

The Economic Loss Rule And Negligent Misrepresentation

Law360, New York (October 3, 2016, 10:55 AM EDT) --

In California, the economic loss rule has played a critical role in the development of the dichotomy between tort and contract law. The rule precludes plaintiffs from recovering economic losses which result from the use of a product[1]; in other words, plaintiffs may recover damages against a manufacturer for bodily injury caused by a product, or for damages to property other than the product itself.[2] At its heart, the rule's purpose is to protect consumers' reasonable expectations regarding recovery for injuries or damages caused by a product, without exposing manufacturers to an endless scope of liability.[3] This article focuses on the rule's application to negligent misrepresentation causes of action, an issue that has resulted in myriad conflicting opinions by California federal district courts and the United States Court of Appeal, Ninth Circuit.



William "Skip" Martin

The Development of the Economic Loss Rule in California

In California, the rule can be traced back to the California Supreme Court's decision in *Seely v. White Motor Company*. [4] In *Seely*, the California Supreme Court held that economic losses are not recoverable in an action for products liability or negligence. [5] The plaintiff in *Seely* purchased a truck manufactured by the defendant, White Motor Company, for use with hauling heavy-duty loads. [6] The truck had a tendency to bounce when a heavy load was placed on its bed, making the truck unfit to haul heavy loads. [7] The plaintiff sought to recover the profits he lost because he was unable to use the truck for its intended purpose. [8] The California Supreme Court held that even if the defendant's product caused damage to the plaintiff's property in addition to lost profits, the plaintiff cannot use the property damage to bootstrap recovery for the economic loss in a strict liability action. [9] As to negligence, the California Supreme Court expressly noted "[e]ven in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone." [10]



Kristian Moriarty

Since *Seely*, the California Courts of Appeal have routinely dismissed negligence and strict products liability claims which only involve economic losses. [11] The rationale for the application was best summarized by the California Supreme Court in *Robinson Helicopter Co. Inc. v. Dana Corp.*, [12] where the court noted:

Simply stated, the economic loss rule provides: "[W]here a purchaser's expectations in a sale are frustrated because the product he bought is not working properly, his remedy is said to be in contract alone, for he has suffered only 'economic' losses." This doctrine hinges on a distinction

drawn between transactions involving the sale of goods for commercial purposes where economic expectations are protected by commercial and contract law, and those involving the sale of defective products to individual consumers who are injured in a manner which has traditionally been remedied by resort to the law of torts.”[13]

It is now well settled that the economic loss rule requires a purchaser to recover in contract for purely economic loss due to disappointed expectations, unless the purchaser can demonstrate harm above and beyond a broken contractual promise.[14]

What remains unclear is whether the economic loss rule bars claims for negligent misrepresentation which arise from underlying promises when the contract is for the sale of goods.

Exception to the Economic Loss Rule for Fraud Causes of Action

The lack of clarity with respect to causes of action for negligent misrepresentation arises from a judicially created exception to the economic loss rule allowing causes of action for fraud (i.e., intentional misrepresentation) even where the only damages alleged are economic in nature. In *Robinson Helicopter Co. Inc. v. Dana Corp.*,[15] the California Supreme Court held that the economic loss rule did not bar claims for intentional misrepresentation, leaving unaltered the lower court’s holding that negligent misrepresentation was also barred by the economic loss rule.

The rationale for the exception was explained as follows:

“Tort damages have been permitted in contract cases where a breach of duty directly causes physical injury [citation]; for breach of the covenant of good faith and fair dealing in insurance contracts [citation]; for wrongful discharge in violation of fundamental public policy [990] [citation]; or where the contract was fraudulently induced. [Citation.]” (*Erich v. Menezes*, supra, 21 Cal.4th at pp. 551–552.) “[I]n each of these cases, the duty that gives rise to tort liability is either completely independent of the contract or arises from conduct which is both intentional and intended to harm. [Citation.]”[16]

The court further noted that an exception to the economic loss rule lies where “the means used to breach the contract are tortious, involving deceit or undue coercion.”[17]

The decision and rationale in *Robinson* has led to multiple contradictory decisions by federal district courts applying California law to determine whether the exceptions described in *Robinson* applies to causes of action for negligent misrepresentation.

Rationale in Favor of Precluding Negligent Misrepresentation Claims

Various California courts have determined that the economic loss rule must apply to preclude claims for negligent misrepresentation.[18] Generally, these courts rely on two principles in support of the determination.

First, the *Robinson* court expressly noted that in each of the cases where an exception to the rule was applied, “the duty that gives rise to tort liability is either completely independent of the contract or arises from conduct which is both intentional and intended to harm.”[19] Negligent misrepresentation, by its very nature, does not involve conduct that is intentional or intended to harm.

Second, the decisions are premised on the inherent dichotomy between tort and contract law. Generally, the courts recognize that negligent misrepresentation causes of action arising out of purported negligent promises are a means to circumvent other contractual provisions which may preclude the type of recovery afforded by a negligent misrepresentation cause of action. These courts are evidently concerned that the contract terms negotiated by parties in privity will be circumvented if a recovery is allowed in tort.

By way of example, such circumvention could potentially occur where a contract for the sale of goods precludes the buyer from recovering consequential or incidental damages which result from a breach of the contract; or where a contract limits the buyer to certain contractual remedies. If the economic loss rule does not preclude negligent misrepresentation claims which arise from the contractual promises, then the negotiated terms can effectively be voided by pursuing remedies available under a cause of action for negligent misrepresentation.

Rationale Favoring an Exception to the Economic Loss Rule for Negligent Misrepresentation Claims

On the other side of the spectrum, there are various decisions holding that negligent misrepresentation claims are not barred by the economic loss rule.[20] Generally, these decisions reason that the cause of action for “negligent misrepresentation” is a tort of deceit, therefore falling within the Robinson exception to the economic loss rule.

Notably, California Civil Code § 1710 provides:

1710. A deceit, within the meaning of the last section, is either:

1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
2. The assertion, as a fact, of that which is not true, by one who has no reasonable ground for believing it to be true;
3. The suppression of a fact, by one who is bound to disclose it, or who gives information of other facts which are likely to mislead for want of communication of that fact; or,
4. A promise, made without any intention of performing it.

The definition of deceit (mainly subsection 2) arguably includes negligent misrepresentations.

An additional argument is that the California Judicial Council Civil Jury Instructions for negligent misrepresentation claims fall within the “Fraud or Deceit” causes of action.[21]

The Anticipated Resolution of the Issue

This issue is ripe for clarification by the California Supreme Court, given the number of conflicting opinions in the lower courts, and the two differing opinions of different panels of the Ninth Circuit, To the extent the issue is submitted by writ of certiorari to California’s high court, it seems likely the court would accept the matter given the disparity of decisions in the lower courts.

Given the discussion of the supreme court in Robinson, these authors maintain that the supreme court will ultimately determine that causes of action for negligent misrepresentation are barred by the

economic loss rule when the purported “misrepresentation” implicates the terms of a written contract between the disputing parties. The Robinson court made clear that: (1) where a purchaser's expectations in a sale are frustrated because the product he bought is not working properly, his remedy is said to be in contract alone, and not tort; and (2) an exception to the rule applies only when the duty that gives rise to tort liability is either completely independent of the contract or arises from conduct which is both intentional and intended to harm.

Permitting negligent misrepresentation actions which are premised on purported promises which formed the contract between the parties would completely shatter the dividing wall between contract and tort. It would provide consumers with a tort remedy that was otherwise precluded by negotiated contractual terms. The California Supreme Court has expressed disdain for such a crossover between tort and contract law and, accordingly, the authors believe it is unlikely the court will permit the line to be further blurred.

Further, application of the rule to negligent misrepresentation causes of action buttresses the two fundamental policies supporting application of the rule. First, the reasonable expectations of consumers can be protected through negotiated contract terms providing for the recovery of economic losses. Second, application of the rule to negligent misrepresentation claims will ensure that manufacturers and product sellers are not exposed to a limitless scope of potential liability.

For these reasons, it is expected that the California Supreme Court will ultimately sustain application of the economic loss rule to causes of action for negligent misrepresentation.

—By William (Skip) Martin, Jr., and Kristian Moriarty, Haight Brown & Bonesteel LLP

William O. (Skip) Martin, Jr. is a partner and Kristian Moriarty is an attorney with Haight Brown & Bonesteel LLP in California.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] 50A Cal. Jur. 3d Products Liability § 89 citing KB Home v. Superior Court (2003) 112 Cal. App. 4th 1076, 5 Cal. Rptr. 3d 587 (2d Dist. 2003), as modified on denial of reh'g, (Nov. 19, 2003).

[2] 50A Cal. Jur. 3d Products Liability § 89 citing Jimenez v. Superior Court (2002) 29 Cal. 4th 473; KB Home v. Superior Court (2003) 112 Cal. App. 4th 1076, as modified on denial of reh'g, (Nov. 19, 2003).

[3] 50A Cal. Jur. 3d Products Liability § 89 citing Fieldstone Co. v. Briggs Plumbing Products Inc. (1997) 54 Cal. App. 4th 357.

[4] (1965) 63 Cal.2d 9 (“Seely”)

[5] Id. at 18.

[6] Id. at 12.

[7] Id.

[8] Id.

[9] Id. at 16.

[10] Id. at 18.

[11] See *Sacramento Regional Transit Dist. v. Grumman Flexible* (1984) 158 Cal.App.3d 289, 298; *Food Safety Net Services v. Eco Safe Systems USA Inc.* (2012) 209 Cal.App.4th 1118, 1131; and *State Ready Mix Inc. v. Moffatt & Nichol* (2015) 232 Cal.App.4th 1227, 1232.

[12] *Robinson Helicopter Co. Inc. v. Dana Corp.* (2004) 34 Cal.4th 979, 988

[13] Id. quoting *Neibarger v. Universal Cooperatives Inc.* (1992) 439 Mich. 512, 486 N.W.2d 612, 615, fns. omitted.

[14] *Robinson Helicopter Co. Inc. v. Dana Corp.* (2004) 34 Cal.4th 979, 988 citing *Redarowicz v. Ohlendorf* (1982) 92 Ill.2d 171, 441 N.E.2d 324, 327.

[15] (2004) 34 Cal.4th 979, 993.

[16] [Emphasis added.] Id.

[17] Id. at 990.

[18] See *Astrium S.A.S. v. TRW Inc.* (9th Cir. 2006) 197 F. App'x 575, 577 (finding district court did not err in holding negligent misrepresentation claim to be barred by economic loss rule); *United Guar. Mortgage Indem. Co. v. Countrywide Fin. Corp.* (C.D. Cal. 2009) 660 F. Supp. 2d 1163, 1184-85 (finding negligence and negligent misrepresentation claims barred by the economic loss rule where "the alleged misrepresentations are not conceptually distinct from the contract"); *JMP Sec. LLP v. Altair Nanotechnologies Inc.* (N.D. Cal. 2012) 880 F. Supp. 2d 1029, 1042-43 (finding fraud and negligent misrepresentation claims barred by the economic loss rule where "[t]he tort claims consist of nothing more than [the defendant's] alleged failure to make good on its contractual promises"); *Vavak v. Abbott Laboratories Inc.* (C.D. Cal. June 17, 2011) SACV 10-1995 JVS RZX, 2011 U.S. Dist. LEXIS 111408, 2011 WL 10550065 (finding negligent misrepresentation claim barred by the economic loss rule because "[w]here damages are purely economic, recovery may only be in contract"); *Lincoln Gen. Ins. Co. v. Access Claims Adm'rs Inc.* (E.D. Cal. Aug. 29, 2007) CIV. S071015LKK/EFB, 2007 U.S. Dist. LEXIS 67172, 2007 WL 2492436 (finding negligence and negligent misrepresentation claims barred by the economic loss rule where "[t]he allegations made with regard to the breach of contract claim closely parallel those made with regard to the negligence and negligent misrepresentation claims."); *Frye v. Wine Library Inc.* (N.D. Cal. Dec. 4, 2006) 06-5399 SC, 2006 U.S. Dist. LEXIS 96075, 2006 WL 3500605 ("As Plaintiff's negligent misrepresentation claim can be characterized as relating to Defendant's inducement of Plaintiff to contract, there is also no question of it being barred by the economic loss rule"). See also *Mod Craft Inc. v. Am. Ready Mix Inc.* (Cal. Ct. App. Mar. 12, 2003) F038907, 2003 Cal. App. Unpub. LEXIS 2479, 2003 WL 1090376 ("We find no exception [to the economic loss rule] where the action is based on negligent misrepresentation as opposed to simple negligence.").

[19] *Robinson Helicopter Co. Inc. v. Dana Corp.* (2004) 34 Cal.4th 979, 993.

[20] See *Hannibal Pictures Inc. v. Sonja Prods. LLC* (9th Cir. 2011) 432 Fed.Appx. 700, 701 (holding a jury

verdict in favor of a negligent misrepresentation claim was not precluded by the economic loss rule where “one party has lied to the other”); *Kalitta Air, L.L.C. v. Central Texas Airborne Sys. Inc.* (9th Cir. 2008) 315 Fed.Appx. 603, 607 (holding negligent misrepresentation is a “species of fraud” under California law, for which “economic loss is recoverable”).

[21] See California Civil Jury Instructions (CACI) 1903. Negligent Misrepresentation.

All Content © 2003-2016, Portfolio Media, Inc.