The Expansion of the Economic Loss Doctrine Stalls: Tort Claims Based on Service Contracts are not Barred

by: Monte Weiss - Weiss Law Office, S.C.

Recently, the Supreme Court of Wisconsin held that where there is a pure services contract – one in which no product is provided- the economic loss doctrine will not apply. Insurance Company of North America v. Cease Electric.

In Cease Electric, an egg farm hired an electrical contractor to install a ventilation system. The ventilation system failed and 17,865 hens died. The egg farm sued on solely a tort theory. The electrical contractor argued, *inter alia*, that the economic loss doctrine should apply to even service contracts where there are commercial parties, a contract (albeit an oral one here) and solely economic loss. As such, according to the electrical contractor, the tort claim could not stand in the face of the doctrine. The Supreme Court disagreed, finding that none of the underlying policy rationales for the doctrine's application supported the extension to service contracts.

While acknowledging the three underlying policy rationales that support the application of the economic doctrine, the Court concluded that none of them supported the expansion of the doctrine. Those policy rationales are designed:

1. To maintain the fundamental distinction between tort and contract law;
2. To protect commercial parties' freedom to allocate economic risk by contract; and
3. To encourage the party best suited to assess the risk of economic loss to assume, allocate or insure against that risk.

In addressing the first policy rationale, the Court noted that maintaining the distinction between contract and tort law presupposes that the "bargaining parties will allocate the risks and remedies." However, when this assumption--that the parties will have negotiated the risks of non-performance and of the remedies in such an event--is not warranted, the incentive to apply the doctrine is lessened.

In light of the informal nature of the typical service contract, the assumption of actual pre-contract negotiation is, according to the Court, unwarranted. Generally, the consumer does not have the opportunity to review any limitations or restrictions of available remedies until the service work is completed and the customer is presented with the invoice – which contains the limitations. Thus, this policy rationale did not support the extension of the doctrine to service contracts.

The second policy rationale, that the parties should be free allocate the risk of economic loss via their contracts, is again, according to the Court, undermined by the informal nature of most service contracts. While acknowledging that parties to service contracts can allocate risk and limit remedies via a written contract, most do not address these issues until after the loss occurs. As such, the Court reasoned that this policy rationale does not support the extension of the doctrine to service contracts.

In addressing the third policy rationale, the Court recognized that doctrine's application encourages the party in the best position to allocate, assume or insure against the risk of economic loss.

However, like the other two policy rationales, this presupposes equal bargaining power between the contracting parties. The determination of who is the best position to determine the risk of economic loss must be determined on a case by case basis when service contracts are in issue. As such, the assumption that the purchaser is in the best position is not always warranted and this policy rationale "neither supports nor negates the application of the economic loss doctrine to service contracts."

The Court also noted that doctrine itself has its roots in the Uniform Commercial Code which also militates against the doctrine's extension to service contracts. Service contracts do not have the UCC to fall back upon to provide 'gap filling' warranties – warranties as to fitness or merchantability that are implied by law to the parties' contracts if they are not otherwise specifically written into their agreements.

Thus, despite the presence of solely economic loss, commercial parties and a contract, the Court declined to extend the doctrine to service contracts.

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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.

Reference

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