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STATE OF WASHINGTON

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No: 37596-6-II

No.: 81520-8

SUPREME COURT
OF THE STATE OF WASHINGTON

RICHARD and PENNY
BORISH,

Appellants

v.

KEITH R. and JODI T.
OLSON; and KRISTY M.
RUSSELL and JOHN DOE,

Respondents;
and

JOHN L. SCOTT, INC.;
KIMBERLY GARTLAND
and JOHN DOE
GARTLAND; STEPHEN
BONO and JANE DOE
BONO; and JIM O'BRIEN
and JANE DOE O'BRIEN,

Defendants

No. 81520-8
Ct of Appeals No. 375966
Sup Ct No. 06-2-04562-4

BRIEF OF APPELLANTS RICHARD AND PENNY BORISH

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I. INTRODUCTION

In *Alejandre v. Bull*, 159 Wn.2d 674, 683, 153 P.3d 864 (2007), this Court broadly held that the economic loss rule will “bar recovery for alleged breach of tort duties where a contractual relationship exists and the losses are economic losses.” That holding extinguished any claim for negligent misrepresentation. Following the reasoning of that holding, Division One has now barred claims for fraud. *Carlile v. Harbour Homes, Inc.* 2008 WL 4648423, 4, ___ Wn.App. ___, ___ P.3d ___ (2008). Left unchecked, the economic loss rule as explained in *Alejandre* will continue its relentless march, extinguishing claims for professional negligence, breach of fiduciary duty, and any other tort claim that can be tied to a contract. The economic loss rule was intended to preserve, not destroy, established principles of tort law.

This Court should abandon the mistaken notion that it has ever recognized an absolute “bright line distinction between the remedies offered in contract and tort with respect to economic damages.” *Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1*, 124 Wn.2d 816, 827, 881 P.2d 986, 992 (1994). Washington law has always recognized that parties to a contract may owe each other independent legal duties even if they have a contract, and that a breach of those duties may be grounds for a tort claim. *American Nursery Products, Inc. v. Indian*

Wells Orchards, 115 Wash.2d 217, 230, 797 P.2d 477, 485 (1990). In fact, as recently as 2004, this Court affirmed the general rule that an action is based in contract rather than tort when it is not based on such an independent duty. *Bank of America NT & SA v. Hubert*, 153 Wn.2d 102, 124, 101 P.3d 409, 420 (2004) (“An action sounds in contract when the act complained of is a breach of a specific term of the contract, without reference to the legal duties imposed by law on that relationship.”).

This Court should reconsider the expansive language in *Alejandre* and expressly adopt the independent legal duty exception to the economic loss rule. The mere existence of a contract should not be an insurmountable defense to a breach of a common law duty recognized by Washington courts.

In the context of this case, the Court should hold that in adopting a cause of action for negligent misrepresentation under Section 552 of the Restatement of Torts, this Court acknowledged that parties have an independent duty to exercise reasonable care in providing information to others for guidance in transactions irrespective of any contract between them. *Schaaf v. Highfield*, 127 Wn.2d 17, 23, 896 P.2d 665, 668-69 (1995). Accordingly, this Court should hold that the economic loss rule does not apply to claims for negligent misrepresentation or any other common law claim recognized by Washington courts.

II. ASSIGNMENTS OF ERROR

1. The trial court erred in granting summary judgment on the negligent misrepresentation claims asserted by defendants Keith and Jodi Olson (“Olson”) and Kristi M. Russell (“Russell”) under the economic loss rule.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Should the Court adopt the independent duty exception to the economic loss rule?

2. Is a claim for negligent misrepresentation under Section 552 of the Restatement of Torts an independent duty exception to the economic loss rule?

IV. FACTUAL BACKGROUND

In 2005, Appellants Rick and Penny Borish (“Borish”) agreed to purchase a waterfront home on Horsehead Bay in Pierce County from Respondents Keith and Jodi Olson (“Olson”) for \$680,000.00. CP 79-81; 112-30. The house was listed for sale with John L. Scott, Inc. (not a party to this appeal) and advertised as a waterfront parcel with a one-bedroom house “Stick Built on Lot,” and a detached two-car garage. CP 643-45. Borish made an offer to purchase the subject property from Olson on January 26, 2005 based on the information contained in the listing.

Supplemental CP 653-70. The parties reached mutual acceptance on or around January 27, 2001. Supplemental CP 112.

After Borish made the offer, they received a copy of Olsons' Real Property Transfer Disclosure Statement (Northwest Multiple Listing Service Form No. 17) for the subject property, signed by the Olsons and dated October 7, 2004. CP 647-51. In answer to the question on the seller disclosure statement of whether there had been any "conversions, additions or remodeling" on the subject property, the Olsons answered "no." CP 649. In answer to the question on the form of whether there were any defects in the foundation, deck, exterior walls, or other portions of the property, Olson answered "no." CP 649. In answer to whether there were any "zoning violations, nonconforming uses, or any unusual restrictions on the property that would affect future construction or remodeling," Olson answered "no." CP 647. The section that addressed questions that would apply if the property included a manufactured home was crossed out. CP 650. In reliance upon these representations, Borish signed the Seller Disclosure Statement on January 30, 2005. CP 651.

The Borishes' lender, First Financial Equities/Landsafe, hired appraiser Kristy M. Russell ("Russell") to appraise the property. CP 881; CP 710-26. Russell's appraisal stated that "[t]he subject is a good quality one story dwelling in good condition," and indicated a cost approach value

of \$682,318.00. CP 710-11. The appraisal further stated that the house was not a manufactured home. CP 710.

After the sale closed, Borish learned that the home was a remodeled manufactured home. CP 850. The manufactured home had been substantially remodeled and was structurally unsound. CP 850.

Borish sued Olson under several legal theories, including negligent misrepresentation. CP 49 at ¶ 4.3. Borish also sued Russell, the appraiser, for negligent misrepresentation. CP 49 at ¶4.4. After the Supreme Court issued its opinion in *Alejandre v. Bull*, 159 Wn.2d 674, 153 P.3d 864 (2007), both Olson and Russell filed for summary judgment dismissal of the negligent misrepresentation claims based on the economic loss rule articulated in *Alejandre*. CP 168-176. The trial court granted both the motions. CP 387-389; CP 574. The order dismissed Russell from the case. The remaining claims against Olson were tried to a jury and resulted in a defense verdict. CP 573-74. Borish appeals only the summary judgment orders in favor of Russell and Olson.

V. LEGAL ANALYSIS

A. Negligent Misrepresentation in Washington.

Washington courts first recognized a claim for negligent misrepresentation in *Fleenor v. Erickson*, 35 Wn.2d 891, 900, 215 P.2d 885, 891 (1950), and only sporadically referred to the claim over the

following thirty years. See *Brown v. Underwriters at Lloyd's*, 53 Wn.2d 142, 332 P.2d 228 (1958); *J & J Food Centers, Inc. v. Selig*, 76 Wn.2d 304, 456 P.2d 691 (1969).

It was not until Washington recognized a claim under Section 552 of the Restatement of Torts in *Burien Motors, Inc. v. Balch*, 9 Wn.App. 573, 576, 513 P.2d 582, 585 (1973), that negligent misrepresentation truly became a mainstream cause of action. In *Transamerica Title Ins. Co. v. Johnson*, 103 Wash.2d 409, 415, 693 P.2d 697 (1985), this Court held that a claim for negligent misrepresentation “falls within the ambit of Restatement (Second) of Torts § 552(1) and (2) (1977).” Since that time, Washington courts appear to have analyzed claims for negligent misrepresentation exclusively under Section 552 of the Restatement.

A claim under Section 552 of the Restatement has a number of specific elements, all of which have been strictly required by Washington courts.

To determine whether a plaintiff has stated a claim for negligent misrepresentation, this court adheres to the standards in the Restatement (Second) of Torts § 552(1), (2) (1977) which provides:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, 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.

(2) Except as stated in Subsection (3), [which pertains to the liability of one who is under a public duty to furnish such information] the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

Haberman v. Washington Public Power Supply System; 109 Wn.2d 107, 161-62, 744 P.2d 1032, 1067 (1987); *Alejandre v. Bull*, 159 Wn.2d 674, 686, 153 P.3d 864, 870 (2007).

In *ESCA Corp. v. KPMG Peat Marwick*, 135 Wn.2d 820, 827-28, 959 P.2d 651, 654 (1998), this Court expressly approved a jury instruction parsing six elements from Section 552 for a claim of negligent misrepresentation.

Seafirst has asserted a claim against KPMG for negligent misrepresentation. To prevail on its claim, Seafirst has the burden of proving the following propositions:

(1) That KPMG supplied information for the guidance of others in their business transactions that was false; and

(2) That KPMG knew or should have known that the information was supplied to guide Seafirst in business transactions; and

(3) That KPMG was negligent in obtaining or communicating false information; and

(4) That Seafirst relied on the false information supplied by KPMG; and

(5) That Seafirst's reliance on the false information supplied by KPMG was justified (that is, that reliance was reasonable under the surrounding circumstances); and

(6) That the false information was the proximate cause of damages to Seafirst.

Subsequent decisions have uniformly applied these six elements to claims for negligent misrepresentation. *E.g.*, *Ross v. Kirner*, 162 Wn.2d 493, 499, 172 P.3d 701, 704 (2007); *Van Dinter v. Orr*, 157 Wn.2d 329, 332, 138 P.3d 608, 609 (2006); *Lawyers Title Ins. Corp. v. Baik*, 147 Wn.2d 536, 545, 55 P.3d 619, 623 (2002). Elements 1 and 6 are of particular relevance to this appeal.

1. False Information Must Be Provided for Guidance in a Business Transaction.

The first element limits claims to information that is provided for the guidance of others in a business transaction. In other words, it is not possible to have a claim for negligent misrepresentation except in the context of a business transaction. This Court extensively considered the requirement of a business transaction when it rejected a claim for

negligent misrepresentation against an upstream seller of an automobile in *Colonial Imports, Inc. v. Carlton Northwest, Inc.*, 121 Wn.2d 726, 732-34, 853 P.2d 913 (1993).

The negligent misrepresentation cause of action outlined by the Restatement incorporates this concept. Section 551(2) assumes that the duty will be invoked as between parties to "a business transaction". Accordingly, the next section generally circumscribes this liability to situations involving the provision of business advice, either by one who publicly proclaims expertise or by one having a financial stake in the matter under consideration. Restatement § 552. Cases and treatises discussing negligent misrepresentation similarly premise the finding of a duty to disclose upon the nature of the relationship between the parties. *See, e.g., Onita Pac. Corp. v. Trustees of Bronson*, 315 Or. 149, 160-65, 843 P.2d 890 (1992) (examining nature of parties' relationship to decide whether to allow negligent misrepresentation claim); *Taggart v. Ford Motor Credit Co.*, 462 N.W.2d 493, 501 (S.D.1990) (emphasizing that plaintiff in misrepresentation case must be a party to the transaction). *See generally* 2 Fowler V. Harper, Fleming James, Jr., & Oscar S. Gray, *Torts* § 7.6, at 405-06 (2d ed. 1986); W. Page Keeton, Dan B. Dobbs, Robert E. Keeton & David G. Owen, *Prosser and Keeton on Torts* 746 (5th ed. 1984).

We conclude that the relationship, such as it was, between the parties to this lawsuit was insufficient to support a duty to disclose. There was no pre-existing special relationship between Colonial and Don Carlton, and Don Carlton was not in the business of giving financial advice. The two principals had never spoken before this brief phone call, and the only arguable link between them was the successive transfer of the MSOs. Both principals are experienced and independent businesspersons. Each party conducted an independent transaction with Imports Unlimited, and neither was in any sense a party to the same business transaction. Imports Unlimited was not acting as

the agent of either party. While Don Carlton had experienced delays in payment from Imports Unlimited, it ultimately received payment and knew naught of the precarious financial situation of Imports Unlimited. The relationship between these two parties is simply too tenuous to support liability for negligent misrepresentation. Imposition of a duty to disclose under these circumstances would expand the bounds of negligent misrepresentation beyond its reasonable parameters. We hold that, under the facts of this case, there could be no duty to disclose. Hence, Colonial's claim of negligent misrepresentation must fail.

Division Three of the Court of Appeals rejected a claim for negligent misrepresentation in a letter of recommendation for the same reason. *Richland School Dist. v. Mabton School Dist.*, 111 Wn.App. 377, 386-87, 45 P.3d 580, 586 (2002) (“A letter of recommendation from a former employer to potential employers does not constitute a business transaction involving a quasi-fiduciary relationship between a seller and buyers. Consequently, negligent misrepresentation in the context of Section 551 does not apply to these facts.”).

In *Schaaf v. Highfield*, 127 Wn.2d 17, 896 P.2d 665 (1995), this Court recognized that the relationship between a home buyer and an appraiser satisfied the “business transaction” requirement.

We conclude that § 552 applies to a real estate appraiser like Olson, who “in the course of his business, profession or employment ... supplies false information for the guidance of others in their business transactions”. The crucial consideration here is to what extent this duty of care extends to third parties not in privity with the appraiser.

After *Transamerica*, this court decided several cases that serve to define and limit the duty of care.

* * * *

We conclude that a third party in Washington may state a claim for negligent misrepresentation against a real estate appraiser pursuant to Restatement (Second) of Torts § 552. The liability of a real estate appraiser in these circumstances extends only to those involved in the transaction that triggered the appraisal report, including, but not necessarily limited to, the buyer and the seller. We leave defining the precise scope of the appraiser's duty of care to a factual determination by a future trial court.FN7 We hold that Schaaf stated a cause of action, pursuant to § 552, against Olson for allegedly rendering a negligent appraisal.

Id. at 23, 26 (footnote omitted).. In extending liability to those who were not in privity with the defendant, the Court necessarily recognized that a party who is in privity of contract may assert a claim for negligent misrepresentation.

6. The Plaintiff Must Suffer “Pecuniary Loss.”

Washington law and Section 552 of the Restatement limits the recovery of damages to “pecuniary loss.” *Van Dinter v. Orr*, 157 Wn.2d 329, 332, 138 P.3d 608, 609 (2006). Only one reported Washington case analyzes this element in any depth. In *Janda v. Brier Realty*, 97 Wn.App. 45, 984 P.2d 412 (1999), Division One of the Court of Appeals decided an appeal based on the meaning of “pecuniary loss.”

Citing the Restatement, the *Janda* court first explained that the benefit of the bargain, the traditional measure of damages for fraud and breach of contract, is not available under negligent misrepresentation.

Under the Restatement, damages for negligent misrepresentation are limited to “those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause” and include:

(a) the difference between the value of what he has received in the transaction and its purchase price or other value given for it; and

(b) pecuniary loss suffered otherwise as a consequence of the plaintiff's reliance upon the misrepresentation.

Restatement (Second) of Torts § 552B. Recovery of damages for the benefit of the plaintiff's contract with the defendant is specifically not allowed under the Restatement. *Id.*

Id. at 50.

Janda remains the only published Washington decision discussing the “pecuniary loss” measure of damages for negligent misrepresentation. However, courts in other states have reached the same conclusion based upon the language in the Restatement.

Many jurisdictions that have considered the appropriate standard of damages for negligent-misrepresentation causes of action have adopted damage formulations based upon out-of-pocket damages. We join those jurisdictions and embrace the notion that damage awards in connection with negligent-misrepresentation cases include (1) the difference

between the value of what the plaintiff received in the induced transaction and the value given for it, and (2) pecuniary loss sustained in consequence of the plaintiff's reliance upon the false representation.

Goodrich & Pennington Mortg. Fund, Inc. v. J.R. Woolard, Inc., 120 Nev. 777, 782, 101 P.3d 792, 795-96 (2004) (collecting cases, footnotes omitted).

The damages recoverable for a negligent misrepresentation are those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause, including (a) The difference between the value of what he has received in the transaction and its purchase price or other value given for it; and (b) Pecuniary loss suffered otherwise as a consequence of the plaintiff's reliance upon the representation.

The out-of-pocket measure of damages is consistent with Georgia's general measure of damages in negligence cases, which seeks to place the injured party in the same place it would have been had there been no injury or breach of duty. It is also consistent with our prior decision in *Robert & Co.*, in which we recognized that the important distinction between cases of intentional misrepresentation and cases of negligent misrepresentation is the culpability of the defendant. As noted in the commentary to section 552B, an out-of-pocket measure of damages is commensurate with the culpability of the tortfeasor, who acted negligently, rather than intentionally or maliciously. Furthermore, utilizing the out-of-pocket standard for negligent misrepresentation and the benefit-of-the-bargain standard for fraudulent misrepresentation is a middle position that is consistent with our statement in *Badische Corp. v. Caylor* that our adoption of section 552 represents a "middle ground" standard. Finally, a majority of jurisdictions favor the Restatement position.

BDO Seidman, LLP v. Mindis Acquisition Corp., 276 Ga. 311, 312, 578 S.E.2d 400, 401 (2003) (collecting cases, footnotes omitted).

Under Washington law and the Restatement, the tort of negligent misrepresentation therefore seems to have a unique and specific measure of damages that includes economic losses but falls short of the damages available for fraud or breach of contract. It is perhaps for this reason that courts have occasionally strained to categorize the claim, sometimes designating it as a case of ordinary negligence (*E.g., ESCA Corp. v. KPMG Peat Marwick*, 135 Wn.2d 820, 827, 959 P.2d 651, 654 (1998)), while at other times calling it a “species of fraud” (*E.g., Schaaf v. Highfield*, 127 Wn.2d 17, 22, n. 6, 896 P.2d 665, 668 (1995)).

B. The Economic Loss Rule in Washington.

By most accounts, the economic loss rule originated in the 1960s within the context of products liability law. *See Town of Alma v. Azco Const., Inc.*, 10 P.3d 1256, 1259 (Colo., 2000). Largely over the past decade, the economic loss rule has become a pervasive, if perplexing, part of negligence jurisprudence. *See Grams v. Milk Products, Inc.* 283 Wis.2d 511, 540, 699 N.W.2d 167, 181 (2005) (“Although simple to state, the doctrine's meaning and application are confounding litigants, their lawyers, and the courts.”).

In theory, “the purpose of the economic loss rule is to bar recovery for alleged breach of tort duties where a contractual relationship exists and the losses are economic losses.” *Alejandre v. Bull*, 159 Wn.2d 674, 683, 153 P.3d 864, 868 (2007). Other courts have stated the rule similarly, but with nuanced differences. *Medical City Dallas, Ltd. v. Carlisle Corp.*, 251 S.W.3d 55, 61 (Tex., 2008) (“Under the economic loss rule, the nature of the injury helps determine which duty or duties are breached and, ultimately, which damages are appropriate: ‘When the injury is only the economic loss to the subject of a contract itself, the action sounds in contract.’”); *Association of Apartment Owners of Newtown Meadows ex rel. its Bd. of Directors v. Venture 15, Inc.*, 115 Hawai‘i 232, 286, 167 P.3d 225, 279 (2007) (“The economic loss rule bars recovery in tort for purely economic loss.”); *EBWS, LLC v. Britly Corp.*, 181 Vt. 513, 524, 928 A.2d 497, 507 (2007) (“The economic-loss rule prohibits recovery in tort for purely economic losses.”). No matter how the rule is stated, its application varies widely from state to state and even from case to case within a state.

Few “rules” are subject to as many *ad hoc* exceptions as the economic loss rule. Division Two recognizes an exception for fraud claims (*Stieneke v. Russi*, 145 Wn.App. 544, 560, 190 P.3d 60, 68 (2008)), but Division One does not (*Carlile v. Harbour Homes, Inc.* 2008 WL

4648423, 4, ___ Wn.App. ___, ___ P.3d ___ (2008).). Florida recognizes an exception for professional malpractice. *Moransais v. Heathman*, 744 So.2d 973, 983 (1999). Illinois recognizes exceptions when

(1) the plaintiff has sustained a personal injury or property damage as a result of a sudden or dangerous occurrence; (2) the plaintiff's damages are proximately caused by the defendant's intentional, false misrepresentation; or (3) the plaintiff's damages are proximately caused by a negligent misrepresentation made by a defendant in the business of supplying information for the guidance of others in their business transactions.

Trans States Airlines v. Pratt & Whitney Canada, Inc., 177 Ill.2d 21, 224 Ill.Dec. 484, 682 N.E.2d 45, 48 (1997). Maryland has an exception if “the conduct complained of creates a risk of death or personal injury.” *Lloyd v. General Motors Corp.*, 397 Md. 108, 125, 916 A.2d 257, 267 (2007). The Oregon Supreme Court recently struggled through its own interpretation of the economic loss rule and its exceptions before finally simply concluding that the economic loss rule did not apply because “the focus of the claimed negligence is on physical damage to property.” *Harris v. Suniga*, 344 Or. 301, 312, 180 P.3d 12, 18 (2008)

The economic loss rule in Washington appears to have first arisen in *Berg v. General Motors Corp.*, 13 Wn.App. 326, 534 P.2d 838 (1975), in which a commercial fisherman sought to recover damages from a manufacturer and dealer for losses resulting from a defective engine. The

Court of Appeals held that the plaintiff was limited to his remedies in contract because there was no accident or physical damage. *Id.* at 327. This Court reversed, rejecting the argument of a “distinction being made as to the nature of the damages, or whether the injury is alleged to be tort or contract.” *Berg v. General Motors Corp.*, 87 Wn.2d 584, 594, 555 P.2d 818, 823 (1977). The legislature overruled *Berg* in 1981 when it enacted the products liability act. *Stanton v. Bayliner Marine Corp.*, 123 Wash.2d 64, 84, 866 P.2d 15, 26 (1993).

In 1987, this Court revisited the issue in *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wn.2d 406, 745 P.2d 1284 (1987). In *Stuart*, this Court held that no cause of action for negligent construction exists, adopting the view that a negligence claim may not be asserted for economic loss “where only the defective product is damaged,” the so-called “risk of harm” test. *Id.* at 420. However, *Stuart* did not end the controversy over the meaning of economic loss. In *Washington Water Power Co. v. Graybar Elec. Co.*, 112 Wash.2d 847, 774 P.2d 1199 (1989), this Court explained that the risk of harm test still leaves open the question whether tort liability requires a “sudden and dangerous” event or merely an unreasonable risk of one. *Washington Water Power Co. v. Graybar Elec. Co.*, 112 Wn.2d 847, 866, 774 P.2d 1199, 1210 (1989). The Court declined to decide that issue on the record before it. *Id.*

The term “economic loss rule” did not really become established in Washington law until this Court’s decision in *Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1*, 124 Wn.2d 816, 881 P.2d 986 (1994). In *Berschauer*, this Court held that “the economic loss rule does not allow a general contractor to recover purely economic damages in tort from a design professional.” *Id.* at 823. The actual holding of *Berschauer* was narrow.

We follow the *Stuart* and *Atherton* line of cases and maintain the fundamental boundaries of tort and contract law **by limiting the recovery of economic loss due to construction delays to the remedies provided by contract.** We so hold to ensure that the allocation of risk and the determination of potential future liability is based on what the parties bargained for in the contract. We hold parties to their contracts. If tort and contract remedies were allowed to overlap, certainty and predictability in allocating risk would decrease and impede future business activity. The construction industry in particular would suffer, for it is in this industry that we see most clearly the importance of the precise allocation of risk as secured by contract. The fees charged by architects, engineers, contractors, developers, vendors, and so on are founded on their expected liability exposure as bargained and provided for in the contract. As Justice Cardozo warned, the expansion of duty in tort to include economic interests would expose defendants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.

Id. at 826-27 (emphasis added).

The *Berschauer* court also considered and rejected a claim for negligent misrepresentation against the design professionals.

Alternatively, *Berschauer/Phillips* requests that this court apply the Restatement (Second) of Torts § 552 (1977) to permit a general contractor not in privity of contract to bring a tort cause of action against a design professional for negligent misrepresentations. We acknowledge that § 552 provides support for the recovery of economic damages in the construction industry for negligent misrepresentations. *See* § 552, illustration 9. The Restatement is equivocal in its support, however. *See* Restatement (Second) of Torts § 766C (1979) (economic damages resulting from a party who negligently makes the performance of a contract more expensive to perform are not recoverable absent physical harm); *but see* § 766C cmt. e (§ 766C may not apply if § 552 applies). We also acknowledge that the tort of negligent misrepresentation is recognized in Washington. *See, e.g., Havens v. C & D Plastics, Inc.*, 124 Wash.2d 158, 180, 876 P.2d 435 (1994) (employment termination); *Haberman v. WPPSS*, 109 Wash.2d 107, 744 P.2d 1032, 750 P.2d 254 (1987) (bond and security misrepresentations). We hold that when parties have contracted to protect against potential economic liability, as is the case in the construction industry, contract principles override the tort principles in § 552 and, thus, purely economic damages are not recoverable. *Accord, Floor Craft Floor Covering, Inc. v. Parma Comm'ty Gen. Hosp. Ass'n*, 54 Ohio St.3d 1, 7, 560 N.E.2d 206 (1990) (§ 552 of the restatement not adopted to allow a general contractor to recover economic damages from a design professional); *Williams & Sons Erectors, Inc. v. South Carolina Steel Corp.*, 983 F.2d 1176, 1181-83 (2d Cir.1993) (under New York law, § 552 not adopted to permit a general contractor to recover economic damages from an architect); *but see Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 188-89, 677 P.2d 1292 (1984) (an architect, absent privity of contract, may be liable to a general contractor for economic damages under § 552).

Id. at 827-828. The *Berschauer* court did not address whether the economic loss rule had any exceptions. In *Griffith v. Centex Real Estate Corp.*, 93 Wn.App. 202, 212-13, 969 P.2d 486, 491 (1998), Division One of the Court of Appeals subsequently followed *Berschauer* without much analysis in a negligent misrepresentation case where the parties had actually negotiated an allocation of risk.

The implications of *Berschauer* and *Centex* seem largely to have escaped the notice of the bar and the courts. Between 1998 when *Centex* was decided and 2007, numerous published decisions have affirmed judgments or reversed summary judgment on negligent misrepresentation claims. *E.g.*, *Sabey v. Howard Johnson & Co.*, 101 Wn.App. 575, 5 P.3d 730 (2000) (dismissal of negligent misrepresentation claim reversed); *Bolser v. Clark*, 110 Wash.App. 895, 43 P.3d 62 (2002) (affirming judgment on negligent misrepresentation claim against appraiser); *Westby v. Gorsuch*, 112 Wash.App. 558, 50 P.3d 284 (2002) (affirming judgment for negligent misrepresentation in purchase of Titanic souvenir); *Lawyers Title Ins. Corp. v. Baik*, 147 Wash.2d 536, 55 P.3d 619 (2002) (reversing summary judgment on negligent misrepresentation claim); *Guarino v. Interactive Objects, Inc.*, 122 Wash.App. 95, 86 P.3d 1175 (2004); (reversing summary judgment on negligent misrepresentation claim); *Flower v. T.R.A. Industries, Inc.*, 127 Wash.App. 13, 111 P.3d 1192

(2005) (reversing summary judgment on negligent misrepresentation claim); *Shah v. Allstate Ins. Co.*, 130 Wash.App. 74, 121 P.3d 1204 (2005) (reversing summary judgment on negligent misrepresentation claim). All of these cases concerned only “economic loss” as defined in *Berschauer* and *Centex*.

On March 1, 2007, everything changed when this Court announced its decision in *Alejandre v. Bull*, 159 Wn.2d 674, 153 P.3d 864 (2007). *Alejandre* concerned what theretofore had been a routine negligent misrepresentation claim between a buyer and seller over a failed septic system. Although the Court’s decision was nominally only an incremental step from *Berschauer*, its holding barring claims for negligently misrepresenting defects in real estate transactions resulted in a tsunami of dismissals across the state and changed the landscape of seller liability.

The *Alejandre* Court’s holding left no room for argument that the theory of negligent misrepresentation is still viable.

In this case involving the sale of a residence with a defective septic system, we hold that the economic loss rule applies and forecloses the buyers' claim that the seller negligently misrepresented the condition of the septic system.

Id. at 691. Subsequent court decisions have struggled to implement the *Alejandre* decision. In *Stieneke v. Russi*, 145 Wn.App. 544, 555-57, 190

P.3d 60 (2008), Division Two analyzed the question under the analysis whether the claim was for injury to the defective property or other property was injured. *Stieneke* further held that “the rule does not bar recovery for personal injury or damage to property other than a defect in the property.” *Id.* at 560. In *King v. Rice*, 191 P.3d 946, 951, ___ P.3d ___ (2008), Division One held that “the rule does not bar recovery for personal injury or damage to property other than a defect in the property.” Most recently, Division One broadly held that *Alejandre* bars claims for intentional fraud: “More importantly, there is no reason here to exempt an intentional misrepresentation claim from the general exclusion of tort-based claims under the rationale of the economic loss rule.” *Carlile v. Harbour Homes, Inc.* 2008 WL 4648423, 4, ___ Wn.App. ___, ___ P.3d ___ (2008).

In this context, it is somewhat surprising that this Court remanded a negligent misrepresentation claim for trial in *Ross v. Kirner*, 162 Wash.2d 493, 172 P.3d 701 (2007). Prior to *Alejandre*, that decision would have been unremarkable, but it cannot be reconciled with *Alejandre*. The confusion in the Courts of Appeals and the questions raised by the *Ross* decision should lead this Court to reconsider its holding in *Alejandre*.

C. **The Existence of an Independent Legal Duty Is a Recognized Exception to the Economic Loss Rule.**

Perhaps the most important sentence in *Alejandre* is the Court's statement that:

If the claimed loss is an economic loss, and no exception applies to the economic loss rule, then the parties will be limited to contractual remedies.

Alejandre, 159 Wash.2d at 684. As explained above, other states have recognized exceptions to the economic loss rule, and *Alejandre* anticipates but does not adopt exceptions to Washington's economic loss rule.

Both fraud and negligent misrepresentation are claims that arise in a contractual setting and result in economic losses. The accepted measure of damages for both fraud and breach of contract is the benefit of the bargain. *Sigman v. Stevens-Norton, Inc.*, 70 Wn.2d 915, 921, 425 P.2d 891, 895-96 (1967) (fraud); *McInnis & Co. v. Western Tractor & Equipment Co.*, 67 Wn.2d 965, 970, 410 P.2d 908, 912 (1966) (fraud); *Diedrick v. School Dist. 81*, 87 Wn.2d 598, 610, 555 P.2d 825 (1976) (contract). The measure of damages for negligent misrepresentation is "pecuniary loss" in a "business transaction." *Van Dinter v. Orr*, 157 Wn.2d 329, 332, 138 P.3d 608, 609 (2006). The Illinois Supreme Court recently summarized such claims as "economic torts."

In light of the origin of this cause of action, it is not surprising that the tort of fraudulent misrepresentation has

been historically treated as purely an economic tort under which one may only recover damages for pecuniary harm. See W. Keeton, *Prosser & Keeton on Torts* § 105, at 726 (5th ed.1984) (the application of the tort of fraudulent misrepresentation has been limited to remedying harm of a commercial or financial nature); *Restatement (Second) of Torts*, Scope Note, at 54 (1977) (the tort of fraudulent misrepresentation has traditionally been associated with liability for pecuniary loss); *Restatement (Second) of Torts* § 531, at 66 (1977) (setting forth the “General Rule” for fraudulent-misrepresentation actions and defining damages solely in terms of pecuniary loss).

Doe v. Dilling, 228 Ill.2d 324, 343-344, 888 N.E.2d 24, 36 (2008).

“Fraud, deceit and negligent misrepresentation are economic torts.”

Nelson v. Progressive Corp. 976 P.2d 859, 867 (Alaska,1999) (quoting

Dan B. Dobbs, *Law of Remedies* § 9.2(4), at 559-60 (2d ed.1993).

The concept of an economic tort cannot coexist with the economic loss rule. Indeed, *Alejandre* seems to reject the notion of economic torts altogether: “Tort law has traditionally redressed injuries properly classified as physical harm.” *Alejandre*, 159 Wn.2d at 682 (quoting *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wn.2d 406, 420, 745 P.2d 1284 (1987)). No Washington court, however, has ever decided whether recognized economic torts should be an exception to the economic loss rule. The issue was raised in *Griffith v. Centex Real Estate Corp*, but the Court of Appeals believed it was precluded from considering it by *Berschauer/Phillips*.

The Class asserts that this rule does not (or should not) apply to negligent misrepresentation claims, and points to several cases from other jurisdictions declining to apply the rule in this context. Yet in announcing the rule, the Berschauer/Phillips court characterized its application of the economic loss rule as a “bright line distinction between the remedies offered in contract and tort with respect to economic damages [which] encourages parties to negotiate toward the risk distribution that is desired or customary.” Berschauer/Phillips, 124 Wash.2d at 827, 881 P.2d 986.

Griffith, 93 Wn.App. at 212. The Court should now consider those cases and their reasoning.

Other states that have considered the appropriate reach of the economic loss rule have relied on factors that this Court may find persuasive.

The most fundamental exception to the economic loss rule is for tort claims based on a duty independent of the contract. This concept has been expressed in a number of ways. First, many states outright decline to apply the economic loss rule to a claim based on an independent duty.

However, where a duty that lies outside the terms of the contract is owed, many states allow a plaintiff to recover economic loss in tort against the defendant contracting party. *Ellis*, 128 N.H. at 363, 513 A.2d 951; *see also Griffin Plumbing & Heating v. Jordan*, 320 S.C. 49, 463 S.E.2d 85, 88 (1995); *Congregation of the Passion v. Touche Ross*, 159 Ill.2d 137, 201 Ill.Dec. 71, 636 N.E.2d 503, 514 (1994), *cert. denied*, 513 U.S. 947, 115 S.Ct. 358, 130 L.Ed.2d 312 (1994). “[W]hen an independent duty exists, the economic loss rule does not bar a tort claim because the claim is based on a recognized independent duty of care and thus does not fall within the scope of the rule.”

Farmers Alliance, 452 F.Supp.2d at 1174 (quotations omitted). In such a case, there is privity among the parties, yet an independent duty in tort owed by the defendant.

Plourde Sand & Gravel v. JGI Eastern, Inc., 154 N.H. 791, 794, 917 A.2d 1250, 1253-54 (N.H.,2007).

Where there exists a duty of care independent of any contractual obligations, the economic loss rule has no application and does not bar a plaintiff's tort claim because the claim is based on a recognized independent duty of care and thus falls outside the scope of the economic loss rule. *Town of Alma*, 10 P.3d at 1264.

A.C. Excavating v. Yacht Club II Homeowners Ass'n, Inc., 114 P.3d 862, 866 (Colo., 2005); *Oates v. JAG, Inc.*, 314 N.C. 276, 279, 333 S.E.2d 222, 225 (1985); *Hermansen v. Tasulis*, 48 P.3d 235, 240 (Utah, 2002); *Robinson Helicopter Co., Inc. v. Dana Corp.*, 34 Cal.4th 979, 991, 102 P.3d 268, 27, 22 Cal.Rptr.3d 352, 360 (2004) ("We hold the economic loss rule does not bar Robinson's fraud and intentional misrepresentation claims because they were independent of Dana's breach of contract."); *Presnell Const. Managers, Inc. v. EH Const., LLC*, 134 S.W.3d 575, 590 (Ky., 2004).

Other courts have found claims to be outside the economic loss rule because the alleged conduct occurred before a contract was formed, and thus was independent of the contract. *E.g.*, *Keller v. A.O. Smith Harvestore Products, Inc.*, 819 P.2d 69, 72 (Colo., 1991) ("a contracting

party's negligent misrepresentation of material facts prior to the execution of an agreement may provide the basis for an independent tort claim”); *Greenfield v. Heckenbach*, 144 Md.App. 108, 130, 797 A.2d 63, 76 (2002) (“the law in Maryland, as enunciated in *Fowler*, is that a plaintiff can successfully bring a tort action for fraud that is based on false pre-contract promises by the defendant”).

Similarly, some states exclude claims for conduct that induced a contract as separate from the contract itself. *E.g.*, *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, 685 So.2d 1238, 1240 (Fla., 1996) (“cause of action for fraud in the inducement is an independent tort and is not barred by the economic loss rule”); *Kaloti Enterprises, Inc. v. Kellogg Sales Co.*, 283 Wis.2d 555, 585, 699 N.W.2d 205, 219 (2005) (“a fraud in the inducement claim is not barred by the economic loss doctrine ‘where the fraud is extraneous to, rather than interwoven with, the contract.’” (citation omitted)).

Still other states require contractual privity between the parties before the economic loss rule can be applied. *See Generally Association of Apartment Owners of Newtown Meadows ex rel. its Bd. of Directors v. Venture 15, Inc.*, 115 Hawai'i 232, 285-297, 167 P.3d 225, 278-90 (2007) (collecting cases and comparing privity rules). Washington, of course, permits negligent misrepresentation cases between parties who are not in

contractual privity. *Schaaf v. Highfield*, 127 Wn.2d 17, 26, 896 P.2d 665, 670 (1995) (“In summary, under § 552, lack of privity is no defense to a claim of negligent misrepresentation.”). One of the claims dismissed in this case was negligent misrepresentation against a real estate appraiser, the very cause of action recognized in *Schaaf*. *Id.* at 27.

In addition, courts across the country have created numerous *ad hoc* exceptions, only to distinguish them in subsequent cases. *Colleton Preparatory Academy, Inc. v. Hoover Universal, Inc.*, 666 S.E.2d 247, 254 (S.C., 2008) (exception for “clear, serious and unreasonable risk of bodily injury or death”); *Moransais v. Heathman*, 744 So.2d 973, 983 (1999) (professional negligence).

D. This Court Should Adopt the Independent Duty Exception.

Where it is followed, the economic loss rule has led to one of two unacceptable results: either the rule becomes so flexible through exceptions that its application cannot be predicted, or the rule is strictly applied and eliminates entire bodies of accepted tort law. Simply put, all damages other than personal injuries are ultimately economic.

Every physical injury to property can be characterized as a species of “economic loss” for the property owner, because every injury diminishes the financial value of the property owner's assets. Damage to a car reduces the value of the car-one of the owner's assets. A tree falling on a person's residence is damage to property, but also can be characterized as a financial loss because it reduces the

value of the residence, which the owner may properly view as an asset or financial investment as well as a residence. Yet the law ordinarily allows the owner of the damaged car or residence to recover in negligence from the person who caused the damage. In *Onita Pacific Corp.*, this court used the term “economic losses” to describe “financial losses such as indebtedness incurred and return of monies paid, *as distinguished from damages for injury to person or property.*” 315 Or. at 159 n. 6, 843 P.2d 890 (emphasis added). That definition did not purport to be comprehensive, but it plainly indicated that the court was adhering to the distinction that had developed in the common law between “purely economic losses,” on the one hand, and damages for physical injuries to person or property, on the other.

Harris v. Suniga, 344 Or. 301, 310, 180 P.3d 12 (2008).

Alejandre interprets the economic loss rule as a nearly absolute maxim that effectively eliminates any claim for negligent misrepresentation because such claims require a transaction and damages are limited to “pecuniary loss.” Simply following the reasoning of the decision, Division One has effectively abolished claims for fraud relating to a contract, which would seem to include almost all of them. *Carlile v. Harbour Homes, Inc.* 2008 WL 4648423, 4, ___ Wn.App. ___, ___ P.3d ___ (2008). Under the Court’s holding, claims for breach of fiduciary duty, legal malpractice and other professional negligence, and tortious interference with contract would all violate the economic loss rule.

Modern jurisprudence has developed a class of “economic torts,” and this Court should hold that the economic loss rule does not apply to

economic torts that have been recognized in Washington. The basis of any tort claim is a duty, which is a question of law. *Mutual of Enumclaw Ins. Co. v. Dan Paulson Const., Inc.*, 161 Wn.2d 903, 916, 169 P.3d 1, 8 (2007). The existence of a duty is a question of law, not a question of contract. *Sheikh v. Choe*, 156 Wn.2d 441, 448, 128 P.3d 574, 577 (2006). Legal duties exist independent of the contract. *See, e.g., Lawyers Title Ins. Corp. v. Baik*, 147 Wn.2d 536, 559, 55 P.3d 619, 630 (2002) (“As a title insurance company, Lawyers Title has an independent duty ‘to make a thorough and competent search of the record title.’) (citations omitted)).

Washington courts have long recognized that parties to a contract are subject to tort claims arising out of independent legal duties.

As to the first ground, it is a sufficient answer to say that where there is a positive duty created by implication of law independent of the contract, though arising out of a relation or state of facts created by the contract, an action on the case as for a tort will lie for a violation or disregard of that duty. *Sharpe v. National Bank of Birmingham*, 87 Ala. 644, 7 South. 106; *Nevin v. Pullman Palace Car Co.*, 106 Ill. 222, 46 Am. Rep. 688; *Hinks v. Hinks*, 46 Me. 423; 6 Cyc. 688.

Flessner v. Carstens Packing Co., 93 Wash. 48, 52, 160 P. 14, 15 (1916);

Jones v. Matson, 4 Wash.2d 659, 668-669, 104 P.2d 591, 596 (1940).

We next consider whether Indian Wells may recover incidental and consequential damages under a negligence theory. Generally, a breach of contract does not give rise to

an action in tort. *See* 57A Am.Jur.2d *Negligence* § 119 (1989). However, the negligent performance of a contract may create a tort claim if a duty exists independently of the performance of the contract. *See* 57A Am.Jur.2d *Negligence* § 119, at 176.

American Nursery Products, Inc. v. Indian Wells Orchards, 115 Wash.2d 217, 230, 797 P.2d 477, 485 (1990).

This Court therefore should adopt the “independent duty” exception to the economic loss rule and should further rule that the duties recognized under Washington’s common law are such independent duties. Persons providing guidance to others in business transactions have a duty to exercise reasonable care. *Colonial Imports, Inc. v. Carlton Northwest, Inc.*, 121 Wn.2d 726, 732, 853 P.2d 913, 917 (1993). For example, sellers of real estate have an independent legal duty to disclose known latent material facts to buyers. *Obde v. Schlemeyer*, 56 Wn.2d 449, 452, 353 P.2d 672, 674 (1960). Appraisers owe a duty of care to a buyer. *Schaaf v. Highfield*, 127 Wn.2d 17, 23, 896 P.2d 665, 668 (1995).

Adopting the independent duty exception to the economic loss rule would logically require the reversal of *Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1*, 124 Wn.2d 816, 881 P.2d 986 (1994), *Alejandre v. Bull*, 159 Wn.2d 674, 153 P.3d 864 (2007) and *Carlile v. Harbour Homes, Inc.* 2008 WL 4648423, 4, ___ Wn.App. ___, ___ P.3d ___ (2008). It also would require reversal of the orders granting summary

judgment to the Olsons and Russell because those claims are squarely based on established duties independent of the contract.

It bears noting that adopting the independent duty exception to the economic loss rule would not preclude the parties from allocating even tort risks in their contracts. Washington law permits exculpatory clauses in contracts, provided that they are not unconscionable. *Puget Sound Financial, L.L.C. v. Unisearch, Inc.*, 146 Wash.2d 428, 47 P.3d 940 (2002). Under *Alejandre*, most contracts automatically preclude most tort claims, acting as a *de facto* exculpatory clause without consideration of conscionability.

E. The Court Should Recognize Negligent Misrepresentation Claims As An Exception to the Economic Loss Rule.

Negligent misrepresentation is perhaps the most widely accepted independent duty exception to the economic loss rule. Many courts have identified Section 552 of the Restatement of Torts itself as an exception to the economic loss rule.

Having found that Bilt-Rite states a viable claim for negligent misrepresentation under Section 552, and that privity is not a prerequisite for maintaining such an action, logic dictates that Bilt-Rite not be barred from recovering the damages it incurred, if proven. Indeed, to apply the economic loss doctrine in the context of a Section 552 claim would be nonsensical: it would allow a party to pursue an action only to hold that, once the elements of the cause of action are shown, the party is unable to recover for its losses. Thus, we hold that the economic loss rule does

not apply to claims of negligent misrepresentation sounding under Section 552.

Bilt-Rite Contractors, Inc. v. The Architectural Studio, 581 Pa. 454, 483-84, 866 A.2d 270, 288 (2005); *Russell v. Sherwin-Williams Co.*, 767 So.2d 592, 593 (Fla.App. 2000) (“Section 552 of the Restatement (Second) of Torts is a narrow exception to the economic loss rule which has been applied in certain limited circumstances.”); *Holloman v. D.R. Horton, Inc.*, 241 Ga.App. 141, 147-48, 524 S.E.2d 790, 796 (1999).

Other states have rejected or limited an exception to the economic loss rule for negligent misrepresentation claims. *E.g.*, *Vesta Const. and Design, L.L.C. v. Lotspeich & Associates, Inc.*, 974 So.2d 1176, 1181-82 (Fla.App. 2008) (exception does not apply when parties are in contractual privity); *Sterling Chemicals, Inc. v. Texaco Inc.*, 259 S.W.3d 793, 797 (Tex.App. 2007) (exception did not apply when benefit of bargain damages are sought).

In choosing an approach for Washington, this Court should bear in mind that negligent misrepresentation claims were a regular, but small, part of Washington jurisprudence before *Alejandre* was decided. *Alejandre* is written as if it were necessary to prevent a torrent of negligent misrepresentation claims from swamping contract law, but that plainly was not the case. *Alejandre* solved a problem that did not exist, and did so

by precluding relief for persons who justifiably relied on false information that was negligently supplied to them for their guidance in transactions.

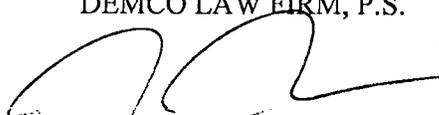
VI. CONCLUSION

This Court should expressly adopt the independent duty exception to the economic loss rule and further hold that the duties recognized under Washington's common law are such independent duties. It therefore should reverse the orders granting summary judgment and remand for trial on the negligent misrepresentation claims.

Respectfully submitted and dated this 27th day of October, 2008.

DEMCO LAW FIRM, P.S.

*LAMS NOTE WSBA 2871
FOR MATT DAVIS*



Matthew F. Davis, WSBA # 20939
L. Nayim Shuman-Austin, WSBA # 30505
Attorneys for Appellants

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STATE OF WASHINGTON

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BY RONALD R. CARPENTER

DECLARATION OF SERVICE

I, Ellen Krachunis, state:

On this day I caused to be delivered by e-mail to the ^{CLERK} Washington State

Supreme Court at supreme@courts.wa.gov and via email to:

Douglas S. Tingvall - RE-LAW@comcast.net
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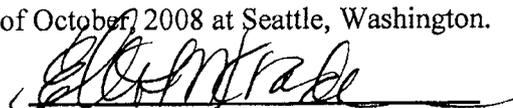
Michelle A. Corsi - mac@leesmart.com
Lee Smart, P.S., Inc.
1800 One Convention Place
701 Pike Street
Seattle, WA 98101-3929

A copy of the following documents:

Brief of Appellants Richard and Penny Borish

Declarant is a resident of the State of Washington and over the age of eighteen (18) years. I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Dated this 27th day of October, 2008 at Seattle, Washington.



Ellen Krachunis