

## A TALE OF TWO "STATE'S" VIEWS ON THE ECONOMIC LOSS RULE

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### I. Introduction:

Mistakenly applied and confusing, the economic loss rule prevents plaintiffs from recovering "economic" damages in tort, and requires those types of damages be pursued in contract claims. For example, homeowners (and their insurance carriers) are often barred from pursuing construction defect damages under the economic loss rule unless the owner entered into a contract with the builder — regardless of whether or not there is a strong case that a builder was negligent. Recently, courts are eroding, or even replacing, the economic loss doctrine. Two states are discussed below: Washington and Utah.

### II. The Economic Loss Rule in Washington

In a November 2010 decision, the Washington Supreme Court replaced its longstanding application of the economic loss rule with what it termed the "independent duty doctrine." The case, *Affiliated FM Ins. Co. v. LTK Consulting Services, Inc.*,<sup>1</sup> stemmed from a fire in Seattle's monorail system. Prior to the fire, the City of Seattle had contracted with SMS to run the monorail, and had also contracted with LTK to perform engineering services on the system. After the fire, SMS's subrogating carrier, Affiliated FM, sued LTK in tort (alleging its negligence caused the fire). However, LTK argued, and the trial court agreed, that Affiliated FM's tort claim was properly dismissed under Washington's economic loss rule because the alleged damages (repair costs and business interruption) were solely economic and therefore only recoverable under a contract claim. Since SMS (Affiliated FM's insured) did not contract with LTK, the trial court effectively ruled that FM had no cause of action against LTK, even if its engineering work caused the fire.

The Washington Supreme Court overturned the lower court, holding FM could proceed with a tort claim against LTK. After discussing the confusion and misapplication of the economic loss rule in other cases, the court stated that a "court's task is not to superficially classify the plaintiff's injury as economic or noneconomic."<sup>2</sup> Instead, the court continued, "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."<sup>3</sup> In the case of LTK, the court found that "engineers who undertake engineering services in this state are under a duty of reasonable care."<sup>4</sup> Since this independent duty existed, it was irrelevant to the court that SMS did not contract with LTK, that SMS's damages were "economic" in nature, or that SMS did not actually own the property that was damaged (it was owned by the city, but SMS was contractually obligated to pay for repairs).

### III. Utah's View on Economic Loss Rule

While not as sweeping as Washington, Utah courts have also begun to apply an independent duty doctrine in place of the economic loss rule. The Utah version of the independent duty doctrine dates back to 2002, as first explained by the Utah Supreme Court in *Hermansen v. Tasulis*.<sup>5</sup> In *Hermansen*, the court stated that where the economic loss rule is at issue, the "initial inquiry" becomes "whether a duty exists independent of any contractual obligations between the parties."<sup>6</sup> If such a duty exists, the court continued, "the economic loss rule does not bar a tort claim 'because the claim is based on a recognized independent duty of care and thus does not fall within the scope of the rule.'"<sup>7</sup>

2 *Id.*, slip op. at 8.

3 *Eastwood v. Horse Harbor Found*, No. 81977-7, slip op. at 10 (Wash. Nov. 4, 2010).

4 *Affiliated FM*, slip op. at 15-16.

5 *Hermansen v. Tasulis*, 48 P.3d 235 (Utah 2002).

6 *Hermansen*, 48 P.3d at 240.

7 *Id.* (quoting *Town of Alma v. Azco Construction, Inc.*, 10 P.3d 1256, 1263 (Colo. 2000)).

1 *Affiliated FM Ins. Co. v. LTK Consulting Services, Inc.*, No. 82738-9 (Wash. Nov. 4, 2010).

While explained in nearly identical terms to the Washington version of the independent duty doctrine, Utah courts have been much more hesitant to apply it. To date, the only formally recognized “independent duties” have been applied to contractor-sellers,<sup>8</sup> real estate agents,<sup>9</sup> and real estate appraisers.<sup>10</sup> Perhaps most important in the subrogation context, and in stark contrast to the Washington application, the Utah Supreme Court recently reaffirmed that there is no independent duty to conform to building codes or to act without negligence in constructing a home.<sup>11</sup> Finally, unlike Washington, the Utah legislature has codified the economic loss rule in Utah Code section 78B-4-513.

#### Economic Loss Rule Cases

Both Utah and Washington courts have recently shown a willingness to revisit cases in which the economic loss doctrine has historically acted as a legal bar. By adopting new rules such as the independent duty doctrine, we believe subrogating carriers will have new opportunities for recovery going forward.

#### IV. Conclusion: Careful Analysis Needed when Evaluating

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<sup>8</sup> *Yazd v. Woodside Homes Corp.*, 143 P.3d 283 (Utah 2006).

<sup>9</sup> *Hermansen v. Tasulis*, 48 P.3d 235 (Utah 2002).

<sup>10</sup> *West v. Inter-Fin., Inc.*, 139 P.3d 1059 (Utah 2006).

<sup>11</sup> *Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, LC*, 221 P.3d 234 (Utah 2009).