach provides a logical distinction between service contracts with the consumer and sales contracts with the manufacturer. Most importantly, it suggests a clear limit to the product-component analysis of *East River*. As the Supreme Court reasoned, a re-seller's warranty for a product should not eliminate the possibility of tracing a tort action back to the original manufacturer.<sup>104</sup>

### III. THE ECONOMIC LOSS RULE IN CONSTRUCTION MATERIAL DEFECT CASES

Although *East River* was an admiralty case, it had a broad impact on products liability law in state courts.<sup>105</sup> *Saratoga* has gained some recognition but generally represents a limited

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101. *Id.* at 884.

102. *Id.* at 884-85.

103. *Id.*

104. *Id.* at 880-81.

105. See CAROLYN L. CARTER ET AL., NAT'L CONSUMER LAW CTR., CONSUMER WARRANTY LAW § 12.2.1 (4th ed. 2010) (describing the influence of *East River* on state law); Peter A. Alces & Aaron S. Book, *When Y2K Causes "Economic Loss" to "Other Property,"* 84 MINN. L. REV. 1, 44 (1999) (describing *East River* as "the seminal decision on the economic loss issue").

restriction of *East River*.<sup>106</sup> Even when state courts apply a product-component analysis, they do not uniformly accept either *East River* or *Saratoga*.<sup>107</sup> The following discussion will describe how state courts frequently apply the ELR to construction cases and will show that this application is problematic in the context of damage caused by defective construction materials.

#### A. Application of the Economic Loss Rule in Construction Cases

States have independently adopted their own versions of the ELR, often including some form of the *East River* product-component analysis.<sup>108</sup> Because construction law is a specialized subset of contract law, state courts often apply a previously established ELR to construction claims without evaluating the unique aspects of construction contracts.<sup>109</sup> As a result, the *East River* product-component analysis, rather than *Saratoga* marketplace analysis, tends to provide the framework for evaluating the ELR in construction law claims.<sup>110</sup>

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106. See, e.g., *Gunkel v. Renovations, Inc.*, 822 N.E.2d 150, 153 n.1, 156 n.8 (Ind. 2005) (considering *Saratoga* to limit the product-component analysis to the contractual scope of work); CARTER ET AL., *supra* note 105, § 12.2.8.2 (discussing *Saratoga*'s restriction of *East River*).

107. CARTER ET AL., *supra* note 105, § 12.2.8.3.

108. See generally A STATE-BY-STATE GUIDE TO CONSTRUCTION & DESIGN LAW (Carl J. Circo & Christopher H. Little eds., 2d ed. 2009) [hereinafter GUIDE] (providing a current summary of the economic loss rule in each state). *But see id.* at 447 (indicating that Louisiana, for example, does not recognize any ELR); Edward E. "Ned" Nicholas III & Sean M. Golden, *The Economic-Loss and Source-of-Duty Rules and the Wall Between Tort and Contract in Virginia*, 59 VA. LAW 42, 44-45 (2010) (discussing the additional complications posed by the source of duty rule in Virginia).

109. See Circo, *supra* note 12, at 40-43 (explaining the need for a vigorous economic loss defense tailored for the construction industry). See generally GUIDE, *supra* note 108 (providing a current summary of the ELR in each state). Some states do not have written opinions addressing the ELR in the context of building construction. *Id.* at 535, 590 (providing the examples of Michigan and Mississippi); see also ABA COMM. ON CONSTR. LITIG., STATE BY STATE SURVEY OF THE ECONOMIC LOSS DOCTRINE IN CONSTRUCTION LITIGATION (1996) (analyzing early applications of the ELR to construction claims).

Other articles outline practical approaches to pursue claims against a manufacturer or supplier under the current ELR product-component analysis. See, e.g., Daniel S. Brennan, *Construction Defect Claims Against Manufacturers and Suppliers*, CONSTR. L., Spring 2003, at 15.

110. See, e.g., *Sensenbrenner v. Rust, Orling & Neal, Architects, Inc.*, 374 S.E.2d 55, 57-58 (Va. 1988) (citing *East River* to bar recovery for the consequences of a construction defect).

When applying the product-component analysis, courts will likely classify an entire building, defined by the contractual scope of work, as the product.<sup>111</sup> Construction materials are therefore often classified as components of a unified product: the building.<sup>112</sup> When these construction materials fail and damage the rest of the building, this building damage will likely be classified as economic loss, which is barred from recovery in tort.<sup>113</sup>

*Bay Breeze Condominium Ass'n v. Norco Windows, Inc.* provides an example of this reasoning.<sup>114</sup> The court in *Bay Breeze* evaluated a condominium association's claims of negligence, breach of warranty, and strict products liability against a window manufacturer.<sup>115</sup> The manufacturer's windows leaked water into the walls, resulting in extensive damage to the entire wall structure.<sup>116</sup>

Evaluating the application of the ELR to the strict liability claim, the court noted that Wisconsin's "integrated system" test superseded a previous case distinguishing different parts of a building as "other property."<sup>117</sup> Relying on this test and looking to approaches in other jurisdictions, the court found that the building, as a whole, was a finished product.<sup>118</sup> The court then classified the water damage to the wall as economic loss, which could not be recovered in tort.<sup>119</sup>

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111. See, e.g., *Casa Clara Condo. Ass'n v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244, 1247 (Fla. 1993) ("[T]o determine the character of a loss, one must look to the product purchased by the plaintiff, not the product sold by the defendant."). But see *Lord v. Customized Consulting Specialty, Inc.*, 643 S.E.2d 28, 33 (N.C. Ct. App. 2007) ("Because there was no contract between the [plaintiff homeowners] and [the defendant truss manufacturer], we further find that the economic loss rule does not apply and therefore does not operate to bar the [homeowners'] negligence claims.").

*Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, LC*, 221 P.3d 234 (Utah 2009), is noteworthy because it expanded the product-component analysis of building construction to its logical conclusion. Looking to the subject of the construction contract, the court defined the "product" as an entire complex of townhomes. *Id.* at 244.

112. See 6 PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 19:10, at 46-47 (2002).

113. *Id.*

114. 651 N.W.2d 738 (Wis. Ct. App. 2002).

115. *Id.* at 741.

116. *Id.* at 740-41.

117. *Id.* at 744.

118. *Id.* at 746.

119. *Id.* at 744-46.

*B. The Problem with Applying the Economic Loss Rule to Construction Material Defect Cases*

As discussed above,<sup>120</sup> a single contract rarely governs an entire construction project. Instead, a chain of contracts dictates each participant's role in the project.<sup>121</sup> These contracts include both service contracts and sales contracts.<sup>122</sup> The Owner is only a party to a portion of these contracts and is rarely a party to the sales contracts for the construction materials.<sup>123</sup>

This contractual paradigm severely limits each participant's ability to negotiate the risk of defective construction materials. Although contractors typically provide a warranty to guarantee the quality of the materials used in the project,<sup>124</sup> the Owner likely lacks any meaningful capacity to negotiate risk directly with a manufacturer or supplier.<sup>125</sup> Liability for harm caused by defective materials is therefore forced to trickle through the chain of contracts, tracing individual warranties.<sup>126</sup> Although other avenues are available, the chain of contracts is most likely to resolve the issue.<sup>127</sup> As the following case illustrates, the ELR tends to encumber courts with complex, wasteful litigation.<sup>128</sup>

*Bellevue South Associates v. HRH Construction Corp.*<sup>129</sup> illustrates the consequences of inflexible reliance on this contractual

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120. *See supra* Part I.

121. Circo, *supra* note 12, at 96-97 (discussing how the ELR fails to appreciate the complexity of the relationships in a construction project).

122. *See supra* Part I.

123. *See supra* Part I.

124. *See Senter, supra* note 35, at 17 (discussing the contractor warranty provisions of form contracts provided by the American Institute of Architects, the Associated General Contractors of America, and the Construction Owners Association of America).

125. Because building owners rely on contractors to purchase construction materials, it is unlikely that they have an opportunity to meaningfully negotiate risk as contemplated by *Seely* or *East River*. *See supra* Parts I, II.

126. Although a manufacturer might provide an express warranty to the building owner, "a manufacturer or supplier may have disclaimed consequential damages in the contract." Brennan, *supra* note 109, at 15; *see also* Senter, *supra* note 35, at 18-19 (discussing the "exclusion of consequential damages"). These warranties are susceptible to "battle of the forms" boilerplate material. *Id.* at 19.

127. *See generally* GUIDE, *supra* note 108 (describing the statutory warranties that each state provides); *infra* Part IV.C (addressing, briefly, the insurance consequences of building damage).

128. *See also infra* Part IV.C (noting the additional complications created by insurance).

129. 579 N.E.2d 195 (N.Y. 1991).

structure's allocation of risk. Although the case did not involve consequential building damage, it usefully illustrates the complexities of specifying and purchasing construction materials, a process that tends to drag the entire Project Team into litigation when a construction material is defective.<sup>130</sup>

The plaintiff, a building owner, hired a contractor to build a housing project.<sup>131</sup> The contractor then hired a subcontractor to provide the floor tiles according to the architect's specification.<sup>132</sup> This subcontract included an indemnity provision.<sup>133</sup> According to the architect's specifications, only a specific manufacturer's tile could be used in the project.<sup>134</sup> The subcontractor proposed a substitute manufacturer, an alternative that the architect initially rejected.<sup>135</sup> Eventually, the architect approved the substitution on the condition that the tile meet specific performance characteristics.<sup>136</sup>

After installation, individual tiles began to fall apart.<sup>137</sup> Although the contractor and subcontractor initially replaced defective tiles, they refused to continue replacement after a year.<sup>138</sup> The building owner subsequently sued both the contractor and subcontractor for breach of contract, breach of express warranty, breach of implied warranty of merchantability, and negligence.<sup>139</sup> He also brought claims against the tile manufacturer for strict liability, negligence, and breach of implied warranty.<sup>140</sup> The subcontractor then sued the manufacturer for indemnity.<sup>141</sup>

Although both the trial court and appellate court permitted the plaintiff's strict liability claim against the manufacturer,<sup>142</sup> New York's Court of Appeals found that the ELR barred tort claims

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130. The only harm was floor tile delamination. *Id.* at 197.

131. *Id.* at 196.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.* at 197.

138. *Id.*; *see also supra* note 35 and accompanying text (explaining why the contractor and subcontractor likely limited their remedial action to one year).

139. *Bellevue*, 579 N.E.2d at 197.

140. *Id.*

141. *Id.*

142. *Id.*

against the manufacturer.<sup>143</sup> Any recovery, therefore, required tracing the contracts between the plaintiff, contractor, and subcontractor. The trial court dismissed the breach of implied warranty claims, but the plaintiff ultimately prevailed against the contractor and subcontractor on the breach of contract claims.<sup>144</sup>

The value of the damages that the court awarded to the plaintiff exceeded the cost of replacing the tile,<sup>145</sup> so *Bellevue* does not suggest that contract inadequately protects building owners. Instead, it shows that exclusive reliance on these provisions unduly burdens the intermediate parties between the building owner and the manufacturer. The case also demonstrates how the uncertainty of construction litigation requires each party to allege a broad spectrum of claims against the remaining members of the construction project.

Notably, the jury found that the underlying defect in the tile originated at the factory.<sup>146</sup> Neither the contractor nor the subcontractor was likely to be better able to find or evaluate this latent defect than the manufacturer.<sup>147</sup> Perhaps most importantly, no individual party was able to make a unilateral decision about what product to use. The architect provided a proprietary specification for a particular manufacturer's tile,<sup>148</sup> so when the subcontractor wanted to use a different tile, the architect had to approve the decision through the chain of contracts. This process precluded the kind of "shopping around" that the *Seely* court believed would protect a plaintiff from "industry-wide" liability provisions for defective products.<sup>149</sup> This common contractual structure, in the end, does not provide the meaningful allocation of risk that is relied upon to justify the ELR.

To understand why this contractual structure does not represent the warranty theories of *Seely* or *East River*, one must distinguish

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143. *Id.* at 200.

144. *Id.* at 197. The trial court also dismissed the subcontractor's indemnity claim because of a remote business relationship to the manufacturer, but the Court of Appeals ordered that the claim be retried. *Id.* at 203.

145. *Id.* at 197.

146. *Id.*

147. The problem with the tile was "[a] failure of the adhesion between the wood slats and foam backing." *Id.* at 197.

148. See *supra* note 42 (describing proprietary specifications).

149. *Seely v. White Motor Co.*, 403 P.2d 145, 151-52 (Cal. 1965).

a negotiated *allocation of risk* from a construction contract's use of warranty to transfer the cost of defects back to the source of the defect.<sup>150</sup> Consider Seely's purchase of the truck. Seely approached the truck market with unilateral authority to evaluate the risk posed by each truck he encountered. He had the freedom to balance this risk against the sale price and his desire to purchase the truck. By purchasing White's truck, Seely accepted a risk that reflected his personal valuation of these factors. The contract therefore adequately accommodated the possibility that the truck would not meet Seely's expectations. In essence, the contract *allocated risk*.

As described above, construction projects use a different process. The selection of each product relies on the assent of multiple parties within the project. The Contractor or subcontractor who purchases a product relies on the Architect's specifications to select adequate construction materials. Likewise, the building owner relies on the Contractor or subcontractor to negotiate the purchase of the materials and screen for defects once the materials are delivered to the site. No single party has unilateral authority to make decisions about what product to use; the process is cumulative.

This lack of unilateral authority precludes any individual member of the project from evaluating the total cost-benefit analysis of a single manufacturer's product relative to alternative products. Instead, each member must rely on the overall structure of the construction contract to transfer the potential cost of defective products to someone else. The individual construction contracts within the chain, therefore, do not represent a negotiated allocation of risk as envisioned by *Seely* or *East River*. Indeed, they merely establish a framework to transfer the cost of defects when a building owner triggers the warranty provisions.

This cost-transference role of construction contracts shows that the mere presence of a warranty should not represent the kind of deliberate contemplation and negotiation of risk that *Seely* or *East River* deemed to govern a purchaser's expectations in a product. When warranty merely provides a structure for cost transference,

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150. This concept of using a contractual structure to transfer the cost of defects should be distinguished from a "loss spreading" policy of products liability. See SHAPO, SEARCH, *supra* note 46, at 10-11 (discussing policy considerations of products liability). The author believes construction contracts use a "cost transference" process to protect the building owner while simultaneously filtering the burden of defects back to the manufacturer.

contract law should not be considered superior to a legal allocation of risk in tort.

#### IV. PROPOSED SOLUTION

This Note criticizes the *East River* product-component analysis on the grounds that it relies too heavily on a desire to provide a bright line separation of tort from contract.<sup>151</sup> This framework leaves little flexibility for complex agreements, such as construction contracts, that mix service contracts with sales contracts. Courts should distinguish the services in a construction contract from the sales contracts for construction materials. As described below, *Saratoga* provides a useful framework for this distinction. It appreciates the ultimate purchase of a product from the market as a static limit on the conceptual expansion of a product. Using the *Saratoga* analysis, courts should classify individual construction materials, rather than entire construction projects, as the products governed by the ELR.

Under this theory, an Owner would be permitted to bring a tort action for the damage that a defective construction material caused to the building, regardless of the contractual fortuity surrounding the initial purchase of that material. The ELR would still apply to economic losses, such as defective construction or the harm an individual material caused to itself, because these actually are risks that are properly governed by construction contracts.

##### *A. Building Construction Should Be Distinguished from Product Manufacturing*

Seely might have been able to shop around for his ideal truck,<sup>152</sup> but Owners seeking construction materials do not always enjoy the same freedom.<sup>153</sup> Rather than perpetuating this fiction, courts should appreciate the substantive distinctions between product manufacturing and building construction. As described above,

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151. See *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 866 (1986) (“It is clear, however, that if this development [of products liability] were allowed to progress too far, contract law would drown in a sea of tort.”).

152. *Seely*, 403 P.2d at 152.

153. See *supra* Part III.B.

courts evaluating construction claims typically look to the Owner and what he “purchased” when applying the ELR.<sup>154</sup> The *East River* analysis often interprets the Owner as having purchased a building; this approach suggests that each individual construction material is a component of that product. In reality, however, the Contractor merely performs a service by purchasing construction materials on the market and then assembling them according to the Architect’s unique design.

This construction process is distinguishable from product manufacturing because product manufacturing involves the mass production of products from unique components designed specifically for that product.<sup>155</sup> The manufacturing process therefore places a manufacturer in the best position to inspect this multitude of products, and their component parts, for defects before releasing the completed products en masse to the unsuspecting public.<sup>156</sup>

The Contractor, who purchases construction materials on the market, simply does not have the same opportunities for product evaluation.<sup>157</sup> Contractors build each project on site according to unique plans and specifications, and they may use different materials on each project. Although the Construction Team is appropriately required to inspect, and sometimes test, the construction materials, the Contractor is ultimately an assembler, not a manufacturer. It is therefore unreasonable to interpret the Contractor’s warranty as providing the exclusive remedy for hidden defects generated by the construction material manufacturer.<sup>158</sup> The ELR should distinguish between sale of goods transactions within the construction process and the service contracts with the Owner when evaluating the scope of “other property.” Such recognition would give the Owner discretion to pursue a claim directly against a

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154. See *supra* Part III.

155. Consider, for example, the number of parts that are unique to an automobile that a single manufacturer produces in any given year. Within that product, the parts can be further distinguished by finish level or style of the production model. See AUTO PARTS WAREHOUSE, <http://www.autopartswarehouse.com> (last visited Sept. 25, 2011).

156. See *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 883-84 (1997).

157. See *supra* note 36.

158. “[I]f the ‘defect’ is with the component part itself and not with the manner of its use by the assembler-manufacturer, it would seem that the component part maker should be directly responsible to one physically harmed by an event proximately caused by such defect.” KEETON ET AL., *supra* note 3, at 705.

negligent manufacturer rather than force him to disrupt a possibly amiable relationship with the Construction Team or A/E.

*B. Saratoga, not East River, Provides the Ideal Framework for Construction Material Defect Claims*

When a defective construction material damages the surrounding built environment, a distinction between “disappointed expectations” and “other property” is arbitrary if defined merely by the construction project’s contractual scope. The Contractor’s responsibility to build a wall adjacent to a defective window has no bearing on whether the defective window will ultimately leak and damage that wall.<sup>159</sup> Even if the Owner is disappointed that the building did not meet his expectations, he is ultimately concerned that his property—the wall—was damaged by a defective window. The definition of “other property” under the ELR should not turn fortuitously on the scope of the construction contract when property damage is attributable to the failure of a specific construction material. The wall will be similarly damaged and the Owner will be similarly disappointed in the resultant property damage, notwithstanding the wall’s classification as either new or existing construction. Therefore, courts should consistently apply the classification of “other property” to both new and existing construction.

For this reason, a Contractor’s contractual liability and a manufacturer’s tort liability should not, as *East River* suggests, be considered mutually exclusive.<sup>160</sup> The Owner’s disappointed expectations in the project should be recognized as a direct and foreseeable consequence of the underlying product defect, which is

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159. Likewise, a Contractor’s use of defective Chinese drywall, which subsequently corrodes metal components of a building, should not supplant the drywall manufacturer’s or supplier’s tort liability for this product. For more information on this notorious product, see Kristan B. Burch, *Has Chinese Drywall Affected the Economic Loss Rule?*, VA. LAW., Oct. 2010, at 30; Press Release, U.S. Consumer Prods. Safety Comm’n, Press Statement on Corrosion in Homes and Connections to Chinese Drywall (Nov. 23, 2009), available at <http://www.cpsc.gov/info/drywall/nov2009statement.pdf>; *Drywall Information Center*, U.S. CONSUMER PRODUCTS SAFETY COMMISSION, <http://www.cpsc.gov/info/drywall/index.html> (last visited Sept. 25, 2011).

160. See *Saratoga*, 520 U.S. at 882-83 (“[It has not been] explained why the ordinary rules governing the manufacturer’s tort liability should be supplanted merely because the user/reseller may in theory incur an overlapping liability in contract.”).

attributable to the manufacturer.<sup>161</sup> Though a Contractor's warranty can assuage the Owner's general dissatisfaction with the project, it should not supplant the underlying tort liability of the window manufacturer.<sup>162</sup> The source of the Owner's dissatisfaction is the defective window—which the manufacturer released into the market—not the Contractor's diligence in constructing the adjacent wall.

In this regard, *Saratoga* provides a ready framework to apply the ELR in construction material defect cases.<sup>163</sup> The defective construction material is analogous to the ship in *Saratoga*. Just as adding nets and fishing equipment to a defective ship did not recharacterize the added equipment as part of a defective product, the installation of a defective window into a satisfactory wall should not require classifying the entire construction project as the subject of disappointed expectations. Under this proposal, the Contractor is equivalent to the "Initial User" in *Saratoga* because he assembled marketable construction materials according to their intended uses.<sup>164</sup> The Contractor's process of aggregating discrete products should not conceptually merge one defective product with the surrounding products. Instead, the ELR should consistently interpret the "product" as the underlying defective construction material. The rest of the building should therefore be classified as "other property."

To be clear, construction contracts *can* effectively negotiate the risks associated with the performance of services. As discussed above, the Owner negotiates directly with the Architect and Contractor and has the ability to allocate risk for these services, including any subcontracted services.<sup>165</sup> If the Contractor did not adequately perform his services, by incorrectly installing the

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161. *Cf.* *Grams v. Milk Prods., Inc.*, 699 N.W.2d 167, 185-88 (Wis. 2005) (Abrahamson, C.J., dissenting) (arguing, with reference to *Saratoga*, that "disappointed expectations" and "other property" are not mutually exclusive concepts).

162. *Cf. Saratoga*, 520 U.S. at 882-83.

163. The range of construction materials available at Lowe's or Home Depot provides a stark contrast to the "high pressure turbine" in *East River*. See *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 860 (1986).

164. *Saratoga*, 520 U.S. at 884 ("[E]quipment added to a product after the manufacturer ... has sold the product to an Initial User is not part of the product that itself caused physical harm. Rather ... it is 'other property.'").

165. See *supra* Part I.

window, for example, then the contract properly governs the Owner's expectations in the project.

*C. There Is Precedent for Reevaluating the East River Analysis in Construction Cases*

Although this Note's proposed reliance on *Saratoga* is novel, it does not represent an unprecedented departure from the current ELR analysis. As discussed above, state courts do not uniformly apply the ELR.<sup>166</sup> This Part will show that the influence of *East River* is not absolute.

Most relevant to this Note's thesis is a recent near-rejection of the ELR by the Supreme Court of Washington.<sup>167</sup> In *Eastwood v. Horse Harbor Foundation, Inc.*, the court refuted the argument that tort and contract remedies are mutually exclusive under the ELR.<sup>168</sup> Instead, the court held that the ELR merely demands a nexus between the claimed injury and an independent tort duty to support a tort cause of action.<sup>169</sup> This is a case-by-case analysis, which requires consideration of all circumstances, including "common sense, justice, policy, and precedent."<sup>170</sup>

In reaching this conclusion, the court referenced several construction cases. It rationalized the application of the ELR in these cases by recognizing that the construction contract provided the Contractor's, or Architect's, only source of duty when the claimed injury did not involve any independent duty of care under tort.<sup>171</sup> The court's analysis accords with the general thesis of this Note: the ELR should remain in effect regarding the contracted services of a construction project, but it should not look to the construction contract to preclude otherwise actionable tort claims against remote construction material manufacturers or suppliers.

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166. *See supra* Part III.A.

167. *See Eastwood v. Horse Harbor Found., Inc.*, 241 P.3d 1256, 1261 (Wash. 2010).

168. *Id.* at 1261-62.

169. *Id.* at 1262 ("A review of our cases on the economic loss rule shows that ordinary tort principles have always resolved this question [about how a court can distinguish between claims in which a plaintiff is limited to contract remedies and cases in which recovery in tort may be available]. An injury is remediable in tort if it traces back to the breach of a tort duty arising independently of the terms of the contract.").

170. *Id.*

171. *Id.* at 1262-64.

Some courts have also implicitly weakened the conceptual integrity of the ELR in their analyses of construction-related claims arising under commercial general liability (CGL) insurance policies.<sup>172</sup> Tort claims, not breach of contract claims, typically trigger CGL policies.<sup>173</sup> Insurers can therefore invoke the ELR as a shield. The typical *East River* product-component analysis supports classifying many construction claims as economic loss governed by contract rather than as property damage covered by the policy, thereby eliminating them from coverage.<sup>174</sup> To find coverage under a CGL policy, courts have departed from their classification of the entire building as a single product.<sup>175</sup> In this context, the courts have understood damage to a building as “property damage” under the policy, notwithstanding the contract and warranty governing the Owner’s expectations in the project.<sup>176</sup> If nothing else, this inconsistency between classifications of “other property” in the traditional ELR context and property damage under CGL insurance policies suggests that it is possible to refine the ELR analysis.

#### *D. This Proposed Solution Does Not Unfairly Burden the Supply Team*

The justification of the ELR’s separation of tort from contract relies partly on a desire to protect manufacturers from potentially unlimited liability and to encourage the development of new products.<sup>177</sup> The Court addressed these concerns in *Saratoga*,

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172. Patrick J. Wielinski, *Negligence, Breach of Contract, and the Economic Loss Rule: Dilemma for Insurance Defense Counsel in Construction Defect Litigation?*, CONSTRUCT!, Spring 2004, at 14, available at [http://apps.americanbar.org/litigation/mo/premium-lt/newsletters/construction/con\\_spring2004.pdf](http://apps.americanbar.org/litigation/mo/premium-lt/newsletters/construction/con_spring2004.pdf).

173. *Id.* at 15.

174. *Id.* at 16-18.

175. *Id.* at 17.

176. *Id.*; see *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65, 74-75 (Wis. 2004) (permitting the insured Contractor to recover under the CGL policy, notwithstanding the court’s acceptance that the ELR might apply to the building damage at issue). *But see id.* at 91 (Roggensack, J., dissenting) (“[W]hile the economic loss doctrine is not *directly* applicable to the insurance policy [the Contractor] purchased from American Family, it is implicated in the coverage question because through the operation of the economic loss doctrine, [the Contractor] cannot become ‘legally obligated to pay’ [the Owner] for a tort claim.”).

177. See *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 870-71 (1986); *Seely v. White Motor Co.*, 403 P.2d 145, 150-51 (Cal. 1965); see also SHAPO, SEARCH, *supra* note 46, at 171-83 (describing criticisms of products liability).

recognizing that the availability of a tort claim is not dispositive of the merits of that claim.<sup>178</sup> Courts still must consider factors that have been raised throughout this Note, such as foreseeability and proximate cause.<sup>179</sup>

Courts applying the *East River* product-component analysis tend to look to the entire building as a product because it was the subject of a construction contract.<sup>180</sup> Yet, if a Contractor subsequently renovates the building, the product component analysis requires limiting the building “product” to the contractual scope of the renovation. This example shows, again, that the manufacturer’s tort liability for building damage turns fortuitously on the scope of work within a construction contract. The belief that tort subjects the Supply Team to excessive liability is therefore countered with the argument that the ELR unfairly insulates the Supply Team.

Looking to the greater context of a construction project to distinguish “other property” from economic loss particularly insulates the Supply Team from liability because construction materials are intended for specific applications, notwithstanding the contractual arrangement used to purchase them. As the Court asked in *Saratoga*: “Why should a series of resales, after replacement and additions of ever more physical items, progressively immunize a manufacturer to an ever greater extent from the liability for foreseeable physical damage that would otherwise fall upon it?”<sup>181</sup> In other words, a hypothetical window manufacturer should anticipate that a defective window will likely cause damage to the surrounding walls, regardless of whether the window was purchased by a subcontractor in a design-bid-build construction project or by an ambitious homeowner renovating his own garage.

#### CONCLUSION

Construction material defect claims show that the *East River* product-component analysis is not justified by the mere presence of an overarching contract or warranty. Courts should reevaluate this analysis to accommodate the practical application of warranty in

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178. *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 884 (1997).

179. *Id.*

180. *See supra* Part III.A.

181. *Saratoga*, 520 U.S. at 881.

complex contract structures, such as construction contracts. *Saratoga* has already established a useful framework to begin this reevaluation because it distinguishes between the strengths of contract and tort while appreciating the practical realities of warranty law in complex contractual relationships. Looking to *Saratoga*, courts should begin classifying building damage as “other property” when it is caused by defective construction materials.

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