A View Five Years From *Eastwood* and *Affiliated FM*: Washington's Transition From Economic Loss Doctrine To Independent Duty Doctrine

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For the better part of a quarter century, design professionals in Washington had been able to rely upon the "economic loss doctrine" (ELD) as a bulwark against both third party tort claims and certain tort claims brought by parties with whom they had contracted. However, in 2010, two Washington State Supreme Court decisions created uncertainty by turning the economic loss doctrine on its head with the adoption of the "independent duty doctrine" (IDD). Since then, Washington appellate courts have revisited the issue in several new cases. The takeaway is that some traditional ELD-type protections appear to remain viable, whereas in other instances, things are murkier. In our view, the state of the law remains in flux and subject to further interpretation and refinement as new cases continue to address the IDD analysis. As a consequence, design professionals are advised to continue to re-evaluate their risks of claims in the near term until the courts provide greater clarity.

Traditional ELD analysis

The economic loss doctrine is a policy adopted by courts to address whether certain claims may be asserted in tort (i.e., negligence) or only brought as breach of contract suits. It was originally conceived of and applied in the context of consumer protection cases, but was subsequently applied in other areas of the law, including, and specifically, construction law. Various states accept the doctrine and, until 2010, Washington had been among those with a long—and strong—history of recognizing the ELD with a particular emphasis in enforcing it in the construction arena.

Courts have historically considered the nature of claimed damages—whether the damages are purely "economic" in nature, or whether they involve injury to persons or the property of others—in deciding the proper boundaries for tort and breach of contract claims. In Washington, and most other jurisdictions recognizing the ELD, when the damages sought are essentially economic in nature (i.e., lost profits, cost overruns, project delays) and the parties have allocated the risk of economic loss in their contracts, courts have generally held that only a breach of contract claim is permitted; as a consequence, only a party in contractual privity may recover from the party alleged to be at fault. Tort claims from third parties are barred, and even among those in privity, typically only breach of contract claims are permitted. On the other hand, when a claim involves (1) an injury to a person or (2) damage to third party property, any aggrieved party may assert a tort claim, such as professional negligence, against the responsible party, regardless of whether any contractual relationship exists between the two.

This analysis has been applied to the construction industry in Washington and many other states. Contracts typically intend to address the *financial* expectations of the parties; accordingly, under ELD analysis, a remedy pursuant to contract is the proper means by which to address disputes about purely economic issues, which are the subject matter of the contract. When a construction project results in injury to persons (i.e., injured worker or third party) or damage to the property

of others (i.e., neighboring property damage), courts have tended to permit a tort claim to be asserted to protect those interests

In the construction field in Washington, the ELD had been an important safeguard and tool for design professionals to manage risk. In the traditional "design-bid-build" paradigm, third parties (such as contractors not in contractual privity with a design professional) have usually been barred from asserting tort claims for purely economic losses. Moreover, even a party in privity with the design professional, such as a project owner, could only assert breach of contract when the damages at issue are economic in nature. Thus, in the "design-bid-build" model, where an architect or engineer has a contract with an owner, who in turn has a contract with the builder, the builder would be barred from asserting a tort claim directly against the architect or engineer for economic damages such as claims for undue delay or cost overruns. Likewise, the owner in privity with the architect or engineer would be limited to contractual remedies only—he or she may sue for breach of contract, but is barred from pursuing a *tort* claim, such as professional negligence, for economic losses.

The policy rationale behind the ELD makes sense especially in the construction industry. Typically in this area of commerce, sophisticated parties have fairly and knowingly negotiated an agreement that allocates risks and rewards. The contract between parties creates a legal relationship to each other that makes risks more predictable and, thus, reasonably quantifiable. In one of Washington's leading cases, *Berschauer/Phillips Constr. Co. v. Seattle School Dist. No. 1*, decided in 1994, the state Supreme Court went to great lengths to specifically endorse this policy for the construction industry as a means of achieving the goals of reasonable risk allocation, price certainty and greater commercial security for parties to construction projects. Since that decision came down, *Berschauer/Phillips* has been a standard for application of the ELD analysis in Washington construction cases, and relied upon with great frequency by courts working through these disputes in construction cases.

Accordingly, it was this very certainty that for several years provided design professionals both stable predictability in contracts and, equally important, an effective shield in litigation from certain tort claims brought by owners and contractors alike.

Shift in legal theory in 2010

However in 2010, the Washington Supreme Court issued two simultaneous decisions: *Eastwood v. Horse Harbor Foundation, Inc., et al*, and *Affiliated FM Insurance Co. v. LTK Consulting Services, Inc.* These cases, issued as companion cases, effected a cardinal change in the law about the economic loss doctrine in Washington, where, apparently, the court intended to replace the economic loss doctrine with the independent duty doctrine. These cases significantly muddied the waters about how this doctrine will work going forward. With the ostensible rejection of ELD analysis and the adoption of IDD analysis in these two decisions, what has been particularly confusing for parties in the construction arena is that in the apparent switch to IDD analysis, the Court *did not reverse any of the previous cases that had applied the economic loss doctrine specifically in the construction area*.

As a consequence, we were left with two decisions that purport to substantially alter, or even eliminate, the ELD in Washington, yet simultaneously do not disturb previous ELD decisions in the construction law arena. Further complicating things, both decisions were "plurality" decisions—that is to say, no single opinion from the Court garnered a majority of five votes; rather each was decided by competing opinions that offered different perspectives on how such analysis should be applied.

In *Eastwood,* all three plurality opinions from the Supreme Court rejected application of the ELD under that case's facts (in a non-construction case involving the state statute for "waste"). As expressed in *Eastwood*, the independent duty doctrine should conceptually replace the economic loss doctrine regarding whether a tort claim may be brought by **shifting the question** from "*whether damages are purely economic in nature*" to "*whether there is an independent tort duty to exercise due care outside of contractual obligations*." To accomplish this analysis, the *Eastwood* plurality justices advocated that the courts apply "considerations of logic, common sense, justice, policy and precedent" on a case-by-case basis.

As mentioned above, the authors of the plurality opinions advocating application of independent duty analysis actually discussed the significant prior construction law decisions where the ELD was applied as a bar to tort claims and agreed that all of these ELD cases were correctly decided under the new IDD analytical framework. So, for example, the *Berschauer/Phillips* case mentioned above was specifically noted to have been "correctly" decided even under IDD scrutiny and is, therefore, still "good law" in Washington.

It was in *Affiliated FM* that *Eastwood*'s plurality endorsement of the independent duty doctrine was applied as a guiding principle in a construction law case. *Affiliated FM* involved the Seattle Monorail train fire in 2004, when dozens of passengers had to be evacuated from 50 feet above street level from the smoldering monorail. No one was injured, but the monorail train sustained substantial damage. The lawsuit arose as a subrogation action by an insurance company that paid on a property damage claim to the City (the monorail owner) and to a vendor for lost profits incurred due to the period of time the monorail was subsequently out of business during the repair period.

This case gives credence to the old lawyer's adage that "bad facts make bad law." The Supreme Court justices were plainly troubled by the fact that a catastrophic tragedy had nearly occurred and were disinclined to consider barring a tort claim merely because the actual damages were purely economic. The lead opinion declared that because the fire was allegedly attributable to bad engineering, it was appropriate that a third party (which had only suffered economic losses) be allowed to assert a tort claim for the *lost business expectancy* attributable to the engineer's supposedly negligent work. The lead opinion's logic was essentially that because fires endanger the public and engineers should design to avoid fires, the engineer's "independent duty" to protect the public from safety hazards gives rise, as a matter of policy, to a right to sue for negligence, even though the claimant was suing merely because it lost money while the monorail was out of service and the insurance company's subrogation claim had nothing to do with public safety.

Anecdotally, we can report that since these two cases came down, more plaintiffs (and in particular, owners) have felt emboldened to assert tort claims where they may not have in the past. We have also seen some plaintiffs attempt to characterize claims specifically to implicate a hypothetical risk of bodily harm (one contractor's lawyer actually raised the specter of a "terrorist attack" in an attempt to contrive a risk of harm to meet IDD scrutiny and make a tort claim viable).

Subsequent cases interpreting IDD analysis

Since *Eastwood* and *Affiliated FM* were decided, a few cases have filtered into the appellate courts with the opportunity for some clarification. The first notable case was *Elcon Constr., Inc. v. E. Wash. Univ.*, decided in 2012. Another construction case, the *Elcon* decision seemed to offer parameters around how and when the independent duty doctrine would be applied—the Washington Supreme Court noted that the doctrine would apply only to a "narrow" class of cases, mostly pertaining to construction and real estate claims.

It would appear that the Court is effectively following a rationale that previously was a major underpinning of ELD jurisprudence—which is to say, the focus on contractual relationships as central to evaluating whether there is some extra-contractual duty that arises as a basis to assert that a tort claim should exist independent of the contractual agreement allocating risk between the parties.

Elcon actually involved a claim for fraud, which is a recognized tort in Washington. The Court noted that it had never applied the IDD to bar fraud claims. Thus, the trial and appellate courts' application of the IDD to bar such a claim was in error, although inconsequential since the fraud claim failed because the mandatory elements could not all be proved. Thus, the Court's comments about application of the IDD analysis were somewhat gratuitous.

However, notably, *Elcon* dealt with the issue of fraud—a discrete issue we have seen raised in other states that have considered ELD analysis. Similarly, and more commonly, tort claims for negligent misrepresentation are often raised to circumvent ELD analysis. Negligent misrepresentation, a close cousin to the tort of fraud, likewise has a number of mandatory elements required to be proved to establish the tort. Nonetheless, it is a commonly used tactic by plaintiffs seeking to assert a tort claim to allege some negligent omission or error in some statement on the part of a design professional when the statement turns out to be wholly or partially false. Of those states that historically recognize the ELD, there are a handful of jurisdictions that have declined to apply ELD protection to claims of negligent misrepresentation. The policy rationale given by courts is typically that this particular tort is different than negligence because the duty to avoid misrepresentations that induce a party into executing a contract arises independently of the contract.

So too now in Washington, where in 2012, the Supreme Court next discussed application of IDD analysis as it specifically applies to negligent misrepresentation in *Jackowski v. Borchelt*. In *Jackowski* purchasers of a home sued the sellers and all the realtors involved after the home was damaged by a landslide. Included amongst their claims were claims for fraud and fraudulent concealment, which the trial court dismissed based on its application of the ELD. However, the

Court's decisions in *Eastwood* and *Affiliated FM* were issued while *Jackowski* was pending review by the Supreme Court. The Court held that the IDD should apply retroactively to decide the *Jackowski* case. The Court went on to declare reliance on the ELD was error because the "duty not to commit fraud is independent of the contract, the [IDD] permits a party to pursue a fraud claim regardless of whether a contract exists." Then, despite no such claim being involved in the *Jackowski* case, the Court went on to say "[t]he same is true for a claim of negligent misrepresentation, but only to the extent the duty not to commit negligent misrepresentation is independent of the contract."

The following year, the Supreme Court had the opportunity to address a negligent misrepresentation claim head on in *Donatelli v. D.R. Strong Consulting Engineers, Inc.* In *Donatelli*, an engineer entered into both an oral and, later, a written contract with the owner for assistance with permitting and platting of a parcel of land for development. The engineer promised to complete a scope of work within a certain amount of time (but didn't), to do so for a certain price (but subsequently billed 400% of that amount), and to timely obtain permit approvals (but failed to do so, resulting in a foreclosure on the property). The owners sued for breach of contract and negligent misrepresentation; the engineer sought to have the latter claim dismissed as being a barred tort claim. The Supreme Court affirmed the trial court's refusal to dismiss the owner's negligent misrepresentation claims precisely because the owners' claimed that they were falsely induced to enter into the contract by the specific promises of time, money and performance, none of which were met. Accordingly, the Court held that it was appropriate to allow the tort claim to go forward and that a duty, independent of the contract, existed to avoid such unfair or improper inducements to the formation of a contract. Worth noting was the Court's opinion that as regards negligent misrepresentation, the Court endorses a narrower expression of the duty than applied in other jurisdictions; in some jurisdictions the duty to avoid negligent misrepresentation is always considered to arise independently of the contract, while this Court holds that such a duty may be assumed in a contract.

Appellate courts dealing with IDD analysis subsequent to the Supreme Court opinions above, have focused on the Supreme Court's admonition in *Elcon "*not to apply the [IDD] to [bar] tort remedies 'unless and until this court has, based upon considerations of common sense, justice, policy and precedent, decided otherwise.'" In *Key Dev. Investment, LLC v. Port of Tacoma*, decided in 2013, the court held that the IDD did not bar a property owner's tort claims for tortious interference with business expectancies and fraudulent and negligent misrepresentation arising out of a real estate transaction. The court noted the Supreme Court's admonition not to apply IDD to bar tort claims unless it had already so ruled, and that the Supreme Court had thus far permitted tort claims for fraud, negligent misrepresentation and tortious interference with contract. In *Seattle-Tacoma Int'l Taxi Ass'n v. Kochar et al.*, an unpublished decision issued in 2014, the court declined to apply the IDD to a contractual dispute, noting that the Supreme Court has not applied the doctrine in a situation that does not involve real property or construction. The court similarly noted that it would not expand the IDD beyond precedent as instructed by the Supreme Court.

Conclusion

The state of the law morphing from ELD analysis to IDD analysis is obviously in flux and will likely continue to be so for the next few years. It is not difficult to predict that other construction cases will follow that will compel the Washington appellate courts to further consider this problem and how the law will evolve as to the paradigm between tort and contract. It is plain that counsel for owners, contractors and other potential third party claimants will closely look for opportunities to bring negligence claims against design professionals that previously had been barred.

Likewise, given the confusing nature of these decisions, there will very likely be a lack of predictability at the trial court level as various judges try to figure out whether the economic loss doctrine still exists and, if so, how, in whatever form, it is to be applied under this "independent duty" analysis. Anecdotally, we have had some success in persuading trial courts to effectively follow traditional ELD analysis, even under the new IDD paradigm. However, some courts will no doubt conclude that the doctrine is indeed gone and perform their own independent duty analysis to reach their own conclusions as to whether a tort claim may lie against a design professional.

Although these recent decisions leave us with more questions than answers, we can predict that:

- In cases involving personal injuries or *even the risk* of personal injuries, design professionals will typically be considered to have an "independent duty" apart from contractual obligations and will be exposed to negligence claims, either from a party in contract or from third parties.

- In cases involving catastrophic or unexpected events leading to damage to third party property, design professionals, likewise, risk being found to have an extra-contractual "independent duty" exposing them to negligence claims.

- In cases involving damage to the project property, uncertainty will reign as to whether design professionals will be exposed to tort claims, in addition to the remedies and limitations in the contract, or from claims brought by a third party, especially the construction contractor.

- Even in cases with purely economic damages, aggrieved third parties can be expected to contrive to articulate theories intended to implicate some "independent duty" by which a tort claim that was previously barred in this state can be asserted.

With these risks in mind, we offer these observations and suggestions:

- We recommend that all firms review their insurance programs with these risks in mind. This review should extend not only to the forms and policy limits of professional liability insurance, but also to available general commercial liability coverage that may be available from owners and contractors and for which design professionals can be named as "additional insureds."

- Design professionals should also be mindful of builder's risk coverage and pay careful attention to subrogation clauses in these policies. The *Affiliated FM* case was actually a subrogation claim by a property carrier, who had paid on the property damage claim and then stood in the shoes of the vendor to bring the negligence claim against the engineer.

- Design professionals should pay careful attention to all indemnity and other risk-shifting clauses to be sure they comport with Washington law. This is especially true for limitation of liability and indemnity clauses.

- Probably the best defense against these risks is to pay careful attention to quality assurance in all aspects of the work of the firm. Most negligence-based claims can be avoided in the first place by instituting and maintaining the quality assurance/quality control practices and adhering to them.