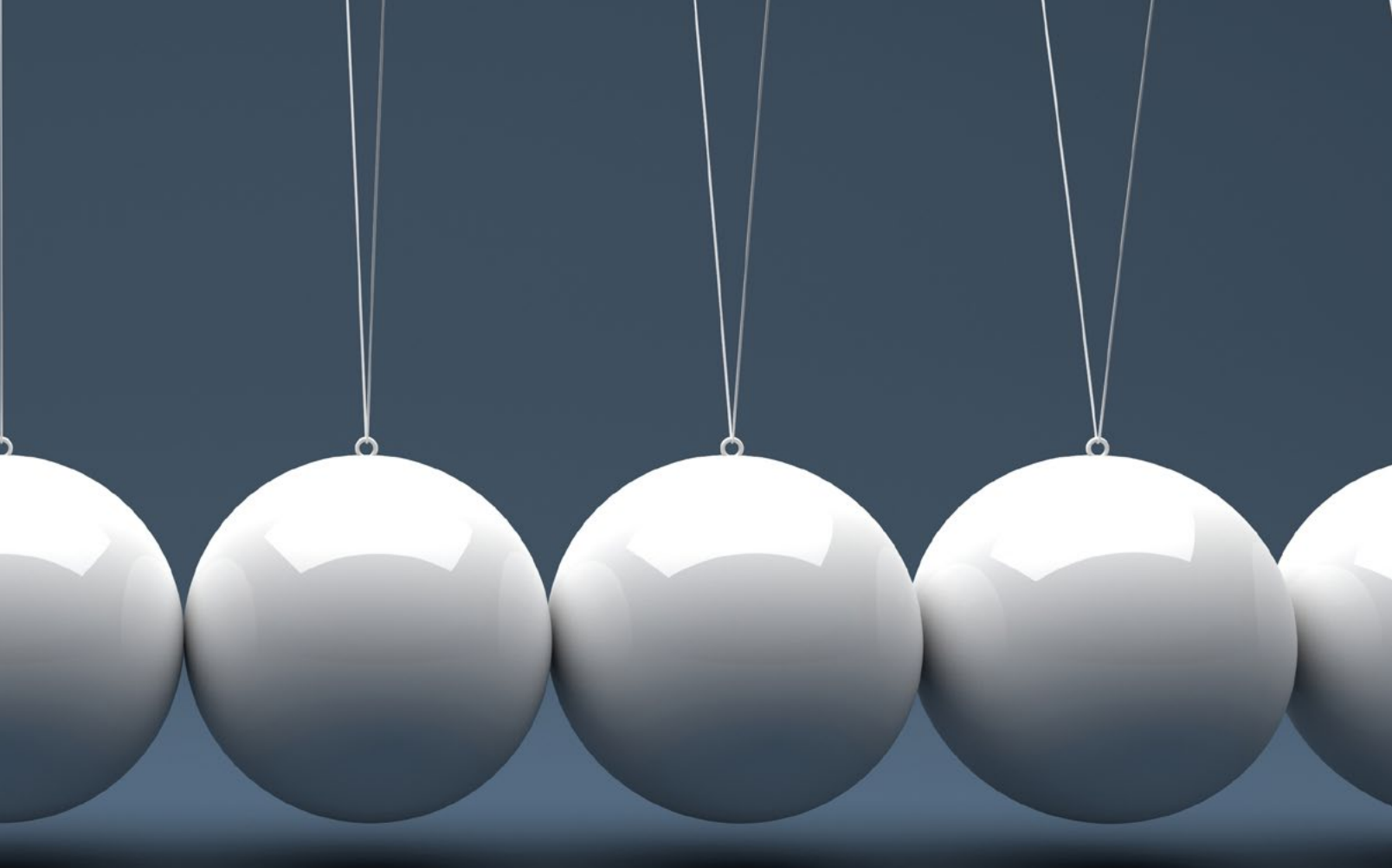




The impact of Ohio's economic loss rule on commercial and professional liability litigation

David J. Oberly

In recent years, the economic loss rule has expanded rapidly throughout Ohio in the areas of commercial and professional liability litigation. Attorneys should familiarize themselves with the doctrine to successfully navigate the contours of the rule in the context of commercial and professional liability claims.



The economic loss rule prevents the assertion of a tort claim for pure economic loss in the absence of any physical injury or property damage to the claimant. The rule operates to avoid a party's liability for tort damages arising from negligence-based claims for purely financial losses, where there is no privity of contract. In recent years, the economic loss rule has expanded rapidly throughout Ohio in the areas of commercial and professional liability litigation. When applicable, the economic loss rule represents an almost insurmountable obstacle to overcome, completely shielding professionals and companies of all types from liability for economic losses under tort law. As a result of the strength of the defense and the increasing frequency in which the doctrine is being used throughout Ohio courts, it is imperative that both plaintiff's attorneys and defense practitioners maintain an intricate understanding

of the doctrine to successfully use or sidestep application of the rule in the litigation of claims involving commercial and professional liability.

Overview of the economic loss rule

The economic loss rule operates as a limitation on recovery. In Ohio, the economic loss rule generally prevents recovery in tort damages for purely economic loss. The economic loss rule works to bar the use of negligence or strict liability theories of recovery of economic losses arising out of commercial transactions where the loss is not a consequence of an event causing personal injury or damage to another's property.

This rule preserves the distinction between contract and tort law by preventing parties to a contract from avoiding agreed-upon contract remedies and seeking broader remedies under tort theory than the contract

would have permitted. Tort law is not designed to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement. That type of compensation necessitates an analysis of the damages that were within the contemplation of the parties when framing their agreement, but rather remains the particular province of the law of contracts.

Economic losses are intangible losses that do not arise from tangible harm to persons or property. They are typically defined as wages, salaries, or other compensation lost as a result of an injury or loss to person or property or any other expenses as a result of an injury or loss (other than attorney's fees). Thus, where only economic losses are asserted, damages may be recovered only in contract; there can be no recovery in negligence due to the lack of physical harm to persons and tangible things.

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The economic loss rule applies primarily in the absence of contractual privity when a plaintiff seeks to recover in tort for purely economic loss. The rule is based on the principle that, in the absence of privity of contract between two disputing parties, there is no duty to exercise reasonable care to avoid intangible economic loss or losses to others that do not arise from tangible physical harm to persons and tangible things. Absent some agreement between the parties, no duty exists with respect to purely economic harm, and no cause of action exists in tort to recover economic damages. As a result of the economic loss rule, most building project owners are barred from recovering purely economic damages against a subcontractor based on a breach of contractually created duties.

Exceptions to the economic loss rule

As always, however, rules come with exceptions. Although the economic loss rule sweeps widely, it does not preclude all tort claims for economic damages.

One major exception pertains to claims based on a pre-existing independent tort duty. In this respect, a plaintiff may pursue such a tort claim if it is based exclusively on a discrete pre-existing duty in tort and not on any terms of a contract or rights accompanying privity. Here, the economic loss rule does not apply, and a party who suffered only economic damages can proceed in tort where the defendant breaches a duty that does not arise solely from contract.

The types of exempt claims for which the economic loss rule is inapplicable also includes claims for negligent misrepresentation. A person is liable for negligent misrepresentation if he or she, in the course of business, negligently supplies false information, knowing that the recipient intends to rely on it in business. The courts have found that negligent misrepresentation based on a claim for professional negligence is based on a separate duty owed in tort, and therefore the economic loss rule does not apply to claims for negligent misrepresentation. For example, the

rule does not preclude professional negligence claims resulting only in economic loss when a professional such as an accountant provides advice to a foreseeable plaintiff. Similarly, one who holds himself out to be an investment advisor and for a fee gives investment advice to another is liable to such other person if he negligently gives inaccurate advice causing damage to the other person as a result of relying on such investment advice.

In addition, purely economic losses may be recovered in a negligence action where privity or a sufficient nexus to substitute for privity is established. Privity serves to identify an interest or establish a relationship necessary to allow for the bringing of a tort action for purely economic damages. With that said, a lack of privity is not an absolute bar to a claim against a professional when there is a sufficient nexus that can serve as a substitute for privity. Such a nexus exists when the party asserting the claim is a member of a limited class whose

reliance is specifically foreseen. For example, a sufficient nexus exists to impose a duty of care on surveyors and civil engineers owed toward subsequent purchasers of property when the surveyors and engineers could foresee that the later purchasers would rely on their representations.

Application of the economic loss rule

The economic loss rule's application has widened broadly in recent years. During this time, Ohio courts having extended the rule's reach to many new areas of professional liability litigation.

For example, several courts have expanded the scope of the economic loss rule to include insurance agents, holding that negligence claims by insureds against their insurance agents for failing to procure coverage are specifically barred by the economic loss doctrine. The application of the economic loss doctrine was analyzed in the context of insurance agent liability in *Mafcote, Inc. v. Genatt Associates*.¹ In that case, a paper manufacturer sued its insurance agent alleging that it negligently failed to procure an insurance policy covering business interruption losses. A boiler

accident at the policyholder's plant disrupted its supply chain and caused the policyholder to purchase more expensive substitute product, which was not covered under the insurance contract. The insured claimed that the insurance agent's failure to obtain proper coverage caused the insured to be uninsured for the loss. The court disagreed, and rejected the claim. In doing so, the court applied the economic loss rule, finding that an insurance agent cannot be sued by a policyholder for negligence unless the insurance agent committed an act or error that caused physical injury



or property damage. The alleged failure to procure proper insurance coverage does not give rise to such a claim. Accordingly, the court held that the economic loss rule applied to bar the cause of action for negligent procurement, thus entitling the agent to summary judgment on the negligence claim asserted against it.

A similar outcome was seen recently in *Federal Insurance Company v. Fredericks, Inc.*² In that case, the court applied the economic loss doctrine in the context of a construction defect claim. The Fredericks litigation arose out of the collapse of a commercial facility that was under construction in Vandalia, Ohio.

The landowner, Pasco, Inc., intended to build a cross-dock facility that was to be used by two other companies, Carter Express and Carter Logistics. All three sister entities were owned by the same parent company, J.P. Holding Co. Pasco hired Fredericks, Inc. to construct the facility pursuant to a handshake agreement and without a written contract.

Fredericks, in turn, subcontracted construction of the pre-engineered steel framework to Skiles Construction. The contract between Fredericks and Skiles identified Pasco as the property owner. However, while the subcontractor knew that Carter Express would be a tenant in the facility, none of the other three affiliates were incorporated into the agreement.

Skiles was negligent and failed to perform in a workmanlike manner by failing to adequately brace the steel framework, causing a substantial portion of the structure to collapse during a strong windstorm that blew through the area during construction. The property owner and its three affiliates all filed suit against the subcontractor to recover damages related to Skiles' negligent construction.

On appeal, the Second Appellate District held that damages for

economic losses were available only to Pasco as an intended beneficiary of the contract. However, the three other companies could not recover against the subcontractor in the absence of a contractual relationship pursuant to the economic loss rule. The court concluded the affiliates could not sue the subcontractor directly in contract to recover for economic losses because, while liability in contract may be available where the facts establish privity or a substitute for privity, in that particular instance there was no substitute for privity because the subcontractor did not exercise "excessive control" over the project.

The court noted that under the general rule in Ohio that "mere knowledge by the subcontractor of the identity of the project owner, without more, does not create a nexus sufficient to establish privity or its substitute," the subcontractor was not liable to the three affiliates simply because it was aware of their relationship to the facility's owner.

Furthermore, the court found that the affiliates could not maintain their damages claim as third-party beneficiaries to the subcontract in the absence of any evidence of an intent to benefit any of the three, as none of the affiliates were even referenced in the subcontract.

Finally, the court rejected the affiliates' argument that they were entitled to recover for indirect economic loss that was caused by tangible property damage when the construction collapsed, as the separate identities of each corporate affiliate barred recovery of any of the entities other than Pasco. Consequently, the economic loss rule precluded J.P. Holding Co., Carter Express, and Carter Logistics from maintaining their tort claims against the subcontractor.

The potential of Ohio's economic loss doctrine

The significant expansion of Ohio's economic loss doctrine in recent years has provided a robust defense to tort claims brought against business

entities and professionals that packs the potential to completely preclude liability for economic losses under tort law whenever a pure negligence claim is brought against an individual or company in the commercial or professional liability context. If a plaintiff sues for purely economic damages, and there is no loss to the plaintiff's person (bodily injury) or to his property (property damage), then that plaintiff has no cause of action against the allegedly negligent party.

Increasingly, where the parties have no contract, courts are finding that plaintiffs have no commercial or professional negligence claim. The implications of this trend toward restricting remedies against companies and professionals for breach of contract damages cannot be understated. As a result, attorneys on both sides of the table are well advised to familiarize themselves with the doctrine and develop a strong understanding of the rule's scope and limitations to successfully navigate the contours of the rule in the context of commercial and professional liability claims. 📖

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Endnotes

¹2007 U.S. Dist. Lexis 10117 (S.D. Ohio 2007).

²2015 Ohio 694 (2d Dist.).