Tiara Condominium: The Demise of the Economic Loss Rule in Construction Defect Litigation and Impact on the "Property Damage" Requirement in a General Liability Policy

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The Florida Supreme Court's recent decision in *Tiara Condominium Association, Inc. v. Marsh & McLennan Companies, Inc.*, 110 So. 3d 399 (Fla. 2013), significantly narrowed the application of the economic loss rule in Florida, holding that "the application of the economic loss rule is limited to products liability cases." Although *Tiara* was not a construction insurance coverage case, the Court's holding that the economic loss rule applies only in the context of product liability actions allows policyholders to argue that "property damage" under a Commercial General Liability ("CGL") policy includes economic losses.

The Tiara Decision

In *Tiara*, a condominium association sued its insurance broker for allegedly failing to advise the association that its loss limit was per occurrence rather than in the aggregate. The United States Court of Appeals for the Eleventh Circuit affirmed summary judgment against the condominium association on the association's claims for breach of contract, negligent misrepresentation, and breach of implied covenant of good faith and fair dealing. As to the claims for negligence and breach of fiduciary duty, however, the Eleventh Circuit certified a question to the Florida Supreme Court regarding the "professional services" exception to the economic loss rule as applied in Florida. Rather than answer the question posed by the Eleventh Circuit, which asked whether the professional services exception applied to insurance brokers, the Florida Supreme Court restated the question as follows:

> Does the economic loss rule bar an insured's suit against an insurance broker where the parties are in contractual privity with one another and the damages sought are solely for economic losses?

In *Tiara*, the Florida Supreme Court answered: "Because we now limit the application of the economic loss rule to cases involving products liability, it is not necessary for us to decide whether the economic loss rule exception for professionals applies to insurance brokers. Based on the foregoing, we answer the rephrased certified question in the negative and hold that the application of the economic loss rule is limited to products liability cases."

The Application of Economic Loss Principles in Construction Coverage Disputes

The economic loss rule has its genesis in product liability actions in which a purchaser of goods or products sought damages under negligence or other tort theories for purely "economic" harms such as costs of repair and lost profits. *See East River S.S. Corp. v. Transamerica DeLaval*, 476 U.S. 858, 871–876, 106 S. Ct. 2295, 90 L. Ed. 2d 865 (1986); *Seely v. White Motor Co.*, 63 Cal. 2d 9, 45 Cal. Rptr. 17, 403 P.2d 145, 149 (Cal. 1965). In most jurisdictions, the application of the economic loss rule generally precludes a plaintiff from suing in tort where the injury consists only of damage to the goods themselves. The economic loss doctrine affects the remedy available to a plaintiff by limiting recovery for purely economic loss to the remedies provided by, and perhaps limited by, the contract between the parties. Although the economic loss rule is a liability defense or remedies doctrine, insurers have borrowed from the economic loss doctrine and have argued that a CGL policy does not cover "economic loss."

A primary question for a policyholder in any construction defect or faulty workmanship coverage analysis under the CGL policy is whether the insuring agreement of the CGL policy affords coverage. The insuring agreement of the standard form CGL provides:

> **"We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies."**

Thus, the preliminary question in determining whether a claim associated with any construction defect or faulty workmanship claim is potentially covered by a CGL policy is whether there is "property damage" caused by an "occurrence." The term "property damage" is defined under the CGL policy as either "physical injury to tangible property" or "loss of use of tangible property that is not physically injured." The CGL policy further provides that the "property damage" must be caused by an "occurrence," which is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The policyholder bears the burden of establishing that the claims fall within insuring agreement or coverage grant of the CGL policy.

Policyholders have argued that the plain language of the CGL policy contains no reference to economic loss and does not draw a distinction between tort damages or contract damages. In addition, policyholders have argued there is nothing in the definition of "property damage" that requires damage to third-party property. In response to such arguments, insurers have borrowed from the economic loss doctrine and have argued, with varying degrees of success, that a CGL policy does not provide coverage for breach of contract claims or for "economic loss."

Some courts have rejected insurer arguments that the CGL policy does not provide coverage for breach of contract claims. In *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, the Texas Supreme Court explained that the "CGL policy makes no distinction between tort and contract damages. The insuring agreement does not mention torts, contracts, or economic losses; nor do these terms appear in the definitions of' 'property damage' or 'occurrence.'" 242 S.W.3d

1, 13 (Tex. 2007) (noting that "any preconceived notion that a CGL policy is only for tort liability must yield to the policy's actual language"); *Commercial Union Ins. Co. v. Roxborough Village Joint Venture*, 944 F. Supp. 827 (D. Colo. 1996) (rejecting insurer's argument that it owed no indemnification duty under policies because the claims in the underlying suit "sounded in contract, rather than tort").

As commentators have noted, insurers have also asserted that the "occurrence" provision of the CGL policy precludes coverage for pure economic loss: "The claims against the insured fall within the economic loss rule; thus, the claims are not for a tort but essentially for disappointed economic expectations; thus, the claims cannot be for an accident, and should not be covered." Ellen S. Pryor, "The Economic Loss Rule and Liability Insurance," 48 *Ariz. L. Rev*. 905, 915 (2006) (citing cases).

When deciding whether the economic loss rule precludes CGL policy coverage for faulty workmanship, some courts have rejected the argument. For example, in *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004), the project owner sought to recover from its general contractor for damage to a warehouse resulting from settlement of the foundation that caused sinking, buckling, and cracking of the warehouse structure. The general contractor's insurer denied the claim and argued that the economic loss doctrine barred coverage. *Id.* at 75. The Wisconsin Supreme Court rejected the insurer's argument stating:

> The economic loss doctrine operates to restrict contracting parties to contract rather than tort remedies for recovery of economic losses associated with the special contract relationship . . . . The economic loss doctrine is a remedies principle. It determines how a loss can be recovered—in tort or in contract/warranty law. It does not determine whether an insurance policy covers a claim, which depends instead upon the policy language.

Id. Similarly, the Texas Supreme Court has noted, ["t]he economic-loss rule, however, is not a useful tool for determining insurance coverage . . . . It is a liability defense or remedies doctrine,

not a test for insurance coverage." *Lamar Homes*, 242 S.W.3d at 12-13; *Trinity Homes LLC v. Ohio Cas. Ins. Co.*, 864 F. Supp. 2d 744, 752 (S.D. Ind. 2012) ("[T]he economic loss doctrine is a remedies doctrine; thus, it has no application to an insurance coverage dispute.").

Even in cases where courts do not specifically reference the economic loss rule, however, some courts implicitly apply the economic loss doctrine in construing the "property damage" provision of the insuring agreement. For example, while policyholders have argued that neither the plain language of the insuring clause nor the definition of "property damage" contains such a requirement, some courts have required damage to property of a third-party, other than the property of the insured, to find "property damage" under the CGL policy. *Amerisure Mut. Ins. Co. v. Auchter Co.*, 673 F.3d 1294, 1306 (11th Cir. 2012); *Travelers Indem. Co. of Am. v. Moore & Assocs.*, 216 S.W.3d 302, 310 (Tenn. 2007) (noting that a claim in which "the sole damages are for replacement of a defective component or correction of faulty installation" does not constitute "property damage" under the CGL policy).

Other courts have noted that the CGL policy exclusions regarding the work of the insured would not be necessary if "property damage" was limited only to the property of third-parties. *See, e.g., Ferrell v. W. Bend Mut. Ins. Co.*, 393 F.3d 786, 795 (8th Cir. 2005) (holding that the measure of damages under the economic loss rule "is distinct from the question whether there was 'property damage' under the policy").

The Potential Impact of Tiara

Even though courts may not explicitly invoke the economic loss rule when making coverage determinations or may even state that the economic loss rule is not applicable to a coverage determination, courts implicitly apply the doctrine when requiring damage to property beyond the property that is the subject of the contract.

Because the Florida Supreme Court has ruled that the economic loss rule only applies in the product liability context, the *Tiara* decision could have a significant impact on insurance coverage for construction defect claims, at least in Florida, and perhaps in other jurisdictions that have limited the scope of the economic loss rule. As a result of the *Tiara* decision, where an insurer argues that "property damage" occurs only where there is damage to property other than the work or property of the insured, a policyholder can respond that such an argument improperly applies the economic loss rule outside its intended scope.