

## Evolution of the Economic Loss Doctrine in Arizona

Lena Pond

The economic loss doctrine bars a plaintiff from recovering tort damages, limiting the plaintiff solely to contract remedies, in certain situations. It has been applied in Arizona in the context of products liability, construction defects, and service contracts. The main public policy behind the economic loss doctrine is that contract law and tort law protect different interests. Contract law aims to enforce the expectancy interests between contracting parties and provide redress for parties who do not receive the benefit of their bargain, while tort law seeks to protect the public from harm to persons or property. *Evans v. Singer*, 518 F. Supp. 2d 1134, 1139 (D. Ariz. 2007). Generally, tort law provides “duty-based recovery,” while contract law allows for “promise-based recovery.” *Id.* Thus, in situations where parties specify the details of their agreement in a contract, it is reasonable to require those parties to seek remedies through contract when they have lost nothing other than the benefit of the bargain. *Id.*

### **The Economic Loss Doctrine: Products Liability**

The Arizona Supreme Court most recently discussed the economic loss doctrine in the context of products liability in *Salt River Project Agr. Imp. & Power Dist. v. Westinghouse Elec. Corp.*, 143 Ariz. 368, 694 P.2d 198 (1984) *abrogated on other grounds by Phelps v. Firebird Raceway, Inc.*, 210 Ariz. 403, 111 P.3d 1003 (2005). In *Salt River*, the court set out a three-part test to determine if a plaintiff may recover tort damages for a purely economic loss: (1) the economic nature of the loss; (2) whether the defect was “unreasonably dangerous,” and (3) whether the loss occurred in a “sudden, accidental manner.” *Id.* at 379, 694 P.2d at 209. When some combination of these factors preponderates, tort remedies will be available.

### **The Economic Loss Doctrine: Construction Defects**

The Arizona Supreme Court discussed the economic loss doctrine in the context of construction defects in *Flagstaff Affordable Housing Limited Partnership v. Design Alliance, Inc.*, 223 Ariz. 320, 223 P.3d 664 (2010). There, the court held the economic loss doctrine bars a building owner from recovering tort damages arising from faulty work by an architect when the work causes “economic loss but no physical injury to persons or

other property.” *Id.* at 326-327, 670-671. “Economic loss,” as used in *Flagstaff Affordable Housing*, refers to pecuniary or commercial damage, including any decreased value or repair costs for a product or property that is itself the subject of a contract between the plaintiff and defendant, and consequential damages such as lost profits. *Id.* at 323, 667.

Physical injury to “other property” means that the damage resulting from the construction defects damaged property *other than* property that was “itself the subject” of the contract between the plaintiff and defendant. *Desert Mountain Properties Ltd. P'ship v. Liberty Mut. Fire Ins. Co.*, 225 Ariz. 194, 203, 236 P.3d 421, 430 (Ct. App. 2010) *aff'd*, 226 Ariz. 419, 250 P.3d 196 (2011).

The court expressly declined to extend *Salt River's* three-factor test to construction defect cases. *Flagstaff Affordable Housing Limited Partnership*, 223 Ariz. at 326, 223 P.3d at 670. The court clarified that parties can contractually agree to preserve tort remedies for solely economic loss, but if they do not provide otherwise in their contract, they will be limited to contractual remedies for any loss of the bargain resulting from construction defects that do not cause personal injury or damage to other property. *Id.*

### **The Economic Loss Doctrine: Services Contracts**

The Arizona Court of Appeals extended the holding in *Flagstaff Affordable Housing Limited Partnership* to service contracts in *Cook v. Orkin Exterminating Co.*, 227 Ariz. 331, 258 P.3d 149 (Ct. App. 2011). In *Cook*, the plaintiffs sued Orkin Exterminating for failing to properly perform exterminating services pursuant to an exterminating contract. The plaintiffs alleged claims for breach of contract, breach of the implied covenant of good faith and fair dealing, breach of warranty, breach of fiduciary duty, negligence, negligent and intentional misrepresentation, and fraud. *Id.* at 333, 151. The court applied the economic loss doctrine and held the Cooks were limited to their contractual remedies for the purely economic loss they suffered due to Orkin's alleged failure to adequately perform its promises under their contract. *Id.* at 335, 153.

### **The Economic Loss Doctrine: Recent Developments**

The most recent case extending the scope of the economic loss doctrine was *Sullivan v. Pulte Home Corp.*, 237 Ariz. 547, 354 P.3d 424 (Ct. App. 2015), *review denied* (Jan. 5, 2016) (“*Sullivan I*”). The issue in *Sullivan* was whether a subsequent (i.e., non-original) homeowner may maintain a negligence cause of action against a homebuilder for economic losses, unaccompanied by physical injury to persons or other property, arising from latent construction defects. The case went to the Arizona Supreme Court, where the court held in general, if a homeowner

does not have a contract with the homebuilder, the economic loss doctrine does not bar the homeowner's negligence claims. *Sullivan v. Pulte Home Corp.*, 232 Ariz. 344, 306 P.3d 1 (2013) (“*Sullivan P*”). However, the court qualified that holding stating that the holding does not “imply that [the homeowner's negligence] claims will ultimately succeed.” *Id.* at 345, 2. The court remanded the case to the trial court and directed it to consider the applicable substantive law in order to determine if the non-contracting parties could recover economic losses in tort.

On remand, the trial court dismissed the negligence claims based on the theory a homebuilder does not owe a duty of care to a subsequent purchaser to prevent the subsequent purchaser from economic harm. *Sullivan II*, 354 P.3d at 426. The homeowners appealed, arguing that a public policy-based tort duty arises from a municipal building code, as well as from statutes and regulations governing residential contractors. *Id.* at 425.

The Court of Appeals first stated “[a] statute or regulation typically gives rise to a tort duty premised on public policy only if it is designed to protect the class of persons, in which the plaintiff is included, against the risk of the type of harm which has in fact occurred as a result of its violation.” *Id.* at 427 (citing *Estate of Hernandez v. Ariz. Bd. of Regents*, 177 Ariz. 244, 253, 866 P.2d 1330, 1339 (1994)).

The Court of Appeals rejected the contention the City of Phoenix Uniform Building Code created a public policy tort duty because the Building Code specifically stated its purpose is not to protect or benefit any class or group of persons. *Id.* The Court of Appeals further held Arizona's statutory and administrative schemes governing licensed contractors do not provide a sufficient basis for imposing public policy based tort duties in this case, citing the purposes of regulating contractors as “(1) to control contractors by issuance, suspension or revocation of licenses, and (2) to offer additional protection to persons damaged by failure of the contractor to perform his contract in the manner required by the statute, or to pay for materials or labor, by requiring bonds to insure payment of such damages.”

The *Sullivan II* Court concluded Arizona courts should not “recognize a duty premised on codes and ordinances that offer no indication that such result was intended” and explained should the Arizona Legislature deem it appropriate, it is free to expand civil remedies based on construction-related statutes and codes.

### **Conclusion**

Although it was first acknowledged in 1984, the economic loss doctrine has become an increasingly common legal theory in recent years. Since 2010, Arizona Courts have

expanded the economic loss doctrine to bar recovery of tort damages in cases involving construction contracts, service contracts, and even non-contracting parties where a court determines that the plaintiff was not owed a duty of care. The economic loss doctrine can be a useful defense tool to limit a plaintiff's potential recovery in cases where the only damages are economic losses.

### **ABOUT THE AUTHOR**

Lena Pond is a graduate of the Sandra Day O'Connor College of Law at Arizona State University. She specializes in insurance defense, insurance coverage disputes, insurance bad faith, professional liability, and general civil litigation. Contact her at 602.386.5654 or [lpond@tysonmendes.com](mailto:lpond@tysonmendes.com).