PERSPECTIVES ON THE LAW

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New Development in "Economic Loss Rule" for Construction Defect Claims

— *by* **Tim Heinson**

The rule in Oregon is that "one ordinarily is not liable for negligently causing a stranger's purely economic loss without injuring his person or property." Hale v. Groce, 304 Or 281, 284 (1987). The Oregon Court of Appeals recently applied this rule in the construction defect context and the decision has broad implications for those involved in handling such claims.

In Jones v. Emerald Pacific Homes, Inc., 188 Or App 471 (July 2, 2003), the Court held that the plaintiff homeowners could not make a claim for negligent construction against their general contractor. As in the typical construction defect claim, the homeowners had sued their general contractor for alleged construction defects, asserting both negligence and breach of contract claims. The Court of Appeals held that the trial court had properly dismissed the negligence claim, stating that even where there is a contract between the parties, a negligence claim does not arise unless the claimed damages "result from breach of an obligation that is independent of the terms of the contract, that is, an obligation that the law imposes on the defendant because of his or her relationship to the plaintiff, regardless of the terms of the contract between them." Jones, 188 Or App at 476.

The type of relationship required before allowing negligence claims is one imposing obligations "beyond the common law duty to exercise reasonable care to prevent foreseeable harm." Such relationships generally fall into categories such as: "between 'professionals' such as lawyers, physicians, architects and engineers and their clients; those between principals such as brokers and their agents; those between trustees and beneficiaries; and, in some instances, those between insurers and their insureds." Jones, 188 Or App at 477. In general, "parties to a contract are in a 'special relationship' imposing a heightened duty of care and thereby creating potential tort liability when one party delegates to the other the authority to make important decisions with the understanding that the authority is to be exercised on behalf of and for the benefit of the authorizer." Jones 188 Or App 478. The court concluded that, despite the contractual relationship between the parties, there was no "special relationship" supporting a negligence claim.

The Jones opinion implicitly recognized the "economic loss rule" in the context of a construction defect case for the first time in Oregon. This "rule," long recognized in jurisdictions throughout the United States, including all of Oregon's neighbors, states that one is not generally liable in negligence for "purely economic loss." In the construction context, tort law protects persons from the foreseeable danger of physical harm to either their person or property other than the structure itself. Construction defects are not "property damage" but a reduction in the benefit of the bargain inherent in the contract and the only remedy available for such economic loss

should be in contract against the seller. The economic loss rule, therefore, does not eliminate negligence claims for personal injury (such as a deck collapse) or damages to other property (such as damage to furniture from a water leak) but it does eliminate such claims for damage to the structure itself, including cost of repair.

The purpose of the rule has been described by one court as follows:

"(T)he economic loss doctrine serves to define the scope of duty and shields a defendant from unlimited liability for all of the economic consequences of a negligent act, particularly in a commercial or professional setting, and thus … keeps the risk of liability reasonably calculable. Permitting plaintiffs to recover in tort for purely economic losses would result in open-ended liability, since it is virtually impossible to predict all the economic consequences of a given act." Calloway v. City of Reno, 993 P2d 1259 (2000).

It is clear from Jones that absent a "special relationship" between parties to a construction contract, a rare occurrence, homeowners cannot sue their general contractor for negligence resulting in only "economic loss." The broader implication of Jones is with regard to negligence claims for economic loss made against persons with whom they have no contractual relationship, such as homeowners against subcontractors or remote general contractors. As those who deal with construction defect claims in Oregon know, general contractors and subcontractors have effectively faced "open-ended liability" under Oregon law. Many times, a subsequent purchaser of a home sues a contractor five or ten years after the original construction, claiming negligent construction.

Although decided in the context of a contract between homeowners and a general contractor, the Jones court's holding should be applicable even if there is no contract between the parties. Jones upheld the dismissal of the plaintiffs' negligence claim not because they also had a contract but because there was no special relationship between the parties that could justify imposing negligence liability. In cases in which there is no relationship at all between the parties, such as with the remote purchaser versus the builder, a court should likewise find no liability. When a homeowner sues a general contractor or subcontractor with whom there was no contract, the only cause of action would be in negligence. Jones implies that such claims will not be allowed.

One case in particular, Newman v. Tualatin Development Co., 287 Or 47 (1979), has been cited as authority allowing such claims. Newman, however, did not actually address the question of whether a special relationship must be shown in order to impose tort liability. Newman held only that if a builder-vendor could be found liable in negligence, lack of a contractual relationship would not prevent recovery. Jones simply supplements and complements this holding, stating that one is not liable in tort for economic loss in the absence of such a special relationship.

A potential argument by claimants is that the economic loss rule does not apply to the major element of damages in construction defect claims, the cost of repair, since such cost is not "economic loss." This issue has not been specifically decided in Oregon. One Oregon case, Meininger v. Henris Roofing & Supply of Klamath County, Inc., 137 Or App 451 (1995), awarded damages consisting of the cost of repair of a roof, implying that they were "purely economic loss." Courts in many other jurisdictions have specifically held such damages to be economic loss, including: Washington (Griffith v. Centex Real Estate Corp., 969 P2d 486 (Wash App 1998)). Idaho (State v. Mitchell Construction Co., 699 P2d 1349 (1984)); California (Aas v Superior Court, 12 P3d 1125 (2000)); Nevada (Calloway v.

City of Reno, 993 P2d 1259 (2000)). Based upon the abundance of law from other jurisdictions, it seems likely that Oregon courts would hold that cost of repair is "economic loss."

At least one Multnomah County Circuit Court judge has applied Jones to dismiss third-party indemnity and contribution claims by a general contractor against a subcontractor where the only claim again the general by the homeowner was in negligence. In that case, the plaintiff homeowner was a subsequent purchaser of a house allegedly constructed by the contractor. In light of Jones, other judges will undoubtedly be given the opportunity to decide this issue in the coming months. If you have a construction defect claim in which a negligence claim is alleged, Jones is certainly worth taking a look at. ❖

— If you have any questions about this subject, please feel free to contact the author, Tim Heinson, by telephone, (503) 768-9600, or by e-mail, tim@lerlaw.com.