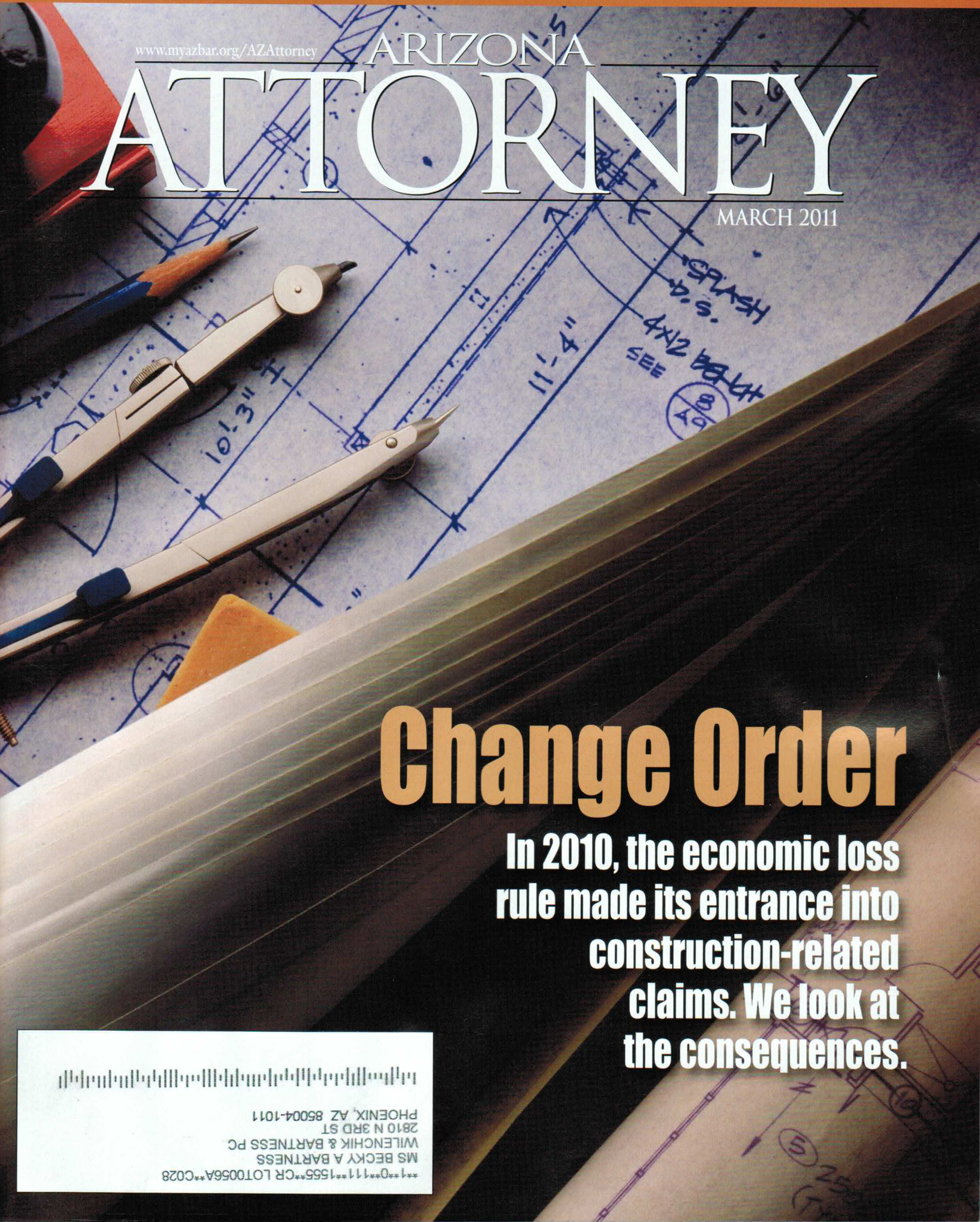
2011 EXPERT WITNESS GUIDE (p. 48)

www.myazbar.org/AZAttorney

ARIZONA ATTORNEY

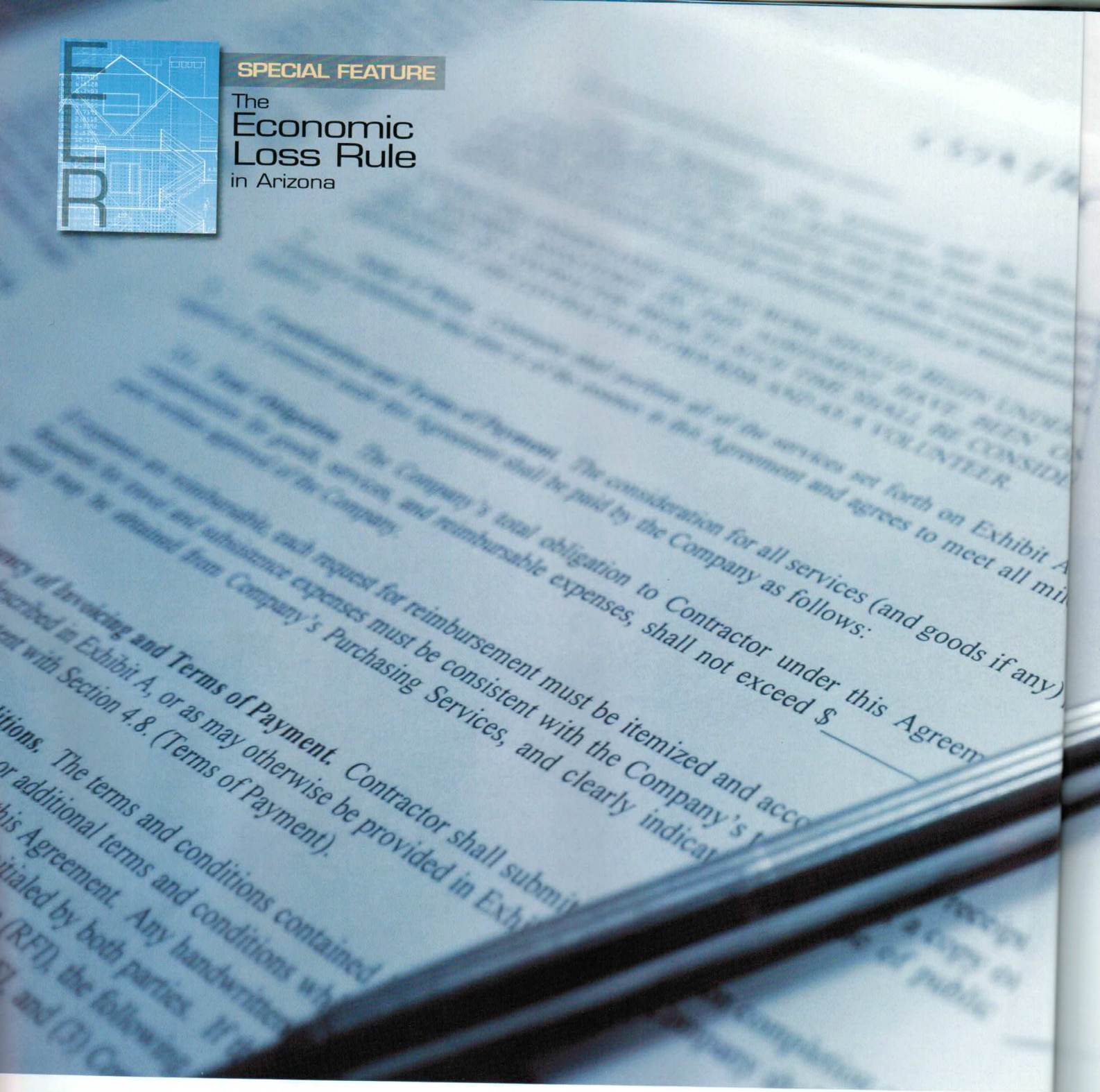
MARCH 2011



Change Order

In 2010, the economic loss rule made its entrance into construction-related claims. We look at the consequences.

10**111**1555**CR LOT0056A**C028
MS BECKY A BARTNESS
WILENCHIK & BARTNESS PC
2810 N 3RD ST
PHOENIX, AZ 85004-1011



SPECIAL FEATURE

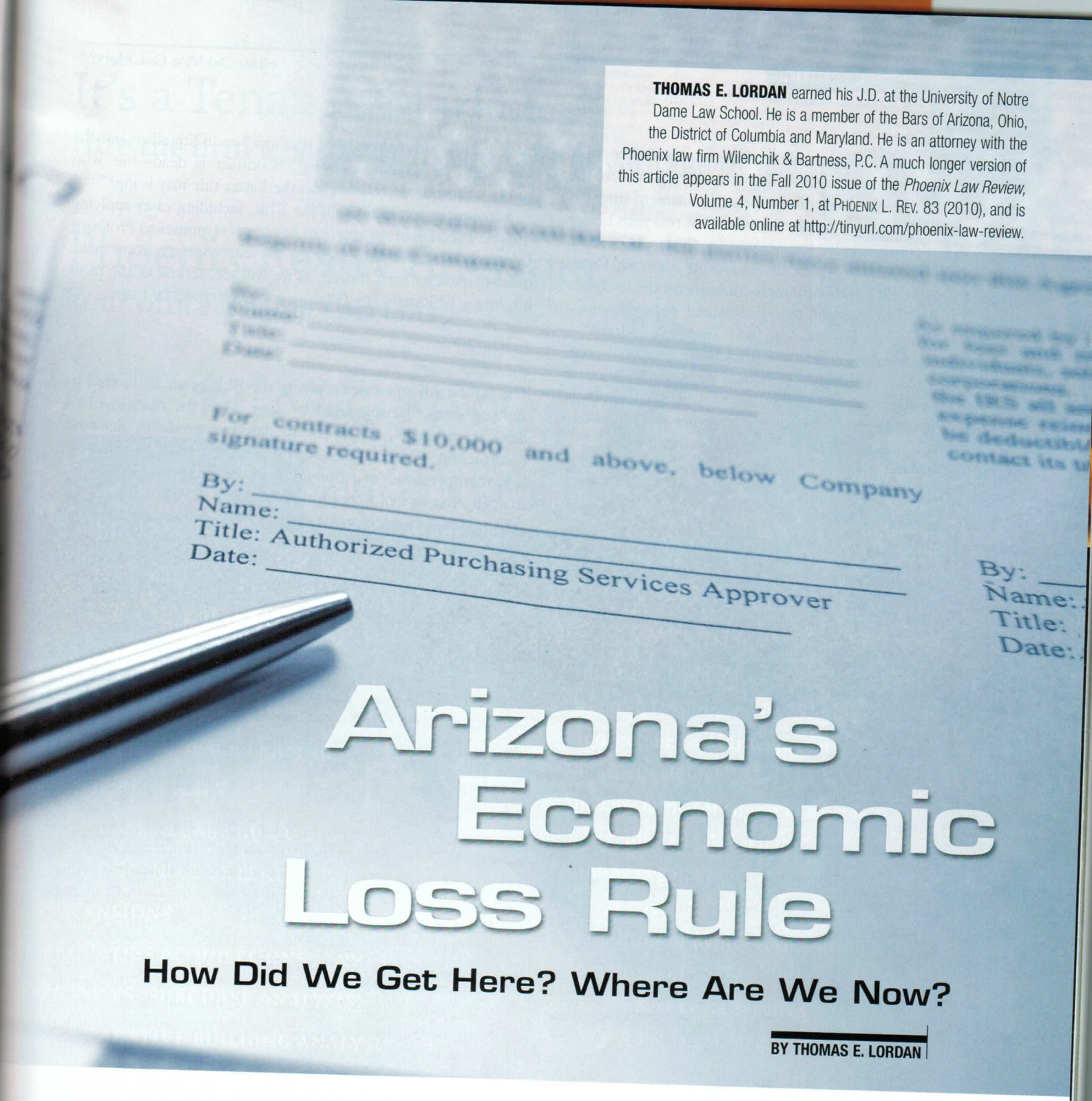
The Economic Loss Rule in Arizona

Perhaps the most interesting and significant development in the common law over the last few decades has been the development and expansion of the so-called "economic loss rule" (the "ELR"). The ELR, when it applies, eliminates tort causes of action, leaving the parties to their contract remedies, if any. It can radically alter the nature and scope of a case. The question is, when does the ELR apply?

In *Flagstaff Affordable Housing Limited Partnership v. Design Alliance, Inc.*,[1] the Arizona Supreme Court had occasion to revisit and reaffirm the ELR for the first time since 1984, and after much confusion as to the extent of its application under Arizona law. There, the Court, reversing the Court of Appeals, which had itself reversed the trial court, held that a property owner is limited to its contractual remedies when an architect's negligent design causes economic loss but no physical injury to persons or other property, even when, as in *Flagstaff*, the owner has no contract remedies.

Considering the state of Arizona law on the ELR leading up to *Flagstaff*, the case left many questions in its wake. This will be a most fertile ground for appellate litigation over the next several

THOMAS E. LORDAN earned his J.D. at the University of Notre Dame Law School. He is a member of the Bars of Arizona, Ohio, the District of Columbia and Maryland. He is an attorney with the Phoenix law firm Wilenchik & Bartness, P.C. A much longer version of this article appears in the Fall 2010 issue of the *Phoenix Law Review*, Volume 4, Number 1, at PHOENIX L. REV. 83 (2010), and is available online at http://tinyurl.com/phoenix-law-review.



Arizona's Economic Loss Rule

How Did We Get Here? Where Are We Now?

BY THOMAS E. LORDAN

years. This article addresses two questions relative to the ELR: How did we get here? Where are we now?

Tort and Contract

We begin in the shrouded mists of antiquity. Around 1500, contract emerges from tort.[2] From its birth, contract must battle tort to establish autonomy.

In that battle, contract is at a great disadvantage. Where on the facts either an action in tort or one in contract is open to the plaintiff, "[G]enerally speaking, the tort remedy is likely to be more advantageous to the injured party in the greater number of cases, if only because it will so often permit the recovery of greater damages."[3] When contract developed out of tort, "the more or less inevitable efforts of lawyers to turn every breach of contract into a tort forced the English courts to find some line of demarcation."[4]

In the long history of the common law, the ELR represents a relatively recent "line of demarcation."

Seely v. White Motor Co.

Seely v. White Motor Co.[5] is cited by some commentators as the

origin of the rule in American law.[6] The ELR emerged in *Seely* simply as a response to the development of a "super tort," namely, strict liability in tort, in the field of products liability. Just two years before *Seely*, Justice Traynor wrote the opinion in *Greenman v. Yuba Power Products, Inc.*,[7] in which the California Supreme Court adopted strict liability in tort to impose liability on the manufacturer of a defective product that had caused personal injury. *Greenman* became the leading case, and it swept the country.[8]

Seely, which involved a defective truck that caused only economic losses, confronted Justice Traynor with the question of whether strict liability in tort would be available to plaintiffs in such cases. In holding that it would not, Traynor placed the economic loss rule into the stream of American jurisprudence.

The doctrine of strict liability in tort was designed, he said, to govern the distinct problem of physical injuries. Purely economic loss means that the plaintiff has lost the benefit of his bargain, that is, the product plaintiff received is worth less than it was supposed to be. The loss must turn on what the bargain was, and the bargain will be unique to the case. The bargain a plaintiff strikes will be a function of the contract he made with, including the warranty he received from, the defendant. *Quality*, as opposed to *safety*, is a matter for *contract*, rather than *tort*.

Thus, at its origin, the ELR was designed merely to restrict the application of a single tort—strict liability—in a single context—defective products cases—to the type of damages the tort was designed to protect against—personal injuries.

Grant Gilmore and *The Death of Contract*

The next impetus to the ELR came from the academic world. In 1970, Professor Grant Gilmore of the Yale Law School gave a series of lectures at the Ohio State University Law School, which were later published as a book titled *The Death of Contract*.[9] One of the themes of the lectures was that as contract had emerged from tort, so it was inexorably being reabsorbed back into tort, because of the tendency of tort to overpower contract as a cause of action.

Gilmore wrote, "Classical contract theory might well be described as an attempt to stake out an enclave within the general domain of tort. The dykes which were set up to protect the enclave have, it is clear enough, been crumbling at a progressively rapid rate."[10]

He cited the creation of the super tort of strict liability as one example of the predominance of tort over contract and warranty. "Here again, I suggest, we see an almost instinctive choice of tort over contract as the principle of liability in a rapidly developing field."[11] However, Gilmore did not anywhere address or even mention the ELR, even when he cited *Seely*. It seems fair to say, then, that he did not foresee the ELR as a doctrine with the potential to reverse or at least modify to some extent what he seemed to see as an irreversible slide of contract back into tort.

The conclusion to Gilmore's lectures is ambiguous. Though he said that it may be "the fate of contract to be swallowed up by tort (or both of them to be swallowed up in a generalized theory of civil obligation),"[12] he suggested that the process of law may be subject to "alternating rhythms," as in literature and the arts.[13] And he ended by saying, "Contract is dead—but who knows what unlikely resurrection the Easter-tide may bring?"[14]

Subsequent applications of the ELR, including cases applying Arizona's version of the rule, can be seen as responses to Professor Gilmore's academic challenge to prevent contract from being overwhelmed by tort. Indeed, as we will see, several of the most important ELR cases cite Gilmore and his lectures by name.

Early Arizona Cases, Including *Salt River Project*

The earliest Arizona cases applying the ELR generally limited its application to that suggested by *Seely*. Thus the cases involved defective products, or, similar to defective products, defective construction, which caused solely economic losses. The cases[15] held that tort causes of action in not just strict liability in tort but in negligence as well were precluded by the ELR.

The first Arizona Supreme Court case to adopt the ELR—and the only Arizona Supreme Court case on the ELR until *Flagstaff*—was *Salt River Project Agricultural Improvement and Power District v. Westinghouse Electric Corp.*[16] It too was a products liability case, in effect, Arizona's own *Seely*.

There, a product installed in a generator unit malfunctioned, damaging the unit. The *SRP* Court could have followed the lead of *Seely*, a case with which it was most familiar, citing it as the "genesis" of the ELR.[17] But where *Seely* had fashioned a *per se* rule denying the use of strict liability in tort to plaintiffs who suffered only economic losses from defective products, *SRP* took a more cautious approach.

In language repeated many years later in *Flagstaff*, the Court said that to determine whether tort or contract applies in a specific case, the court must consider the facts of the case, bearing in mind the fundamental purpose of tort law—promoting the *safety* of persons and property—as contrasted with the fundamental purpose of contract law—protecting the *expectation interests*, or *benefit of the bargain*, of the parties.

Although no all-inclusive rule governed this consideration, the Court noted that three interrelated factors were to be analyzed: the nature of the product defect that caused the loss to the plaintiff, the manner in which the loss occurred, and the type of loss for which the plaintiff seeks redress. Only the third part of the test implicated the ELR.

The Court said: "Unfortunately, few cases conform neatly to an 'all or nothing' configuration. Each case must be examined to determine whether the facts preponderate in favor of the application of tort law or commercial law exclusively or a combination of the two."[18] In applying the test to the facts of the case, the Court held that the three factors militated in favor of the conclusion that tort theory *was* available to SRP. *SRP* thus took a narrower approach to the ELR than had *Seely*, and it staked out Arizona's own version of the Rule.

East River Steamship

The next development of the rule came at the highest judicial level. If *Seely* was the "origin" of the American ELR, the case that really

put the rule on the legal map was a case in admiralty decided by the United States Supreme Court in 1986: *East River Steamship Corp. v. Transamerica Delaval, Inc.*[19] *East River*, like *Seely* and *SRP*, involved an allegedly defective product purchased in a commercial transaction that malfunctioned, injuring only the product itself and causing purely economic loss. Citing *Seely* and Grant Gilmore's lectures, the Court said:

> Products liability grew out of a public policy judgment that people need more protection from dangerous products than is afforded by the law of warranty. *See Seely v. White Motor Co.* ... It is clear, however, that if this development [strict liability in tort] were allowed to progress too far, contract law would drown in a sea of tort. See G. GILMORE, THE DEATH OF CONTRACT 87-94 (1974). We must determine whether a commercial product injuring itself is the kind of harm against which public policy requires manufacturers to protect, independent of any contractual obligation.[20]

The Court, noting that the question had spawned a variety of answers, followed *Seely*, the majority, *per se*, approach, and answered it in the negative. The Court rejected the minority view, because it "fails to account for the need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages. ... Permitting recovery for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums."[21] The Court also rejected the middle position staked out by cases like *SRP* as "too indeterminate"[22]:

> Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies .... In exchange, the purchaser pays less for the product. Since a commercial situation generally does not involve large disparities in bargaining power ... we see no reason to intrude into the parties' allocation of the risk.[23]

Apollo, *Carstens*, and the "High Water Mark" of the ELR

Until 1995, Arizona's ELR had been applied only in two types of cases—products liability and construction defects—and principally to tame the same tort with which *Seely* had been concerned, the super-tort of strict liability. Furthermore, the principal Arizona case on the ELR, *SRP*, had taken a more conservative approach to the Rule than had *Seely* or *East River*. In addition, there had been other cases in Arizona in which plaintiffs had suffered only economic losses, but had been allowed to bring tort claims, although those were cases in which the plaintiff and the defendant were not in privity of contract.[24] But now we come to two strange turns in the law.

Apollo Group, Inc. v. Avnet, Inc.[25] was the first of many cases in which federal courts sitting in diversity tried to determine the parameters of Arizona's ELR. In *Apollo*, the Ninth Circuit, inexplicably reading *SRP* as a "broad" application of the ELR, applied the ELR to preclude the tort of negligent misrepresentation in a

Until 1995, Arizona's ELR had been applied only in two types of cases—product liability and construction defects.

case involving the sale of computer hardware. The Court's opinion began by quoting the very first sentence in the "Introduction" to Gilmore's *The Death of Contract*: "We are told that Contract, like God, is dead."[26] Such an opening suggested a Court concerned to prove Gilmore wrong. Sure enough, the next sentence of the opinion stated, "In this computer age case, we learn that Contract, at least, is very much alive and well in the Ninth Circuit." And the relevant part of the opinion ends, "Contract lives!"[27] *Apollo*, which somehow read the *narrow* holding in *SRP* "*broadly*," was soon followed by other federal courts supposedly interpreting Arizona law, but really interpreting *Apollo*, and similarly giving a "broad" reading to Arizona's ELR.

The next major development—and, like *Apollo*, another strange turn in the law—came with a decision of Division 1 of the Arizona Court of Appeals, *Carstens v. City of Phoenix*,[28] which further "broadened" the ELR. *Carstens* extended the ELR to preclude tort claims brought by plaintiffs who had no contractual relationship with, and therefore no contractual remedies against, the defendants. The purpose of the ELR is to limit parties to their contractual remedies where policy reasons justify such a limitation. What purpose is to be served by applying the ELR to parties who do not have a contractual relationship in the first place?

Carstens also broadened the ELR by formulating it in very broad terms: "The economic loss rule bars a party from recovering economic damages in tort unless accompanied by physical harm, either in the form of personal injury or secondary property damage."[29] Read literally, as it was to be read by some subsequent courts, the ELR, as thus formulated, was a simple rule that barred *any* plaintiff from recovering *any* economic damages via *any* tort claim.

A number of cases applying the ELR after *Carstens* still insisted on privity. But in any event, after *Carstens*, as after *Apollo*, courts interpreting Arizona's ELR read the rule very broadly indeed. This period may be characterized as the high-water mark of the Arizona ELR.

The Federal Backlash

We have seen the ELR go from a limited rule applied in products liability and construction defect cases to a limited number of torts—principally strict liability and negligence—to an expansive rule applied in multiple settings to virtually every commercial tort. Now we encounter a backlash to the broad reading of the ELR

given by *Apollo*, *Carstens*, and other courts.

The backlash occurred in federal court cases, which was ironic, given that it had been the federal courts that had given the Arizona ELR the broadest readings. Most of these "backlash" cases occurred in the period of 2006 through 2007, and included *Giles Construction, Inc. v. Commercial Federal Bank*,[30] *KD & KD Enterprises, LLC v. Touch Automation, LLC*,[31] *Moshir v. Patchlink Corp.*,[332] and *Evans v. Singer*.[32] These cases had in common a concern that too broad an application of the ELR would in effect eliminate tort causes of action that were designed, at least in some circumstances, precisely to provide recovery for economic losses, such as fraud and negligent misrepresentation.

For example, in *KD*, Judge Martone said that the key rationale underlying the ELR presupposes that there has been a fair and equitable negotiation of the allocation of risk between the parties. Assuming that, parties should be held to the terms of their agreement. Fraudulent misrepresentation, however, undermines the rationale for the rule. The court concluded that the extension of the ELR to the tort of fraud "would eliminate the tort of fraud."[34] In *Evans*, Judge Bolton, criticizing *Apollo*, said:

> The independent development of the economic loss rule case law in the distinct areas of construction defects and products liability demonstrates that economic loss is not a concept that easily migrates from one unique factual circumstance to another. Rather, it is a precise tool used to uphold traditional separation between contract and tort in areas of the law that are particularly susceptible to blurring of the two.[35]

Despite these cases, other courts continued to apply the ELR broadly.

Other Cases in 2007-2009

A number of other cases involving the ELR were decided in the period from 2007 to 2009, and reached disparate results. One of the cases decided during this period deserves special mention. In *Valley Forge Insurance Company v. Sam's Plumbing, LLC*, 220 Ariz. 512, 207 P.3d 765 (App. 2009), Division 2 of the Court of Appeals embraced *SRP*'s case-by-case approach, noting that *SRP* had rejected the *per se* rule adopted by *Seely* and *East River*, and specifically rejected *Carstens*, which had been decided by Division 1 of the Court of Appeals.

Flagstaff Affordable Housing

Now we come to *Flagstaff Affordable Housing*. The difficulty courts have with the application of the ELR can be seen in the history of the case itself, where the Supreme Court reversed the Court of Appeals, which had reversed the trial court. To briefly give the facts of the case, the plaintiff–owner entered into a contract with the defendant–architect for the design of apartments. The design failed to comply with certain federal Fair Housing Design Construction requirements. The owner was forced to incur substantial expense to remedy the design deficiencies, and sued the architect, alleging breach of contract and professional negligence. The owner sought only economic losses as damages. The owner was forced to withdraw its breach of contract claim, but argued that the ELR did not apply to professional negligence claims.

The trial court granted the architect's motion to dismiss. The Court of Appeals reversed the trial court, arguing that although federal courts applying Arizona law had applied the ELR in a wide variety of contexts, Arizona courts had applied the ELR in only two categories of disputes—construction defects and products liability—and that the case before it fell into neither category. The Court of Appeals held that the ELR did not apply to a claim for professional negligence against a design professional.

But the fundamental reason for the Court of Appeals' reluctance to apply the ELR to the case before it was its understanding of the essential nature of actions to recover for breach of a professional's duties. According to cases like *Barmat v. John & Jane Doe Partners A-D*,[36] such cases do not "arise out of contract," that is, the breach of promises made by one party to the other, but rather arise out of tort, that is, the breach of legal duties imposed by law. Therefore it would be anomalous to apply the ELR in such cases.

Think of it this way. In the context of professional and certain other relationships, absent the breach by the defendant of an express, specific promise to do something other than just perform the services competently (which is a tort, not a contract, duty), *Barmat* and its progeny eliminate any contract claims. Damages in professional negligence cases will usually be limited to pecuniary damages. If the ELR is then applied to eliminate tort claims, the plaintiff will be left remedy-less. Here we would have a convergence of *Barmat* and the ELR, the effect of which would be the elimination of both contract and tort claims.[37]

And so the Court of Appeals in *Flagstaff*, citing *Barmat*, said that because the architect's professional duties arose independently of any contract, the purpose of the ELR—maintaining a distinction between tort and contract actions—was not implicated. The owner's claim against the architect for professional negligence was based in tort, said the court, not in contract. The court accordingly refused to apply the ELR.[38]

Flagstaff at the Supreme Court

As can be gathered from the foregoing, the Supreme Court's decision in *Flagstaff* was much anticipated. We have followed the Arizona ELR on something of a roller-coaster ride. At times the rule was up, and at other times it was down. It is probably fair to say, however, that the trajectory of the rule before the Supreme Court decision in *Flagstaff* was down. This conclusion is based on a number of factors, foremost among them the Court of Appeals' decision in *Flagstaff* itself, but also *Valley Forge* and the "federal backlash" cases.[39] Had the Supreme Court affirmed the Court of Appeals, the argument that the Arizona ELR is narrow would be hard to assail. The fact that the Arizona Supreme Court reversed the Court of Appeals gave new life to the ELR in Arizona.

That is not to say that *Flagstaff* gave clear direction to the application of the ELR in cases unlike the one before it. The holding in *Flagstaff* was simply that a plaintiff who contracts for construction cannot recover in tort for purely economic loss, unless the contract otherwise provides. The key move the Court made was to restore the concept of privity of contract to the central place it held in ELR jurisprudence prior to *Carstens*. The Court also rejected the "overly broad" formulation of the ELR from *Carstens* on which some subsequent courts had relied, noting, "[I]n many

contexts, tort recovery is available for solely pecuniary losses."[40] The Court sided with *Evans* against *Apollo* in finding that *SRP* did not apply the ELR "broadly," and with *Valley Forge* against *Carstens* in finding that *Carstens* misconstrued *SRP*. At the heart of the case, the Court said that describing the ELR in an overly broad way:

> conflates two distinct issues: (1) whether a contracting party should be limited to its contract remedies for purely economic loss; and (2) whether a plaintiff may assert tort claims for economic damages against a defendant absent any contract between the parties. As explained below, we believe the economic loss doctrine is best directed to the first of these issues, and we use the phrase to refer to a common law rule limiting a contracting party to contractual remedies for the recovery of economic losses unaccompanied by physical injury to persons or other property.[41]

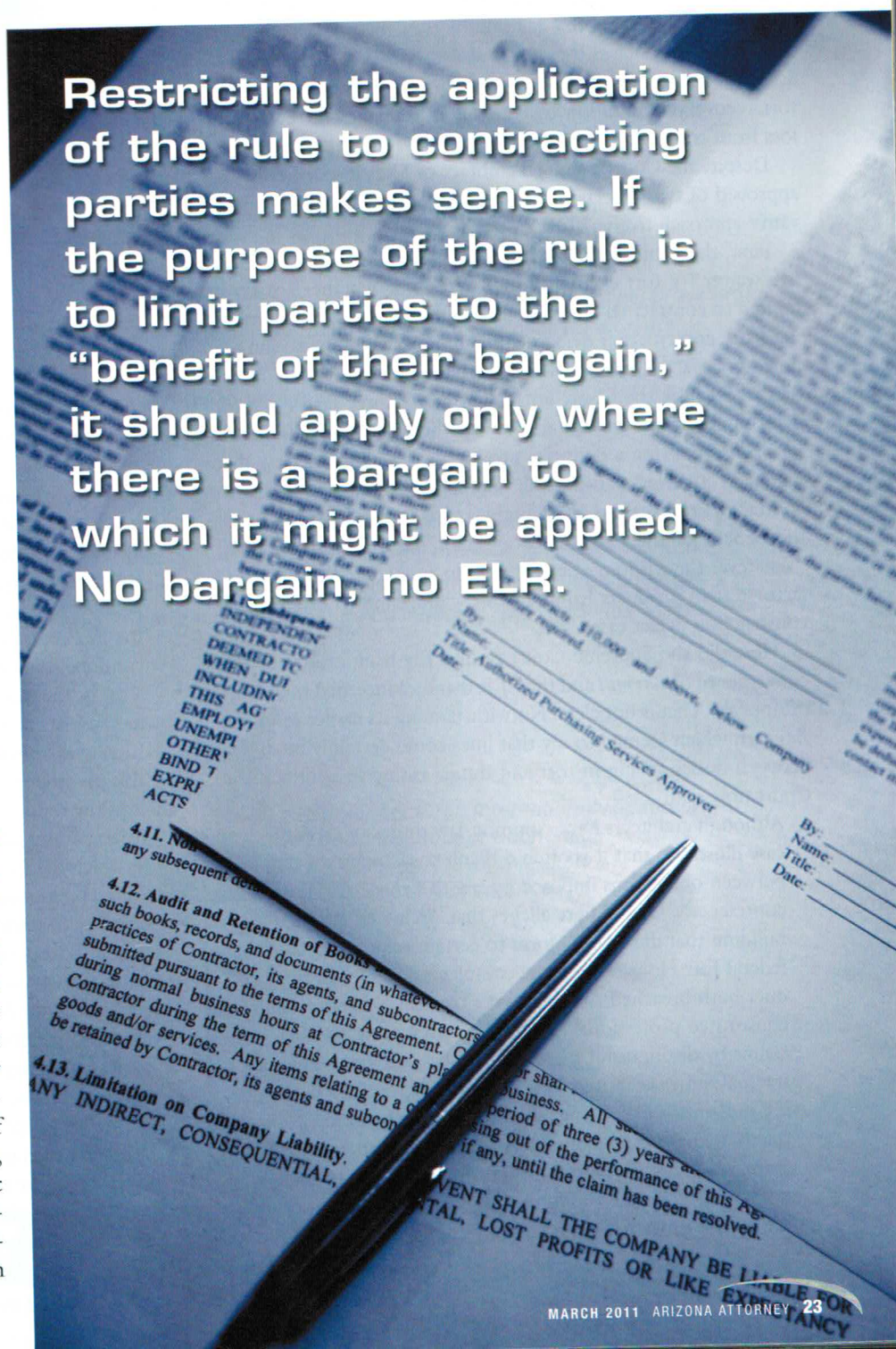
Indeed, the Court said, "[T]he *principal* function of the economic loss doctrine, in our view, is to encourage private ordering of economic relationships and to uphold the expectations of the parties by limiting a plaintiff to contractual remedies for loss of the benefit of the bargain. These concerns are not implicated when the plaintiff lacks privity and cannot pursue contractual remedies."[42]

Restricting the application of the rule to contracting parties makes sense. If the purpose of the rule is to limit parties to the "benefit of their bargain," it should apply only where there is a bargain to which it might be applied. No bargain, no ELR. And knowing that the ELR applies only as between contracting parties still does not tell us *when* it will apply between contracting parties, that is, in what *contexts* it will apply and to what *torts* it will apply.

In *Flagstaff*, the Court was faced with a dispute between *contracting parties*. The Court noted that the assumption was widespread that Arizona law applied the ELR to construction defect cases, in addition to products liability cases, but said that that assumption was based on a misinterpretation of its opinion in *Woodward v. Chirco Construction Co.*[43] The Court also said, "Nor does the fact that the doctrine applies to product defects necessarily establish that it should also apply to construction defects."[44] In turning to the question of whether to apply the ELR in the case before it, the Court resurrected the case-specific approach it had adopted the last time it considered the ELR, 26 years before, in *SRP*, saying, "The economic loss doctrine may vary in its application depending on context-specific policy considerations. To determine whether the doctrine should apply here, we must consider the underlying policies of tort and contract law in the construction setting."[45] In "consider[ing] the underlying policies of tort and contract law in the construction setting," the Court focused on three factors: the contract law policy of upholding the expectations of the parties; the adequacy of contract remedies; and the policies of accident deterrence and loss-spreading.

As to the first factor, the Court found that this policy:

> has as much, if not greater, force in construction defect cases as in product defect cases. Construction-related contracts



often are negotiated between the parties on a project-specific basis and have detailed provisions allocating risks of loss and specifying remedies. In this context, allowing tort claims poses a greater danger of undermining the policy concerns of contract law. That law seeks to encourage parties to order their prospective relationships, including the allocation of risk of future losses and the identification of remedies, and to enforce any resulting agreement consistent with the parties' expectations.[46]

As to the second factor, the Court found contract remedies adequate in construction defect cases involving only pecuniary losses related to the building that is the subject of the parties' contract. As to the third factor, the Court also found that the policies of accident deterrence and loss-spreading do not require allowing tort recovery in addition to contractual remedies for economic loss from construction defects.

Despite the Court's general embrace of *SRP*, it specifically disapproved of two aspects of the case that were part of its conservative approach to the ELR.

First, the Court said, "*Salt River*'s requirements for an effective waiver [of tort claims] do not determine whether a party is limited to contractual remedies for purely economic losses resulting from construction defects. Instead, a party will be so limited unless the parties have provided in their contract for tort remedies."[47] Second, the Court noted that *SRP*'s three-factor test for determining, on a case-specific basis, whether to apply the ELR to claims involving a defective product was a minority view that had been criticized as being too unpredictable and allowing non-contractual recovery when a purchaser has only been deprived of the benefit of the bargain. Citing *East River*, the Court said, "Whatever the wisdom of continuing to apply *Salt River*'s three-factor test in products liability cases, we decline to extend it to construction defect cases."[48]

How did the Supreme Court resolve the issue caused by the convergence of *Barmat* and the ELR that so concerned the Court of Appeals? That is not clear. Notwithstanding its earlier cases like *Barmat*, which seemed to say that lines could certainly be drawn between duties arising in tort and duties arising in contract, the Court now said:

> Although architects have common-law duties of care, this case illustrates that it is often difficult to draw bright lines between obligations imposed by law and those arising from contract … . Owner here alleges that Architect designed a building that did not conform to certain requirements of the federal Fair Housing Act; the complaint alleges that this conduct both breached Architect's contractual obligations and constituted professional negligence. Attempting to label claims by distinguishing between contractual and extra-contractual duties is an unduly formalistic approach to determining if plaintiffs like Owner should be limited to their contractual remedies for economic loss …. Rather than extend *Barmat*'s approach here, we think application of the economic loss doctrine should rest on explicit consideration of the relevant tort and contract law policies.[49]

The Court also rejected another of the owner's arguments that had impressed the Court of Appeals, stating that the professional status of architects should not determine whether to apply the ELR. Finally, the Court rejected the owner's argument that applying the ELR to architects would imply that it also applies to other claims for professional negligence, such as claims for legal malpractice. The Court said, "Lawyers owe fiduciary duties to their clients and generally are barred from entering agreements that prospectively limit their liability."[50] This at least suggests that the ELR will not be applied to claims of legal malpractice, and other malpractice claims where a fiduciary relationship may be present, and that the ELR may not be applied to claims of breach of fiduciary duty between contracting parties generally.

Practical Conclusions and Practice Pointers

The following conclusions may be drawn from the Court's formulation of the ELR in *Flagstaff*: (1) Where parties are in privity of contract and the plaintiff's losses are purely economic, the ELR *may* apply to preclude tort claims; and (2) Where parties are not in privity of contract, the ELR *will not* apply to preclude tort claims even if the plaintiff's losses are purely economic, although there may be other reasons why tort claims will not be available having to do with the applicable substantive tort law. In the first category, we might further distinguish two sub-categories of cases.

1. *Cases in which there is firmly established precedent applying the ELR to preclude certain tort claims.* For example, the ELR will apply in products liability and construction defect cases to preclude claims for strict liability in tort and negligence. And, pursuant to *Flagstaff* itself, the ELR will apply in cases involving certain professional relationships to preclude tort claims against the professionals.
2. *Cases in which there may be precedent applying the ELR, but it is called into question by other precedent.* Relative to such cases, the ELR currently exists, and, by its nature, may necessarily continue to exist, in something of an "in-between" state. That is, there is an ELR in Arizona, but it will not be applied to eliminate all torts causing merely economic losses. The ELR may or may not apply in these cases. Most of the available precedent here will be from federal courts trying to discern the status of Arizona law. Remember also that there are Arizona cases allowing tort claims for purely economic losses in which the ELR is not even mentioned. Questions that counsel may want to ask will include the following: Does the claim involve the expectation interests of the parties? The benefit of the bargain? Was the contract freely bargained between two parties relatively equal in bargaining power and sophistication? Is the contract a standard form? Can it be argued that any of the following factors were involved in the bargaining process or the contract itself: misrepresentation, mistake, duress, undue influence, unconscionability, violation of public policy? Does the contract contain detailed provisions allocating risks of loss and specifying remedies? Did the parties allocate the specific risk at issue in the contract? Does the claim concern the quality of the property that is the subject matter of the contract, or implicate safety considerations? Does the claim grow out of circumstances independent of the

contractual relation? Is the claim based on alleged non-performance under the contract, and is it thus in reality a breach of contract claim masquerading as a tort claim? Is the claim for misfeasance (tort) or nonfeasance (contract)? Is the claim in conflict with the contract? Is the claim covered in some sense by the contract? Is the proposed tort one that has historically been used to recover economic losses? Did the duty alleged to have been breached arise out of the contract (promise-based duty) or out of public policy (tort-based duty)? Are the losses plaintiff seeks to recover under its proposed tort claim the same as the losses that would be recovered under a contract claim? Is the field in which the claim arises one traditionally regulated by tort law? Are the damages plaintiff seeks themselves the subject of the contract? If the claim is for misrepresentation, are terms within the contract itself the basis for the claim of misrepresentation?

3. Finally, in cases in which the ELR applies, a party will be limited to its contract remedies *unless* the parties have specifically provided in their contract for tort remedies. This *Flagstaff* twist may change the way in which contracts are drafted and negotiated in Arizona.

Conclusion

The ELR is an important device to ensure that parties do not use tort claims to evade freely made bargains. It fosters the spirit of classical liberalism, encouraging the private ordering of relationships. It protects contract law from the "sea of tort." It prevents plaintiffs from converting contract claims into tort claims.

At the same time, as our history has shown, it is not easy—it has never been easy since contract emerged from tort—to know what is solely a contract claim, what is solely a tort claim, and when there may be both. In the wake of the Supreme Court's decision in *Flagstaff*, the rule is very much alive in Arizona.[51] Its continued development should be one of the hottest topics in appellate litigation for many years to come.

endnotes

1. 223 P.3d 664 (Ariz. 2010).
2. F. W MAITLAND, THE FORMS OF ACTION AT COMMON LAW 44, Lectures IV-VII (1971).
3. WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 92 (4th ed. 1971).
4. *Id.*
5. 403 P.2d 145 (Cal. 1965) (Traynor, J.).
6. "The economic loss rule is a judicially created doctrine, first articulated by the California Supreme Court in *Seely v. White Motor Co.*" R. Joseph Barton, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Cases*, 41 WM. & MARY L. REV. 1789, 1794 (May 2000).
7. 377 P.2d 897 (Cal. 1963).
8. WILLIAM L. PROSSER & JOHN W. WADE, CASES AND MATERIALS ON TORTS 710, n.1 (5th ed. 1971).
9. GRANT GILMORE, THE DEATH OF CONTRACT (1974).
10. *Id.* at 87.
11. *Id.* at 92-93.
12. *Id.* at 94.
13. *Id.* at 102-103.
14. *Id.* at 103.
15. *Flory v. Silvercrest Indus., Inc.*, 633 P.2d 383 (Ariz. 1981); *Arrow Leasing Corp. v. Cummins Arizona Diesel, Inc.*, 666 P.2d 544 (Ariz. Ct. App. 1983); *Woodward v. Chirco Constr. Co., Inc.*, 687 P.2d 1275 (Ariz. Ct. App. 1984), *approved as supplemented*, 687 P.2d 1269 (Ariz. 1984); *Nastri v. Wood Bros. Homes, Inc.*, 690 P.2d 158 (Ariz. Ct. App. 1984).
16. 694 P.2d 198 (Ariz. 1984), *abrogated on other grounds, Phelps v. Firebird Raceway, Inc.*, 111 P.3d 1003 (Ariz. 2005).
17. 694 P.2d at 209.
18. *Id.* at 210.
19. 476 U.S. 858 (1986). "In the United States, the single most influential case in defining the contours of the economic loss rule is the 1986 United States Supreme Court decision in *East River Steamship Corp. v. Transamerica Delaval, Inc.*" Edward P. Ballinger, Jr. & Samuel A. Thumma, *The Continuing Evolution of Arizona's Economic Loss Rule*, 39 ARIZ. ST. L. J. 535, 537 (Summer 2007).
20. 476 U.S. at 866.
21. *Id.* at 870-71 and 874.
22. *Id.* at 870.
23. *Id.* at 872-73.
24. The principal such case, to be questioned in subsequent cases until definitively approved in *Flagstaff*, was *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 677 P.2d 1292 (Ariz. 1984), *rejected on other grounds, Gipson v. Kasey*, 150 P.3d 228 (Ariz. 2007). *See also St. Joseph's Hosp. and Med. Ctr. v. Reserve Life Ins. Co.*, 742 P.2d 808 (Ariz. 1987).
25. 58 F.3d 477 (9th Cir. 1995).
26. *Id.* at 478.
27. *Id.* at 481.
28. 75 P.3d 1081 (Ariz. Ct. App. 2003).
29. *Id.* at 1083.
30. 2006 WL 2711501 (D. Ariz. 2006).
31. 2006 WL 3808257 (D. Ariz. 2006).
32. 2007 WL 505344 (D. Ariz. 2007).
33. 518 F. Supp. 2d 1134 (D. Ariz. 2007).
34. 2006 WL 3808257 at * 3.
35. 518 F. Supp. 2d at 1142.
36. 747 P.2d 1218 (Ariz. 1987).
37. While beyond the scope of this article, a full consideration of *Barmat*, its progeny, and its implications is obviously of great importance in any consideration of the ELR in the context of professional service relationships. In addition to *Barmat*, *see, e.g., Lewin v. Miller Wagner & Co., Ltd.*, 725 P.2d 736 (Ariz. Ct. App. 1986); *Western Technologies, Inc. v. Sverdrup & Parcel, Inc.*, 739 P.2d 1318 (Ariz. Ct. App.1986); *Collins v. Miller & Miller, Ltd.*, 943 P.2d 747 (Ariz. Ct. App. 1996); *Towns v. Frey*, 721 P.2d 147 (Ariz. Ct. App. 1986); *Keonjian v. Olcott*, 169 P.3d 927 (Ariz. Ct. App. 2007); *Asphalt Engineers, Inc. v. Galusha*, 770 P.2d 1180 (Ariz. Ct. App. 1989); *Ramsey Air Meds, LLC v. Cutter Aviation, Inc.*, 6 P.3d 315 (Ariz. Ct. App. 2000).
38. *Barmat* itself sounded this fearful note: "[T]he 'distinction between tort and contract liability ... has become an increasingly difficult distinction to make.' ... Perhaps the best we can say is that, as with pornography, we cannot define a tort but can recognize one when we see it." 747 P.2d at 1222-23.
39. *See supra* notes 30-32 and accompanying text.
40. 223 P.3d at 667.
41. *Id.*
42. *Id.* at 671 (emphasis added).
43. 687 P.2d 1269 (Ariz. 1984).
44. *Flagstaff*, 223 P.3d at 669.
45. *Id.*
46. *Id.*
47. *Id.* at 670.
48. *Id.*
49. *Id.* at 672.
50. *Id.* at 673.
51. The ELR remains one of the hottest topics in Arizona law. Even though the Supreme Court's opinion in *Flagstaff* was handed down in just February of 2010, already there are many cases citing and discussing it, and there will be many more.