



# Charting Your Course After *Flagstaff and Hughes*

Applying the Economic Loss Doctrine  
to Claims and Contracts

P. Douglas Folk  Folk & Associates, P.C.

# Learning Objectives

- Define Economic Loss Doctrine
- Review recent recent appellate decisions that affect the Economic Loss Doctrine
- Understand new contract implications because of these decisions
- Understand top 10 problematic contract clauses for design professionals

# . Navigating A Sea of Risk . .



- Clients expect design professionals to sign one-sided contracts that create more risk than fee will compensate
- They also expect perfection . . . results better than standard of care or contract require . . . but . . .
- Insurers deny claims based on breach of contract, warranty or guarantee unless insured negligently breached standard of care in performing professional services

# ... To Find *Terra Incognita* ...

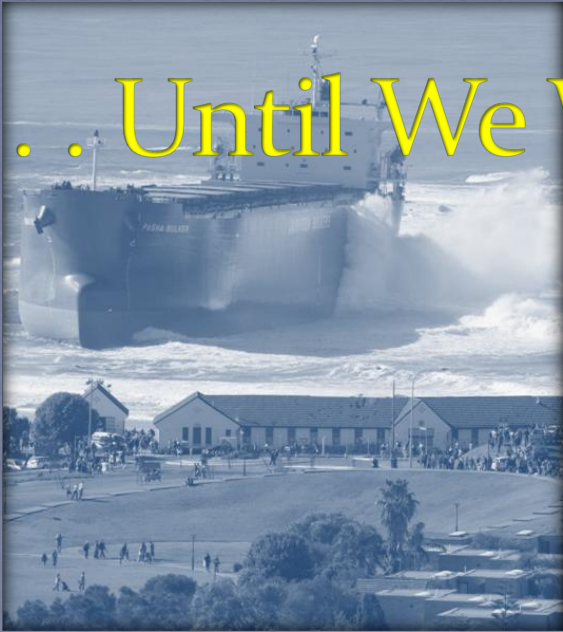
The Economic Loss Doctrine was created to divide contract and tort law by resolving claims for “economic loss” (benefit of the bargain) damages under contract’s terms and remedies.

“Economic loss” includes contractual benefits, diminished value or repair costs, and consequential damages such as lost revenue or profits

ELD prevents owners from using tort standard of care to get more than the contract requires.



# ... Until We Were Blown Off Course



- In 2009, trio of appellate decisions threw in doubt design professional's use of ELD defense to tort claims for "benefit of bargain" damages:
  - *Flagstaff Affordable Housing, LP v. Design Alliance, Inc.*
  - *Valley Forge Insurance Co. v. Sam's Plumbing, LLC*
  - *Hughes Custom Building, LLC v. Davey*

- Rejected precedents—held design professionals could not use ELD as matter of public policy
- Applied complicated ELD rule from products liability cases that does not work for design and construction defect cases
- If left unchanged, new rule created significant risk of negligence claims from clients and third parties regardless of contract terms or remedies
- Immediate action needed to salvage ELD defense

# Deciphering the Signals



*Flagstaff Affordable Housing, LP v. Design Alliance, Inc.*

- Developer sued architect for cost of correcting ADA violations in apartments—claimed architect breached professional and statutory duty in design
- Contract claim was barred by statute of repose so developer sued for negligence—a tort claim
- Trial judge dismissed tort claim because it was barred by Economic Loss Doctrine
- Court of Appeals reversed—held design professionals cannot use ELD to defeat a client’s claim of professional negligence or breach of statutory duty

# Charting A New Course....

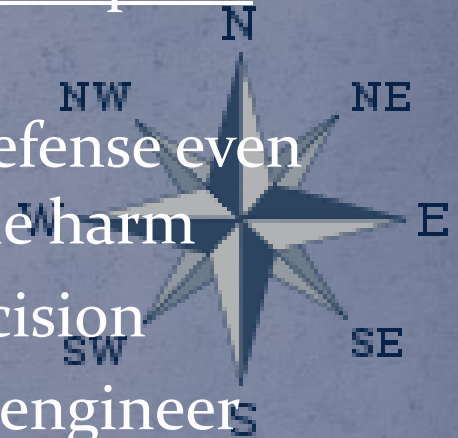


- Architect sought review by Arizona Supreme Court with support from AIA, ACEC-AZ, and ASFE
- Economic Loss Doctrine restored for design professionals and re-defined
- Supreme Court held:
  - Client limited to contractual remedies in recovering “economic losses” absent physical injury to persons or other property
  - Professional status and statutory duties do not override ELD if otherwise applicable
  - Public policy encourages allocation of risk for future losses and enforcement of remedies as parties have agreed in their contract
  - But this rule does not apply to claims by third parties

# Guidance But No Clear Direction....

## Hughes Custom Building, LLC v. Davey

- Homebuilder sued civil engineer for negligence after houses damaged by soils problem even though it did not have contract with engineer and engineer's plans were not used to build houses
- Court of Appeals rejected engineer's ELD defense even though "economic losses" were builder's sole harm
- Reconsideration required after *Flagstaff* decision
- Court of Appeals could not decide whether engineer had duty of care to builder
- Published opinion withdrawn; case returned to trial court for resolution in unpublished decision





# Where Are We Today?

- Good contracts even more important because they control “benefit of bargain” or economic loss claims
- Third party claims still a risk if “applicable substantive law allows liability in the particular context”, such as:
  - Duty of care expressly assumed to third party
  - Third party—such as owner, lender or contractor—received and required to rely on plans or specifications
- Contract also important in third party cases to limit duty, standard of care (performance criteria) and class of persons with right to rely

# More Storms Lie Ahead



Flagstaff creates new risks:

“Parties can contractually agree to preserve tort remedies for solely economic loss just as they may otherwise specify remedies that modify common law recovery.”

“Donnelly correctly implied that it [ELD] would not apply to negligence claims by a plaintiff who has no contractual relationship with the defendant.”

# Batten Down the Hatches!



Watch for new contract terms to counter *Flagstaff*:

- “The parties to this contract expressly agree that all tort remedies for recovery of economic loss are preserved.”
- “The rights and remedies of this contract are cumulative with those allowed by tort law.”
- “A/E expressly agrees to defend, indemnify and hold Client [*and others*] harmless from all direct, indirect, and consequential damages, losses, penalties, attorneys’ fees and expenses caused by A/E’s act or omission regardless of Client’s sole or partial fault.”

# Steer Clear of The Usual Mines . . .

## Contracts with:

1. Vague/incomplete scope of services
2. Elevated standard of care
3. Duties assumed to third parties
4. Uncompensated risks
5. Presumption of fault from cost overruns
6. Contract and claims assignable at will
7. Client having power to withhold payment
8. Missing or inadequate limitation of liability
9. Schedule or delivery method that invite disputes with contractor



# To Reach A Safe Harbor



For help in navigating the rough seas of contract negotiations and risk management assessments, call us . . .



P. Douglas Folk, Attorney

Folk & Associates, P.C.

3636 N. Central Avenue

Suite 600

Phoenix, Arizona 85012

602.222.4400

[pdfolk@folklaw.com](mailto:pdfolk@folklaw.com)