



Litigation News Alert

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Washington Supreme Court Muddies Economic Loss Rule

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The Washington Supreme Court recently issued two decisions that inject substantial uncertainty into how courts interpret contractual obligations—and duties that may arise outside of the boundaries of a contract.

In light of these new Washington cases, we suggest that product sellers and service providers review their contracts and consider (a) whether the contracts should disclaim all liability arising out of any tort (including negligence) and (b) whether the contracts should limit all remedies available under any theory of recovery, whether based on contract, warranty, tort (including negligence, strict liability, or otherwise), or statute. No matter where a company is doing business, clear contractual limitations may help protect against unexpected claims and reduce costs for sellers and buyers alike.

The two cases concern what is commonly known as the “economic loss rule” or “economic loss doctrine.” Most jurisdictions recognize some form of the economic loss rule. Different courts define the rule in different ways. But in general the rule is that a party in a contractual relationship with another party does not have a tort claim for its economic losses—that is, losses that reflect what the disappointed party hoped to obtain through contract.

For example, if a person buys a product that fails to function properly, the economic loss rule will generally limit the buyer’s remedies to contractual remedies. The buyer (or a third party) can assert a tort claim if the product causes personal injury or damage to other property (or, in Washington, fails in some dangerous way). In general, though, the buyer will not have a tort claim simply because the product doesn’t function properly.

On November 4, the Washington Supreme Court issued opinions in *Affiliated FM Insurance Co. v. LTK Consulting Servs., Inc.*, No. 82738-9, and *Eastwood v. Horse Harbor Foundation*, No. 81977-7. Each case resulted in three opinions, with no one opinion garnering enough votes to count as a majority opinion. Because of this splintering, it is hard to tell what will become of the economic loss rule in Washington state. But three things are clear: (a) the economic loss rule will now be known as the “independent duty rule”; (b) the courts will have to decide, on a case-by-case basis, whether the seller or service provider owed an “independent duty,” beyond its contractual duties, to the plaintiff; and (c) there will be a great deal of litigation before parties, attorneys, and the courts will have some clear understanding of the new regime.

Despite the uncertainty created by these new opinions, the court did allow the possibility for parties to protect themselves through contract. In *Eastwood*, the court stated (in dicta) that it was not “disturb[ing] [t]he general rule . . . that a party to a contract can limit liability for damages resulting from negligence.” (Slip op. at 17 n.3) (citing *American Nursery Prods., Inc. v. Indian Wells Orchards*, 115 Wn.2d 217, 230, 797 P.2d 477 (1990)).

To confront the uncertain dimensions of the “independent duty” rule, product sellers and service providers should consider reviewing their standard contract terms and conditions to determine whether they are adequately protected against tort claims connected with those contracts.

Please let us know if you have any questions about these new developments.

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