The Economic Loss Doctrine – A Coverage Defense?

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The short answer is: not really. This issue has come to the forefront as a result of a barrage of cases dealing with the economic loss doctrine, particularly the recent Wisconsin Supreme Court decision in American Family Mutual Insurance Company, v. American Girl, Inc., f/k/a Pleasant Company, Inc.

While the economic loss doctrine is technically not a coverage defense, it still may help in establishing a defense to insurance coverage. Officially, the letter of the law in this State is that the economic loss doctrine does not determine coverage. In spite of this, the economic loss doctrine does have an effect on coverage. Under certain circumstances, application of the economic loss doctrine can adversely impact a litigant's attempt to establish insurance coverage for a particular loss.

A working knowledge of ELD is required in order to understand how the doctrine affects coverage. The economic loss doctrine is a remedies principle that simply tells us which theory of recovery is available, either contract or tort, in a given situation. If the doctrine applies to a situation, the parties are limited to the remedies in their contract and may not sue in tort.

Virtually every reported case dealing with the economic loss doctrine describes it as a judicially created doctrine that bars a commercial (under Dannen & Janssen, Inc. v. Cedarapids, Inc.,) or a consumer (under State Farm Mutual Automobile Insurance Company v. Ford Motor Company) purchaser of a product a recovery from a manufacturer (or distributor) under tort theories of negligence or strict products liability for damages that are solely economic in nature. In other words, when certain criteria are met, the purchaser/end-user cannot sue the manufacturer in tort as a result of the failure of a product itself, but is limited to the contract's remedies and warranties. While outside the scope of this article, it should be noted that the economic loss doctrine is not limited to products. The doctrine has been extended to apply to other situations, including the transfer of real estate.

One of the requirements for the economic loss doctrine to apply is that the loss or damages must be solely economic. Economic loss is generally defined as damages due to the inadequate value of the product because it is inferior and does not work for the general purposes for which was it manufactured or sold. Economic loss is limited to damage to the product itself or monetary loss caused by the defective product, including both direct and indirect loss. Loss or damages that cause personal injury or damage to other property are not "economic" and fall outside the doctrine's scope.

"Direct" economic loss is loss in value of the product itself whereas "indirect" economic are other economic losses attributable to the product defect. Direct economic loss is damage based on insufficient product value and constitutes the difference between the value of the product as represented and the value of the actual product, also known as the benefit of the bargain. Indirect economic losses are consequential losses; that is, they flow from the loss of the product and include lost profits resulting from the inability to use the defective product.

With these principles in mind, we can now examine how the ELD may limit parties to those remedies explicitly or implicitly agreed to. When a product fails to perform as expected only damaging itself, under the ELD tort remedies should not be available to the parties.

The economic loss doctrine's application can be seen in a routine transaction, for example, someone purchases a new car. With the new car comes a factory warranty with a duration typically based on either a set amount of time or number of miles (usually whichever is first). If the transmission fails within the warranty period causing the vehicle to stop moving, and if there is no personal injury or damage to other property, what recourse does the consumer have against the vehicle manufacturer? The consumer can have the vehicle towed to dealership and the vehicle's transmission repaired (or replaced), typically at no charge. The consumer is not, however, permitted to sue the manufacturer under a tort theory – those remedies are precluded and the consumer is limited to the remedies in the warranty that came with the car and (in theory) included as part of its purchase price.

The consumer and the manufacturer agreed, by virtue of the warranty, that if there is a defect with the vehicle that causes no damage to any person or other property, the consumer cannot sue in tort. Rather, the consumer and manufacturer agreed that the manufacturer will repair or replace the defective component(s) at no cost to the consumer.

Do the consumer's options change if the defect occurs outside of the warranty period? Again, assuming there is no damage to other property or personal injury (for example, that the car's transmission fails and the vehicle speeds uncontrollably into a brick wall), the answer is no. The contract's warranty was the agreement between the two parties concerning the obligations of the manufacturer to correct the defects without cost to the consumer. Like every contract, the warranty had a limited duration. That is, the manufacturer agreed to cover the costs of parts and the labor to repair the vehicle for a specific period of time.

Merely because the contract had a finite duration does not create additional rights for the consumer. One of the central underpinnings of the economic loss doctrine is to encourage parties best suited (usually the purchaser) to assume, allocate, or insure against the loss. A consumer can purchase an extended warranty like the consumer in State Farm or self-insure by obtaining separate first party coverage that deals with this type of loss. Once the warranty period expires, the consumer no longer has a contractual right to insist that the manufacturer repair or replace the defective part(s) free of charge – as this was part of the bargain.

So, how can the economic loss doctrine impact coverage? It can impact the existence of coverage based on the remedies available under the contract.

It should be noted that the mere fact that the essence of the claim is one for a breach of contract does not, necessarily, preclude the possibility of insurance coverage. The thought that a breach of contract claim was *ipso facto* not a covered claim was supported by the Wisconsin Supreme Court's decision in Wausau Tile, Inc. v. County Concrete Corp.

Wausau Tile involved the claim that defective concrete was supplied to Wausau Tile and used to create concrete paving blocks. The defective concrete caused the blocks to expand and crack. Wausau Tile sued the supplier and its insurer on negligence and strict liability claims that were dismissed under the economic loss doctrine. The Court decided the defective concrete did not damage other property despite Wausau's argument that the cement (the defective product) caused damage to property other than the defective product. The argument was rejected because, when a component part of an integrated system causes damage to the system as a whole, the system is not considered "other property." The ruling left Wausau Tile with only its contract remedies.

With dismissal of the tort claims (leaving only the contract claims) so too, went Wausau Tile's hope of establishing insurance coverage for the alleged negligence of the supplier. According to the opinion, “In addition, it is undisputed that the breach of a contract or warranty is not a covered ‘occurrence’ under the Travelers policy.” From this language the defense that a breach of contract was not an occurrence under a CGL policy was born.

A more recent Supreme Court case, American Girl, however now provides an argument that a breach of contract can, potentially, encompass an occurrence. American Girl involved the failed construction of a warehouse. During the warehouse’s construction, it suffered serious structural problems from soil settlement. The “cause” of the soil settlement was some “faulty site-preparation advice of the soil engineering subcontractor.”

American Girl contracted with The Renschler Company for the warehouse’s construction. In an unusual contract provision, The Renschler Company specifically agreed to be responsible for any and all consequential damages occasioned by the warehouse’s construction. When American Girl raised the defects in the warehouse’s construction, The Renschler Company placed its carriers on notice of the claim. American Family Mutual Insurance Company, one of The Renschler Company’s liability carriers, argued that the economic loss doctrine barred the tort claims asserted against its insured and therefore only the contract claims were left. Under Wausau Tile, it argued, breach of contract claims are not occurrences thus leaving no coverage under its policies of insurance.

The Wisconsin Supreme Court rejected American Family’s contention, stating that the parties in Wausau Tile agreed that breach of contract claims could not constitute occurrences. According to the Court, the conclusion that the breach of contract claim was not an occurrence was the result of the agreement between the parties in that case. There was no such agreement in American Girl; the issue of whether a breach of contract could be an occurrence was “disputed.” The Supreme Court’s distinction between the apparent stipulation of the parties in Wausau Tile and the disputed issue in American Girl has opened the door for litigants to claim breach of contracts can be an occurrence.

Wise counsel will not read American Girl superficially. Arguably, American Girl stands for the limited proposition that faulty acts by a subcontractor could be an occurrence.

Nevertheless, if American Girl does stand for the broader proposition that a breach of contract can be an occurrence, then counsel needs to continue the analysis of the contract claim and the insurance policy’s provisions. In other words, even if a breach of contract can be an occurrence, it does not necessarily follow that the damages sought are *property damage* as defined in the policy; further, even if there is property damage caused by an occurrence any number of exclusions may apply to preclude an indemnity payment.

Perhaps more importantly, the contract itself may limit the damages that would be recoverable in the event of a breach. Even if there is an *occurrence* and even *property damage* as defined by the policy, the economic loss doctrine may still impact the coverage determination. As noted *supra*, the economic loss doctrine is a remedies principle – channeling the route to recovery via a tort or a contract theory. If the economic loss doctrine could preclude the tort remedy, counsel must determine if the damages that the contract allows for meet the definition of *property damage*.

For example, if contract requires an insured to repair or replace the work that failed, it is likely that an impaired property or like exclusion would apply as a bar to an indemnity payment. Typically this exclusion precludes coverage for:

“Property damage” to “impaired property” or property that has not been physically injured, arising out of:

- A defect, deficiency, inadequacy or dangerous condition in “your product” or “your work”; or
- A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

In addition, exclusion such as the "Damage to Your Product" and "Damage to "Your Work" exclusions might also serve to preclude coverage under these circumstances.

Further, if the contract requires an insured to simply refund the contract price in the event of a total frustration of the contract's purpose, it is unlikely that such "damage" is *property damage* as defined by the insurance policy, as Wisconsin Courts have held that mere economic loss is not property damage.

While the economic loss doctrine is not a defense to coverage claims of *per se*, it co-exists with insurance coverage and could assist in determining the absence of coverage.

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Monte E. Weiss is the president of Weiss Law Office, S.C. His practice primarily involves the defense of bodily injury, property damage and product liability cases for insurance companies and self-insured companies. He routinely represents insurance carriers on insurance contract interpretation issues and claims of bad faith. His work also involves the defense of real estate agents. Mr. Weiss was graduated from Case Western Reserve University School of Law in 1991. He would also like to thank JP Fernandes for his assistance with this article.

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11 American Girl, 2004 WI at ¶5.
12 American Girl, 2004 WI at ¶46.
13 See American Girl, 2004 WI at P48 (See also, Anderson's Wisconsin Insurance Law: A Preview of the Fifth Edition Breach of Contract is not an Occurrence, Wisconsin Civil Trial Journal, Volume 2, Number 1).
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