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A Good Rule Assailed

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A Good Rule Assailed



By David E. Boelzner, Esquire

It may reflect the general abdication of responsibility increasingly tolerated in our society, but one of the core legal protections of design professionals is embattled and losing ground. What lawyers call the economic loss "rule" (ELR) is actually a common law principle of decision rather than a written rule. It holds that a party cannot recover solely economic losses in a

negligence action where the parties have governed their dealings with contractual agreements.

The reasoning behind this principle is that the parties who best know the details of their business have allocated the risks of that business in agreements, and the courts should not come behind and tidy up with the benefit of hindsight. Thus in the classic triad of owner-designer-contractor, the contractor and architect usually have contracts with the owner but not with each other. The contractor therefore cannot sue the architect directly because there is no contractual duty owed by the architect to the contractor (what lawyers quaintly call "privity"), and the ELR prevents a tort (negligence) action for purely economic loss. (By contrast, tort law does impose a duty on each of us to avoid, for example, inflicting injury or property damage on another, even if a stranger.)

The ELR does not leave the contractor without recourse. The typical owner-contractor agreement includes a warranty of plans and specifications, so the contractor can impose the costs of addressing any defects on the owner, who in turn can look to the designer under the design contract. For a variety of reasons, economic and legal, lawyers representing contractors will frequently try to circumvent the economic loss rule to seek damages directly from a design professional for cost overruns.

The *Bilt-Rite* Decision

The Pennsylvania Supreme Court has become the latest forum to permit this end run around the contractual risk allocations of the parties. The decision in *Bilt-Rite Contractors, Inc. v. The Architectural Studio*, 866 A.2d 270 (Pa. 2005), with a third of the court dissenting, formally adopted and applied to a construction case section 552(1) of the Restatement (Second) of Torts. Restatements are learned compendiums of legal principles; they are not per se the law of any jurisdiction but are rather scholarly attempts to distill the legal principles applied in various court decisions. Sometimes, as in *Bilt-Rite*, they serve to stimulate development of new law rather than summarize existing law. Restatement of Torts § 552(1) states:

One who, in the course of his business, profession or employment... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

On its face this provision seems benign enough. The accounting audit is a paradigm for its application: shareholders and investors rely on the soundness of the auditor's findings, and he knows and expects that they will. If he negligently fails to provide accurate information, it will surely result in bad decisions and potential monetary losses. It is easy to see the facile appeal of applying this principle to construction. The designer supplies information in the form of plans and specifications that he knows a builder will rely upon in constructing the project. Why is it not fair to subject him to liability to the contractor if he does not exercise reasonable care? The Pennsylvania court expressed essentially this notion in adopting the rule:

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Section 552 is not radical or revolutionary; reflecting modern business realities, it merely recognizes that it is reasonable to hold such professionals to a traditional duty of care for foreseeable harm.

As a cynic, I suspect snake oil whenever I hear a justification based on "modern business realities." But the more precise problem of section 552 in the construction context is that it disturbs the calculation upon which experienced parties have based their conduct, their legal assumption of risk, and their economic expectations.

Construction Is Fraught With Risk

The Pennsylvania Chief Justice dissented in *Bilt-Rite* on precisely this ground. The owner, architect and contractor all negotiate project fees based on expected scope of work and anticipated costs, plus contingency for unanticipated difficulties. Construction is fraught with the latter and therefore with risk. The experienced participant limits his gamble through his contract, based on his experience and economic leverage. Exposure not only to parties he negotiates with but to many others as well complicates immensely the calculation of liability, and, of course, when the designer and owner enter their contract, the cabinet maker hasn't even been engaged yet.

Restatement 552 may also skew the analysis of breach. The standard of care applied by courts in almost all states to design work does not contemplate perfect performance but only reasonable skill and diligence, i.e. no more and no worse errors or omissions than a reasonable designer in similar circumstances would make. Design fees are based on this performance standard. But if a designer is liable for supplying information that is "false," then erroneous depiction of one pipe hookup among several hundred would be false information as to that connection, and in an action against the subcontractor who is incommenced by that error, the level of care will not likely be deemed reasonable.

Risk can be, and often is, taken into account and quantified in the contract between owner and designer by including contingency percentages. What would the network of contracts look like if parties have to try to calculate and protect against risks of exposure to, and litigation with, every contractor, subcontractor and supplier on the job?

The Pennsylvania court asserted that Restatement § 552 "promotes the important social policy of encouraging the flow of commercial information upon which the operation of the economy rests." Oh? How does liability to an indeterminate number of parties, with which one has no dealings, encourage the flow of information? Will it not more likely make the designer who considers this risk wary and guarded? Will not this wariness tend to restrict communication, encourage over-design, and thus increase costs?

The *Bilt-Rite* decision does not say why the contractor sought recovery directly from the architect instead of suing the owner for defective plans. But even if this contractor would have had no remedy but for the court's visitation of liability onto the unsuspecting designer, it is at best a lamentable instance of a hard case making bad law.

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