Washington Law Review

Volume 86 | Number 2

5-1-2011

Eastwood's Answer to *Alejandre*'s Open Question: The Economic Loss Rule Should Not Bar Fraud Claims

Katherine Heaton

EASTWOOD'S ANSWER TO *ALEJANDRE*'S OPEN QUESTION: THE ECONOMIC LOSS RULE SHOULD NOT BAR FRAUD CLAIMS

Katherine Heaton

Abstract: The economic loss rule is a judicially created doctrine that bars plaintiffs from suing in tort for purely economic losses when the entitlement to recovery arises only from a contract. In *Alejandre v. Bull*, the Washington State Supreme Court acknowledged that there are exceptions to the rule but explicitly declined to say whether it would recognize an exception for fraud. Washington's appellate courts answered *Alejandre*'s open question, holding that the economic loss rule barred all fraud claims except for the narrow tort of fraudulent concealment. The appellate courts interpreted *Alejandre* broadly to apply the economic loss rule whenever the parties had a contractual relationship and the losses were purely economic. The Washington State Supreme Court responded to these appellate decisions in *Eastwood v. Horse Harbor Foundation*. In *Eastwood*, the Court explicitly rejected the appellate courts' broad view of *Alejandre* and held that the economic loss rule does not bar a plaintiff from bringing a tort claim where the tort duty is independent of the contract. This Comment argues that, in light of *Eastwood*, Washington's economic loss rule should not bar fraud claims because the duty not to commit fraud is independent of any contract.

INTRODUCTION

A newlywed couple awoke to violent shaking and a horrible cracking noise as their cliff-side home started falling into the sea. They had purchased the house just a few weeks earlier upon assurances that it was safe from landslides. When the newlyweds confronted the previous owner, he told them he had purposely built the house on low-cost fill even though he knew it was a landslide risk. He had lied about the risk to induce the newlyweds to buy his house. This is fraud. But under the Washington Court of Appeals holdings in *Carlile v. Harbour Homes, Inc.*[1] and *Poulsbo Group, LLC v. Talon Development, LLC*,[2] the economic loss rule would bar the newlyweds from recovering damages for this obvious tort.

The doctrine that Washington courts once called the economic loss rule, and now call the independent duty doctrine, is a judicially created doctrine that bars plaintiffs from suing in tort for purely economic

1. 147 Wash. App. 193, 205–06, 194 P.3d 208, 286 (2008).
2. 155 Wash. App. 339, 347, 229 P.3d 906, 910 (2010).

losses[3] when the entitlement to recovery arises only from a contract.[4] In *Alejandre v. Bull*,[5] the Washington State Supreme Court held that the economic loss rule barred a homebuyer from bringing tort claims against the seller unless the tort was a recognized exception to the rule.[6] The economic loss rule barred the plaintiffs' negligence claim in *Alejandre*; however, the Court recognized an exception to the economic loss rule that would have allowed the plaintiffs to bring a fraudulent concealment claim.[7] In a footnote, the Court mentioned that it was aware that some courts had found a broad exception to the economic loss rule that would allow plaintiffs to bring any fraud claim in tort, but the Court explicitly declined to say whether it would adopt such an exception.[8] Washington's appellate courts wrestled with how to interpret *Alejandre*,[9] but ultimately decided that the economic loss rule barred all fraud claims except for fraudulent concealment.[10]

---

3. In *Alejandre v. Bull*, the Washington State Supreme Court defined economic losses as an injury in a contractual relationship "where the parties could or should have allocated the risk of loss, or had the opportunity to do so." 159 Wash. 2d 674, 687, 153 P.3d 864, 870 (2007). Economic losses occur when the defendant's action causes the plaintiff to lose money, or something of purely economic value, as opposed to suffering personal injury or injury to other property. *Id.* at 684, 153 P.3d at 869. Some courts say that economic losses are more properly remedied in contract law because "[t]ort law has traditionally redressed injuries properly classified as physical harm." Stuart v. Coldwell Banker Commercial Grp., Inc., 109 Wash. 2d 406, 420, 745 P.2d 1284, 1291 (1987).

4. *Alejandre*, 159 Wash. 2d at 682, 153 P.3d at 868.

5. 159 Wash. 2d 674, 153 P.3d 864 (2007).

6. *Id.* at 685–86, 153 P.3d at 870.

7. *Id.* at 691, 153 P.3d at 872–73.

8. *Id.* at 690 n.6, 153 P.3d at 872 n.6.

9. *Compare* Jackowski v. Borchelt, 151 Wash. App. 1, 17, 209 P.3d 514, 522 (2009) (citing *Alejandre* for the proposition that neither fraud nor fraudulent concealment claims are barred by the economic loss rule), *and* Stieneke v. Russi, 145 Wash. App. 544, 560, 190 P.3d 60, 68 (2008) (allowing the plaintiff to get to the merits of his fraud claim, because "[t]he *Alejandre* court reaffirmed that the economic loss rule does not apply to claims of fraud"), *and* Baddeley v. Seek, 138 Wash. App. 333, 338, 156 P.3d 959, 961 (2007) (allowing the plaintiff to get to the merits of his fraud claim, because "[m]any outside jurisdictions have held the economic loss rule does not bar fraud"), *with* Carlile v. Harbour Homes, Inc., 147 Wash. App. 193, 204, 194 P.3d 280, 285 (2008) (interpreting *Alejandre* as creating an exception to the economic loss rule for fraudulent concealment but not other kinds of fraud).

10. *See* Poulsbo Grp., LLC v. Talon Dev., LLC, 155 Wash. App. 339, 347, 229 P.3d 906, 910 (2010); *Carlile*, 147 Wash. App. at 204–05, 194 P.3d at 285. *Carlile* discusses fraudulent concealment as though it were a completely separate tort from fraud. *Id.* This Comment argues that the appellate courts' distinction between fraud and fraudulent concealment does not make sense because fraudulent concealment is just a shorthand name for one way of proving fraud, not a separate tort. *See infra* Part IV.C.

The Washington State Supreme Court clarified its economic loss rule in *Eastwood v. Horse Harbor Foundation*.[11] In that case, the Court held that the economic loss rule does not bar a plaintiff from bringing a tort where the tort duty is independent of the contract.[12] To underscore this point, and to help alleviate the appellate court confusion, the Court abandoned the term "economic loss rule" and renamed it the "independent duty doctrine."[13] The Court did not, however, explicitly state whether tort damages for fraud could be recovered under the newly renamed doctrine.

This Comment argues that, contrary to the appellate court holdings in *Carlile v. Harbour Homes, Inc.*[14] and *Poulsbo Group, LLC v. Talon Development, LLC*,[15] Washington's economic loss rule should not bar fraud claims,[16] because the duty not to commit fraud is independent of any contract. Part I presents the origins of the economic loss rule and its underlying purpose. Part II discusses the variations in the rule and the three main approaches courts use to decide whether the rule bars fraud claims. Part III details the development and recent interpretation of the rule in Washington. Part IV argues that under *Eastwood*'s independent duty doctrine, a plaintiff should be able to recover damages from fraud for three reasons. First, barring fraud claims would create an uncertain marketplace because it is impossible for contracting parties to bargain against the risk of fraud. Second, under the Uniform Commercial Code (UCC), fraud claims supplement contract law rather than subvert it. Finally, *Carlile* and *Poulsbo* were based on a misunderstanding of *Alejandre* and the tort of fraud. Because fraud is always independent of a contract, these cases should be overruled.

---

11. 170 Wash. 2d 380, 387, 241 P.3d 1256, 1261 (2010) ("Seeing both a contractual relationship and an economic loss, the Court of Appeals believed that *Alejandre* therefore compelled a holding that Eastwood's only remedy was a recovery for breach of lease. The Court of Appeals' broad reading of this court's jurisprudence on the economic loss rule, while perhaps understandable, is not correct.").

12. *Id.* at 393, 241 P.3d at 1264.

13. *Id.* at 402, 241 P.3d at 1268.

14. 147 Wash. App. at 205–06, 194 P.3d at 286.

15. 155 Wash. App. at 347, 229 P.3d at 910.

16. Fraud is an intentional tort with the following basic elements: (1) representation of an existing fact; (2) materiality; (3) falsity; (4) the speaker's knowledge of its falsity; (5) intent of the speaker that it should be acted upon by the plaintiff; (6) plaintiff's ignorance of its falsity; (7) plaintiff's reliance on the truth of the representation; (8) plaintiff's right to rely upon the representation; and (9) damages suffered by the plaintiff. W. Coast, Inc. v. Snohomish Cnty., 112 Wash. App. 200, 206, 48 P.3d 997, 1000 (2002).

I. COURTS DEVELOPED THE ECONOMIC LOSS RULE TO KEEP TORT LAW FROM CIRCUMVENTING CONTRACT LAW

To understand the economic loss rule, it is instructive to understand its origins. Although some believe that the economic loss rule first developed in the context of products liability in the 1960s,[17] the historical roots of the rule run much deeper.[18] As far back as the nineteenth century, plaintiffs have tried to cast their contract claims as torts to avoid being denied recovery because of technical contract law reasons, such as an expired statute of limitations or the lack of privity between the parties.[19] For as long as plaintiffs have tried to subvert negotiated contract terms with tort law, judges have been hostile to the use of tort claims to recover purely economic losses.[20] As a result, judges developed the economic loss rule to police the boundary between tort and contract and "ensure that contract claims are resolved by contract law."[21]

To separate contract claims from tort claims, the economic loss rule bars a plaintiff from bringing a tort claim when the matter would be better resolved in contract.[22] The critical distinction between tort law and contract law is the source of the duty.[23] Contractual duties arise from agreements between the parties.[24] The key assumption in contract law is that in the course of bargaining, contracting parties are able to allocate

---

17. *See, e.g.*, R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1794 (2000) ("The economic loss rule is a judicially created doctrine, first articulated by the California Supreme Court in *Seely v. White Motor Co.*"); Amanda K. Esquibel, *The Economic Loss Rule and Fiduciary Duty Claims: Nothing Stricter than the Morals of the Market Place?*, 42 VILL. L. REV. 789, 791 (1997).

18. Sidney R. Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. REV. 891, 897 (1989) ("The economic loss doctrine often is described as a creature of product defect litigation. Its historical roots, however, lie in the nineteenth century.").

19. *Id.* at 897–98 ("For as long as injured plaintiffs have been denied recovery in contract for reasons such as the expiration of statute of limitations for contract actions, lack of privity, unavailability of punitive damages, avoidance of contractual restrictions, or simply because the other contracting party is insolvent, resourceful lawyers have sought to recover in tort.").

20. *Id.* at 898.

21. Dinsmore Instrument Co. v. Bombardier, Inc., 199 F.3d 318, 320 (6th Cir. 1999).

22. *See, e.g.*, Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist., 124 Wash. 2d 816, 822, 881 P.2d 986, 990 (1994).

23. *See, e.g.*, Pa. Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165, 1169 (3d Cir. 1981); Barton, *supra* note 17, at 1796.

24. *See* St. Denis v. Dep't of Hous. & Urban Dev., 900 F. Supp. 1194, 1202 n.11 (D. Alaska 1995).

risks and costs.[25] For example, a buyer can choose to insist on additional warranties or to assume a greater risk in exchange for a lower price.[26] The role of contract law is to protect against the loss one party to a contract suffers when the other party fails to perform the bargained-for promise.[27]

In contrast, tort duties arise from policy considerations.[28] For example, the duty not to engage in fraud to induce the other party to contract comes from common sense, policy considerations, and case precedent.[29] Unlike a warranty claim in contract law, the duty not to engage in fraud exists regardless of whether the contract is ultimately formed.[30] Moreover, the tort duty may not be waived because parties cannot reasonably contemplate the risk of fraud.[31] Tort law governs only the narrow subset of buyer-seller relationships where it is impractical, or impossible, to negotiate either the terms of a sale or each party's duty to the other.[32]

Despite the distinction between contract duties and tort duties, both a contract claim and a tort claim can arise from the same, or closely related, conduct.[33] For example, a contract may require one party to deliver cows that are free of infection; thus, failure to do so would be a breach of contract.[34] Under that contract, the defendant may be acting negligently by failing to test the cows when a reasonable person would have done so.[35] Thus, the same action—failing to test the cows before delivery—gives rise to two claims: breach of contract and negligence.[36] Despite the fact that misrepresentations are fundamentally different from

---

25. *See* Neibarger v. Universal Coops., Inc., 486 N.W.2d 612, 615 (Mich. 1992).

26. *See* Detroit Edison Co. v. NABCO, Inc., 35 F.3d 236, 240 (6th Cir. 1994).

27. Christopher J. Faricelli, Note, *Wading into the "Morass": An Inquiry into the Application of New Jersey's Economic Loss Rule to Fraud Claims*, 35 RUTGERS L.J. 717, 722 (2004).

28. *See St. Denis*, 900 F. Supp. at 1202 n.11.

29. Eastwood v. Horse Harbor Found., 170 Wash. 2d 380, 389, 241 P.3d 1256, 1262 (2010) ("The existence of a duty is a question of law and depends on mixed considerations of logic, common sense, justice, policy, and precedent." (citations omitted)).

30. Barton, *supra* note 17, at 1830 (describing the similarities and differences between fraud and warranty claims).

31. *Id.* If a party "cannot rely on the opposite party to speak truthfully during negotiations regarding the subject matter of the contract—if they cannot tell what is a lie and what is not," then "[h]ow can parties freely allocate risk"? Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1148 (E.D. Wis. 1998).

32. Detroit Edison Co. v. NABCO, Inc., 35 F.3d 236, 239 (6th Cir. 1994).

33. Barton, *supra* note 17, at 1797.

34. Hofstee v. Dow, 109 Wash. App. 537, 540–41, 36 P.3d 1073, 1075–76 (2001).

35. *Id.*

36. *Id.*

broken promises,[37] a party's assertion of fact can also serve as that party's implied promise to give some kind of satisfaction if the fact proves to be false.[38] Thus, it can be difficult to distinguish between fraud (an intentional misrepresentation), remedied in tort, and a broken promise, remedied in contract.[39]

Because a tort claim and a contract claim can arise from the same conduct, plaintiffs may be able to articulate their contract claims as tort claims.[40] Casting a claim under tort law provides at least three advantages over contract law.[41] First, contract law generally limits recovery to parties in privity of contract.[42] On the other hand, tort law generally allows any injured party to recover.[43] Second, a plaintiff may be able to bring a tort claim long after the statute of limitations has run on the analogous contract claim because, in tort law, the statute of limitations begins to run only after the plaintiff knew or should have known of the injury.[44] Third, nearly every state allows punitive damages for fraud, while contract law limits remedies to the benefit of the

37. *Id.* ("A representation is a statement by the representer as to his existing state of mind regarding the existence of a past or present fact. Therefore, such liability as is imposed on a representer for stating something that proves to be false must be based on a tort theory."); Barton, *supra* note 17, at 1834 ("[F]raud consists of a promise never intended to be performed (i.e., a lie) while breach consists of a promise intended to be performed but is not performed (i.e., a broken promise).").

38. W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS § 95, at 656 (5th ed. 1984) ("[W]arranty-representations or representations made under circumstances when the representee can reasonably regard the statements as manifestations of an intention to guarantee are the basis for contractual obligations and contract claims. Thus, a merchant-seller, in the absence of stipulations in the contract of sale clearly indicating the contrary, impliedly represents that the product he sells is merchantable and therefore reasonably fit for its primary purposes, and that he will give satisfaction of some kind if it is not."). For an example of how a party's assertion of fact can be an implied promise to give some sort of satisfaction if the fact proves to be false, consider the following: a seller tells the buyer that the cow he is selling will produce milk. This is an assertion of fact. But the parties might also consider this to be a promise that if the cow does not produce milk then the buyer can return the cow and get his money back.

39. *Id.*

40. Barton, *supra* note 17, at 1797.

41. *Id.* at 1825.

42. *See* William K. Jones, *Product Defects Causing Commercial Loss: The Ascendancy of Contract over Tort*, 44 U. MIAMI L. REV. 731, 738 (1990).

43. *Id.*

44. *See* Moorman Mfg. Co. v. Nat'l Tank Co., 414 N.E.2d 1302, 1314 (Ill. App. Ct. 1980) ("[A] cause of action for misrepresentation does not accrue until the injury is discovered."), *aff'd in part, rev'd in part*, 435 N.E.2d 443 (Ill. 1982); Thurin v. A.O. Smith Harvestore Prods., Inc., Nos. 95-2415, 95-3127, 1998 WL 378840, at *7 n.8 (Wis. Ct. App. July 9, 1998) (stating that the discovery rule applies to misrepresentation but not to contract claims).

bargain.[45] Given all the benefits of tort law for plaintiffs, courts developed the economic loss rule to prevent plaintiffs from using tort law "to trump contract law and render the parties' bargains and the careful allocation of duties and risks in the UCC meaningless."[46]

II. THE ECONOMIC LOSS RULE IS MULTIFORM AND HAS MANY VARIATIONS

Courts and commentators often refer to the economic loss rule as though it were one uniformly described and applied rule.[47] In reality, it is "multiform rather than unitary in character."[48] For example, some variations of the rule bar intentional torts while others bar only negligence or strict liability suits.[49] This Comment focuses on fraud, an intentional tort.[50] In particular, it addresses the situation where a homeowner intentionally lies to a prospective homebuyer to induce the buyer to agree to purchase the home.[51] Courts must decide whether the

45. *See* PETER A. ALCES, THE LAW OF FRAUDULENT TRANSACTIONS § 2.02[6][b][i], at 2-33 (1989).

46. Christopher Scott D'Angelo, *The Economic Loss Doctrine: Saving Contract Warranty Law from Drowning in a Sea of Tort*, 26 U. TOL. L. REV. 591, 599 (1995).

47. *See* Gary T. Schwartz, *Economic Loss in American Tort Law: The Examples of* J'Aire *and of Products Liability*, 23 SAN DIEGO L. REV. 37, 37–38 (1986) ("In recent years . . . a number of scholars have each attempted to develop a general theory to cover the problem of tort law and economic loss . . . I recommend that we abandon any effort to formulate any single general theory.").

48. *Id.* at 38 (reasoning that the economic rule is multiform because "[u]nfair competition differs from fraud, which in turn differs from negligent misrepresentation, which in turn differs from the negligent polluting of public fishing waters, which in turn differs from the lawyer's malpractice liability to his client (let alone to a range of third parties), which in turn differs from the destruction of buildings by fire, which in turn differs from compensating plaintiffs for lost income in personal injury suits"); *see also* F. Malcolm Cunningham, Jr. & Amy L. Fischer, *The Economic Loss Rule: Deconstructing the Mixed Metaphor in Construction Cases*, 33 TORT & INS. L.J. 147, 147 (1997) (describing the economic loss rule as a "multifaceted, seemingly inconsistent and ever changing doctrine").

49. DAN B. DOBBS & ELLEN M. BUBLICK, CASES AND MATERIALS ON ADVANCED TORTS: ECONOMIC AND DIGNITARY TORTS 629 (2009). *Compare* Seely v. White Motor Co., 403 P.2d 145, 150–51 (Cal. 1965) (barring only negligence and strict liability suits, not intentional tort claims), *with* Digicorp, Inc. v. Ameritech Corp., 662 N.W.2d 652, 665–66 (Wis. 2003) (barring an intentional tort claim).

50. *See supra* note 16 (listing the elements of fraud).

51. *See, e.g.*, Poulsbo Grp., LLC v. Talon Dev., LLC, 155 Wash. App. 339, 343–44, 229 P.3d 906, 908 (2010) (seller lied on a seller disclosure statement by stating that there were no pending or existing assessments against the property and lied by telling buyer that there would not be a latecomer assessment); Jackowski v. Borchelt, 151 Wash. App. 1, 7–8, 209 P.3d 514, 517 (2009) (sellers lied on the Form 17 Seller Disclosure Form, saying that there had been no damage from landslides, but they later amended the Form 17 saying that the property contained a Landslide Hazard Area).

buyer can sue for fraud or will be limited to bringing contract claims against the seller. Some jurisdictions allow the plaintiff to bring the fraud claims while others do not.[52]

A. The Economic Loss Rule Balances Several Factors to Determine the Defendant's Liability

Courts do not employ a unitary economic loss rule to cover all types of tort claims. Instead, courts weigh a number of factors including whether the defendant supplied a product or information,[53] whether the parties were in privity of contract,[54] whether the plaintiff is seeking damages or rescission,[55] and whether a contract claim is available.[56] For example, in *Jackowski v. Borchelt*,[57] a Washington appellate court case, purchasers of a waterfront home that was damaged in a landslide brought fraud and contract claims against the sellers, the sellers' real estate agent, and their own real estate agent.[58] The court held that the economic loss rule barred the purchasers' tort claims against the sellers,[59] but not their tort claims against the real estate agents.[60] The court made the distinction between the private sellers and the real estate agents because it did not want the economic loss rule to "abrogate[] all

52. *See* discussion *infra* Part II.B (some courts have held that the economic loss rule does not bar fraud; some have held that it does not bar fraud claims that are independent of the contract; and some have held that it bars all fraud claims).

53. *Compare Seely*, 403 P.2d at 151 (economic loss rule barred claim against the supplier of a product), *with Jackowski*, 151 Wash. App. at 14, 209 P.3d at 521 (economic loss rule does not bar claim against the supplier of information), *and* Hydro Investors, Inc. v. Trafalgar Power Inc., 227 F.3d 8, 18 (2d Cir. 2000) (economic loss rule does not bar malpractice claims), *and* Collins v. Reynard, 607 N.E.2d 1185, 1187 (Ill. 1992) (clients can sue their lawyers in tort for malpractice even though the representation arose out of a lawyer-client contract).

54. *Compare* Borish v. Russell, 155 Wash. App. 892, 904, 230 P.3d 646, 653 (2010) (discussing how the economic loss rule bars claims only when there was a contract between the parties), *and* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 534 (Fla. 2004) (reasoning that if the parties are not in privity of contract, the economic loss rule does not bar any tort claim other than one based on a product defect), *with Seely*, 403 P.2d at 148 ("Since there was an express warranty to plaintiff in the purchase order, no privity of contract was required.").

55. *See, e.g.*, *Jackowski*, 151 Wash. App. at 13, 16, 209 P.3d at 520, 521 (economic loss rule bars claim seeking damages but not claim seeking rescission of contract).

56. *See, e.g.*, Hofstee v. Dow, 109 Wash. App. 537, 544–45, 36 P.3d 1073, 1077 (2001) ("Was the damage suffered by commercial parties who bargained at arm's length for expectations that were frustrated, or was it an unexpected injury suffered by parties who could not negotiate to avoid the risk of the defective product?").

57. 151 Wash. App. 1, 209 P.3d 514 (2009).

58. *Id.* at 6, 209 P.3d at 516–17.

59. *Id.* at 13, 209 P.3d at 520.

60. *Id.* at 15, 209 P.3d at 521.

professional malpractice claims, particularly where a client hires a professional and, therefore, establishes a privity of contract with that professional."[61] The court also held that the economic loss rule did not bar the plaintiffs' claim against the sellers seeking rescission of the contract.[62] As indicated in the introduction, this Comment focuses on the situation where a homebuyer sues the seller for fraud. In that context, a court is likely to find that the claim is barred by the economic loss rule because the claim is made against the seller, the parties are in privity of contract, and the plaintiff is seeking damages.[63]

B. Courts Use Three Approaches to Determine Whether the Economic Loss Rule Bars Fraud

Prior to 1995, only a handful of cases had applied the economic loss rule to bar fraud claims.[64] It is perhaps a bit surprising that it took so long for the rule to develop in this context, because "[f]raud expressly allows for the recovery of purely economic losses arising out of a defendant's misrepresentations in a sale of goods or other property."[65] Prior to 1995, however, courts routinely allowed plaintiffs to recover purely economic losses for fraud claims when the defendant's misrepresentation induced the transaction.[66] Today, courts take one of three approaches: (1) the economic loss rule does not bar fraud claims (the "lenient" approach),[67] (2) the economic loss rule bars fraud claims that are not "independent" of the contract (the "middle ground"

---

61. *Id.* at 14, 209 P.3d at 520.

62. *Id.* at 16, 209 P.3d at 521.

63. *See supra* notes 53–56.

64. Barton, *supra* note 17, at 1802 (citing Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541, 544 (Mich. Ct. App. 1995) ("[T]he issue [of whether fraud is barred by the economic loss rule] has been addressed in only a handful of jurisdictions."); *see, e.g.*, N. States Power Co. v. Int'l Tel. & Tel. Corp., 550 F. Supp. 108 (D. Minn. 1982) (addressing the question of whether the economic loss rule bars fraud that induces a contract); Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443 (Ill. 1982) (addressing the question of whether the economic loss rule bars fraud claims generally).

65. Barton, *supra* note 17, at 1803.

66. *Id.* at 1802; *see, e.g.*, Haarberg v. Schneider, 117 N.W.2d 796, 799 (Neb. 1962) (finding that the proper measure of damages in fraud is the difference between the value represented and the actual value); Stewart v. Potter, 104 P.2d 736, 739 (N.M. 1940) (holding defrauded purchaser could recover the difference between the real and represented value of the automobile); Clouse v. Chairtown Motors, Inc., 195 S.E.2d 327, 329 (N.C. Ct. App. 1973) (allowing recovery of purely economic loss in fraud).

67. *See, e.g.*, First Midwest Bank, N.A. v. Stewart Title Guar. Co., 843 N.E.2d 327, 333 (Ill. 2006); Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 452 (Ill. 1982).

approach),[68] or (3) the economic loss rule bars all fraud claims (the "strict" approach).[69]

Under the lenient approach, courts hold that the economic loss rule does not bar fraud claims because the duty not to commit fraud is independent of any contract.[70] According to the Supreme Court of Texas, for example, there is "a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations," and this duty is "separate and independent from the duties established by the contract itself."[71] An essential difference between fraud and other torts barred by the economic loss rule is that fraud "impugns defendants' conduct," while other tort claims assail "the safety and efficacy of the product."[72] Plaintiffs can bring fraud claims without subverting contract law because the viability of a fraud claim depends only on the defendant's conduct, not on the type of damage or on the existence of an underlying contract.[73]

Under the middle ground approach, courts recognize an exception to the economic loss rule for fraud claims only where the misrepresentations are "independent" of the underlying contract.[74] These jurisdictions consider misrepresentations to be related to an underlying contract if they concern the subject matter of the contract, such as the quality or characteristics of the goods.[75] Thus, in a case where the defendant fraudulently induced the plaintiff to contract by making

---

68. *See, e.g.*, Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541, 546 (Mich. Ct. App. 1995) (leading case); Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 223 F.3d 873, 884–87 (8th Cir. 2000); Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 537 (Fla. 2004).

69. *See, e.g.*, Nigrelli Sys., Inc., v. E.I. Dupont de Nemours & Co., 31 F. Supp. 2d 1134, 1138–39 (E.D. Wis. 1999) (analyzing a plaintiff's strict liability and fraud claims together and concluding that the economic loss rule applied "equally" to all the claims); *In re* Ford Motor Co. Bronco II Prods. Liab. Litig., MDL-991, 1995 U.S. Dist. LEXIS 18207, at *21–22 (E.D. La. Dec. 4, 1995) (construing the New York economic loss rule to bar fraud claims).

70. *See, e.g.*, *First Midwest Bank*, 843 N.E.2d at 333; *Moorman*, 435 N.E.2d at 452.

71. Formosa Plastics Corp. v. Presidio, 960 S.W.2d 41, 46–47 (Tex. 1998) (holding that the economic loss rule does not apply to fraud claims, regardless of whether the duties were later subsumed into a contract or whether the losses were purely economic).

72. Kahn v. Shiley, Inc., 266 Cal. Rptr. 106, 112 (Cal. Ct. App. 1990) (holding that a product manufacturer may be liable for fraud when it misleads potential users about material product information because fraud claims are not barred by the economic loss rule).

73. *Id.*; *see also* Barton, *supra* note 17, at 1804.

74. *See, e.g.*, Huron Tool & Eng'g Co. v. Precision Consulting Servs., 532 N.W.2d 541, 546 (Mich. Ct. App. 1995) (leading case); Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 223 F.3d 873, 884–87 (8th Cir. 2000); Indem. Ins. Co. of N. Am. V. Am. Aviation, Inc., 891 So. 2d 532, 537 (Fla. 2004).

75. *Huron Tool*, 532 N.W.2d at 546.

misrepresentations about the quality of the goods, the Michigan Court of Appeals found that there was no *independent* intentional misrepresentation and held that the economic loss rule barred the plaintiffs' fraud claim.[76]

To understand the essential difference between the lenient and middle ground approaches, consider a case where one party fraudulently induces the other party to enter into a contract. Fraud in the inducement occurs when one party makes a "[m]isrepresentation as to the terms, quality or other contractual relation, venture or other transaction that leads a person to agree to enter into the transaction with a false impression or understanding of the risks, duties or obligations she has undertaken."[77] Thus, fraud in the inducement must always be "related to" the contract because the tort of fraud *is* the inducement of someone to enter into a contract.[78] The *tort itself*, however, arises from the breach of the duty not to fraudulently induce another, and, thus, is always independent of the contract.[79] Because fraud in the inducement must always be related to the contract, no jurisdiction that has adopted the middle ground position has ever found that a misrepresentation was independent of the contract.[80] Thus, the practical effect of the middle ground makes it identical to the economic loss rule that bars all fraud in the inducement claims (the strict approach).[81]

Under the strict approach, courts hold that the economic loss rule bars all fraud claims simply because fraud is a tort and the economic loss rule bars all tort claims.[82] For example, in *Flagg Energy Development Corp.*

---

76. *Id.*

77. BLACK'S LAW DICTIONARY 661 (6th ed. 1990). "Fraud in the inducement" is just the tort of fraud where the facts indicate that the defendant lied to the plaintiff to get the plaintiff to enter into a contract. It is a subset of fraud, or one way of proving fraud, not a separate tort. *Id.*

78. *See* Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147 (E.D. Wis. 1998).

79. *See id.*

80. *See id.* at 1146 n.2. In *Huron Tool*, the Michigan Court of Appeals seemed to recognize that fraud that induces a contract is independent of the contract itself. 532 N.W.2d at 544. But then the court went on to define the "distinction between fraud in the inducement and other kinds of fraud . . . as the distinction . . . between fraud extraneous to the contract and fraud interwoven with the breach of contract." *Id.* at 545. The court held that the "plaintiff may only pursue a claim for fraud in the inducement extraneous to the alleged breach of contract." *Id.* at 546. Ultimately, the court held that the economic loss rule barred the plaintiff's fraud claim because the misrepresentations concerned the quality and characteristics of the goods sold by the defendants and, thus, were "not extraneous to the contractual dispute." *Id.* at 545. By imposing the additional requirement that the tort be extraneous to the contract, "the court vitiated the exception and for all practical purposes created no exception at all." Barton, *supra* note 17, at 1833.

81. *See Budgetel*, 8 F. Supp. 2d at 1147.

82. *See, e.g.*, Nigrelli Sys., Inc., v. E.I. Dupont de Nemours & Co., 31 F. Supp. 2d 1134, 1138–39 (E.D. Wis. 1999) (analyzing a plaintiff's strict liability and fraud claims together and concluding

v. General Motors Corp. Allison Gas Turbine Division,[83] the plaintiff brought a fraud claim after the defendant's misrepresentations about the quality of a product induced the plaintiff to purchase the product.[84] The trial court dismissed the claim as barred by the economic loss rule and the Connecticut Supreme Court agreed, reasoning that fraud claims cannot arise out of a transaction governed by the UCC.[85]

III. THE WASHINGTON STATE SUPREME COURT IS STILL DEVELOPING ITS ECONOMIC LOSS RULE

In Washington, the state legislative originally created the economic loss rule. After the Washington State Supreme Court had initially rejected the economic loss rule, the legislature passed the Washington Products Liability Act (WPLA) to ensure its application to product purchase contracts.[86] Following the legislature's lead, the Washington State Supreme Court soon adopted a common law economic loss rule and expanded its coverage beyond the WPLA.[87] As the Court continued to develop its rule, it considered whether the rule should bar torts like fraud. In *Alejandre v. Bull*, the Court noted that it was aware that some courts recognized a broad exception to the economic loss rule for fraud claims (the lenient approach), but the Court explicitly declined to say whether it would adopt such an exception.[88] Washington's appellate courts chose not to adopt the lenient approach and instead held that the economic loss rule barred all fraud claims except the narrow tort of fraudulent concealment.[89] In *Eastwood v. Horse Harbor Foundation*, the

---

that the economic loss rule applied "equally" to all the claims); *In re* Ford Motor Co. Bronco II Prods. Liab. Litig., MDL-991, 1995 U.S. Dist. LEXIS 18207, at *21–22 (E.D. La. Dec. 4, 1995) (construing the New York economic loss rule to bar fraud claims).

83. 709 A.2d 1075 (Conn. 1998).

84. *Id.* at 1087.

85. *Id.* at 1089.

86. Act of Apr. 17, 1981, ch. 27, 1981 Wash. Sess. Laws 112 (codified as amended at WASH. REV. CODE §§ 7.72.010–.070 (2010)); Stanton v. Bayliner Marine Corp., 123 Wash. 2d 64, 84, 866 P.2d 15, 26 (1993).

87. *See* Berschauer/Phillips Const. Co. v. Seattle Sch. Dist., 124 Wash. 2d 816, 827, 881 P.2d 986, 993 (1994).

88. 159 Wash. 2d 674, 690 n.6, 153 P.3d 864, 872 n.6 (2007).

89. *See* Poulsbo Grp., LLC v. Talon Dev., LLC, 155 Wash. App. 339, 347, 229 P.3d 906, 910 (2010); Carlile v. Harbour Homes, Inc., 147 Wash. App. 193, 204–05, 194 P.3d 280, 285 (2008). *Carlile* discusses fraudulent concealment as though it were a completely separate tort from fraud. 147 Wash. App. at 204–05, 194 P.3d at 285. This Comment will argue that the appellate courts' distinction between fraud and fraudulent concealment does not make sense because fraudulent concealment is just a shorthand name for one way of proving fraud, not a separate tort. *See infra* Part IV.C.

Washington State Supreme Court responded to lower court treatment of the economic loss rule, holding that the rule does not bar a plaintiff from bringing a tort where the tort duty is independent of the contract.[90]

A. The Washington State Supreme Court First Developed Its Economic Loss Rule in Response to the Washington Product Liability Act

Although the economic loss rule has been almost universally accepted,[91] Washington courts originally chose not to adopt it.[92] In *Berg v. General Motors Corp.*,[93] the Washington State Supreme Court permitted a plaintiff to recover in tort for purely economic damages after a defectively manufactured engine malfunctioned during a commercial fishing trip.[94] But the *Berg* rule did not last long. In 1981, the Washington State Legislature effectively overruled *Berg* by enacting the WPLA.[95] The WPLA created an economic loss rule in the product liability context, limiting plaintiffs seeking purely economic damages to contract claims under the UCC.[96]

A few years after the WPLA was enacted, the Washington State Supreme Court developed a common law economic loss rule to govern outside the product liability context. In *Berschauer/Phillips Construction Co. v. Seattle School District*,[97] the plaintiff, a general contractor, brought a tort claim of negligent misrepresentation against an architect and a structural engineer, alleging that their inaccurate and incomplete engineering plans caused the plaintiff to spend more money and time to complete the construction project than originally anticipated.[98] The plaintiff's claims were not governed by the WPLA because architectural and engineering services are not "products" under

90. 170 Wash. 2d 380, 393, 241 P.3d 1256, 1264 (2010).

91. *See* Esquibel, *supra* note 17, at 789. For a list of states that have adopted the economic loss rule, and for exceptions to the rule, with case citations, see D'Angelo, *supra* note 46, at 609.

92. *See* Berg v. Gen. Motors Corp., 87 Wash. 2d 584, 594, 555 P.2d 818, 823 (1976).

93. 87 Wash. 2d 584, 555 P.2d 818 (1976).

94. *Id.* at 584, 594, 555 P.2d at 818, 823.

95. Act of Apr. 17, 1981, ch. 27, 1981 Wash. Sess. Laws 112 (codified as amended at WASH. REV. CODE §§ 7.72.010–.070 (2010)); Stanton v. Bayliner Marine Corp., 123 Wash. 2d 64, 84, 866 P.2d 15, 26 (1993) ("The Legislature overruled *Berg* and adopted the analysis of the Supreme Court of California in *Seely v. White Motor Co.*, when it enacted the 1981 product liability act." (citations omitted)).

96. WASH. REV. CODE §§ 7.72.010–.070; *Bayliner Marine Corp.*, 123 Wash. 2d at 84, 866 P.2d at 26.

97. 124 Wash. 2d 816, 881 P.2d 986 (1994).

98. *Id.* at 819–20, 881 P.2d at 988–89.

the WPLA.[99] The Court reasoned that an economic loss rule was necessary 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."[100] Thus, the Court held that when parties have contracted to protect against potential economic liability, the economic loss rule bars the tort of negligent misrepresentation, even in cases that fall outside the WPLA.[101]

B. In Alejandre*, the Washington State Supreme Court Left Its Approach to Fraud Claims an Open Question*

After *Berschauer/Phillips*, the next Washington State Supreme Court case to develop the economic loss rule was *Alejandre v. Bull*. In *Alejandre*, the buyers discovered that the house they purchased had a defective septic system.[102] They sued the seller, alleging fraud and misrepresentation.[103] The Court held that the economic loss rule barred recovery for alleged breach of tort duties where a contractual relationship exists[104] and the damage is "more properly remediable only in contract."[105] The Court reasoned that "tort law is not intended to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement."[106] To determine whether the economic loss rule limits a plaintiff to contract remedies, the Court devised the following rule:

> The key inquiry is the nature of the loss and the manner in which it occurs, i.e., are the losses economic losses, with economic losses distinguished from personal injury or injury to other property. If the claimed loss is an economic loss, and no

---

99. *See* WASH. REV. CODE § 7.72.010(3) (2010) ("'Product' means any object possessing intrinsic value, capable of delivery either as an assembled whole or as a component part or parts, and produced for introduction into trade or commerce."); *Berschauer/Phillips*, 124 Wash. 2d at 822, 881 P.2d at 990.

100. *Berschauer/Phillips*, 124 Wash. 2d at 826, 881 P.2d at 992.

101. *Id.* at 828, 881 P.2d at 993.

102. Alejandre v. Bull, 159 Wash. 2d 674, 680, 153 P.3d 864, 867 (2007).

103. *Id.*

104. Although the economic loss rule applies only if a contractual relationship between the parties exists, the rule can bar a tort claim even when the specific risk of loss at issue was not expressly allocated in the parties' contract. *Id.* at 688, 153 P.3d at 871.

105. *Id.* at 681, 153 P.3d at 867 (quoting *Berschauer/Phillips*, 124 Wash. 2d at 822, 881 P.2d at 990).

106. *Id.* at 682, 153 P.3d at 868 (citing Factory Mkt., Inc. v. Schuller Int'l, Inc., 987 F. Supp. 387, 395 (E.D. Pa. 1997)).

> exception applies to the economic loss rule, then the parties will be limited to contractual remedies.[107]

The Court in *Alejandre* held that the economic loss rule precluded a homebuyer's negligent misrepresentation tort claim against the seller, but it noted that there are exceptions to the economic loss rule.[108] In particular, the Court explicitly recognized that the economic loss rule does not bar fraudulent concealment claims.[109] It is not entirely clear whether the *Alejandre* Court intended fraudulent concealment to be a completely distinct tort from fraud or if it intended fraudulent concealment to be a shorthand name for one way of proving fraud.[110] The Court merely explained that, to maintain a claim for fraudulent concealment, the plaintiff must prove that the vendor had a duty to disclose, which arises:

> (1) where the residential dwelling has a concealed defect; (2) the vendor has knowledge of the defect; (3) the defect presents a danger to the property, health, or life of the purchaser; (4) the defect is unknown to the purchaser; and (5) the defect would not be disclosed by a careful, reasonable inspection by the purchaser.[111]

The plaintiffs in *Alejandre* failed to show that the defect in the septic system would not have been discovered through a reasonably diligent inspection.[112] Had the plaintiffs been able to prove this element, the Court would have allowed them to recover for their purely economic losses.[113]

Alejandre left open the possibility that fraudulent concealment is not the only exception to the economic loss rule.[114] But the Court explicitly

---

107. *Id.* at 684, 153 P.3d at 869.

108. *Id.* at 685–86, 153 P.3d at 870.

109. *Id.* at 689, 153 P.3d at 871.

110. In *Carlile v. Harbor Homes, Inc.*, Division I of the Washington Court of Appeals said that fraudulent concealment is a completely separate tort from fraud (which it called intentional misrepresentation), and that the two tort claims have different elements. 147 Wash. App. 193, 204–05, 194 P.3d 280, 285–86 (2008). In Part IV.C., this Comment argues that fraudulent concealment is just a type of fraud. This Comment uses the term "fraudulent concealment" as a shorthand name for one way of proving fraud, but that usage does not intend to endorse the view that fraudulent concealment is a distinct tort.

111. *Alejandre*, 159 Wash. 2d at 689, 153 P.3d at 872.

112. *Id.* at 689–90, 153 P.3d at 872.

113. *Id.* at 689, 153 P.3d at 871–72 ("[T]he Alejandres' fraudulent concealment claim is not precluded by the economic loss rule. However, the fraudulent concealment claim fails because, as the trial court ruled, the Alejandres failed to present sufficient evidence to support the claim.").

114. *Id.* at 690 n.6, 153 P.3d at 872 n.6 ("The Alejandres urge the court to hold that the economic loss rule does not apply to claims of fraud in the inducement, and they argue their fraud claims are

declined to resolve the question of whether the economic loss rule has an exception for fraud generally or if there is an exception only for a certain subset of fraud claims.[115] The Court noted that "some courts recognize a broad exception to the economic loss rule that applies to intentional fraud," while other courts take a middle ground position, recognizing an exception to the economic loss rule for fraud claims where the misrepresentations are extraneous to the contract itself.[116] Ultimately, the Court chose not to decide which approach it would take.[117]

C. The Washington Appellate Courts Decided that the Economic Loss Rule Barred All Fraud Claims Except for "Fraudulent Concealment"

After *Alejandre*, Washington appellate courts continued to develop the application of *Alejandre*'s economic loss rule to homebuyers' tort claims.[118] At first, they appeared to disagree about the answer to *Alejandre*'s open question: whether there is an exception for all fraud or only for fraudulent concealment.[119] Ultimately they decided that the only recognized exception to the economic loss rule was for fraudulent concealment.[120]

---

claims of fraud in the inducement . . . We need not address the question whether any or all fraudulent representation claims should be foreclosed by the economic loss rule because we resolve the Alejandres' fraudulent representation claims on other grounds.").

115. *Id.* ("We need not address the question whether any or all fraudulent representation claims should be foreclosed by the economic loss rule because we resolve the Alejandres' fraudulent representation claims on other grounds.").

116. *Id.*

117. *Id.*

118. *See, e.g.*, Poulsbo Grp., LLC v. Talon Dev., LLC, 155 Wash. App. 339, 345–47, 229 P.3d 906, 909–10 (2010); Cox v. O'Brien, 150 Wash. App. 24, 34–36, 206 P.3d 682, 687–88 (2009); Jackowski v. Borchelt, 151 Wash. App. 1, 12–15, 209 P.3d 514, 519–21 (2009); Carlile v. Harbour Homes, Inc., 147 Wash. App. 193, 203–07, 194 P.3d 280, 285–87 (2008); Stieneke v. Russi, 145 Wash. App. 544, 555–65, 190 P.3d 60, 66–70 (2008); Baddeley v. Seek, 138 Wash. App. 333, 337–40, 156 P.3d 959, 961–62 (2007).

119. *Compare Jackowski*, 151 Wash. App. at 17, 209 P.3d at 522 (citing *Alejandre* for the proposition that neither fraud nor fraudulent concealment claims are barred by the economic loss rule), *and Stieneke*, 145 Wash. App. at 560, 190 P.3d at 68 (allowing the plaintiff to get to the merits of his fraud claim because "[t]he *Alejandre* court reaffirmed that the economic loss rule does not apply to claims of fraud"), *and Baddeley*, 138 Wash. App. at 338, 156 P.3d at 961 (allowing the plaintiff to get to the merits of his fraud claim because "[m]any outside jurisdictions have held the economic loss rule does not bar fraud"), *with Carlile*, 147 Wash. App. at 204–05, 194 P.3d at 285–86 (interpreting *Alejandre* as creating an exception to the economic loss rule for fraudulent concealment but not other kinds of fraud).

120. *Carlile*, 147 Wash. App. at 204–05, 194 P.3d at 285–86 (recognizing an exception for fraudulent concealment but holding that the exception does not extend to intentional misrepresentation claims); *Poulsbo*, 155 Wash. App. at 347, 229 P.3d at 910 (same).

In *Carlile v. Harbour Homes, Inc.*, Division I of the Washington Court of Appeals held that the economic loss rule barred a homebuyer's fraud claim.[121] The plaintiffs in *Carlile* sued the developer of their residential property for misrepresentation and breach of contract, alleging that their homes had construction defects.[122] The court compared the elements of a fraudulent concealment claim with the elements of a general fraud claim.[123] Because of the differences between the elements, the court concluded that the two should not receive the same treatment.[124] The court found that "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."[125] But *Carlile* failed to articulate a rationale for why the economic loss rule should preclude fraud claims. The court interpreted *Alejandre* as creating one narrow exception to the economic loss rule for fraudulent concealment, and it declined to extend this exception to other types of fraud.[126]

In *Poulsbo Group, LLC v. Talon Development, LLC*, the plaintiffs asked Division II of the Washington Court of Appeals to conclude that the economic loss rule does not bar fraud claims, contrary to the ruling of Division I in *Carlile*.[127] After analyzing *Alejandre*, Division II agreed with the *Carlile* court.[128] The *Poulsbo* court reasoned that the overarching rule in *Alejandre* required that "[p]arties should be limited to contract remedies when a loss potentially implicates contract and tort relief."[129] Similar to *Carlile*, however, the court failed to articulate a reason for why the economic loss rule should bar fraud claims when it does not bar fraudulent concealment claims.

---

121. *Carlile*, 147 Wash. App. at 206, 194 P.3d at 286.

122. *Id.* at 198–99, 194 P.3d at 282.

123. *Id.* at 204–05, 194 P.3d at 285–86.

124. *Id.*

125. *Id.* at 205, 194 P.3d at 286.

126. *Carlile* discusses fraudulent concealment as though it were a completely separate tort from fraud. *Id.* at 204–05, 194 P.3d at 285–86. This Comment argues that the appellate courts' distinction between fraud and fraudulent concealment does not make sense because fraudulent concealment is just a shorthand name for one way of proving fraud, not a separate tort. *See infra* Part IV.C.

127. Poulsbo Grp., LLC v. Talon Dev., LLC, 155 Wash. App. 339, 346, 229 P.3d 906, 910 (2010).

128. *Id.* at 347, 229 P.3d at 910.

129. *Id.*

D. In Eastwood, *the Washington State Supreme Court Held that the Economic Loss Rule Does Not Bar Torts that Arise Independent of the Contract*

On November 4, 2010, the Washington State Supreme Court finally brought some clarity to *Alejandre*. In *Eastwood v. Horse Harbor Foundation*, the lessor of a horse farm sued the lessee for breach of lease, which was a contract claim, and the commission of waste, which was a tort claim.[130] The Washington State Supreme Court held that the economic loss rule does not bar a plaintiff from bringing a tort claim where the tort duty is independent of the contract.[131] To underscore this point and help alleviate the appellate court confusion, the Court abandoned the term "economic loss rule" and renamed this rule the "independent duty doctrine."[132] The Court explained that "[t]he term 'economic loss rule' has proved to be a misnomer. It gives the impression that this is a rule of general application and any time there is an economic loss, there can never be recovery in tort."[133]

The *Eastwood* Court explicitly rejected the courts of appeals' broad reading of *Alejandre*.[134] Despite *Alejandre*'s pronouncement that the key inquiry is whether the loss is an economic loss,[135] the economic loss rule does not bar a plaintiff from bringing a tort claim simply because the injury is an economic loss and the parties have a contractual relationship.[136] The Court explained that in the past, when it has held that the economic loss rule applies, "what we have meant is that considerations of common sense, justice, policy, and precedent in a particular set of circumstances led us to the legal conclusion that the

130. 170 Wash. 2d 380, 384, 241 P.3d 1256, 1259 (2010).

131. *Id.* at 393, 241 P.3d at 1264.

132. *Id.* at 402, 241 P.3d at 1268.

133. *Id.* at 387–88, 241 P.3d at 1261.

134. *Id.* ("Seeing both a contractual relationship and an economic loss, the Court of Appeals believed that *Alejandre* therefore compelled a holding that Eastwood's only remedy was a recovery for breach of lease. The Court of Appeals' broad reading of this court's jurisprudence on the economic loss rule, while perhaps understandable, is not correct." (internal citation omitted)).

135. Alejandre v. Bull, 159 Wash. 2d 674, 684, 153 P.3d 864, 869 (2007) ("The key inquiry is the nature of the loss and the manner in which it occurs, i.e., are the losses economic losses, with economic losses distinguished from personal injury or injury to other property. 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.").

136. *Eastwood*, 170 Wash. 2d at 388–89, 241 P.3d at 1261 ("Thus, the fact that an injury is an economic loss or the parties also have a contractual relationship is not an adequate ground, by itself, for holding that a plaintiff is limited to contract remedies.").

defendant did not owe a duty."[137] Under *Eastwood*, the key to distinguishing cases where the plaintiff can recover in tort from those where the plaintiff is limited to contract remedies is to analyze whether there is an independent tort duty.[138] As the Court explained, "[a]n injury is remediable in tort if it traces back to the breach of a tort duty arising independently of the terms of the contract."[139]

This newly authored independent duty doctrine is not limited to the tort of waste; it applies to all torts.[140] After setting out its new approach to the economic loss rule, the Court concluded that the defendant in *Eastwood* had violated a tort duty that was independent of the contract's existence.[141] The Washington State Supreme Court reaffirmed its new

137. *Id.* at 389, 241 P.3d at 1262.

138. By requiring a case-by-case analysis of whether there is an independent tort duty, *Eastwood* limits the defendant's liability by limiting the defendant's scope of duty. *Id.* Courts can limit a defendant's liability either by limiting the defendant's scope of duty or by finding that the damages were not "proximately caused" by the defendant's actions. Barrett, *supra* note 18, at 898–99. For another example in which the court limited the defendant's liability by limiting his scope of duty, see *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931). In *Ultramares*, an accountant negligently prepared a financial statement. The accountant was sued by a person who did not have a contract with the accountant but had relied on the accountant's accuracy. *Id.* at 442–43. Then-Judge Cardozo limited the defendant's liability by holding that an accountant owes no duty to third parties to refrain from negligently causing economic injury. *Id.* at 444. The other method of limiting a defendant's liability is to recognize that the defendant does owe a duty to the plaintiff, but hold that the damages are sufficiently remote that the defendant's act did not proximately cause the plaintiff's harm. *See, e.g.*, H. Rosenblum, Inc. v. Adler, 461 A.2d 138, 153 (N.J. 1983) (extending an accountant's malpractice duty to all foreseeable plaintiffs). When courts say that the plaintiff did not proximately cause the harm, they mean that, "because of convenience, of public policy, of a rough sense of justice, the law arbitrarily declines to trace a series of events beyond a certain point." Palsgraf v. Long Island R. Co., 162 N.E. 99, 103 (N.Y. 1928) (Andrews, J., dissenting). A court can use either method to define the boundaries of the defendant's liability, but the scope-of-duty analysis has been more popular with the courts than proximate cause analysis. *See* JOHN L. DIAMOND ET AL., UNDERSTANDING TORTS 187 (1996).

139. *Eastwood*, 170 Wash. 2d at 389, 241 P.3d at 1262.

140. This conclusion is evident from the fact that the Court speaks very generally about torts and, only after developing the new rule, goes on to discuss the tort of waste in particular. *See, e.g.*, *id.* at 393, 241 P.3d at 1264 ("In sum, the economic loss rule does not bar recovery in tort when the defendant's alleged misconduct implicates a tort duty that arises independently of the terms of the contract."); *id.* at 398, 241 P.3d at 1266 ("Having described what we now will call the independent duty doctrine, we next must decide whether the duty to not cause waste arises independently of the contract.").

141. *Id.* at 402, 241 P.3d at 1268 ("We hold the duty to not cause waste is an obligation that arises independently of the terms of a lease covenant, and sufficient evidence supported the trial court's findings of a causal connection between Eastwood's losses and a breach of this independent duty. Thus, the Court of Appeals was mistaken to hold Eastwood could not recover tort damages for waste.").

approach to the economic loss rule in *Affiliated FM Insurance Co. v. LTK Consulting Services, Inc.*,[142] decided the same day.[143]

IV. WASHINGTON SHOULD ADOPT THE LENIENT APPROACH SO THAT ITS ECONOMIC LOSS RULE DOES NOT BAR FRAUD CLAIMS

The Washington State Supreme Court has renamed its "economic loss rule" the "independent duty doctrine."[144] The shift in the rule's name highlights the essential feature of Washington's new take on the economic loss rule, namely that it "does not bar recovery in tort when the defendant's alleged misconduct implicates a tort duty that arises independently of the terms of the contract."[145] *Eastwood* addressed the general question of when a plaintiff can sue in tort law. The natural implication of this decision is that Washington's courts should adopt the lenient approach with respect to fraud, holding that the economic loss rule does not bar fraud claims, because the duty not to commit fraud is independent of any contract.[146]

When the appellate courts held that the economic loss rule barred all fraud except for fraudulent concealment, they did so based on a broad reading of *Alejandre*. *Eastwood* has now explicitly rejected that broad reading.[147] Moreover, the appellate courts' determination that parties to a

---

142. 170 Wash. 2d 442, 243 P.3d 521 (2010). After the Seattle monorail caught fire, its operating company suffered millions of dollars in losses. *Id.* at 443–44, 243 P.3d at 523. The company sued an engineering firm that worked on the monorail maintenance for negligently causing the fire, a tort. *Id.* at 444, 243 P.3d at 523. The engineering firm argued that the operating company's tort claim was barred by the economic loss rule because the losses were purely economic. *Id.* The Washington State Supreme Court disagreed, citing *Eastwood*'s independent duty doctrine. *Id.* at 449, 243 P.3d at 526. The Court held that the tort law duty of reasonable care was independent of the contractual obligations. *Id.* at 453–54, 243 P.3d at 528–29.

143. *Id.* Washington's new approach has already been recognized by the federal courts. *See* Putz v. Golden, No. C10-0741JLR, 2010 WL 5071270 (W.D. Wash. Dec. 7, 2010); Trinity Glass Int'l, Inc. v. LG Chem., Ltd., No. 09-5018RJB, 2010 WL 5071295 (W.D. Wash. Dec. 7, 2010).

144. *Eastwood*, 170 Wash. 2d at 402, 241 P.3d at 1268; *see supra* Part III.D.

145. *Id.* at 393, 241 P.3d at 1264.

146. *See, e.g.*, Barton, *supra* note 17, at 1834–35 ("If the duty arises solely from a provision contained within the contract, then the plaintiff has asserted a contract action. Conversely, if the plaintiff's allegations concern misrepresentations made during contract negotiations, then the claim is a tort. Mere failure to perform a contract does not constitute fraud, but a party can be held liable for fraud when that party makes a misrepresentation without the intent to perform and another party is induced into a transaction. So long as the allegation concerns a misrepresentation made prior to the contract that induced the contract, it is a fraudulent inducement claim.").

147. *Eastwood*, 170 Wash. 2d at 387, 241 P.3d at 1261 ("Seeing both a contractual relationship and an economic loss, the Court of Appeals believed that *Alejandre* therefore compelled a holding that [the plaintiff's] only remedy was a recovery for breach of [contract]. The Court of Appeals'

contract cannot sue for fraud will undermine the UCC and lead to an uncertain marketplace. Thus, contrary to *Carlile* and *Poulsbo*, the answer to *Alejandre*'s open question should be that the economic loss rule does not bar any fraud claims.

A. Barring Fraud Claims Would Create an Uncertain Marketplace

If Washington's economic loss rule is misunderstood and the lower courts continue to hold that the economic loss rule precludes fraud claims, this misunderstanding "would create an uncertain marketplace—where sellers would not be held to their representations and buyers could not rely on explicit representations by the seller."[148] According to Judge Posner, such a rule would increase costs for all commercial transactions because the only way for parties to obtain legal protection against fraud would be through contract law, which would require the parties to insist that all representations are incorporated into the contract itself.[149] Thus, "there will be additional contractual negotiations, contracts will be longer, and, in short, transaction costs will be higher."[150] Moreover, it is impossible to account for every contingency in a contract.[151] Thus, parties could never be completely protected by the terms of their contracts.

Even if the parties attempt to protect themselves from being defrauded through explicit contract provisions, it would be impossible for parties to obtain complete protection because "[a] party to a contract cannot rationally calculate the possibility that the other party will deliberately misrepresent terms critical to that contract."[152] If parties could always discern when the other party is lying, there would be no problem. But it is often difficult to determine when someone is lying. If a party "cannot rely on the opposite party to speak truthfully during negotiations regarding the subject matter of the contract—if they cannot tell what is a lie and what is not," then "[h]ow can parties freely allocate risk"?[153] Contracts cannot adequately protect parties from the possibility

---

broad reading of this court's jurisprudence on the economic loss rule, while perhaps understandable, is not correct." (internal citation omitted)).

148. Barton, *supra* note 17, at 1832 (citing Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1236 (W.D. Wis. 1997)).

149. All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 867 (7th Cir. 1999).

150. *Id.*

151. *See* STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 299–301 (2004).

152. *Stoughton Trailers*, 965 F. Supp. at 1236.

153. Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1148 (E.D. Wis. 1998).

that the other party is lying. This inability to account for dishonesty is why it is necessary to supplement contract law with common law claims like the tort of fraud.

The best way to minimize costs is to require the party with the best access to information to disclose the information:

> When a seller is lying about the subject matter of the contract, the party best situated to assess the risk of economic loss and allocate the risk is not the buyer, who cannot possibly know which of several statements may be a lie, but rather the seller, who clearly knows.[154]

If the economic loss rule bars fraud claims, "the innocent nonbreaching party would bear the burden of trying to police deceitful activity that society as a whole abhors."[155] Moreover, "no interest of society is served by promoting the flow of information not genuinely believed by its maker to be true."[156] Thus, "[p]ublic policy is better served by leaving the possibility of an intentional tort suit hanging over the head of a party considering outright fraud."[157]

B. The UCC Does Not, and Was Never Intended to, Eliminate Fraud Claims

Some courts have held that the economic loss rule bars all fraud claims because they reason that fraud claims are inconsistent with breach of contract and breach of warranty allegations under the UCC.[158] In addition, some courts have "misconstrued" the UCC's goal of promoting uniformity in commercial transactions to mean that "the UCC provides the exclusive source of rights and remedies for parties engaged in the commercial sale of goods."[159] However, "the UCC does not, and was never intended to, eliminate or restrict" fraud claims.[160]

One of the fundamental assumptions underlying the UCC is that "parties to a transaction are bargaining in good faith and are able to

---

154. *Id.*

155. *Id.*

156. *Id.* (quoting Ollerman v. O'Rourke Co., 288 N.W.2d 95, 112 (Wis. 1980)).

157. *Stoughton Trailers*, 965 F. Supp. at 1236.

158. *See, e.g.*, Flagg Energy Dev. Corp. v. Gen. Motors Corp., 709 A.2d 1075, 1088–89 (Conn. 1998) (Fraud claims are "presumptively *inconsistent* with postacceptance claims for breach of warranty." (emphasis in original)).

159. Steven C. Tourek et al., *Bucking the "Trend": The Uniform Commercial Code, the Economic Loss Doctrine, and Common Law Causes of Action for Fraud and Misrepresentation*, 84 IOWA L. REV. 875, 875 (1999).

160. *Id.* at 876.

fairly assess and allocate any risks of liability relating to the purchase and subsequent use of the goods."[161] When one party commits fraud, that party is not operating in good faith, and it is therefore impossible for the other party to assess and allocate risks properly.[162] Thus, preventing parties from suing for fraud would undermine the UCC.[163] Several sections of the UCC "affirmatively underscore the ongoing coexistence of common law fraud rights and remedies."[164] For instance, section 1-103 of the UCC explicitly states that common law fraud "shall supplement its provisions."[165]

Rather than displacing common law fraud claims, the UCC supplements the common law remedies for fraud.[166] In particular, UCC section 2-721, entitled "Remedies for Fraud," provides that "[r]emedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach."[167] Section 2-721 does not displace fraud and misrepresentation claims; rather, it "affirmatively and favorably acknowledges these causes of action by supplementing the common law remedies for fraud and misrepresentation with all remedies that are available under the UCC."[168] Moreover, fraud claims are consistent with the spirit of the UCC, as evinced by section 1-304, which imposes "an obligation of good faith" in every contract or duty to which the UCC applies.[169] It is inconsistent to limit a plaintiff's ability to bring a fraud claim, requiring him to seek contract remedies instead, when contract law was designed to be supplemented by just such a fraud claim.

---

161. *Id.* at 877.

162. *Id.*

163. *Id.*

164. *Id.* at 881.

165. U.C.C. § 1-103 (2003) ("Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.").

166. Tourek et al., *supra* note 159, at 891.

167. U.C.C. § 2-721 (2010).

168. Tourek et al., *supra* note 159, at 881.

169. U.C.C. § 1-304 (2004).

C. *In Light of* Eastwood, *Washington Courts Should Adopt the Lenient Approach and Hold that the Economic Loss Rule Does Not Bar Fraud Claims*

Under *Eastwood*'s economic loss rule, the plaintiff can bring a tort claim whenever the defendant violated a tort duty that is independent of the defendant's contract with the plaintiff.[170] Jurisdictions that take the lenient approach, holding that the economic loss rule does not bar fraud claims, do so because they recognize that the duty not to commit fraud is independent of any contract.[171] In contrast, jurisdictions that take a middle ground position recognize an exception to the economic loss rule only for "independent" fraud claims, which means that the fraud does not involve a misrepresentation about the subject matter of the underlying contract.[172] Requiring that the fraud *itself* be independent of the contract is not the same thing as requiring the tort *duty* to be independent of the contract. For example, if the tort relates to the signing of a contract, the tort itself has already occurred by the time the contract is signed.[173] If a cause of action arises before the parties enter into a contract, the tort duty must be independent of the contract because no duty has yet been created under the contract.[174] By focusing on whether the tort *duty* is independent of the contract, *Eastwood* is in line with the lenient-approach jurisdictions.

Courts taking the middle ground approach have a legitimate desire to prevent a plaintiff from subverting contract law by casting a contract claim as a tort claim of fraud. Ensuring that the tort duty is independent of the contract, however, maintains a clear border between tort law and contract law.[175] For example, although fraud in the inducement is an independent tort claim,[176] non-performance of a contract obligation is a contract claim that a plaintiff might try to call "fraudulent

---

170. Eastwood v. Horse Harbor Found., 170 Wash. 2d 380, 389, 241 P.3d 1256, 1262 (2010).

171. *See supra* Part II.B.

172. *See supra* Part II.B.

173. Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147 (E.D. Wis. 1998).

174. *Id.* ("The fact that the tort by definition also relates to the signing of a contract does not alter the fact that by the time the contract is signed the action causing the tort has already occurred.").

175. Faricelli, *supra* note 27, at 740–41 ("Sellers are not faced with an independent duty to protect buyers from economic loss; rather that duty is provided for by the parties' mutual agreement or contract. On the other hand, there is a common-law duty not to induce another into a contract by fraudulent means." (footnotes omitted)).

176. "Fraud in the inducement" is just the tort of fraud where the facts indicate that the defendant lied to the plaintiff to get the plaintiff to enter into a contract. It is a subset of fraud, or one way of proving fraud, not a separate tort. BLACK'S LAW DICTIONARY 661 (6th ed. 1990).

performance."[177] Although they may seem similar, "[t]here is a considerable difference between a promise never intended to be performed (fraud in the inducement) and a promise intended to be performed but which ultimately is not (breach of contract)."[178] While the duty to protect against fraud in the inducement is independent of any underlying contract, the duty to protect against fraudulent performance of a contract derives directly from the contract itself.[179] *Eastwood*'s formulation of the economic loss rule will allow a plaintiff to bring all fraud in the inducement claims but will preclude fraudulent performance claims, because the contract itself is the only source of the duty to perform a contract obligation.[180] Thus, an independent duty analysis maintains the line between tort and contract.

In light of the Washington State Supreme Court's decision in *Eastwood*, the two appellate court cases that held that the economic loss rule bars all fraud claims except for fraudulent concealment should be overruled. The holding of Division II in *Poulsbo* was based purely on its interpretation of *Alejandre* that the economic loss rule barred a plaintiff from bringing tort claims when contract remedies exist.[181] *Eastwood* explicitly rejected this broad reading of *Alejandre*.[182] *Poulsbo* is therefore inconsistent with *Eastwood* and should be overruled.

Although *Carlile*'s holding was based on a more in-depth consideration of *Alejandre* and the tort of fraud, it too should be

---

177. *See* Barton, *supra* note 17, at 1835 ("The economic loss rule clearly seeks to prevent the mere recasting of a contract claim sounding as a tort of fraud in the inducement, because tort law does not protect parties from breach of duties assumed only by agreement." (footnotes omitted)). "Fraudulent performance" is just a badly named contract claim and is not a type of fraud. *See, e.g.*, Sun Co. (R&M) v. Badger Design & Constr., Inc., 939 F. Supp. 365, 370 (E.D. Pa. 1996) ("[M]ere non-performance . . . is not evidence of fraud.").

178. *Budgetel*, 8 F. Supp. 2d at 1147.

179. Faricelli, *supra* note 27, at 730.

180. Eastwood v. Horse Harbor Found., 170 Wash. 2d 380, 394 n.4, 241 P.3d 1256, 1264 n.4 (2010) ("When a court says, 'the economic loss rule applies,' the court is simply articulating a conclusion that, in a particular set of circumstances, the law of contracts is the only source of a defendant's obligations and no tort duty exists.").

181. Poulsbo Grp., LLC v. Talon Dev., LLC, 155 Wash. App. 339, 346, 229 P.3d 906, 910 (2010) ("The overarching rule in *Alejandre* guides us here: Parties should be limited to contract remedies when a loss potentially implicates contract and tort relief. Thus, the economic loss rule bars [the plaintiff's] intentional misrepresentation claim because contract remedies exist." (internal citation omitted)).

182. *Eastwood*, 170 Wash. 2d at 387, 241 P.3d at 1261 ("Seeing both a contractual relationship and an economic loss, the Court of Appeals believed that *Alejandre* therefore compelled a holding that [the plaintiff's] only remedy was a recovery for breach of [contract]. The Court of Appeals' broad reading of this court's jurisprudence on the economic loss rule, while perhaps understandable, is not correct.").

overruled. *Carlile* determined that the exception to the economic loss rule for fraudulent concealment did not extend to fraud because the elements of fraud differed from the elements of fraudulent concealment.[183] This analysis demonstrates both a fundamental misunderstanding of the tort of fraud and a misinterpretation of *Alejandre*. When the Court in *Alejandre* listed five elements that were necessary for the plaintiffs to prove their fraudulent concealment claim, it did not state that these were the five elements of fraudulent concealment.[184] Rather, the Court said that these were the elements necessary to prove that the vendor had a duty to speak.[185]

Fraudulent concealment is a type of fraud, not a separate tort. Roughly speaking, fraud occurs when (1) the defendant makes a misrepresentation, (2) knows or believes it to be false, (3) makes the misrepresentation with the intent of influencing the plaintiff's conduct, (4) the representation is material, and (5) the plaintiff's reliance upon the representation was justified.[186] Fraudulent concealment is simply fraud where, instead of explicitly saying something false, the defendant makes a misrepresentation by failing to speak.[187] To make a claim for fraudulent concealment, the plaintiff must prove that the defendant had a duty to speak.[188] But proving that the defendant had a duty to speak is

183. Carlile v. Harbour Homes, Inc., 147 Wash. App. 193, 204–05, 194 P.3d 208, 285–86 (2008) ("A claim for fraudulent concealment requires a plaintiff to show: (1) [that] the residential dwelling has a concealed defect; (2) the vendor has knowledge of the defect; (3) the defect presents a danger to the property, health, or life of the purchaser; (4) the defect is unknown to the purchaser; and (5) the defect would not be disclosed by a careful, reasonable inspection by the purchaser. The nine elements of intentional misrepresentation (fraud) are: (1) representation of an existing fact; (2) materiality; (3) falsity; (4) the speaker's knowledge of its falsity; (5) intent of the speaker that it should be acted upon by the plaintiff; (6) plaintiff's ignorance of its falsity; (7) plaintiff's reliance on the truth of the representation; (8) plaintiff's right to rely upon the representation; and (9) damages suffered by the plaintiff. Given the difference in elements between the two types of claims, there is no reason to conclude that an intentional misrepresentation claim should be treated the same as the fraudulent concealment claim in *Alejandre*." (footnotes omitted)).

184. *See* Alejandre v. Bull, 159 Wash. 2d 674, 689, 153 P.3d 864, 872 (2007).

185. *Id.*

186. *See* RESTATEMENT (SECOND) OF TORTS § 525; *see also* W. Coast, Inc. v. Snohomish Cnty., 112 Wash. App. 200, 206, 48 P.3d 997, 1000 (2002) ("(1) representation of an existing fact; (2) materiality; (3) falsity; (4) the speaker's knowledge of its falsity; (5) intent of the speaker that it should be acted upon by the plaintiff; (6) plaintiff's ignorance of its falsity; (7) plaintiff's reliance on the truth of the representation; (8) plaintiff's right to rely upon the representation; and (9) damages suffered by the plaintiff.").

187. Tourek et al., *supra* note 159, at 883 ("If the supplier makes an express material misstatement regarding a product transaction, he is guilty of [fraud]. If he withholds information when he should speak, he is guilty of fraudulent concealment.").

188. If there is no duty to speak, the defendant cannot be held liable for failing to speak. *See Alejandre*, 159 Wash. 2d at 689, 153 P.3d at 872.

not the same as proving that the defendant committed fraudulent concealment: the elements that *Alejandre* listed are not the elements of fraudulent concealment. The *Carlile* court misunderstood *Alejandre*. Moreover, *Carlile*'s conclusion that the economic loss rule bars all fraud except for fraudulent concealment does not make common sense: it allows a plaintiff to sue the defendant for failing to speak but not for intentionally lying. Thus, *Carlile* should be overruled.

CONCLUSION

The economic loss rule was intended to keep parties from casting their contract claims as tort claims. Because fraud claims supplement contract claims, rather than replace or subvert them, they should not be barred by the economic loss rule. The UCC itself explicitly contemplates that common law fraud claims may supplement its provisions by ensuring that parties are not free to make intentional misrepresentations. Without this tort of fraud available to them, contracting parties could never fully trust each other. This lack of trust would create an uncertain marketplace because it is impossible to draft contract provisions to sufficiently guard against intentional misrepresentations. In light of *Eastwood*'s new independent duty doctrine, Washington's economic loss rule should not bar fraud claims because the duty not to commit fraud is independent of any contract. Thus, it is imperative that Washington's courts hold that the economic loss rule does not bar fraud claims.