

## ECONOMIC LOSS DOCTRINE

In the editions of this publication for January/February 1999 and August/September, 1999, I discussed the application of the economic loss doctrine in Wisconsin. That doctrine applies in commercial transactions to the parties who are negotiating for the purchase of products. The doctrine limits the remedies available to an aggrieved purchaser of a product to the remedies provided in the sales contract when the product is defective. As long as there is no claim that other property was damaged or person injured as a result of the product defect, the purchaser's unrealized expectations when buying the product entitles the purchaser to pursue only contract remedies provided for under the terms of the contract. Independent tort claims for negligent design or manufacture of the product are not available to the purchaser of the product.

In *Insurance Company of North America v. Cease Electric, Inc.*, decided by the Wisconsin Supreme Court on November 9, 2004, the Wisconsin Supreme Court held that the economic loss doctrine does not apply to contracts for construction services.

INA's insured, Cold Spring Egg Farm, Inc., sustained a loss of nearly 18,000 chickens when a ventilation system in its barn failed on January 8, 1997. Cold Spring hired an electrical contractor to investigate why its ventilation system failed and it was informed that Cease Electric had improperly wired the main fan control unit to the same power circuit as the backup thermostat. Cold Spring was also informed that Cease Electric had failed to test the newly installed system which would have revealed that the backup thermostat was not functioning. Pursuant to its insurance contract with INA, Cold Spring received \$118,339.20 for loss of income and \$40,704.89 for loss of chickens, and Cold Spring also sustained the loss of \$39,761.02 due to the insurance policy deductible. Both INA and Cold Spring sued Cease Electric based upon the tort theory of negligence.

Cease Electric defended the case by arguing that the economic loss rule barred the recovery of such damages, arguing that it had provided a product to Cold Spring in the form of a ventilation system rather than a service. The circuit court rejected that argument as did the Court of Appeals. Both concluded that the economic loss rule did not bar Cold Spring's recovery under tort law. The Wisconsin Supreme Court agreed.

The Wisconsin Supreme Court determined that the contract at issue was one for services and not for a product. It observed that Cease Electric was not required to do anything but follow a one-page wiring schematic and that it billed based upon the time its electricians did the work rather than charging a price for a ventilation "system." The Court held that evidence of billing is a relevant consideration in determining whether the nature of the contract is for services or for the sale of a product.

The Wisconsin Supreme Court reiterated that the economic loss doctrine prevented a commercial purchaser of a product from recovering for solely economic losses from the manufacturer under theories of negligence or strict liability. Instead, the recovery would be limited to the warranties under the contract of sale. However, until now the Wisconsin Supreme Court had not ruled on whether the economic loss rule applied to purely services performed as distinguished from a product sold. It noted that Cease Electric was asking the Court to extend the economic loss doctrine to contracts for services. The Court refused to do so.

Accordingly, it is now clear that in Wisconsin the economic loss rule does not apply to the performance of construction services and therefore an aggrieved owner dissatisfied with the performance of the service may sue in tort law for negligence, as well as in contract law for breach of contract. Left undecided is the question of whether or not damages normally collectible through tort law are still available to an aggrieved disappointed owner when the contract entered into between the owner and the contractor expressly bars the recovery of consequential damages such as lost profits. In Cold Spring's case, its contract with Cease Electric was oral and it does not appear that the oral agreement contained any limitation on the type of damages recoverable by Cold Spring. Yet, owners entering into construction contracts with contractors will often find such damage limitations in the written contract provisions. Parenthetically, we should observe that such damage limitation provisions are found in design professional contracts. Owners can sue design

professionals in tort as well as contract, because of the Wisconsin Supreme Court's prior decisions that the economic loss rule does not apply to the rendition of professional services. Presumably these contractual damage limitations which prevent the recovery of consequential damages from the design professional would be enforceable against an aggrieved owner who brought its action under tort law.

Now that we know that the economic loss rule does not apply to construction services in Wisconsin, we know that owners may sue contractors in tort as well as contract for negligent construction. The Wisconsin Supreme Court has already held that design professionals may be sued in tort as well as contract. The Wisconsin Supreme Court in the Cold Spring's case noted that actions against professionals often involve purely economic loss without personal injury or property damage, and the economic loss doctrine could be used to effectively extinguish claims in tort if it allows the economic loss doctrine to be applicable to services, but not to professional services. It pointed out that in Illinois, the Illinois Supreme Court has exempted some professions from the economic loss doctrine such as accountants and attorneys, but not others, such as engineers and architects. Therefore in Illinois, attorneys and accountants may be sued in tort while professional engineers and architects may only be sued in contract. The Wisconsin Supreme Court refused to embark upon such a course. It held that it preferred to avoid the beginning of creating exceptions and would determine that the economic loss doctrine is inapplicable to claims for the negligent provision of services as a bright line rule.

In Wisconsin, aggrieved purchasers of design and construction services may sue the provider of those services in either tort or contract. If the purchaser's contract with the design professional or contractor limits the nature of the damages recoverable, there still is some uncertainty about whether the contract damage limitation would bar the recovery of such damages in tort. Presumably it would, but we cannot be certain at this juncture in the law's development.

\*Published in the *Engineering Professional*, January/February, 2005. Written by Attorney Robert J. Kay.