

The “dreaded” economic loss rule and its application to aviation hull claims.¹

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Few legal concepts are so simple to state, while at the same time so difficult to apply, as the economic loss “rule.”³ Although the basic tenets of the rule are widely recognized, it differs greatly in its scope and application from jurisdiction to jurisdiction. Some courts are expanding its application, while others are seeking to restrict it. To make matters worse, whether the rule is applied is often very fact-specific, resulting in differences from case to case. This is particularly true when the rule is applied to aviation hull claims that inject additional issues such as aftermarket products, overhauled components, improper service, warranty issues, component parts, manufacturing and design defects.

This article provides an overview of the principles underlying the rule, some examples of its diverse scope and application, its exceptions, and a few recent cases of interest.

I. The “confusing morass”⁴ of the Economic Loss Rule.

A. The Economic Loss Rule.

The rule sounds relatively simple: a party may not recover in tort for purely economic losses.⁵ The rationale is also clear-cut:

The rule stems from the recognition of a balance between tort law, designed to redress losses suffered by breach of a duty imposed by law to protect societal interests, and contract law, which holds that parties to a commercial transaction should remain free to govern their own affairs.⁶

It is often said that the rule is a fundamental boundary between contract law and tort law.⁷ If the parties are in contractual privity, the economic impact of defects or nonperformance of a product can be bargained for as part of the contract and a party to that contract should not be allowed to circumvent any contractual limitations of liability through tort claims.⁸ Similarly, in the products liability context, the economic loss rule protects manufacturers and distributors from any tort liability beyond any warranties associated with the product when the only damage is to the product itself.⁹

The seminal case on the economic loss rule is *East River Steamship Corp. v. Transamerica Delaval, Inc.*,¹⁰ where the Supreme Court held that when a defect in a product only damages the product itself, the manufacturer cannot be held strictly liable for economic losses¹¹ because the user simply lost the benefit of his bargain.¹² The appropriate remedy is a warranty action, not tort claims.¹³ Thus, “a manufacturer in a commercial relationship has no duty under either negligence or strict products-liability to prevent a product from injuring itself.”¹⁴

The Court also stated that the rule applies regardless of the degree of risk posed by the defective product to persons or other property when such harm does not actually occur. As a result, “even when the harm to the product itself occurs through an abrupt, accident-like event,

the resulting loss due to repair costs, decreased value and loss of profits is essentially the failure of the purchaser to receive the benefit of its bargain—traditionally the core concern of contract law.¹⁵

Numerous jurisdictions have adopted this general rule—that purely economic losses cannot be recovered in tort in the absence of personal injury or damage to property other than damage to the product itself,¹⁶ even when there is no other available remedy.¹⁷

B. The Economic Loss Rule varies from jurisdiction to jurisdiction.

Whether your aviation hull claim will be impacted by the rule often depends on what state’s law is applied. Of those states that recognize the rule, some apply it broadly, barring any tort claim that does not involve personal injury or damage to other property¹⁸ while others are more restrictive, only applying the rule when a tort claim is asserted in an attempt to circumvent a contract or in the product liability context when the property merely damages itself.¹⁹

There are also jurisdictions that apply the rule, but have eliminated the physical injury or damage to other property requirement in special cases. For example, a minority of jurisdictions allow parties to recover economic losses in tort even if there is no personal injury or damage to other property if a “special relationship” exists between the parties and the injury was clearly foreseeable.²⁰ New Jersey is one such state. When it abandoned these requirements, it explained that there are cases where the impact of the defendant’s negligence is sufficiently foreseeable to warrant the imposition of economic loss damages:

A defendant owes a duty of care to take reasonable measures to avoid the risk of causing economic damages, aside from physical injury, to particular plaintiffs or plaintiffs comprising an identifiable class with respect to whom defendant knows or has reason to know are likely to suffer such damages from its conduct. A defendant failing to adhere to this duty of care may be found liable for such economic damages proximately caused by its breach of duty.²¹

Similarly, Alaska and Washington have rejected the Supreme Court’s view in *East River* that the degree of risk potentially posed by a product defect is immaterial when personal injury or damage to other property did not occur. These states employ a “risk-harm” determination that allows damage to the product itself to be the sole basis for a products liability suit if the defect presents a sufficient degree of potential risk to persons or property.²²

Still other jurisdictions consider whether the injured party is a commercial entity or a consumer. For example, Rhode Island limits the application of the rule to disputes between commercial entities with equal bargaining power.²³ Similarly, in Michigan, when a commercial party seeks to recover economic losses caused by a defective product, the exclusive remedy is the Uniform Commercial Code.²⁴ In sum, the rule differs in both form and application from jurisdiction to jurisdiction—producing divergent results.

C. Whether damage is recoverable damage to “other property” also varies from jurisdiction to jurisdiction.

In order to avoid the application of the rule, parties often argue that a defective part or component is a separate product such that the injury to the entire product is injury to “other property,”²⁵ and not injury to the product itself.²⁶ In *East River Steamship Corp. v. Transamerica Delaval, Inc.*,²⁷ the Supreme Court rejected this very argument on the grounds it would eliminate the intent of the rule because “all but the simplest machines have component parts.” As a result, considering each component a separate product would require a finding of other property damage in almost every case where a product damages itself.²⁸

Following this reasoning, courts have held that a helicopter and its engine are not separate pieces of property and that the economic loss rule bars the owner from recovering from the engine manufacturer in tort when an engine failure merely results in damage to the helicopter itself.²⁹ Thus, an integrated component is generally never “other property” when it was in the aircraft at the time it was purchased.

The application of the rule in aviation hull claims, however, becomes even more complicated when the component is an aftermarket item, is separately purchased or is a routine replacement part. The courts often look at whether the components of the aircraft were part of the same “bargain,” purchased at the same time or bargained for separately.³⁰ But the results are not uniform. While one court may hold that a defective replacement part is not part of the originally integrated bargained for product and that it damages “other property,”³¹ another will find that because the sale of an engine included components that “inevitably” need replacement there was no separate, subsequent “bargain” for the replacement parts and they continue to be part of the integrated whole.³² As commentators have observed, in aviation cases the “myriad of factors that must be considered in determining whether the defective component is the ‘same product’ as the damaged whole leads to uncertainty, subjective determination, and a certain arbitrariness of application.”³³

The result of this morass is uncertainty. Whether your hull claim will succeed is heavily influenced by the facts and what law governs your claims.

II. Exceptions to the Economic Loss Rule.

There are numerous exceptions to the economic loss rule, although each exception’s scope varies from jurisdiction to jurisdiction and depends on the facts of each case. Generally, when the claims arise from intentional conduct, services, or a duty separate from any contractual or warranty obligations, the rule will not be applied. For example, courts have held the rule does not bar claims for economic loss when they are asserted as damages for the following claims:

1. Negligent misrepresentation claims;³⁴
2. Statutory claims;³⁵
3. Negligent performance of services;³⁶

4. Tortious interference with a contract;³⁷
5. Fraud and fraudulent inducement;³⁸ and
6. Intentional torts.³⁹

III. Recent Cases.

A. *Isla Nena Air Services, Inc. v. Cessna Aircraft Co.*⁴⁰

In *Isla Nena Air Services, Inc.*, the First Circuit found that under maritime law, or the law of Puerto Rico, the commercial airliner could not recover its economic losses resulting from an in-flight engine failure when there was no damage to other property.

Isla Nena operated a short-haul commercial airline in Puerto Rico. In 2001, it purchased a new 208B from Cessna with a Pratt & Whitney engine. As a result of an engine failure and an emergency water landing, the aircraft suffered major damage and the engine was destroyed. Isla Nena sued Cessna and Pratt & Whitney under negligence and strict liability theories seeking the cost to repair the aircraft and engine, loss of use and lost profits.

Cessna and Pratt & Whitney moved for summary judgment, asserting Isla Nena's claims were barred by the economic loss rule under maritime and Puerto Rico law. The district court granted the motion, holding that maritime law applied, and that the economic loss rule barred recovery, because the only damage was to the aircraft itself. On appeal, Isla Nena argued that Puerto Rican law should apply, and that under Puerto Rico's doctrine of concurrence of actions, its tort claims were not barred by the economic loss doctrine "simply because a warranty claim is not available or not pursued."⁴¹ The appellate court rejected Isla Nena's argument:

If Isla Nena were arguing that [Cessna and Pratt & Whitney's] alleged negligence breached a contract or warranty and also caused damage to other property besides the defective product, Isla Nena would potentially have valid contract and tort claims and could, under the doctrine of concurrence of actions, choose whether to proceed in contract or tort.⁴²

In an issue of first impression, the First Circuit held that the Puerto Rico Supreme Court would adopt the economic loss rule of *East River*, which would bar the airline's tort claims. Thus, Isla Nena's claims were barred under maritime and Puerto Rico law.

B. *United States Aviation Underwriters, Inc. v. Pilatus Business Aircraft, Ltd.*⁴³

In a similar case, the District Court of Colorado held under maritime and Colorado law that economic loss damages for loss of an aircraft resulting from an in-flight engine failure were not barred by the economic loss rule when: (1) the injured party was merely a lessee who did not bargain for the warranty; and (2) the complete loss of the aircraft was not contemplated by the warranty.⁴⁴

Access Air leased an aircraft manufactured by Pilatus with a Pratt & Whitney engine. The aircraft was insured by USAU. When the engine failed in flight, the pilot made an emergency water landing, but the aircraft sank and was never recovered. The pilot and the passengers were not injured.

USAU paid Access and then pursued a subrogation claim against Pilatus and Pratt & Whitney alleging causes of action for negligence. Pratt & Whitney moved for summary judgment on the economic loss rule.

The district court denied the motion, finding that the economic loss rule did not apply to the case under Colorado or maritime law. In reaching its conclusion, the court explained:

[T]he fact that Access Air was the end-user of an airplane it did not purchase in a commercial transaction with manufacturers but leased from a third party militates against limiting it to recovery under the warranties. Access Air did not bargain with any of the aircraft or engine manufacturers, did not negotiate price concessions in exchange for limitations on liability and did not accept or allocate any risks. It succeeded, if at all, to very limited warranties for the repair or replacement of airplane parts. Under the circumstances of this case, I conclude the mid-flight failure of the aircraft's engine over the Sea of Okhotsk is the kind of harm against which public policy requires manufacturers to protect, independent of any contractual obligation.⁴⁵

The *Pilatus* court's holding is a prime example of the divergence of opinions in applying the rule. If the issue had been decided by the First Circuit, or if Access was the purchaser or if the plane could have been repaired, there would likely be a different result.

C. *Turbomeca, S.A. v. French Aircraft Agency, Inc.*⁴⁶

In *Turbomeca*, a Florida court of appeals held the personal injury or other property requirement is specific to the party seeking economic losses, not the incident giving rise to the claim.⁴⁷

French Aircraft owned an Aerospatiale helicopter powered by a Turbomeca engine. The helicopter's original owner installed a fuel flow limiter, designed to protect the engine from potential over temperature failure during high altitude/high power demand operations.

The helicopter crashed, was a total loss, and the pilot and two passengers sustained personal injuries. After the crash, it was discovered that the fuel filter was improperly reinstalled by an inspector upside down. The pilot and passengers sued French Aircraft, Aerospatiale, the inspector and Turbomeca. French Aircraft brought a contribution action against Turbomeca, alleging that the cause of the accident was a defect in the engine's fuel flow limiter.

French Aircraft and Turbomeca agreed to submit their dispute to binding arbitration, but the arbitrator's decision was subject to review on all issues of law. After the arbitrator awarded

French Aircraft damages for the loss of the helicopter, Turbomeca appealed and asserted the award was barred by the economic loss rule. French Aircraft contended the rule did not apply because Turbomeca's damages caused physical injuries in addition to damage to the product itself.

The court of appeals reversed the arbitrator's award, finding that French Aircraft could not rely upon third parties' injuries to avoid the economic loss rule:

Contrary to French Aircraft's assertions, it cannot avoid the economic loss rule, as a matter of law, because French Aircraft has suffered no personal injury or damage to other property. Although the pilot and the two passengers were injured, French Aircraft has no claim against Turbomeca for any physical injuries to itself Physical injury to third parties is insufficient to satisfy this economic loss rule exception

In addition, no other property was harmed. The airframe and engine are not two separate pieces of property—they are one product. Courts have refused to bifurcate products into parts where a component part harms or destroys the finished product This case does not present any facts that would persuade us to depart from these well-reasoned precedents.⁴⁸

Although French Aircraft's argument was creative, it was rejected by this court. If this claim was decided by the *Pilatus* court, the existence of a physical injury and the total loss of the helicopter may have led to a different result.

D. *Robinson Helicopter Co., Inc. v. Dana Corp.*⁴⁹

In *Robinson*, the California Supreme Court recognized that the economic loss rule does not bar fraud claims even if they seek economic loss.

The type certificate used by Robinson to manufacture its R22 and R44 helicopters required that the sprag clutches ground at a particular level of hardness described as "50/55 Rockwell."

For over ten years, Robinson purchased sprag clutches meeting the type certificate specifications from Dana Corp. Dana then changed its grinding process to a higher "61/63 Rockwell" level of hardness but did not tell Robinson, and continued to send certificates to Robinson stating the clutches were manufactured in conformance with the type certificate. When the non-conforming clutches began to fail at a significantly higher rate, Dana eventually disclosed that it had changed the hardness level.

Robinson sued Dana to recover the costs of the recall and asserted negligent and intentional misrepresentation claims. The jury found that Dana committed fraud and awarded Robinson actual and punitive damages. On appeal, the court held that the economic loss rule barred Robinson from recovering in tort.

Robinson appealed to the California Supreme Court, which reversed the court of appeals' decision. The court restated the well-established exception that the economic loss rule does not bar tort claims when a duty exists independent of the contract. It stressed the distinction between contract and fraud claims.

Robinson's claims are based on Dana's intentional and affirmative misrepresentations that risked physical harm to persons. Robinson's helicopters are flown by and carry people. A properly functioning sprag clutch is vital to the safe performance of the aircraft, and compliance with the certificate requirement is part of an integrated regulatory scheme intended to ensure their safe operation. The economic loss rule is designed to limit liability in commercial activities that negligently or inadvertently go awry, not to reward manufacturers who affirmatively misrepresent and put people at risk.⁵⁰

IV. Conclusion.

Past decisions, and recent cases, aptly demonstrate why the economic loss rule is "dreaded"—its varied scope and application lead to unpredictable results, particularly in the arena of aviation hull claims. The call for a more uniform system has yet to be answered. As a result, aviation practitioners must advise their clients, whether manufacturers, distributors, purchasers, end users or insurers, that their risks and potential for recovery will vary from jurisdiction to jurisdiction and case to case.

¹ *Green Acre Prop., Inc. v. Roa*, 933 So.2d 19, 25 (Fla. 2d DCA 2006).

² The author would like to recognize her reliance for part of this article on the prior work of Donald A. Waltz and Catherine Slavin, *The Economic Loss Doctrine and Damage to Aircraft: A Mess Untangled . . . Sort Of*, International Association of Defense Counsel Newsletter, No. 6, March 2005.

³ Defined by Black's Law Dictionary as "Generally, an established and authoritative standard or principal; a general norm mandating or guiding conduct or action in a given type of situation." (8th ed. 1999).

⁴ *Indem. Ins. Co. v. American Aviation, Inc.*, 891 So.2d 532, 544 (Fla. 2004) (Contero, concurring).

⁵ See, e.g., *Kelleher v. Lumber*, 891 A.2d 477, 495 (N.H. 2005); *Corporex Dev. & Constr. Mgt., Inc. v. Shook, Inc.*, 835 N.E.2d 701, 704 (Ohio 2005).

⁶ *Shook*, 835 N.E.2d at 704.

⁷ *Fireman's Fund Ins. Co. v. Childs*, 52 F. Supp.2d 139, 141 (D. Me. 1999); *Daanen & Janssen, Inc. v. Cedar Rapids, Inc.*, 216 Wis.2d 395, 400, 573 N.W.2d 842 (1998).

⁸ *Indem. Ins. Co.*, 891 So.2d at 536-37.

⁹ *Id.* at 538-39.

¹⁰ *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 871 (1986)(adopting economic loss rule in product liability admiralty context).

¹¹ Economic losses are lost "benefit of the bargain" damages such as inadequate value, cost of repair, replacement or lost profits. *Casa Clara Condo. Ass'n., Inc. v. Charley Toppino & Sons, Inc.*, 620 So.2d 1244, 1246 (Fla. 1993)(citing *Economic Loss in Products Liability Jurisprudence*, 66 Colum. L. Rev. 917, 918 (1966)).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.* at 870.

¹⁶ *Jacobs v. Yamaha Motor Corp., USA*, 420 Mass. 323, 329 n.5 (1995); *Hamill v. Pawtucket Mut. Ins. Co.*, 892 A.2d 226, 228 (Vt. 2005); *Border Brook Terrace Condo. Ass'n v. Gladstone*, 137 N.H. 11, 622 A.2d 1248, 1253 (1993); *Sealey v. White Motor Co.*, 63 Cal.2d 9, 45 Cal.Rptr. 17, 403 P.2d 145 (Cal. 1965).

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- ¹⁷ *Airport Rent-A-Car, Inc. v. Prevost Car, Inc.*, 660 So.2d 628, 631 (Fla. 1995).
- ¹⁸ *Nebraska Innkeepers, Inc. v. Pittsburgh-Des Moines Corp.*, 345 N.W.2d 124, 128 (Iowa 1984).
- ¹⁹ *Indemnity Ins. Co.*, 891 So.2d at 536-37.
- ²⁰ *Aikens v. Debow*, 208 W.Va. 486, 541 S.E.2d 576, 589 (2000); *People Express Airlines, Inc., v. Consol Rail Corp.*, 100 N.J. 246, 495 A.2d 107, 116 (1985); *Lowe's v. Philip Morris USA, Inc.*, 207 Or. App. 532, 552, 142 P.3d 1079 (Or. Ct. App. 2006).
- ²¹ *People Express Airlines, Inc.*, 495 A.2d at 116.
- ²² *Pratt & Whitney Canada, Inc. v. Sheehan*, 852 P.2d 1173, 1179-81 (Alaska 1993)(declining to abandon risk-of-harm test); *Washington Water & Power Co. v. Graybar Elec. Co.*, 112 Wash.2d 847, 774 P.2d 1199, 1209-10 (Wash. 1989).
- ²³ *Triton Realty Ltd. P'ship v. Almeida*, No. PC 04-2335, 2006 WL 828733, at *2 (R.I. Sup. Ct. March 29, 2006).
- ²⁴ *Neibarger v. Universal Coops., Inc.*, 439 Mich. 512, 486 N.W.2d 612 (Mich. 1992).
- ²⁵ *Lockheed Martin Corp. v. RFI Supply, Inc.*, 440 F. 3d 549, 555-56 (1st Cir. 2006).
- ²⁶ *Casa Clara*, 620 So.2d at 1244.
- ²⁷ *East River S.S. Corp.*, 476 U.S. at 867.
- ²⁸ *Id.* (quoting *No. Power & Eng'g Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324, 330 (Alaska 1981)).
- ²⁹ *Turbomeca, S.A. v. French Aircraft Agency, Inc.*, 913 So.2d 714, 716-17 (Fla. 3rd DCA 2005; *Am. Eagle Ins. Co. v. United Tech. Corp.*, 48 F.3d 142 (5th Cir. 1995)(aircraft hull damaged by defective engine is not other property); *Nat'l Union Fire Ins. Co. v. Pratt & Whitney Canada, Inc.*, 107 Nev. 535, 815 P.2d 601 (1991).
- ³⁰ *Trans States Airlines v. Pratt & Whitney Canada, Inc.*, 177 Ill.2d 21, 682 N.E.2d 45 (1997).
- ³¹ *Lease Navajo, Inc. v. Cap Aviation, Inc.*, 760 F. Supp. 455 (E.D. Pa. 1991).
- ³² *Agrotors, Inc. v. Bell Helicopter Textron, Inc.*, 2004 WL 2039954 (E.D. Pa. 2004)(unpublished).
- ³³ Donald A. Waltz and Catherine Slavin, *The Economic Loss Doctrine and Damage to Aircraft: A Mess Untangled ... Sort Of*, International Association of Defense Counsel Newsletter, No. 6, March 2005. The authors recommend that the courts adopt a bright line rule in aviation cases that bars tort claims when the product or service is part of the original sale, work warranted as part of the original sale or without cost to the owner while allowing tort remedies for replacement parts and work for which the owner has paid separate consideration.
- ³⁴ *Christiana Marine Serv. Corp. v. Texaco Fuel and Marine Mktg.*, No. Civ. A. 98C-02-217WCC, 2002 WL 1335360, at *6 (Del. Super. Ct. June 13, 2002); *Haddon View Invest. Co. v. Coopers & Lybrand*, 436 N.E.2d 212, 215 (Ohio 1982); *Hydro Investors, Inc. v. Trafalgar Power, Inc.*, 227 F.3d 8, 18 (2d Cir. 2000)(applying New York law); *Moorman Mfg. Co. v. Nat'l Tank Co.*, 435 N.E.2d 443, 452 (Ill. 1992).
- ³⁵ *Delgado v. J.W. Courtesy Pontiac GMC-Truck, Inc.*, 693 So.2d 602, 609 (1997).
- ³⁶ *Ins. Co. of North America v. Cease Elec., Inc.*, 276 Wis.2d 361, 688 N.W.2d 462 (Wis. 2004); *Stuart v. Weisflog's Showroom Gallery, Inc.*, 721 N.W.2d 127, 137-38 (Wis. Ct. App. 2006).
- ³⁷ *Ward v. Ernst & Young*, 435 S.E.2d 628, 632 n.2 (Va. 1993).
- ³⁸ *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, 685 So.2d 1238, 1239 (Fla. 1996);
- ³⁹ *Indem. Ins. Co.*, 891 So.2d at 543.
- ⁴⁰ 449 F.3d 85 (1st Cir. 2006).
- ⁴¹ *Id.* at 89.
- ⁴² *Id.* at 90 n.5.
- ⁴³ 358 F. Supp.2d 1021 (D. Col. 2005).
- ⁴⁴ *Id.* at 1025-26.
- ⁴⁵ *Id.* at 1027.
- ⁴⁶ 913 So.2d 714 (Fla. 3d D.C.A. 2005).
- ⁴⁷ *Id.* at 717-18.
- ⁴⁸ *Id.* at 716-17.
- ⁴⁹ 102 P.3d 268 (Cal. 2004).
- ⁵⁰ *Id.* at 274 n.7.