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The Supreme Court Reinforces the Economic Loss Rule

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The economic loss rule marks the boundary between tort and contract. It has been an important part of construction law ever since 1994, when the Washington Supreme Court decided *Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1*.¹ In a recent decision entitled *Alejandre v. Bull*, the supreme court reinforced the economic loss rule and seemingly expanded (or at least clarified) its scope.²

The dispute in *Alejandre* centered on the sale of a house. The buyers claimed the seller failed to disclose defects in the septic system. In her Form 17, the seller represented there were no defects with the septic system. This was arguably less than accurate. For example, shortly before the sale the seller had to do laundry outside the home because the system had failed. She did not disclose this to the buyers, who sued for negligent misrepresentation and fraud.

The trial court dismissed the lawsuit after the plaintiffs rested their case in chief. The Court of Appeals reversed because the parties' contract did not expressly allocate the risk that the septic system was defective.

The Washington Supreme Court reversed the Court of Appeals and reinstated the dismissal. As part of doing so, the supreme court reiterated the bases for the economic loss rule. It noted that "[t]he economic loss rule applies to hold parties to their contract remedies when a loss potentially implicates both tort and contract relief." It "maintains the 'fundamental boundaries of tort and contract law.'" Parties to a contract have the opportunity to allocate risk during negotiations. If contract and tort remedies were allowed to overlap, a party to a contract could obtain "through a tort claim benefits that were not part of the bargain." "In short, the purpose of the economic loss rule is to bar recovery for alleged breach of tort duties where a contractual relationship exists and the losses are economic losses."

The supreme court then went two steps further, and in the process expanded or at least clarified the scope of the economic loss rule. First, it made clear that "the economic loss rule applies regardless of whether the specific loss at issue was expressly allocated in the parties' contract." Allocation of risk can take place

"directly or indirectly." Therefore, tort claims are precluded whenever "the parties *could or should have* allocated the risk of loss, or had the opportunity to do so" in their contract.

Second, the supreme court rejected the "suggestion that the economic loss rule applies only if the contract is between two sophisticated parties." After *Alejandre*, the economic loss rule bars tort claims regardless of the litigant's sophistication or contracting experience.

Applying these principles to the buyers' case, the *Alejandre* court had little difficulty dismissing their claim for negligent misrepresentation. The buyers' loss was purely economic: Their house was worth less because of the defective septic system.

The parties' contract covered this. The purchase and sale agreement contained a representation by the seller that the property was served by a septic system. It also required the seller to have the septic tank pumped before closing, which was done. The fact that the parties did not expressly allocate this risk

of loss was not material; the economic loss rule was still a bar.

The supreme court also dismissed the buyers' fraud claims, albeit for reasons unrelated to the economic loss rule. The pre-sale inspection

revealed potential problems with the septic system. The buyers were also told that the system had not been fully inspected. They chose to go through with the purchase anyway. Therefore, *Alejandre* held, the buyers could not meet the elements of

fraudulent concealment or common law fraud as a matter of law.

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Magnus R. Andersson's practice focuses on real estate, construction and banking. He has over 10 years' experience handling property transactions, financing, construction, and leasing matters. Magnus has also resolved numerous disputes on behalf of property owners, contractors, banks and other businesses over the years. Many of Magnus' clients are small to mid-sized companies based in the Puget Sound region of Washington State, but he also works with publicly-traded companies as well as individuals who own real estate.

¹ 124 Wn.2d 816, 881 P.2d 986 (1994) (holding general contractor general cannot recover purely economic damages in tort from design professionals with which it was not in privity).

² 159 Wn.2d 674, 153 P.3d 864 (March 1, 2007).