

THE ECONOMIC LOSS DOCTRINE: DISTINGUISHING ECONOMIC LOSS FROM NON-ECONOMIC LOSS

RALPH C. ANZIVINO*

I. INTRODUCTION

When a product fails there are three types of damages that can result. Those damages are identified by the courts as economic loss damages, personal injury damages, and non-economic loss damages. In any given case, there may be one, two, or all three types. It is clear that when a defective product causes personal injury damages, that case will generally proceed as a tort case. However, when the defective product causes economic, non-economic damages, or both, the economic loss doctrine comes into application.

The economic loss doctrine requires that courts distinguish economic loss from non-economic loss. Those damages found to be economic loss can only be recovered through contract law. On the other hand, damages deemed to be non-economic loss are recoverable through tort law. In nearly every state, the theories are mutually exclusive. Therefore, the case can only proceed as a tort or contract case, but not both. The critical determination is whether the damages involved are economic or non-economic losses.

Common damage claims that arise from a product's failure include lost profits, repair or replacement, downtime, overtime, and other incidental and consequential damages. In the absence of any coincident property damage, these damages are generally understood to be economic loss damages recoverable only through contract law. There are, however, some circumstances where purely economic damages are recoverable in tort.

When a product fails and causes property damage, determining whether the damages are economic or non-economic becomes difficult. Distinctions must be made between damage to the product itself, damage to the system of which it is a part, and damage to "other property." There is no consensus rule on how to make such distinctions.

* Professor of Law, Marquette University Law School.

In addition, even though one may conclude that the damages are non-economic losses, there are circumstances where the non-economic loss is recoverable only through contract law. The purpose of this Article is to distinguish economic loss from non-economic loss and to develop a workable rule for making the same distinction when a failed product causes property damage.

II. ECONOMIC LOSS

According to the economic loss doctrine, a buyer who purchases a defective product and suffers “solely economic loss” is required to recover his damages through contract law, including the Uniform Commercial Code (U.C.C.).¹ On the other hand, if the product causes “personal injury” or “other property” damage, then negligence and strict liability theories are available.² The nature of the loss incurred dictates whether the buyer’s claim is to be brought in contract or tort.³ Thus, it is essential to be able to distinguish solely “economic loss” from “personal injury” and “other property” damage. There are a number of sources available to determine when a defective product causes solely “economic losses.”

A. Uniform Commercial Code

The U.C.C. provides a comprehensive system for compensating aggrieved buyers for economic loss that arises from the purchase of a defective product.⁴ Also, the U.C.C. provides protection for manufacturers and sellers through limitation of remedies⁵ and disclaimers.⁶ In fact, it is the existence of the U.C.C. that serves as one of the founding principles for the creation of the economic loss doctrine.⁷ Therefore, an examination of the U.C.C. should prove useful in identifying those damages that are solely economic loss.

A buyer generally purchases a product for its expected performance. Those performance expectations are often understood as express

1. *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 148 Wis. 2d 910, 916, 437 N.W.2d 213, 215 (1989).

2. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 1 (1998).

3. *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 869–71 (1986).

4. *Ins. Co. of N. Am. v. Cease Elec. Inc.*, 2004 WI 139, ¶ 28, 276 Wis. 2d 361, ¶ 28, 688 N.W.2d 462, ¶ 28.

5. U.C.C. § 2-719 (2004); WIS. STAT. § 402.719 (2005–2006).

6. U.C.C. § 2-316 (2004); WIS. STAT. § 402.316.

7. *Cease Elec. Inc.*, 2004 WI 139, ¶¶ 28–31, 276 Wis. 2d 361, ¶¶ 28–31, 688 N.W.2d 462, ¶¶ 28–31.

warranties under the U.C.C.⁸ Even absent any express warranties, the U.C.C. provides a merchantability warranty⁹ and, under specified circumstances, a fitness warranty.¹⁰ In the event any warranty is breached, the U.C.C. defines the damages as the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted.¹¹ A loss of product value is clearly an economic loss covered by the U.C.C.

In addition to loss of product value, the U.C.C. recognizes other economic loss damages that are incident to a breach of warranty or contract. Those “expenses reasonably incurred in the inspection, receipt, transportation and care and custody” of the defective goods are economic loss damages incident to the breach.¹² Also, any commercially reasonable expenses incurred in effecting cover¹³ are economic loss expenses incident to the breach. Collectively, these expenses are known as incidental expenses.¹⁴ These incidental expenses are also economic loss damages.

The final type of contract damages arising from the sale of a defective product recognized by the U.C.C. is consequential damages. Consequential damages can be divided into two types. The first type is any loss that results from the general or particular requirements of the buyer that the seller had reason to know at the time of contracting, and which could not be prevented by cover or otherwise.¹⁵ These damages are often the lost profits suffered by the buyer because the product did not meet performance expectations.¹⁶ These damages do not involve damage to property and are therefore solely economic loss damages.¹⁷

The second type of consequential damages can be further divided into two classes. One class is personal injury that proximately results

8. U.C.C. § 2-313 (2004); WIS. STAT. § 402.313.

9. U.C.C. § 2-314 (2004); WIS. STAT. § 402.314.

10. U.C.C. § 2-315 (2004); WIS. STAT. § 402.315.

11. U.C.C. § 2-714(2) (2004); WIS. STAT. § 402.714(2).

12. U.C.C. § 2-715(1) (2004); WIS. STAT. § 402.715(1).

13. U.C.C. § 2-712 (2004); WIS. STAT. § 402.712.

14. U.C.C. § 2-715(1) (2004); WIS. STAT. § 402.715(1).

15. U.C.C. § 2-715(2)(a) (2004); WIS. STAT. § 402.715(2)(a).

16. See *Harbor Hill Lithographing Corp. v. Dittler Bros.*, 348 N.Y.S.2d 920, 923 (N.Y. Sup. Ct. 1973); *Manouchehri v. Heim*, 941 P.2d 978, 983 (N.M. Ct. App. 1997).

17. *Digicorp, Inc. v. Ameritech Corp.*, 2003 WI 54, ¶ 69, 262 Wis. 2d 32, ¶ 69, 662 N.W.2d 652, ¶ 69; *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 216 Wis. 2d 395, 406–07, 573 N.W.2d 842, 847 (1998); *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 148 Wis. 2d 910, 921, 437 N.W.2d 213, 217–18 (1989).

from any breach of warranty.¹⁸ In the few states that do not recognize the economic loss doctrine,¹⁹ the personal injury claim would be a separate contract claim in addition to a tort claim against the manufacturer or seller. For example, this first class of consequential damages has been used as a basis for liability for a defective air conditioner that caused death,²⁰ a defective machine that caused serious personal injury,²¹ ingested bread that caused illness,²² and a leaky casket that caused mental distress.²³ However, in those states that do recognize the economic loss doctrine,²⁴ the tort claim precludes the contract claim.

18. U.C.C. § 2-715(2)(b) (2004); WIS. STAT. § 402.715(2)(b) (2005–2006).

19. The Supreme Court of Arkansas has chosen not to adopt the economic loss doctrine. *Farm Bureau Ins. Co. v. Case Corp.*, 878 S.W.2d 741, 743 (Ark. 1994); *Blagg v. Fred Hunt Co.*, 612 S.W.2d 321, 324 (Ark. 1981). Montana has likewise declined to follow the economic loss doctrine. *See Jim's Excavating Serv., Inc. v. HKM Assocs.*, 878 P.2d 248, 255 (Mont. 1994).

20. *Garavalia v. Heat Controller, Inc.*, 570 N.E.2d 1227, 1229, 1231–32 (Ill. App. Ct. 1991).

21. *Shaw v. Dauphin Graphic Machs., Inc.*, 240 F. App'x 177, 178–79 (9th Cir. 2007).

22. *Wisniewski v. Great Atl. & Pac. Tea Co.*, 323 A.2d 744, 746–47 (Pa. Super. Ct. 1974).

23. *Hirst v. Elgin Metal Casket Co.*, 438 F. Supp. 906, 907–08 (D. Mont. 1977).

24. ALABAMA: *Lloyd Wood Coal Co. v. Clark Equip. Co.*, 543 So. 2d 671, 672–74 (Ala. 1989). ALASKA: *Pratt & Whitney Can., Inc. v. Sheehan*, 852 P.2d 1173, 1177 (Alaska 1993); *St. Denis v. Dep't of Hous. & Urban Dev.*, 900 F. Supp. 1194, 1200 (D. Alaska 1995). ARIZONA: *Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp.*, 694 P.2d 198, 209 (Ariz. 1984); *Carstens v. City of Phoenix*, 75 P.3d 1081, 1084 (Ariz. Ct. App. 2003); *Apollo Group, Inc. v. Avnet, Inc.*, 58 F.3d 477, 479–80 (9th Cir. 1995). CALIFORNIA: *Robinson Helicopter Co. v. Dana Corp.*, 102 P.3d 268, 272–74 (Cal. 2004). COLORADO: *A.C. Excavating v. Yacht Club II Homeowners Ass'n*, 114 P.3d 862, 865 (Colo. 2005); *Town of Alma v. Azco Constr., Inc.*, 10 P.3d 1256, 1264–65 (Colo. 2000). CONNECTICUT: CONN. GEN. STAT. §§ 52-572m to 52-572n (2005); *Flagg Energy Dev. Corp. v. Gen. Motors Corp.*, 709 A.2d 1075, 1088 (Conn. 1998) (applying principles of the economic loss doctrine in products liability case). *But see Paliwoda v. Mathews*, No. CV020398249S, 2006 Conn. Super. LEXIS 3088, at *16 (Conn. Super. Ct. Oct. 16, 2006) (noting the split in authority in lower courts with regard to the meaning of *Flagg*). DELAWARE: *Danforth v. Acorn Structures, Inc.*, 608 A.2d 1194, 1198 (Del. 1992). FLORIDA: *Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc.*, 891 So. 2d 532, 536 (Fla. 2004). GEORGIA: *Gen. Elec. Co. v. Lowe's Home Ctrs., Inc.*, 608 S.E.2d 636, 638 (Ga. 2005). HAWAII: *City Express, Inc. v. Express Partners*, 959 P.2d 836, 839 (Haw. 1998); *State v. U.S. Steel Corp.*, 919 P.2d 294, 302 (Haw. 1996). IDAHO: *Blahd v. Richard B. Smith, Inc.*, 108 P.3d 996, 1000 (Idaho 2005). ILLINOIS: *First Midwest Bank, N.A. v. Stewart Title Guar. Co.*, 843 N.E.2d 327, 333–34 (Ill. 2006); *Moorman Mfg. Co. v. Nat'l Tank Co.*, 435 N.E.2d 443, 450–51 (Ill. 1982). INDIANA: *Gunkel v. Renovations, Inc.*, 822 N.E.2d 150, 152 (Ind. 2005); IOWA: *Determan v. Johnson*, 613 N.W.2d 259, 261–62 (Iowa 2000). KANSAS: *Prendiville v. Contemporary Homes, Inc.*, 83 P.3d 1257, 1260 (Kan. Ct. App. 2004); *Full Faith Church of Love W., Inc. v. Hoover Treated Wood Prods., Inc.*, 224 F. Supp. 2d 1285, 1289 (D. Kan. 2002) (predicting the Kansas Supreme Court would agree with the Kansas Court of Appeals and endorse the economic loss doctrine). KENTUCKY: *Presnell Constr. Managers, Inc. v. EH Constr., LLC*, 134 S.W.3d 575, 583 (Ky. 2004) (Keller, J. concurring) (stating that the

court should explicitly adopt the economic loss doctrine); *Mt. Lebanon Pers. Care Home, Inc. v. Hoover Universal, Inc.*, 276 F.3d 845, 849 (6th Cir. 2002) (predicting “the Kentucky Supreme Court would apply the economic loss doctrine to business purchases”). MAINE: *Oceanside at Pine Point Condo. Owners Ass’n v. Peachtree Doors, Inc.*, 659 A.2d 267, 270 (Me. 1995). MARYLAND: *Morris v. Osmose Wood Preserving*, 667 A.2d 624, 631 (Md. 1995). MASSACHUSETTS: *Berish v. Bornstein*, 770 N.E.2d 961, 975 (Mass. 2002). MICHIGAN: *Neibarger v. Universal Coops., Inc.*, 486 N.W.2d 612, 615 (Mich. 1992). MINNESOTA: MINN. STAT. § 604.10 (2000). MISSISSIPPI: *Progressive Ins. Co. v. Monaco Coach Corp.*, No. 1:05CV37-DMR-JMR, 2006 U.S. Dist. LEXIS 21251, at *5 (S.D. Miss. Mar. 29, 2006); *E. Miss. Elec. Power Ass’n v. Porcelain Prods. Co.*, 729 F. Supp. 512, 514 (S.D. Miss. 1990) (predicting that the Mississippi Supreme Court would not allow recovery of solely economic losses stemming from a defective product in tort); *State Farm Mut. Auto. Ins. Co. v. Ford Motor Co.*, 736 So. 2d 384, 387 (Miss. Ct. App. 1999). MISSOURI: *Sharp Bros. Contracting Co. v. Am. Hoist & Derrick Co.*, 703 S.W.2d 901, 903 (Mo. 1986); *Self v. Equilon Enters., LLC*, No. 4:00CV1903 TIA, 2005 U.S. Dist. LEXIS 17288, at *40 (E.D. Mo. Mar. 30, 2005). NEBRASKA: *Nat’l Crane Corp. v. Ohio Steel Tube Co.*, 332 N.W.2d 39, 43 (Neb. 1983). NEVADA: *Calloway v. City of Reno*, 993 P.2d 1259, 1266 (Nev. 2000), *rev’d on other grounds*, *Olson v. Richard*, 89 P.3d 31, 33 (Nev. 2004). NEW HAMPSHIRE: *Kelleher v. Marvin Lumber & Cedar Co.*, 891 A.2d 477, 495 (N.H. 2005). NEW JERSEY: *Alloway v. Gen. Marine Indus., L.P.*, 695 A.2d 264, 275 (N.J. 1997). NEW MEXICO: *Amrep Sw., Inc. v. Shollenbarger Wood Treating, Inc.* (In re Consol. Vista Hills Retaining Wall Litig.), 893 P.2d 438, 445–47 (N.M. 1995). NEW YORK: *Bocre Leasing Corp. v. Gen. Motors Corp.*, 645 N.E.2d 1195, 1196–99 (N.Y. 1995). NORTH CAROLINA: *Moore v. Coachmen Indus., Inc.*, 499 S.E.2d 772, 780 (N.C. Ct. App. 1998). NORTH DAKOTA: *Steiner v. Ford Motor Co.*, 606 N.W.2d 881, 885 (N.D. 2000). OHIO: *Corporex Dev. & Constr. Mgmt., Inc. v. Shook, Inc.*, 835 N.E.2d 701, 704 (Ohio 2005). OKLAHOMA: *Dutsch v. Sea Ray Boats, Inc.*, 845 P.2d 187, 193 (Okla. 1992); *Waggoner v. Town & Country Mobile Homes, Inc.*, 808 P.2d 649, 653 (Okla. 1990); *United Golf, LLC v. Westlake Chem. Corp.*, No. 05-CV-0495-CVE-PJC, 2006 U.S. Dist. LEXIS 57531, at *7 (N.D. Okla. Aug. 15, 2006). OREGON: *Or. Steel Mills, Inc. v. Coopers & Lybrand, LLP*, 83 P.3d 322, 328 (Or. 2004); *Onita Pac. Corp. v. Trs. of Bronson*, 843 P.2d 890, 896–97 (Or. 1992); *Hale v. Groce*, 744 P.2d 1289, 1290 (Or. 1987); *Harris v. Suniga*, 149 P.3d 224, 227 (Or. Ct. App. 2006). PENNSYLVANIA: *Bilt-Rite Contractors, Inc. v. Architectural Studio*, 866 A.2d 270, 286–87 (Pa. 2005). RHODE ISLAND: *Rousseau v. K.N. Constr., Inc.*, 727 A.2d 190, 193 (R.I. 1999) (holding economic loss rule is inapplicable to consumer transactions); *Boston Inv. Prop. No. 1 State v. E.W. Burman, Inc.*, 658 A.2d 515, 518 (R.I. 1995). SOUTH CAROLINA: *Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc.*, 463 S.E.2d 85, 88 (S.C. 1995). SOUTH DAKOTA: *Diamond Surface, Inc. v. State Cement Plant Comm’n*, 583 N.W.2d 155, 161–62 (S.D. 1998). TENNESSEE: *Messer Griesheim Indus., Inc. v. Eastman Chem. Co.*, 194 S.W.3d 466, 471–72 (Tenn. Ct. App. 2005); *Trinity Indus., Inc. v. McKinnon Bridge Co.*, 77 S.W.3d 159, 173 (Tenn. Ct. App. 2001). TEXAS: *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 45 (Tex. 1998). UTAH: *Hermansen v. Tasulis*, 48 P.3d 235, 240 (Utah 2002). VERMONT: *Hamill v. Pawtucket Mut. Ins. Co.*, 892 A.2d 226, 229 (Vt. 2005). VIRGINIA: *Filak v. George*, 594 S.E.2d 610, 613 (Va. 2004). WASHINGTON: *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P.2d 986, 990 (Wash. 1994); *Alejandre v. Bull*, 98 P.3d 844, 852 (Wash. Ct. App. 2004); *Reynolds Metals Co. v. Alcan Inc.*, No. C04-0175RJB, 2006 U.S. Dist. LEXIS 29033, at *8–9 (W.D. Wash. May 1, 2006). WEST VIRGINIA: *Aikens v. Debow*, 541 S.E.2d 576, 589 (W. Va. 2000). WISCONSIN: 1325 N. Van Buren, LLC v. T-3 Group, Ltd., 2006 WI 94, ¶ 5, 293 Wis. 2d 410, ¶ 5, 716 N.W.2d 822, ¶ 5. WYOMING: *D & D Transp., Ltd. v. Interline Energy Servs., Inc.*, 117 P.3d 423, 427 (Wyo. 2005).

This is the case in Wisconsin.²⁵ Thus, the first class of consequential damages specified in Article 2 is not actionable in states like Wisconsin that have adopted the economic loss doctrine.

The second class of the second type of consequential damages specified in the U.C.C. is injury to property proximately resulting from any breach of warranty.²⁶ The range of U.C.C. cases that are included in this second class is very broad. There are essentially three categories of cases that are recognized as injury to property. The first category consists of those cases where the defective product injures only itself. An example is a defective mobile home that has repeated ceiling condensation problems.²⁷ The second category consists of those cases where the defective product is a component part of an integrated system.²⁸ Examples of the second category would be a defective water meter that damages the building,²⁹ a defective ingredient that contaminates the finished product,³⁰ or kitchen cabinets that contain a high level of formaldehyde that damages the home.³¹ The third category encompasses those cases where the defective product goes beyond damaging itself or the system of which it is a component, to damaging "other property." Examples of the third category are a mobile home with defective wiring that burns down and destroys all the personal property in the mobile home,³² contaminated hay that kills the horses that ingested the hay,³³ a mobile home that leaks and damages personal property within the home,³⁴ or a driveway sealer that damages the driveway it is placed upon.³⁵ This third category is the crossover group of cases that would appear to be covered by both the U.C.C. and strict tort.³⁶ In those few jurisdictions that have not adopted the economic

25. *Austin v. Ford Motor Co.*, 86 Wis. 2d 628, 644–45, 273 N.W.2d 233, 240 (1979).

26. U.C.C. § 2-715(2)(b) (2004); WIS. STAT. § 402.715(2)(b) (2005–2006).

27. *See Waggoner v. Town & Country Mobile Homes, Inc.*, 808 P.2d 649 (Okla. 1990).

28. *See infra* Part II.B.

29. *See Fed. Ins. Co. v. Vill. of Westmont*, 649 N.E.2d 986, 987 (Ill. App. Ct. 1995).

30. *See Blommer Chocolate Co. v. Bongards Creameries, Inc.*, 644 F. Supp. 234, 234 (N. D. Ill. 1986).

31. *See Marsh Furniture Co. v. Pa. Mfrs. Ass'n Ins. Co.*, No. 02A01-9505-CV-00103, 1996 Tenn. App. LEXIS 367, at *10–11 (Tenn. Ct. App. June 17, 1996).

32. *See Doty v. Parkway Homes Co.*, 368 S.E.2d 670, 671 (S.C. 1988).

33. *See Rothing v. Kallestad*, 159 P.3d 222, 223 (Mont. 2007).

34. *See Lidstrand v. Silvercrest Indus.*, 623 P.2d 710 (Wash. Ct. App. 1981).

35. *See Bazant v. Farmers Union Oil Co.*, No. BDV-95-041, 1996 Mont. Dist. LEXIS 52, at *1–3 (D. Mont. Dec. 19, 1996).

36. Strict tort applies where a defective product causes personal injury or property damage to some third person. *See* RESTATEMENT (SECOND) OF TORTS § 402A (1965) and RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 1 (1998).

loss doctrine, the two bodies of law do overlap so that a plaintiff can coincidentally pursue both theories. The preceding cases in the second and third categories illustrate the potential overlapping of U.C.C. and strict tort claims. In most jurisdictions, however, the claims are mutually exclusive and the court must determine if the property damage is economic or non-economic loss.

An examination of the U.C.C. is helpful in identifying at least three types of losses that qualify as economic loss. The first is the loss of product value when a product does not perform as warranted. The second is any incidental expense associated with the product's failure to perform as warranted, and the third is consequential damage that is foreseeable but not the result of any property damage. The U.C.C., however, does not provide any basis to distinguish economic loss from non-economic loss when the defective product causes property damage.

B. Restatement (Third) of Torts and the Integrated System Rule

The Restatement (Third) of Torts is the most recent pronouncement on a manufacturer/seller's responsibility for the harm caused by its defective product. Obviously, the focus of the Restatement of Torts is to identify those circumstances where a defective product causes harm that can be recovered through tort theories. Necessarily, therefore, the Restatement seeks to distinguish economic loss from non-economic loss. The Restatement defines a product as "tangible personal property distributed commercially for use or consumption."³⁷ Other items such as real estate can also be considered a product when the context of their use is analogous to the use of tangible personal property.³⁸ The Restatement's definition of a "product" is consistent with the Wisconsin Supreme Court's definition of the term.³⁹

The Restatement (Third) of Torts provides that when a defective product causes solely economic loss, the damage claim is to be resolved

37. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 19(a) (1998).

38. *Id.*

39. A cement paver, *see generally* Wausau Tile, Inc. v. County Concrete Corp., 226 Wis. 2d 235, 593 N.W.2d 445 (1999); a milk product, *see generally* Grams v. Milk Prods., Inc., 2005 WI 112, 283 Wis. 2d 511, 699 N.W.2d 167; a machine, *see generally* Daanen & Janssen, Inc. v. Cedarapids, Inc., 216 Wis. 2d 395, 573 N.W.2d 842 (1998); a home, *see generally* Linden v. Cascade Stone Co., 2005 WI 113, 283 Wis. 2d 606, 699 N.W.2d 189; and a forty-two-unit condominium complex, *see generally* 1325 N. Van Buren, LLC v. T-3 Group, Ltd., 2006 WI 94, 293 Wis. 2d 410, 716 N.W.2d 822, have all been held to be "products" by the Wisconsin Supreme Court.

by following contract law and the U.C.C.⁴⁰ The Restatement (Third) of Torts identifies a number of circumstances that constitute solely economic loss. The simplest are the losses that ensue when the product harms only itself.⁴¹ These losses take two forms.⁴² The first is the repair or replacement costs associated with the defective product.⁴³ The second is consequential losses that do not involve harm to the buyer's person or property.⁴⁴ An example of the second form would be lost profits caused by the defective product. The Restatement (Third) of Torts illustration of this second form is a defective conveyor belt that shuts down the buyer's assembly line and causes a disruption in the buyer's production schedule.⁴⁵ The interruption in the buyer's production schedule causes lost profits that are solely economic loss damages. These losses that occur when the defective product damages only itself under the Restatement are consistent with the U.C.C.'s definition of economic loss.

The issue, however, becomes more complex when the defective product causes physical harm beyond itself to surrounding property. The damage caused by the defective product to any surrounding property is clearly "other property" damage.⁴⁶ It is property damage to property "other than" itself. There are, however, two types of damage to "other property." The first type is when the defective product is a component part of a machine or system and the defective product damages the machine or system. The surrounding property that is damaged is limited to the machine or the system of which the defective product is a part. This type of damage is considered to be damage to the product itself.⁴⁷ As such, these damages are not considered to be damage to "other property," but solely economic loss. This principle is known as the integrated system rule.⁴⁸ There are a number of rationales for the rule. First, the deterrent value of tort liability is not needed when the damage is to the product itself or its integrated system.⁴⁹

40. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. a (1998).

41. *Id.*

42. *Id.* § 21 cmt. d.

43. *Id.*

44. *Id.*

45. *Id.* § 21 cmt. d, illus. 3.

46. *Id.* § 21 cmt. e.

47. *Id.*

48. *See id.*; *see also* Grams v. Milk Prods., Inc., 2005 WI 112, ¶ 27, 283 Wis. 2d 511, ¶ 27, 699 N.W.2d 167, ¶ 27.

49. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21, Reporters Notes (1998).

Second, damages to the product itself or its integrated system are foreseeable damages and, as such, are the type of losses that contracting parties are expected to address through their contract.⁵⁰ And, finally, because all but the very simplest machines have component parts, a contrary holding would require a finding of “other property” damage in virtually every case where a product damages itself.⁵¹

The Restatement (Third) of Torts illustrates the integrated system rule with a hypothetical.⁵² A company purchases a conveyor belt that is installed in its assembly line.⁵³ The defective belt subsequently breaks, damaging the assembly line.⁵⁴ All the losses stemming from the defective belt are considered to be damage to the product itself.⁵⁵ As such, all the damages are purely economic losses, not “other property” damages. The net effect of such a rule is to broaden the coverage of the economic loss doctrine and convert otherwise “other property” damage into economic loss. The integrated system rule covers the first type of “other property” damage that can arise when a defective product damages its surrounding property.

The second type of “other property” damage is damage to surrounding property that is *more than* damage to the product or its integrated system.⁵⁶ This second type of damage is clearly “other property” damage that triggers tort liability.⁵⁷ The Restatement (Third) of Torts also illustrates this type of damage with a hypothetical.⁵⁸ A company has an assembly line at its plant.⁵⁹ A defective steering mechanism in the company’s forklift causes the forklift to go out of control and damage the assembly line.⁶⁰ The damages stemming from the defective forklift are considered to be “other property” damage actionable through tort theories.⁶¹ Because the defective steering mechanism caused damage beyond the forklift to the assembly line, the

50. *Id.*

51. *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 867 (1986); RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. e (1998).

52. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. d, illus. 3 (1998).

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.* § 21 cmt. e.

57. *Id.*

58. *Id.* § 21 cmt. e, illus. 4.

59. *Id.*

60. *Id.*

61. *Id.*

integrated system rule is not applicable.⁶² The damages are non-economic losses recoverable through tort theories.

The integrated system rule was created by the United States Supreme Court in *East River Steamship Corp. v. Transamerica Delaval Inc.*⁶³ In *East River*, defective valves damaged the ship's turbine which in turn damaged the propulsion system.⁶⁴ The Court found only economic loss damages and not damage to "other property."⁶⁵ Most states since *East River* have adopted the integrated system rule.⁶⁶

62. *See id.*

63. *See* 476 U.S. 858, 871–72 (1986).

64. *Id.* at 860–61.

65. *Id.* at 875–76.

66. ALABAMA: *Carrell v. Masonite Corp.*, 775 So. 2d 121, 126 (Ala. 2000) (Johnstone, J., concurring) (suggesting that the economic loss doctrine should not apply when damage occurs to the home rather than just a component of the home). ALASKA: *N. Power & Eng'g Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324, 330 (Alaska 1981). ARIZONA: *Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc.*, 666 P.2d 544, 548–49 (Ariz. Ct. App. 1983). CALIFORNIA: *Jimenez v. Superior Ct.*, 58 P.3d 450, 458 (Cal. 2002) (Kennard, J., concurring) (clarifying that economic loss depends on whether component part is "so integrated into the overall unit" that the part loses its own identity). DELAWARE: *Delmarva Power & Light v. Meter-Treater Inc.*, 218 F. Supp. 2d 564, 569–70 (D. Del. 2002) (applying Delaware law). FLORIDA: *Casa Clara Condo. Ass'n, Inc. v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244, 1247 (Fla. 1993). GEORGIA: *Flintkote Co. v. Dravo Corp.*, 678 F.2d 942, 951 (11th Cir. 1982) (applying Georgia law). HAWAII: *Va. Sur. Co. v. Am. Eurocopter Corp.*, 955 F. Supp. 1213, 1216 (D. Haw. 1996) (citing *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 867 (1986)) (predicting Hawaii law and holding that helicopter engine, fitting, and helicopter are all one product for purposes of the economic loss doctrine). IDAHO: *Blahd v. Richard B. Smith, Inc.*, 108 P.3d 996, 1000–01 (Idaho 2005). ILLINOIS: *Trans State Airlines v. Pratt & Whitney Can., Inc.*, 682 N.E.2d 45, 58–59 (Ill. 1997). INDIANA: *Progressive Ins. Co. v. Gen. Motors Corp.*, 749 N.E.2d 484, 490 (Ind. 2001) (agreeing that component parts of a product are not "other property," but rather one product). IOWA: *Richards v. Midland Brick Sales Co.*, 551 N.W.2d 649, 650–51 (Iowa Ct. App. 1996). KANSAS: *Nw. Ark. Masonry, Inc. v. Summit Specialty Prods, Inc.*, 31 P.3d 982, 988 (Kan. Ct. App. 2001). LOUISIANA: *ERA Helicopters, Inc. v. Bell Helicopter Textron, Inc.*, 696 F. Supp. 1096, 1097–98 (E.D. La. 1987) (applying Louisiana law). MAINE: *Oceanside at Pine Point Condo. Owners Ass'n v. Peachtree Doors, Inc.*, 659 A.2d 267, 271 (Me. 1995). MARYLAND: *Pulte Home Corp. v. Parex, Inc.*, 923 A.2d 971, 1004–05 (Md. Ct. Spec. App. 2007). MASSACHUSETTS: *Superior Kitchen Designs, Inc. v. Valspar Indus. (U.S.A.), Inc.*, 263 F. Supp. 2d 140, 145–46 (D. Mass. 2003) (applying Massachusetts law). MICHIGAN: *Sullivan Indus., Inc. v. Double Seal Glass Co.*, 480 N.W.2d 623, 629–30 (Mich. Ct. App. 1991). MINNESOTA: *Minneapolis Soc'y of Fine Arts v. Parker-Klein Assocs. Architects, Inc.*, 354 N.W.2d 816, 819–21 (Minn. 1984), *overruled on other grounds by Hapka v. Paquin Farms*, 458 N.W.2d 683 (Minn. 1990). MISSISSIPPI: *State Farm Mut. Auto. Ins. Co. v. Ford Motor Co.*, 736 So. 2d 384, 388 (Miss. Ct. App. 1999). MISSOURI: *Rockport Pharmacy, Inc. v. Digital Simplistics, Inc.*, 53 F.3d 195, 198–99 (8th Cir. 1995) (applying Missouri law). NEVADA: *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Pratt & Whitney Can., Inc.*, 815 P.2d 601, 604 (Nev. 1991). NEW HAMPSHIRE: *Lockheed Martin Corp. v. RFI Supply, Inc.*, 440 F.3d 549, 555 (1st Cir. 2006) (applying New Hampshire law). NEW YORK: *AKV Auto Transp., Inc. v. Syosset Truck Sales, Inc.*, 806 N.Y.S.2d 254, 256 (N.Y.

Wisconsin adopted the integrated system rule in *Wausau Tile, Inc. v. County Concrete Corp.*⁶⁷ In *Wausau Tile*, Wausau Tile manufactured and sold pavers to distributors.⁶⁸ Pavers are concrete blocks, primarily used for exterior walkways, and are “made of cement, aggregate, water, and other materials.”⁶⁹ Wausau Tile had contracted with several suppliers to supply the cement and aggregate to make the pavers.⁷⁰ Subsequently, it was learned that because of the high alkalinity levels in the cement and aggregate, the pavers suffered various problems, including buckling, excessive expansion, curling, and cracking.⁷¹ As a result, Wausau Tile had to pay damages consisting of (1) repair and replacement of defective pavers; (2) claims paid by their distributors for personal injury and property damage suffered by their distributors’ customers; and (3) its distributors’ lost profits and loss of future business.⁷² The issue was whether the defective components—cement and aggregate—caused damage that fell within the integrated system rule.⁷³ The Wisconsin Supreme Court adopted the integrated system rule and held that the aggregate, cement, and pavers were all part of one product.⁷⁴ Thus, the damages were solely economic loss. Therefore, contract principles, not tort principles, would control resolution of the

App. Div. 2005). NORTH CAROLINA: *Atl. Coast Mech., Inc. v. Arcadis, Geraghty & Miller of N.C., Inc.*, 623 S.E.2d 334, 340 (N.C. Ct. App. 2006). NORTH DAKOTA: *Coop. Power Ass’n v. Westinghouse Elec. Corp.*, 493 N.W.2d 661, 667 (N.D. 1992). OHIO: *HDM Flugservice GMBH v. Parker Hannifin Corp.*, 332 F.3d 1025, 1031 (6th Cir. 2003) (applying Ohio law). PENNSYLVANIA: *King v. Hilton-Davis*, 855 F.2d 1047, 1050–53 (3d Cir. 1988) (predicting Pennsylvania law). SOUTH CAROLINA: *Laurens Elec. Coop., Inc. v. Altec Indus., Inc.*, 889 F.2d 1323, 1324–25 (4th Cir. 1989) (predicting South Carolina law). SOUTH DAKOTA: *City of Lennox v. Mitek Indus., Inc.*, 519 N.W.2d 330, 333–34 (S.D. 1994). TENNESSEE: *Messer Griesheim Indus., Inc. v. Cryotech of Kingsport, Inc.*, 131 S.W.3d 457, 466 (Tenn. Ct. App. 2003) (considering whether product in question is part of an integrated package for purposes of economic loss). TEXAS: *Alcan Aluminum Corp. v. BASF Corp.*, 133 F. Supp. 2d 482, 505 (N.D. Tex. 2001) (predicting Texas law). UTAH: *Am. Towers Owners Ass’n v. CCI Mech., Inc.*, 930 P.2d 1182, 1191 (Utah 1996). VERMONT: *Moffitt v. Icyne, Inc.*, 407 F. Supp. 2d 591, 601 (D. Vt. 2005) (applying Vermont law). VIRGINIA: *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 374 S.E.2d 55, 57–58 (Va. 1988). WISCONSIN: *Wausau Tile, Inc. v. County Concrete Corp.*, 226 Wis. 2d 235, 249–50, 593 N.W.2d 445, 452 (1999). RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21, Reporters Notes (1998).

67. 226 Wis. 2d at 249–50, 593 N.W.2d at 452 (1999).

68. *Id.* at 241, 593 N.W.2d at 449.

69. *Id.* at 241, 593 N.W.2d at 449.

70. *Id.* at 241, 593 N.W.2d at 449.

71. *Id.* at 242, 593 N.W.2d at 449.

72. *Id.* at 248, 593 N.W.2d at 452.

73. *Id.* at 251, 593 N.W.2d at 452.

74. *Id.* at 251, 593 N.W.2d at 453.

dispute.

The Wisconsin Supreme Court recently reaffirmed the integrated system rule in *Linden v. Cascade Stone Co.*⁷⁵ In *Linden*, homeowners contracted for the construction of a new home.⁷⁶ After construction was complete, the home suffered water infiltration through its exterior walls and roof.⁷⁷ The water infiltration caused deterioration to the home, mold, and deficient air quality in the home.⁷⁸ The homeowners sought to use tort theories to recover their losses incurred in remedying the problems caused by the poor construction.⁷⁹ The court concluded that because the defective walls and roof harmed only other components of the house, the integrated system rule was applicable.⁸⁰ The losses were held to be solely economic loss, not “other property” damage, and therefore, only contract principles were available to the homeowners.⁸¹ The essence of the integrated system rule is that if the defective product at issue is a defective component in a larger system, the other components of the system are not regarded as “other property” as a legal matter even if they are different property in a literal sense.⁸²

The Restatement (Third) of Torts is primarily concerned with defective products that cause personal injury and property damage. It, therefore, does not address loss of product value as economic loss. However, the Restatement (Third) of Torts does concur with the U.C.C. that damage to only the product itself constitutes solely economic loss. The losses identified by the Restatement (Third) of Torts are repair and replacement costs for the product and consequential damages that occur in the absence of any property damage. However, the Restatement (Third) of Torts adds an additional element of economic loss through the integrated system rule. The rule provides that any damage to a system of which the defective product is a part is also considered to be damage to the product only, and thus, economic loss.

75. 2005 WI 113, ¶ 32, 283 Wis. 2d 606, ¶ 32, 699 N.W.2d 189, ¶ 32.

76. *Id.* ¶ 2, 283 Wis. 2d 606, ¶ 2, 699 N.W.2d 189, ¶ 2.

77. *Id.* ¶ 3, 283 Wis. 2d 606, ¶ 3, 699 N.W.2d 189, ¶ 3.

78. *Id.* ¶ 3, 283 Wis. 2d 606, ¶ 3, 699 N.W.2d 189, ¶ 3.

79. *Id.* ¶ 3, 283 Wis. 2d 606, ¶ 3, 699 N.W.2d 189, ¶ 3.

80. *Id.* ¶ 29, 283 Wis. 2d 606, ¶ 29, 699 N.W.2d 189, ¶ 29.

81. *Id.* ¶ 29, 283 Wis. 2d 606, ¶ 29, 699 N.W.2d 189, ¶ 29.

82. *Grams v. Milk Prods., Inc.*, 2005 WI 112, ¶ 27, 283 Wis. 2d 511, ¶ 27, 699 N.W.2d 167, ¶ 27.

C. Case Law Defining Economic Loss

1. Economic Loss Recoverable Through Contract Law

There are a number of landmark decisions by various supreme courts that collectively define those losses that constitute economic loss covered by the economic loss doctrine. These cases can generally be classified into two groups. The first group consists of cases where there is loss of product value and coincident consequential damages. In *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, a buyer purchased grading equipment that was defective.⁸³ The buyer sought damages for replacement parts, labor charges, downtime, repair costs, and lost profits.⁸⁴ All the damages were held to be solely economic losses.⁸⁵ In *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, a buyer purchased a rock crusher that subsequently failed.⁸⁶ The buyer suffered repair costs and lost revenue.⁸⁷ The court held such losses to be economic loss recoverable only in a contract action.⁸⁸ Finally, in *Digicorp, Inc. v. Ameritech Corp.*, a distributor of telephone calling services sued a telecommunications provider for fraud and breach of contract.⁸⁹ The plaintiff sought damages in the form of lost profits.⁹⁰ The court held the lost profits were solely economic loss damages and there were no damages in the form of personal injury or “other property damage.”⁹¹ The allegations of fraud were not sufficient to raise a tort claim.⁹²

The second group of cases defining economic loss consists of cases where the defective product damages itself or its integrated system. In *Seely v. White Motor Co.*, a buyer purchased a truck from the seller for use in the buyer’s hauling business.⁹³ The truck had a defective brake system that subsequently caused an accident.⁹⁴ The only physical

83. 148 Wis. 2d 910, 914, 437 N.W.2d 213, 214–15 (1989).

84. *Id.* at 914–15, 437 N.W.2d at 215.

85. *Id.* at 921, 437 N.W.2d at 217–18.

86. 216 Wis. 2d 395, 398, 573 N.W.2d 842, 844 (1998).

87. *Id.* at 398–99, 573 N.W.2d at 844.

88. *Id.* at 406–07, 573 N.W.2d at 847.

89. 2003 WI 54, ¶ 1, 262 Wis. 2d 32, ¶ 1, 662 N.W.2d 652, ¶ 1.

90. *See id.* ¶¶ 12, 14, 262 Wis. 2d 32, ¶¶ 12, 14, 662 N.W.2d 652, ¶¶ 12, 14.

91. *See id.* ¶¶ 68–69, 262 Wis. 2d 32, ¶¶ 68–69, 662 N.W.2d 652, ¶¶ 68–69.

92. *See id.* ¶ 62, 262 Wis. 2d 32, ¶ 62, 662 N.W.2d 652, ¶ 62.

93. 403 P.2d 145, 147 (Cal. 1965).

94. *Id.*

damage in the accident was to the truck.⁹⁵ The buyer sought damages for the repair of the truck and lost profits caused by the loss of its use.⁹⁶ The California Supreme Court held that such damages were solely economic loss and recoverable only through contract theory.⁹⁷ In *East River Steamship Corp. v. Transamerica Delaval Inc.*, a buyer purchased four supertankers.⁹⁸ Upon taking possession of the ships, the buyer discovered the tankers had defective turbines, which damaged the propulsion systems of the tankers.⁹⁹ The buyer sought damages from the seller for the cost to repair the turbines and the lost profits for the time the tankers were out of service.¹⁰⁰ The United States Supreme Court ruled that the turbines were part of an integrated system (the tanker), and thus, the damages suffered were solely economic loss.¹⁰¹

The Wisconsin Supreme Court has decided many economic loss cases. In *Wausau Tile, Inc. v. County Concrete Corp.*, a manufacturer of concrete paving blocks brought an action against a cement supplier for supplying defective concrete that was used in manufacturing the cement pavers.¹⁰² Wausau Tile suffered three types of damages: (1) the cost to repair and replace the defective pavers; (2) the cost of satisfying third party claims that the defective pavers caused personal injury and property damage; and (3) lost profits.¹⁰³ The court reasoned that the defective cement was a component of the final product (the paver) and as such the damages arose from a defective component of an integrated system.¹⁰⁴ Thus, the court held that all the damages were to the product itself.¹⁰⁵ All three types of damages were held to be economic loss damages.¹⁰⁶ In *General Casualty Co. of Wisconsin v. Ford Motor Co.*, a buyer purchased an automobile that contained a defective steering column.¹⁰⁷ The defective steering column caused a fire that destroyed the automobile.¹⁰⁸ The supreme court concluded that the loss was solely

95. *Id.*

96. *Id.* at 150.

97. *See id.*

98. 475 U.S. 858, 859 (1986).

99. *Id.* at 860–61.

100. *Id.* at 861.

101. *Id.* at 867.

102. 226 Wis. 2d 235, 241–42, 593 N.W.2d 445, 449 (1999).

103. *Id.* at 248, 593 N.W.2d at 452.

104. *Id.* at 257, 593 N.W.2d at 453.

105. *Id.* at 257, 593 N.W.2d at 453.

106. *Id.* at 248, 265, 593 N.W.2d at 452, 459.

107. 225 Wis. 2d 353, 355, 592 N.W.2d 198, 199 (1999).

108. *Id.* at 355, 592 N.W.2d at 199.

an economic loss.¹⁰⁹ In *Linden v. Cascade Stone Co.*, a new home owner sought damages from his contractor and subcontractors for water infiltration into his newly constructed home.¹¹⁰ In particular, the exterior walls and roof were defective. The court held that the damage to the walls and foundation fell under the integrated system rule and thus were solely economic loss.¹¹¹ Finally, in *1325 North Van Buren LLC v. T-3 Group Ltd.*, an owner of an industrial warehouse contracted with a builder to convert the warehouse into a forty-two-unit condominium.¹¹² There were numerous construction defects and delays in the project.¹¹³ The court concluded that all the owner's losses were solely economic losses.¹¹⁴

2. Economic Loss Recoverable Through Tort Law

Economic losses are generally recoverable only through contract law, not tort. There are, however, two circumstances where solely economic losses are recoverable in tort.

a. *The Fraud Exception to the Economic Loss Doctrine*

On occasion, a contract for the sale of a product is the result of fraudulent inducements by the seller. The damages suffered by the buyer are solely economic losses, such as loss of product value, lost profits, downtime, repair and replacement costs, or other similar damages. There is no property damage caused by the defective product. States have taken a number of approaches when addressing the problem of the fraudulently induced contract that causes solely economic loss.¹¹⁵ One approach is to ignore the fraud and treat the matter solely under contract law.¹¹⁶ The second approach is to permit the aggrieved party to sue in tort in all cases where the contract is fraudulently induced.¹¹⁷ The third approach is to permit tort recovery only in those circumstances where the fraud is considered extraneous to the contract, as opposed to

109. *Id.* at 361, 592 N.W.2d at 201.

110. 2005 WI 113, ¶ 3, 283 Wis. 2d 606, ¶ 3, 699 N.W.2d 189, ¶ 3.

111. *Id.* ¶ 32, 283 Wis. 2d 606, ¶ 32, 699 N.W.2d 189, ¶ 32.

112. 2006 WI 94, ¶ 2, 293 Wis. 2d 410, ¶ 2, 716 N.W.2d 822, ¶ 2.

113. *Id.* ¶ 2, 293 Wis. 2d 410, ¶ 2, 716 N.W.2d 822, ¶ 2.

114. *Id.* ¶ 5, 293 Wis. 2d 410, ¶ 5, 716 N.W.2d 822, ¶ 5.

115. Ralph C. Anzivino, *The Fraud in the Inducement Exception to the Economic Loss Doctrine*, 90 MARQ. L. REV. 921, 931 (2007).

116. *Id.*

117. *Id.*

intrinsic to the contract.¹¹⁸

Wisconsin adopted the third approach in *Kaloti Enterprises, Inc. v. Kellogg Sales Co.*¹¹⁹ In *Kaloti*, a food wholesaler sued a cereal manufacturing company for damages incurred as a result of the failure of the cereal company to disclose to the wholesaler a change in the manufacturer's marketing strategy.¹²⁰ The cereal manufacturer had decided to market its products directly to supermarkets as opposed to its past practice, which was to sell to the wholesaler who in turn sold to supermarkets.¹²¹ The manufacturer never disclosed its change in marketing strategy when the wholesaler purchased a large quantity of the manufacturer's products for resale to supermarkets.¹²² In essence, both the manufacturer and wholesaler would be competing for the same sales to supermarkets. The court concluded that the losses suffered by the wholesaler in not being able to resell the purchased products were solely economic loss damages.¹²³ Next, the court considered whether the manufacturer had a duty to disclose its change in marketing strategy to the wholesaler prior to the wholesaler's large purchase.¹²⁴ The court held that the manufacturer had a duty to disclose, and the manufacturer's failure to do so was fraud.¹²⁵ Finally, the court considered whether the fraud would warrant an action in tort, or whether the buyer's remedy was solely in contract for the economic loss damages.¹²⁶ The court chose to adopt the minority view¹²⁷ that permits a tort action only when the fraud is extraneous to the contract.¹²⁸ Extraneous fraud is fraud that concerns matters whose risk and responsibility do not relate to the quality or character of the goods for which the parties contracted, or otherwise involves performance under the contract.¹²⁹ The court concluded that the economic loss damages were recoverable in tort because the manufacturer's fraud in not disclosing the change in its marketing strategy constituted extraneous

118. *Id.* at 933.

119. 2005 WI 111, ¶ 42, 283 Wis. 2d 555, ¶ 42, 699 N.W.2d 205, ¶ 42.

120. *Id.* ¶ 9, 283 Wis. 2d 555, ¶ 9, 699 N.W.2d 205, ¶ 9.

121. *Id.* ¶ 5, 283 Wis. 2d 555, ¶ 5, 699 N.W.2d 205, ¶ 5.

122. *Id.* ¶¶ 5–6, 283 Wis. 2d 555, ¶¶ 5–6, 699 N.W.2d 205, ¶¶ 5–6.

123. *Id.* ¶ 27, 283 Wis. 2d 555, ¶ 27, 699 N.W.2d 205, ¶ 27.

124. *Id.* ¶ 14, 283 Wis. 2d 555, ¶ 14, 699 N.W.2d 205, ¶ 14.

125. *Id.* ¶ 22, 283 Wis. 2d 555, ¶ 22, 699 N.W.2d 205, ¶ 22.

126. *See id.* ¶ 30, 283 Wis. 2d 555, ¶ 30, 699 N.W.2d 205, ¶ 30.

127. *See Anzivino, supra* note 115, at 921, 931–34.

128. *Kaloti*, 2005 WI 111, ¶ 42, 283 Wis. 2d 555, ¶ 42, 699 N.W.2d 205, ¶ 42.

129. *Id.* ¶ 48, 283 Wis. 2d 555, ¶ 48, 699 N.W.2d 205, ¶ 48.

fraud.¹³⁰

Similarly, in *Wickenhauser v. Lehtinen*, a debtor borrowed money from a creditor to purchase land.¹³¹ As part of the loan transaction, the creditor fraudulently induced the debtor to execute an option to purchase the land in favor of the creditor.¹³² In subsequent litigation between the parties, the debtor sought damages for the creditor's fraudulent conduct in connection with the loan transaction.¹³³ The court characterized the damages as purely economic losses, but because the fraud was considered extraneous to the contract, the court permitted the plaintiff to proceed in tort law.¹³⁴

b. The Intrinsically Dangerous Substance Exception to the Economic Loss Doctrine

In addition to fraud, there is one other circumstance where a tort remedy is available despite the fact that a defective product caused solely economic loss. That circumstance is when a product contains an intrinsically dangerous substance. In *Northridge Co. v. W.R. Grace & Co.*, a property owner brought an action for damages suffered as a result of the defendant installing a fireproofing product that contained asbestos in the owner's shopping center.¹³⁵ The damages were to cover the costs of asbestos removal and the drop in value of the property.¹³⁶ The court held that the product could be found to have damaged property other than the product itself.¹³⁷ Interpreted as such, the damages would constitute physical harm to "other property," namely the contamination of the building with asbestos, which posed a health hazard.¹³⁸ The *Northridge* decision, however, was before the court's decision in *Wausau Tile*, which adopted the integrated system rule in Wisconsin.¹³⁹ The integrated system rule provides that when a product harms the system of which it is a part, it harms only itself, and thus the damages are solely economic loss. Therefore, under the integrated

130. *Id.* ¶ 51, 283 Wis. 2d 555, ¶ 51, 699 N.W.2d 205, ¶ 51.

131. 2007 WI 82, ¶ 4, 302 Wis. 2d 41, ¶ 4, 734 N.W.2d 855, ¶ 4.

132. *See id.* ¶ 5, 302 Wis. 2d 41, ¶ 5, 734 N.W.2d 855, ¶ 5.

133. *Id.* ¶ 7, 302 Wis. 2d 41, ¶ 7, 734 N.W.2d 855, ¶ 7.

134. *Id.* ¶ 41, 302 Wis. 2d 41, ¶ 41, 734 N.W.2d 855, ¶ 41.

135. 162 Wis. 2d 918, 922, 471 N.W.2d 179, 180 (1991).

136. *Id.* at 922, 471 N.W.2d at 180.

137. *Id.* at 937, 471 N.W.2d at 186.

138. *Id.* at 923, 471 N.W.2d at 180.

139. *Wausau Tile, Inc. v. County Concrete Corp.*, 226 Wis. 2d 235, 251, 593 N.W.2d 445, 453 (1999).

system rule, the fireproofing material in *Northridge* damaged the building of which it was a part; thus, the damages would likely be solely economic loss. There is, however, an alternative understanding of *Northridge*. Because asbestos is an intrinsically dangerous substance that threatens public safety,¹⁴⁰ the court allowed the plaintiff to pursue his tort remedies despite the fact that the harm was solely economic loss.¹⁴¹ The *Northridge* exception to the economic loss doctrine has been further clarified. In *Wausau Tile*, the manufacturer argued that the defective cement and aggregate that were mixed together to form the brick pavers caused the pavers to be dangerous, and therefore a threat to public safety.¹⁴² In fact, a number of people who used the defective pavers were injured.¹⁴³ However, the Wisconsin Supreme Court concluded that the *Northridge* exception applies only to inherently dangerous *substances*, like asbestos, but does not otherwise apply to *products* that may be inherently dangerous.¹⁴⁴ The cement and aggregate were not inherently dangerous substances, and therefore, the dangerous pavers did not qualify under the exception.¹⁴⁵

The foregoing cases are helpful in identifying circumstances that give rise to solely economic loss under the economic loss doctrine. Two of the cases are examples of economic losses that stem from harm to only the product.¹⁴⁶ One case illustrates that economic loss can arise from breach of a distributorship agreement.¹⁴⁷ Six cases illustrate the various circumstances where economic losses may arise when the defective product damages the integrated system of which it is a part.¹⁴⁸ And finally, there are those rare occasions where even though only economic loss has occurred, the aggrieved party will be able to pursue tort theories rather than contract theories because of a defendant's extraneous

140. *See Northridge*, 162 Wis. 2d at 923, 938, 471 N.W.2d at 180, 186.

141. *Id.* at 938, 471 N.W.2d at 186.

142. *Wausau*, 226 Wis. 2d at 260, 593 N.W.2d at 457.

143. *See id.* at 242 n.4, 593 N.W.2d at 449 n.4.

144. *See id.* at 264–65, 593 N.W.2d at 458.

145. *See id.* at 265, 593 N.W.2d at 459.

146. *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 148 Wis. 2d 910, 437 N.W.2d 213 (1989); *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 216 Wis. 2d 395, 573 N.W.2d 842 (1998).

147. *Digicorp, Inc. v. Ameritech Corp.*, 2003 WI 54, ¶ 59, 262 Wis. 2d 32, ¶ 59, 662 N.W.2d 652, ¶ 59.

148. *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858 (1986); 1325 N. Van Buren, LLC v. T-3 Group, Ltd., 2006 WI 94, 293 Wis. 2d 410, 716 N.W.2d 822; *Linden v. Cascade Stone Co.*, 2005 WI 113, 283 Wis. 2d 606, 699 N.W.2d 189; *Wausau*, 226 Wis. 2d 235, 593 N.W.2d 445; *State Farm Mut. Auto. Ins. Co. v. Ford Motor Co.*, 225 Wis. 2d 305, 592 N.W.2d 201 (1999); *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

fraud¹⁴⁹ or because the product is an “intrinsically dangerous substance.”¹⁵⁰

III. NON-ECONOMIC LOSS—“OTHER PROPERTY” DAMAGE

There is a corollary rule to the economic loss doctrine’s directive that a defective product that causes solely economic loss can be brought only under contract law. The corollary rule is that a defective product that causes “other property” damage may be brought as a tort action. In a few states both theories are available.¹⁵¹ However, in those states that have adopted the economic loss doctrine, a choice must be made.¹⁵² The choice depends on the nature of the damages caused by the defective product.¹⁵³ The purpose of this Part will be to examine the Restatement of Torts, relevant case law, and analogous insurance law to determine when a defective product causes non-economic loss in the form of damage to “other property.”

A. Restatement of Torts

The Restatement (Second) of Torts provides that “[o]ne who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm[] thereby caused to the ultimate user or consumer, or to his property.”¹⁵⁴ In other words, there is strict tort liability when a defective product causes damage to a person or his property. These damages are understood to be non-economic losses. Wisconsin adopted the rule that non-economic damages are recoverable in strict tort in *Dippel v. Sciano*.¹⁵⁵ In *Dippel*, the plaintiff was permitted to recover under strict tort for injuries he sustained when a defective pool table collapsed and crushed his left foot.¹⁵⁶ The Wisconsin Supreme Court held that his damages were non-economic damages recoverable in tort.¹⁵⁷ The tort remedies were available notwithstanding that the plaintiff also had a

149. *Wickenhauser v. Lehtinen*, 2007 WI 82, 302 Wis. 2d 41, 734 N.W.2d 855; *Kaloti Enters., Inc. v. Kellogg Sales Co.*, 2005 WI 111, 283 Wis. 2d 555, 699 N.W.2d 205.

150. *Northridge Co. v. W.R. Grace & Co.*, 162 Wis. 2d 918, 471 N.W.2d 179 (1991).

151. See *supra* note 19 for a list of states that have not adopted the economic loss doctrine.

152. See *supra* note 24 for a list of states that have adopted the economic loss doctrine.

153. *E. River*, 476 U.S. at 869–70.

154. RESTATEMENT (SECOND) OF TORTS § 402A (1965).

155. 37 Wis. 2d 443, 458–59, 155 N.W.2d 55, 62–63 (1967).

156. *Id.* at 447, 155 N.W.2d at 56.

157. *Id.* at 458–59, 155 N.W.2d at 62–63.

claim under contract law. There are a number of justifications for this rule of strict liability.¹⁵⁸ First, the seller had undertaken and assumed a special responsibility to any consuming member of the public to protect that person from physical harm to his person or property.¹⁵⁹ Second, the user has a right to expect that reputable sellers will stand behind their product when it causes physical harm.¹⁶⁰ Third, public policy demands that the burden of accidental injuries caused by defective products be placed upon those who place the products in the marketplace.¹⁶¹ Fourth, the cost to compensate the aggrieved user should be treated as a cost of production to be allocated as part of the price of the product.¹⁶² Fifth, the seller is expected to secure liability insurance to cover the cost of compensating aggrieved users.¹⁶³ Sixth, the user of such products is entitled to the maximum protection as the least culpable person in the transaction.¹⁶⁴ And seventh, the responsibility for such damage should be placed on the person most able to remedy future defects in the product.¹⁶⁵

The Restatement (Third) of Torts further expands the responsibility of a manufacturer/seller for a defective product. It provides that “[o]ne engaged in the business of selling or . . . distributing products who sells . . . a defective product” is liable to the injured party for harm caused by the defective product to the user’s person or property.¹⁶⁶ Harm is specifically defined to include economic loss if accompanied by damage to the plaintiff’s property.¹⁶⁷ A product can be defective in any of three ways. It is defective if it (1) contains a manufacturing defect, (2) contains a design defect, or (3) contains inadequate instructions or warnings.¹⁶⁸ It is noteworthy that the Restatement (Third) of Torts has not retained the unreasonably dangerous standard for manufacturing defects.¹⁶⁹ The obvious intent is to expand the reach of strict liability to all cases where the manufacturing defect causes physical harm to a

158. RESTATEMENT (SECOND) OF TORTS: PRODS. LIAB. § 402A cmt. c (1965).

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 1 (1998).

167. *Id.* § 21.

168. *Id.* § 2(a)–(c).

169. *See id.* § 2(a).

user's person or property. This is a clear expansion of tort recovery for non-economic losses. The unreasonably dangerous standard, however, has been retained for design defects and inadequate instructions or warnings.¹⁷⁰

A manufacturing defect is the only one of the three defects recognized by the Restatement (Third) of Torts that will trigger the economic loss rule. A manufacturing defect that causes solely economic loss triggers only contract law.¹⁷¹ A manufacturing defect that causes non-economic loss or "other property" damage triggers tort liability.¹⁷² The Restatement (Third) of Torts uses two illustrations to highlight the difference between damage to only the product (economic loss) and damage to "other property" (non-economic loss). In the first illustration, a seller sells a conveyor belt to the buyer.¹⁷³ The buyer installs the belt in its assembly line.¹⁷⁴ A manufacturing defect in the conveyor belt causes damage to the assembly line.¹⁷⁵ The Restatement (Third) of Torts concludes that any losses flowing from the defective belt are solely economic losses.¹⁷⁶ There is no damage to "other property." The damage is to the product itself (the belt) and the system (the assembly line) of which the belt is a component part.¹⁷⁷ In the second illustration, the breakdown in the assembly line is caused by a defective steering mechanism in a forklift that causes the forklift to damage the assembly line.¹⁷⁸ The damage in the second illustration is clearly stated to be damage to "other property." As such, tort theories are available to recover the damages to the forklift and assembly line as damage to "other property" for non-economic loss.¹⁷⁹

There are very strong public policy reasons to require manufacturers/sellers to be responsible for property damage caused by their defective products. The clear impetus from the Restatement (Second) of Torts to the Restatement (Third) of Torts has been to require even greater accountability from manufacturers/sellers for their defective products. Finally, the Restatement (Third) of Torts makes

170. *Id.* § 2(b)-(c).

171. *Id.* § 21 cmt. a.

172. *Id.*

173. *Id.* § 21 cmt. d, illus. 3.

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.* § 21 cmt. e, illus. 4.

179. *Id.*

clear that there is a very discernable line between solely economic loss and non-economic loss. Damage to the product itself or the system of which it is a component part is solely economic loss and governed by the economic loss doctrine. Property damage that is *beyond* damage to the product itself or the system of which it is a part is damage to “other property” or non-economic loss.

B. Case Law Defining Non-Economic Loss

1. Non-Economic Loss Recoverable Through Tort

Admittedly, it is a difficult task for courts to distinguish economic loss from non-economic loss.¹⁸⁰ Economic loss occurs when a defective product damages itself or its integrated system. Non-economic loss occurs when a defective product damages property *other than* itself or its integrated system. The theoretical distinction that has been drawn by the courts between tort recovery for physical injury to other property and contract recovery for economic loss is not arbitrary.¹⁸¹ Rather the distinction rests “on an understanding of the nature of the responsibility” a manufacturer must assume as the cost for distributing its product.¹⁸² Damage to other property is considered “so akin to personal injury that the two are treated alike.”¹⁸³ A manufacturer/seller should be held liable for physical injuries caused by his defective product by requiring the goods to meet a standard of safety.¹⁸⁴ A user should not be charged with bearing the risk of physical injury simply because he purchased a product on the market. On the other hand, a manufacturer/seller should not be liable for a level of performance of his product in the consumer’s business unless he agreed that the product was designed to meet the buyer’s needs.¹⁸⁵ He should, however, be fairly charged with the risk that his product will not satisfy the buyer’s economic expectations.¹⁸⁶

The leading case discussing what constitutes “other property” under the economic loss doctrine is *Saratoga Fishing Co. v. J.M. Martinac &*

180. *Grams v. Milk Prods., Inc.*, 2005 WI 112, ¶ 24, 283 Wis. 2d 511, ¶ 24, 699 N.W.2d 167, ¶ 24.

181. *Seely v. White Motor Co.*, 403 P.2d 145, 151 (Cal. 1965).

182. *Id.*

183. *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 867 (1986).

184. *Seely*, 403 P.2d at 151.

185. *Id.*

186. *Id.*

*Co.*¹⁸⁷ In *Saratoga*, a defective hydraulic system caused a fire in a boat's engine room that led to its sinking.¹⁸⁸ The initial owner of the boat added equipment to it after he purchased it.¹⁸⁹ In the subsequent admiralty action to recover his losses, the United States Supreme Court determined whether the subsequently added equipment was "other property" that would permit tort theories to be asserted by the boat owner.¹⁹⁰ The Court concluded that the subsequently added equipment did qualify as "other property."¹⁹¹ In reaching its conclusion, the Court highlighted a number of policy reasons for holding that the subsequently added equipment constituted "other property." First, the Court noted that one of the primary concerns behind tort liability for manufacturing defects is product safety.¹⁹² The Court also noted that safety is obviously an important public policy and courts should not create rules that diminish this basic incentive, absent a justification.¹⁹³ Second, a manufacturer/seller can bargain for tort immunity or limitation of remedies in the event its defective product causes physical damage.¹⁹⁴ Thus, courts should not favor a narrow construction of what constitutes "other property." Rather, a broader construction is more consistent with public policy.¹⁹⁵ And third, even though there is overlapping liability in contract, the ordinary rules of a manufacturer's tort liability for a defective product should generally apply.¹⁹⁶

There are a number of cases in addition to *Saratoga* that illustrate when a manufacturer's defective product causes non-economic "other property" damage. These cases are useful because they specifically identify what constitutes "other property" damage. In *Saratoga Fishing*, the United States Supreme Court held that the owner of a fishing vessel that caught fire and sank due to a defective hydraulic system could recover in tort for the extra skiff, nets, spare parts, and other miscellaneous equipment on the boat.¹⁹⁷ The Court held that the lost

187. 520 U.S. 875 (1997).

188. *Id.* at 877.

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.* at 881.

193. *Id.*

194. *Id.* at 882.

195. *Id.* at 881–82.

196. *Id.* at 882–83.

197. *Id.* at 885.

personal property was “other property.”¹⁹⁸ In *Marshall v. Wellcraft Marine, Inc.*, the owner of a yacht who was traveling on vacation began to take on seawater during a storm.¹⁹⁹ The port lights in the bow of the ship were defective and seawater was streaming through them into the boat.²⁰⁰ The water damaged the boat and the owner’s personal property within the boat.²⁰¹ The owner sued in tort to recover the damage to the boat and the owner’s personal property.²⁰² The court held that the action was properly brought in tort because the owner’s personal property was “other property.”²⁰³ The owner’s “other property” consisted of their TV/VCR, a cordless drill, customized towels, canvas, pillows, various electronics, tools, spare parts, photographs, food, supplies, and clothing.²⁰⁴ The court found “other property” damage even though there was significant economic loss. The water damage to the yacht and its component parts was clearly economic loss, but in conjunction with the “other property” damage the total loss became recoverable in tort.²⁰⁵ Similarly, in *A.J. Decoster Co. v. Westinghouse Electric Corp.*, a farmer suffered the loss of over 140,000 chickens when a defective transfer switch failed to activate a back-up ventilation system in his chicken house.²⁰⁶ The farmer sued in tort to recover his losses. Maryland’s highest court had to determine whether the farmer’s dead chickens constituted economic or non-economic loss. The court held that the loss of the chickens was the loss of physical property, i.e., non-economic loss, not economic loss.²⁰⁷ Thus, the farmer’s tort claim was appropriate.²⁰⁸

The Wisconsin Supreme Court has often stated that a product that fails to function and causes harm to surrounding property causes harm to “other property.”²⁰⁹ The court, however, has rarely found “other

198. *Id.* at 884.

199. 103 F. Supp. 2d 1099, 1101 (S.D. Ind. 1999).

200. *Id.* at 1102.

201. *See id.* at 1103.

202. *Id.* at 1101.

203. *See id.* at 1111.

204. *Id.*

205. *See id.* at 1108.

206. 634 A.2d 1330, 1331 (Md. 1994).

207. *Id.* at 1334.

208. *Id.*

209. *Wausau Tile, Inc. v. County Concrete Corp.*, 226 Wis. 2d 235, 249, 593 N.W.2d 445, 452 (1999) (quoting RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. e (1998)); *Linden v. Cascade Stone Co.*, 2005 WI 113, ¶ 27, 283 Wis. 2d 606, ¶ 27, 699 N.W.2d 189, ¶ 27 (quoting *Wausau Tile*, 226 Wis. 2d at 249, 593 N.W.2d at 452).

property” damage that would permit tort liability. The only case where the court did find “other property” damage under the economic loss doctrine was in *Northridge Co. v. W.R. Grace & Co.*²¹⁰ In *Northridge*, a fireproofing product that contained asbestos was applied to the owner’s shopping center.²¹¹ The court held that the owner’s complaint validly stated a claim in tort because it alleged physical harm to property that was other than the product itself.²¹² The alleged physical harm to the “other property” consisted of the contamination of the owner’s building with the asbestos product.²¹³ Today, the Wisconsin Supreme Court would not make a finding of “other property” damage in a factual circumstance like *Northridge*.²¹⁴ Because the product containing asbestos damaged the shopping center to which it was applied, the case would fall under the integrated system rule. As such, there would be no “other property” damage. Frankly, at this point in time, there is no case where the Wisconsin Supreme Court has actually found “other property” damage actionable in tort under the economic loss doctrine.

Prior to the Wisconsin Supreme Court’s adoption of the economic loss doctrine in 1989,²¹⁵ the concept of a defective product damaging “other property” had been well established in Wisconsin for nearly forty years. In *Cohan v. Associated Fur Farms, Inc.*, a mink farmer purchased frozen pork livers to feed his minks.²¹⁶ The livers were purchased from a food processor through its local distributor.²¹⁷ The pork livers were contaminated, which led to the death of a substantial number of the farmer’s minks.²¹⁸ The court stated that it is well established that a manufacturer’s product that causes injury to man is actionable in tort, but it queried whether that principle should equally apply for injury to property.²¹⁹ The court concluded that there was no logical reason for holding that one may recover for injury to his person but may not

210. 162 Wis. 2d 918, 923, 471 N.W.2d 179, 180 (1991).

211. *Id.* at 922, 471 N.W.2d at 180.

212. *Id.* at 923, 471 N.W.2d at 180.

213. *Id.* at 923, 471 N.W.2d at 180.

214. It is very likely that the Wisconsin Supreme Court would still permit a tort action in the case because the asbestos is an intrinsically dangerous substance. For a complete discussion of the concept, see the earlier subsection, The Intrinsically Dangerous Substance Exception to the Economic Loss Doctrine, *supra* Part II.C.2.b.

215. *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 148 Wis. 2d 910, 916, 437 N.W.2d 213, 215 (1989).

216. 261 Wis. 584, 587, 53 N.W.2d 788, 790 (1952).

217. *Id.* at 587, 53 N.W.2d at 790.

218. *Id.* at 588, 53 N.W.2d at 790.

219. *Id.* at 591–92, 53 N.W.2d at 791–92.

recover for injury to his property.²²⁰ The court held that tort liability should extend to property damage in all cases where a causal connection can be established between the defective product and the property damage.²²¹ The dead minks were clearly property damage stemming from the contaminated food, and as such, the non-economic loss was recoverable in tort. Although *Cohan* pre-dates the adoption of the economic loss doctrine, it should be understood as controlling precedent on what qualifies as non-economic loss unless the court indicates otherwise.

2. Non-Economic Loss Recoverable Through Contract Law

In general, when a defective product causes “other property” damage or non-economic loss, the aggrieved party can seek to recover through tort. The public policy of encouraging manufacturers/sellers to deal in safer products justifies tort accountability. There are, however, some exceptions to the general rule. One exception is where the non-economic loss is so *de minimis* that the public policy encouraging safer products is so marginally involved as to not require tort involvement. The second exception is where the non-economic loss was a foreseeable loss and could have been the subject of negotiations between the contracting parties. Both are discussed in the following sections.

a. De Minimis Non-Economic Loss

When a product fails or is defective, the buyer suffers a loss of product value and associated expenses. These losses are understood to be economic losses and recoverable through contract law. In those cases where the product fails or is defective and “other property” damage occurs, both economic and non-economic losses are suffered. The fact that “other property” damage has occurred means that the plaintiff can pursue tort theories to recover both its economic and non-economic losses.²²² But if the buyer has suffered only a nominal amount of non-economic losses in conjunction with the economic losses, should tort theories be available?

There are only a few cases that address this issue. The

220. *Id.* at 591–92, 53 N.W.2d at 792.

221. *See id.* at 591, 53 N.W.2d at 792 (quoting *Marsh Wood Prods. Co. v Babcock & Wilcox Co.*, 207 Wis. 209, 226, 240 N.W. 392, 399 (1932)).

222. *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 216 Wis. 2d 395, 401–02, 573 N.W.2d 842, 845 (1998); *see also Northridge Co. v. W.R. Grace & Co.*, 162 Wis. 2d 918, 923, 471 N.W.2d 179, 180 (1991); RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 (1998).

determination whether sufficient “other property” has been damaged to sustain an action in tort is very fact intensive. The clearest case that made a finding of *de minimis* “other property” damage is *Veeder v. NC Machinery Co.*²²³ In *Veeder*, the buyer purchased a ship that was made according to his specifications.²²⁴ A problem developed with the ship’s engine. When the engine malfunctioned, it sprayed engine oil on adjacent personal property.²²⁵ The court held that the “other property” damage was *de minimis*.²²⁶ Because the oil spray was on cleanable surfaces, the court concluded that the losses suffered were only economic losses.²²⁷ In *Rich Products Corp. v. Kemutec, Inc.*, a buyer purchased a mechanical conveyor to be used in the production of its food products.²²⁸ Unfortunately, the conveyor’s wires frayed and wire strands were found in the buyer’s food products.²²⁹ The buyer suffered eleven million dollars in damages as a result of the recall of its food products.²³⁰ The court noted that the food products were damaged “other property” under the economic loss doctrine.²³¹ However, the court identified the issue as “how much ‘other property’ must be damaged in order to take a case outside the economic loss rule.”²³² The evidence indicated that twenty-nine pieces of wire were found over an eleven to twelve month period during which six million cases of product were processed.²³³ Each case had twelve to twenty-four individual products.²³⁴ The court concluded that the dispute involved only minimal damage to “other property” and thus, was primarily about economic loss.²³⁵ Both *Veeder* and *Rich Products* indicate that nominal, almost imperceptible property damage is not sufficient to engage tort theories for recovery. The results seem sensible because safety concerns engender tort theories, and in both cases the safety concerns were very minimal.

However, in *Winchester v. Lester’s of Minnesota, Inc.*, the non-

223. 720 F. Supp. 847 (W.D. Wash. 1989).

224. *See id.* at 848.

225. *Id.* at 853.

226. *Id.*

227. *See id.*

228. 66 F. Supp. 2d 937, 943 (E.D. Wis. 1999)

229. *Id.* at 951–52.

230. *Id.* at 952.

231. *Id.* at 970.

232. *Id.*

233. *Id.* at 971.

234. *Id.*

235. *See id.* at 971–72.

economic “other property” damage was more than nominal.²³⁶ In *Winchester*, a hog farmer contracted with the defendant to design, manufacture, and construct a hog house on the plaintiff’s farm.²³⁷ The defendant constructed the hog house, and almost immediately, the farmer began experiencing ventilation problems in the hog house.²³⁸ As a result of the defective ventilation, the damages suffered by the farmer included extra labor, dead hogs, losses due to underweight hogs, extra veterinary bills, lost profits, and costs to correct the ventilation system.²³⁹ The Tenth Circuit phrased the issue as whether the damages should be characterized as tort (non-economic) or contract (economic) damages.²⁴⁰ The district court held that all the damages with the exception of the costs to correct the ventilation system were non-economic “other property” damages.²⁴¹ The Tenth Circuit disagreed.²⁴² The district court stated that the farmer’s loss of hogs due to the poor ventilation was unquestionably “other property” damage due to the failure of the hog house.²⁴³ However, on balance, the Tenth Circuit concluded that the essence of their claim was contractual in nature and as such should be treated as economic loss.²⁴⁴ The coincident and material “other property” non-economic damages were not sufficient to engender tort theories.²⁴⁵

On the other side of the ledger is *Marshall v. Wellcraft Marine, Inc.*²⁴⁶ In *Marshall*, the bow lights on a yacht were defective causing water to infiltrate the ship.²⁴⁷ The sea water damaged the ship and the owners’ personal property.²⁴⁸ The ship damage was to the engine compartment, the galley, and the ship’s navigational and communication devices.²⁴⁹

236. See 983 F.2d 992, 994 (10th Cir. 1993).

237. *Id.* at 993.

238. *Id.*

239. *Id.* at 994.

240. *Id.* at 995.

241. *See id.*

242. *Id.*

243. *Id.* at 996.

244. *Id.*

245. Another interpretation (although not expressed) is that the court was using the disappointed performance expectations rule in which “other property” damage is not actionable under tort law. See *infra* Part III.B.2.b for a basic explanation of the disappointed performance expectations test adopted in *Grams v. Milk Prods., Inc.*, 2005 WI 112, 283 Wis. 2d 511, 699 N.W.2d 167.

246. 103 F. Supp. 2d 1099 (S.D. Ind. 1999).

247. *Id.* at 1102.

248. *Id.* at 1101.

249. *Id.* at 1102.

The owners' estimated their property damages to be \$40,000 for yacht repairs, \$18,000 for electronics, \$5,000 for their lost and damaged personal property, \$9,000 for lost use of the vessel, and \$400 for out-of-pocket expenses.²⁵⁰ The owners sought recovery of their damages through tort theories. The defendant opposed the plaintiffs' tort claims on the basis that their "other property" damage was *de minimis*, thereby precluding tort theories.²⁵¹ The court held that even though there was significant economic loss suffered by the owners, the court did not regard their loss of personal property, totaling in the thousands of dollars, to be *de minimis* on its face.²⁵² The owners were permitted to pursue their economic and non-economic losses through tort theories.²⁵³

b. Significant Non-Economic Loss

There exists a line of thought that argues that if a defective product causes property damage, but the property damage is the result of the disappointed expectations of a product's performance, then the damages are pure economic loss. As a result, only contract remedies are available to recover one's losses. The doctrine is known as the disappointed performance expectations test,²⁵⁴ and it applies even though the damage suffered by the plaintiff is to "other property," which would normally permit tort remedies.²⁵⁵ The Wisconsin Supreme Court adopted the disappointed performance expectations test in *Grams v. Milk Products, Inc.*²⁵⁶ In *Grams*, a farmer fed his calves a non-medicated milk substitute purchased from a supplier.²⁵⁷ The milk replacer damaged the calves' immune systems, thereby causing inadequate growth and an increased mortality rate.²⁵⁸ The farmer sued to recover his losses through contract and tort theories.²⁵⁹ The court framed the issue as determining whether the Grams' tort claims were barred by the economic loss doctrine.²⁶⁰ The court acknowledged that

250. *Id.* at 1103

251. *Id.* at 1105.

252. *Id.* at 1111 n.7.

253. *Id.* at 1108.

254. *See Grams v. Milk Prods., Inc.*, 2005 WI 112, ¶ 3, 283 Wis. 2d 511, ¶ 3, 699 N.W.2d 167, ¶ 3.

255. *Id.* ¶ 3, 283 Wis. 2d 511, ¶ 3, 699 N.W.2d 167, ¶ 3.

256. *Id.* ¶ 31, 283 Wis. 2d 511, ¶ 31, 699 N.W.2d 167, ¶ 31.

257. *Id.* ¶ 7, 283 Wis. 2d 511, ¶ 7, 699 N.W.2d 167, ¶ 7.

258. *Id.* ¶ 8, 283 Wis. 2d 511, ¶ 8, 699 N.W.2d 167, ¶ 8.

259. *Id.* ¶ 9, 283 Wis. 2d 511, ¶ 9, 699 N.W.2d 167, ¶ 9.

260. *Id.* ¶ 11, 283 Wis. 2d 511, ¶ 11, 699 N.W.2d 167, ¶ 11.

the milk replacer's damage to the calves' immune systems was property damage.²⁶¹ It is unclear, however, whether the acknowledged property damage qualified as "other property" damage as understood in the Restatement (Third) of Torts and existing case law.²⁶² The *Decoster* case, for example, clearly held that a defective product that killed thousands of chickens caused "other property" damage.²⁶³ More importantly, the Wisconsin precedent established in *Cohan* was that feeding contaminated food to animals that results in their malnutrition and death is damage to "other property" and thus actionable in tort.²⁶⁴ Unquestionably, the milk replacer's damage to the calves' immune systems in *Grams* constitutes "other property" damage that would generally trigger tort liability. Clearly, the "other property" damage was very significant, unlike the *de minimis* "other damage" in the preceding section. Nevertheless, the court concluded that the "other property" damage was the result of the farmer's disappointed expectations for the milk replacer, and as such, the economic loss doctrine barred the plaintiff's tort claims.²⁶⁵ The farmer was permitted to pursue only his contract remedies. The unfortunate effect of the disappointed expectations test is to convert significant non-economic loss into economic loss that allows only contract liability.²⁶⁶

C. Insurance Law

For many years, insurance liability law has been distinguishing economic loss from non-economic loss or "other property" damage. In fact, the rule developed in insurance liability law is unambiguous and has been relatively easy for the courts to apply. Very simply, property damage occurs under insurance liability law when there has been "physical injury to tangible property."²⁶⁷ With one modification, this definition should be borrowed from insurance law and adopted by Wisconsin courts when distinguishing economic loss from non-economic

261. *Id.* ¶ 31, 283 Wis. 2d 511, ¶ 31, 699 N.W.2d 167, ¶ 31.

262. *Id.* ¶¶ 44–45, 283 Wis. 2d 511, ¶¶ 44–45, 699 N.W.2d 167, ¶¶ 44–45.

263. *A.J. Decoster Co. v. Westinghouse Elec. Corp.*, 634 A.2d 1330, 1334 (Md. 1994).

264. *Cohan v. Associated Fur Farms, Inc.*, 261 Wis. 584, 591, 53 N.W.2d 788, 792 (1952).

265. *Grams*, 2005 WI 112, ¶ 3, 283 Wis. 2d 511, ¶ 3, 699 N.W.2d 167, ¶ 3.

266. Although examination of the disappointed expectations test is beyond the scope of this Article, it will be the subject of the author's next article.

267. *Wis. Label Corp. v. Northbrook Prop. & Cas. Ins. Co.*, 2000 WI 26, ¶ 30, 233 Wis. 2d 314, ¶ 30, 607 N.W.2d 276, ¶ 30; *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶ 5, 268 Wis. 2d 16, ¶ 5, 673 N.W.2d 65, ¶ 5; *see also* *Vogel v. Russo*, 2000 WI 85, ¶ 19, 236 Wis. 2d 504, ¶ 19, 613 N.W.2d 177, ¶ 19.

loss under the economic loss doctrine.

In 1940, the insurance industry first promulgated its standard commercial general liability policy.²⁶⁸ Commercial general liability policies are designed to protect the insured from losses arising out of one's business operations.²⁶⁹ There are generally two types of risks associated with a business:²⁷⁰ those risks that arise out of a business operation that are tortious in nature, and those risks that arise from the business not performing on its contractual obligations.²⁷¹ An example of the former would be a defective product that causes personal injury or property damage.²⁷² An example of the latter would be a defective product that fails to function according to its warranties.²⁷³ Under insurance law, this latter group, which is contractual in nature, is called the business risk exclusion.²⁷⁴ Generally, when a business fails to perform in accordance with its contractual obligation the claimant may seek to recover for breach of contract damages. These business risks are not covered by a comprehensive general liability policy and are normally expressed as exclusions from the general coverage of the policy. Thus, a commercial general liability policy with its business risk exclusion is designed to provide coverage for tort liability for personal injury or physical damage to others. The policy is not for contractual liability of the insured for economic loss caused because the product did not perform according to its warranties.²⁷⁵

A commercial general liability policy has two primary parts. The

268. *Wis. Label Corp.*, 2000 WI 26, ¶ 27 n.3, 233 Wis. 2d 314, ¶ 27 n.3, 607 N.W.2d 276, ¶ 27 n.3.

269. *Id.* ¶ 27, 233 Wis. 2d 314, ¶ 27, 607 N.W.2d 276, ¶ 27.

270. *See Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788, 791 (N.J. 1979).

271. *See Grinnell Mut. Reinsurance Co. v. Lynne*, 686 N.W.2d 118, 124 (N.D. 2004); *McGowan v. State Farm Fire & Cas. Co.*, 100 P.3d 521, 524–25 (Colo. Ct. App. 2004); *Custom Planning & Dev., Inc. v. Am. Nat'l Fire Ins. Co.*, 606 S.E.2d 39, 42 (Ga. Ct. App. 2004); *Jim Barna Log Sys. Midwest, Inc. v. Gen. Cas. Ins. Co. of Wis.*, 791 N.E.2d 816, 823–24 (Ind. Ct. App. 2003).

272. *See Kemp v. Miller*, 154 Wis. 2d 538, 544–45, 453 N.W.2d 872, 873–74 (1990); *Ransome v. Wis. Elec. Power Co.*, 87 Wis. 2d 605, 619–20, 275 N.W.2d 641, 647–48 (1979).

273. *See Trio's, Inc. v. Jones Sign Co.*, 151 Wis. 2d 380, 384–85, 444 N.W.2d 443, 444–45 (Ct. App. 1989); *B&D Contractors, Inc. v. Arwin Window Sys., Inc.*, 2006 WI App 123, ¶ 7, 294 Wis. 2d 378, ¶ 7, 718 N.W.2d 256, ¶ 7.

274. *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶ 28, 268 Wis. 2d 16, ¶ 28, 673 N.W.2d 65, ¶ 28.

275. *Grinnell*, 686 N.W.2d at 124; *Wis. Label Corp. v. Northbrook Prop. & Cas. Ins. Co.*, 2000 WI 26, ¶ 27, 233 Wis. 2d 314, ¶ 27, 607 N.W.2d 276, ¶ 27; *Jim Barna*, 791 N.E.2d at 823–24; *Newark Ins. Co. v. Acupac Packaging, Inc.*, 746 A.2d 47, 50–51 (N.J. Super. Ct. App. Div. 2000); *Bonded Concrete, Inc. v. Transcon. Ins. Co.*, 784 N.Y.S.2d 212, 213 (N.Y. App. Div. 2004).

first part is the insuring clause which sets forth the specific risks covered by the policy. The second part is the exclusions clause which removes coverage for risks that would otherwise fall within the coverage of the insuring clause. Together they define the actual coverage of the policy. Commercial general liability policies typically provide coverage for “bodily injury” and “property damage” that is the result of an “occurrence.” The majority of jurisdictions conclude that a breach of contract is almost never an “occurrence” covered by a commercial liability policy.²⁷⁶ Wisconsin does not strictly adhere to that general rule. In Wisconsin, a breach of contract claim may be an “occurrence,” but the claim may also be excluded depending upon the scope of the policy’s exclusions. On at least one occasion, a breach of contract claim was held to be covered by a commercial general liability policy.²⁷⁷ In general, however, a commercial general liability policy is designed and intended to provide coverage to the insured for tort liability for physical injury to the person or property of others.²⁷⁸ A commercial general liability policy is not intended to provide coverage for the insured’s contractual liability which covers solely economic loss.²⁷⁹ In order to provide coverage for tort liability and exclude coverage for contract liability, a number of “business risk” exclusions²⁸⁰ are included within

276. *Lenning v. Commercial Union Ins. Co.*, 260 F.3d 574, 582 (6th Cir. 2001); *Pace Constr. Co. v. U.S. Fid. & Guar. Ins. Co.*, 934 F.2d 177, 180 (8th Cir. 1991); *Keystone Filler & Mfg. Co. v. Am. Mining Ins. Co.*, 179 F. Supp. 2d 432, 439–40 (M.D. Pa. 2002); *Twin City Fire Ins. Co. v. Colonial Life & Acc. Ins. Co.*, 124 F. Supp. 2d 1243, 1248 (M.D. Ala. 2000); *U.S. Fire Ins. Co. v. Milton Co.*, 35 F. Supp. 2d 83, 86 (D.D.C. 1998); *Gibson & Assocs., Inc. v. Home Ins. Co.*, 966 F. Supp. 468, 474 (N.D. Tex. 1997); *Koch Eng’g Co. v. Gibraltar Cas. Co.*, 878 F. Supp. 1286, 1288–89 (E.D. Mo. 1995); *Md. Cas. Co. v. Mike Miller Cos.*, 715 F. Supp. 321, 322 (D. Kan. 1989); *Yegge v. Integrity Mut. Ins. Co.*, 534 N.W.2d 100, 102–03 (Iowa 1995); *Action Ads, Inc. v. Great Am. Ins. Co.*, 685 P.2d 42, 43–44 (Wyo. 1984); *Union Ins. Co. v. Hottenstein*, 83 P.3d 1196, 1201–02 (Colo. Ct. App. 2003); *Am. States Ins. Co. v. Mathis*, 974 S.W.2d 647, 650 (Mo. Ct. App. 1998); *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 825 A.2d 641, 650–51 (Pa. Super. Ct. 2003).

277. *Am. Family*, 2004 WI 2, ¶ 5, 268 Wis. 2d 16, ¶ 5, 673 N.W.2d 65, ¶ 5. In *American Family*, a breach of contract claim was deemed an “occurrence” because of an exception to the business risks exclusions with the net result of placing the contract claim with the definition of an “occurrence.” *Id.*

278. *Custom Planning & Dev., Inc. v. Am. Nat’l Fire Ins. Co.*, 606 S.E.2d 39, 42 (Ga. Ct. App. 2004); *State Farm Fire & Cas. Co. v. Tillerson*, 777 N.E.2d 986, 992 (Ill. Ct. App. 2002); *Weedo v. Stone-E Brick, Inc.*, 405 A.2d 788, 791 (N.J. 1979); *Isle of Palms Pest Control Co. v. Monticello Ins. Co.*, 459 S.E.2d 318, 320 (S.C. Ct. App. 1994).

279. *Bulen v. West Bend Mut. Ins. Co.*, 125 Wis. 2d 259, 264–65, 371 N.W.2d 392, 394–95 (Ct. App. 1985); see also *Custom Planning*, 606 S.E.2d at 42; *State Farm*, 777 N.E.2d at 992; *Weedo*, 405 A.2d at 791; *Isle of Palms*, 459 S.E.2d at 320.

280. The primary business risk exclusions are known as “your work,” “your product,” and “your property.” See ERIC MILLS HOLMES, HOLMES’ APPLEMAN ON INSURANCE

the standard commercial general liability policy. These exist for the express purpose of excluding coverage for risks that relate to the repair or replacement of the insured's faulty work or products, or defects in the insured's work or products themselves.²⁸¹ These "business risk" exclusions are designed to provide coverage for tort liability only, and not for the contractual liability of the insured for economic losses that occur because the product or completed work was not what the other party bargained for.²⁸²

A commercial general liability policy with its standard business risk exclusions provides insurers coverage for "property damage" that is tortious in nature, not contractual. The standard commercial general liability policy defines "property damage" in part as "[p]hysical injury to tangible property."²⁸³ This definition is understood to mean that property suffers physical, tangible injury when it is altered in appearance, shape, color, or in some other material fashion.²⁸⁴ It is important to note that insurance law does not follow the integrated system rule that has been adopted as part of the economic loss doctrine. Nevertheless, insurance cases are very useful in determining what constitutes "physical injury to tangible property." In other words, a defective component integrated into a final product that damages any part of the final product is considered "property damage" under insurance law.²⁸⁵ On the other hand, tangible property does not experience physical injury if the property suffers only economic loss.²⁸⁶ Pure economic losses, such as loss of business, loss of goodwill, loss of profits, loss of investment, and diminution in value, are not property damage under a commercial general liability policy.²⁸⁷ Additionally, the

§ 132.9 (2d. ed. 2002 & Supp. 2007).

281. *Am. Family*, 2004 WI 2, ¶ 29, 268 Wis. 2d 16, ¶ 29, 673 N.W.2d 65, ¶ 29; *Grinnell Mut. Reinsurance Co. v. Lynne*, 686 N.W.2d 118, 124 (N.D. 2004); *Tolomeo v. Emanuelson*, No. 04-C-0486, 2005 WL 1629900, at *3 (E.D. Wis. July 7, 2005); *Weedo*, 405 A.2d at 791; *Bulen*, 125 Wis. 2d at 261, 371 N.W.2d at 394.

282. *See Am. Family*, 2004 WI 2, ¶¶ 28–29, 268 Wis. 2d 16, ¶¶ 28–29, 673 N.W.2d 65, ¶¶ 28–29; *Bituminous Cas. Corp. v. Kenway Contracting, Inc.*, 240 S.W.3d 633, 640 (Ky. 2007); *Grinnell*, 686 N.W.2d at 124; *Weedo*, 405 A.2d at 791; *Bulen*, 125 Wis. 2d at 261, 371 N.W.2d at 393.

283. *Wis. Label Corp. v. Northbrook Prop. & Cas. Ins. Co.*, 2000 WI 26, ¶ 10, 233 Wis. 2d 314, ¶ 10, 607 N.W.2d 276, ¶ 10.

284. *Traveler's Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 481, 496 (Ill. 2001); *United Nat'l Ins. Co. v. Frontier Ins. Co.*, 99 P.3d 1153, 1159 (Nev. 2004) (quoting *Traveler's*, 757 N.E.2d at 496).

285. HOLMES, *supra* note 280, § 129.2.

286. *Traveler's*, 757 N.E.2d at 496; *United Nat'l Ins.*, 99 P.3d at 1159.

287. *Am. States Ins. Co. v. Martin*, 662 So. 2d 245, 248–49 (Ala. 1995); *Nova Cas. Co. v.*

failure of a product to perform as intended does not give rise to property damage.²⁸⁸ Finally, the costs to repair or replace a defective product or defective work are not property damage under a commercial general liability policy.²⁸⁹

Wisconsin has a long history of interpreting commercial general liability policies where “property damage” is defined as “physical injury to tangible property.” A common interpretation issue under commercial general liability policies is whether the claimed loss is property damage or economic loss. A leading case in Wisconsin discussing the distinction between “property damage” and economic loss is *Wisconsin Label Corp. v. Northbrook Property & Casualty Insurance Co.*²⁹⁰ In *Wisconsin Label*, a subsidiary of Wisconsin Label mislabeled certain products that caused the products to be sold for less than half of their intended retail price.²⁹¹ Subsequently, Wisconsin Label was forced to pay the retailer for its losses.²⁹² Thereafter, Wisconsin Label notified its insurer of its intention to seek recovery for the losses under its commercial general liability policy. The insurer informed Wisconsin Label that the policy did not provide coverage because no “property damage” had occurred under the policy.²⁹³ “Property damage” was defined in the policy as “[p]hysical injury to tangible property.”²⁹⁴ The Wisconsin Supreme Court defined the issue to be whether the mislabeling qualified as damage from “physical injury to tangible property.”²⁹⁵ Importantly, the supreme court noted that this

Able Constr. Inc., 983 P.2d 575, 581 (Utah 1999); *F & H Constr. v. ITT Hartford Ins. Co. of the Midwest*, 12 Cal. Rptr. 3d 896, 901 (Cal. Ct. App. 2004); *Giddings v. Indus. Indem. Co.*, 169 Cal. Rptr. 278, 281 (Cal. Ct. App. 1980); *Lamar Truck Plaza, Inc. v. Sentry Ins.*, 757 P.2d 1143, 1144 (Colo. Ct. App. 1988); *Ludwig Candy Co. v. Iowa Nat’l Mut. Ins. Co.*, 396 N.E.2d 1329, 1332 (Ill. Ct. App. 1979); *Bush v. Shoemaker-Beal*, 987 P.2d 1103, 1105 (Kan. Ct. App. 1999); *Houston Petroleum Co. v. Highlands Ins. Co.*, 830 S.W.2d 153, 156 (Tex. App. 1990).

288. *F & H Constr.*, 12 Cal. Rptr. 3d at 901.

289. *Travelers Ins. Co. v. Penda Corp.*, 974 F.2d 823, 831 (7th Cir. 1992); *U.S. Fire Ins. Co. v. Milton Co.*, 35 F. Supp. 2d 83, 86 (D.D.C. 1998); *Auto Owners Ins. Co. v. Tripp Constr., Inc.*, 737 So. 2d 600, 601 (Fla. Dist. Ct. App. 1999); *Amerisure, Inc. v. Wurster Constr. Co.*, 818 N.E.2d 998, 1003–04 (Ind. Ct. App. 2004); *Assurance Co. of Am. v. Dusel Builders, Inc.*, 78 F. Supp. 2d 607, 609 (W.D. Ky. 1999); *George A. Fuller Co. v. U.S. Fid. & Guar. Co.*, 613 N.Y.S.2d 152, 155 (N.Y. App. Div. 1994); *Prod. Sys., Inc. v. Amerisure Ins. Co.*, 605 S.E.2d 663, 666 (N.C. Ct. App. 2004); *Wm. C. Vick Constr. Co. v. Pa. Nat’l Mut. Cas. Ins. Co.*, 52 F. Supp. 2d 569, 582 (E.D.N.C. 1999).

290. 2000 WI 26, 233 Wis. 2d 314, 607 N.W.2d 276.

291. *Id.* ¶ 8, 233 Wis. 2d 314, ¶ 8, 607 N.W.2d 276, ¶ 8.

292. *Id.* ¶ 2, 233 Wis. 2d 314, ¶ 2, 607 N.W.2d 276, ¶ 2.

293. *Id.* ¶ 3, 233 Wis. 2d 314, ¶ 3, 607 N.W.2d 276, ¶ 3.

294. *Id.* ¶ 10, 233 Wis. 2d 314, ¶ 10, 607 N.W.2d 276, ¶ 10.

295. *Id.* ¶ 30, 233 Wis. 2d 314, ¶ 30, 607 N.W.2d 276, ¶ 30.

standard definition of property damage is unambiguous.²⁹⁶ The court reasoned that the word injury standing alone may refer to both physical and non-physical damage, but when it is qualified by “physical,” it requires physical damage to qualify as property damage.²⁹⁷ The court concluded that no physical damage occurred as a result of the mislabeling.²⁹⁸ The court reasoned that while the products were improperly labeled, the product remained physically undamaged at all times.²⁹⁹ The lack of physical damage was demonstrated by the fact that the products were sold to customers with the improper labeling. The court did, however, indicate that mislabeling could cause physical injury to a product if, for example, a caustic adhesive in the label burned the product.³⁰⁰ But that did not occur in this case. The insured further argued that there was clearly physical injury because the mislabeling required a physical repair.³⁰¹ The court noted that the repair required to remedy Wisconsin Label’s defective workmanship was inspection and relabeling as opposed to any physical repair to the products.³⁰² The court reasoned that the economic losses that resulted were not due to “physical injury” to the products but due to Wisconsin Label’s failure to complete its work under its contract.³⁰³ Therefore, the economic losses suffered as a result of Wisconsin Label’s breach of contract were not property damage. Thus, there was no coverage under the commercial general liability policy. On the other hand, where there is physical injury to the tangible property of another, there is property damage under a commercial general liability policy.³⁰⁴

The standard commercial general liability policy defines property damage as “physical injury to tangible property.” Courts have had little difficulty applying this definition when determining whether property damage has occurred under a commercial general liability policy. Under the economic loss doctrine, however, property damage requires that courts also incorporate the integrated system rule. In fact, the

296. *Id.* ¶ 31, 233 Wis. 2d 314, ¶ 31, 607 N.W.2d 276, ¶ 31.

297. *Id.* ¶ 31, 233 Wis. 2d 314, ¶ 31, 607 N.W.2d 276, ¶ 31.

298. *Id.* ¶ 32, 233 Wis. 2d 314, ¶ 32, 607 N.W.2d 276, ¶ 32.

299. *Id.* ¶ 32, 233 Wis. 2d 314, ¶ 32, 607 N.W.2d 276, ¶ 32.

300. *Id.* ¶ 32, 233 Wis. 2d 314, ¶ 32, 607 N.W.2d 276, ¶ 32.

301. *Id.* ¶ 33, 233 Wis. 2d 314, ¶ 33, 607 N.W.2d 276, ¶ 33.

302. *Id.* ¶ 33, 233 Wis. 2d 314, ¶ 33, 607 N.W.2d 276, ¶ 33.

303. *Id.* ¶ 33, 233 Wis. 2d 314, ¶ 33, 607 N.W.2d 276, ¶ 33.

304. *Robert E. Lee & Assocs. v. Peters*, 206 Wis. 2d 509, 523, 557 N.W.2d 457, 463 (Ct. App. 1996); *Nor-Lake, Inc. v. Aetna Cas. & Sur. Co.*, 201 Wis. 2d 816, 549 N.W.2d 286 (Ct. App. 1996) (unpublished opinion).

insurance definition of property damage, without modification, was the “bright-line rule” rejected by the Wisconsin Supreme Court in *Grams*.³⁰⁵ But by incorporating the integrated system rule into the insurance law definition, a very user-friendly and sensible rule is created for the courts. The proposed rule is that non-economic loss occurs when a defective product causes “physical injury to tangible property *other than* the product itself or its integrated system.” The corollary rule is that economic loss occurs when a defective product causes “physical injury to the product itself or its integrated system.” There is some indication in Wisconsin Supreme Court jurisprudence that such a rule and its corollary may be acceptable.³⁰⁶

IV. CONCLUSION

The essence of the economic loss doctrine is that economic losses are resolved under contract law and non-economic losses are resolved under tort law. Unfortunately, it is difficult to distinguish economic loss from non-economic loss. An examination, however, of the U.C.C., the Restatement (Second) and Restatement (Third) of Torts, and relevant case law yields user-friendly and defensible definitions for those facing the contract/tort decision mandated by the economic loss doctrine.

The U.C.C. clearly recognizes and defines three types of economic losses. The first is loss of product value that occurs when a product fails to meet its contractual promises/warranties. A second is expenses that are incidental to the breach of contract. The third is consequential damages, in the absence of property damage that are the result of a product’s failed performance. The Restatement (Third) of Torts recognizes economic loss damage as damage to the product itself or its integrated system. Case law confirms that economic loss includes loss of product value; consequential damages, in the absence of property damage, that flow from the breach; and property damage to the product itself or its integrated system. The economic loss doctrine mandates that all of these economic losses are recoverable only through contract law, not tort law. There are, however, two recognized exceptions to the

305. *Grams v. Milk Prods., Inc.*, 2005 WI 112, ¶¶ 43–44, 283 Wis. 2d 511, ¶¶ 43–44, 699 N.W.2d 167, ¶¶ 43–44.

306. Justice Abrahamson’s dissent in *Grams v. Milk Products, Inc.*, 2005 WI 112, ¶¶ 76–78, 283 Wis. 2d 511, ¶¶ 76–78, 699 N.W.2d 167, ¶¶ 76–78, hypothesizes a defective garage door opener that unexpectedly closes on an owner’s car, or a defective car that unexpectedly shifts into reverse and damages the garage door. *Id.* In both cases, the justice believes the court would consider those damages to be non-economic loss damages recoverable in tort. *Id.*

economic loss doctrine where solely economic losses are recoverable in tort. One is where the contract was induced by a party's extraneous fraud, and the other is where the product contains an intrinsically dangerous substance.

Unlike economic loss, non-economic loss is recoverable in tort. The Restatement (Second) of Torts indicates that there are numerous, strong policy reasons to permit non-economic loss to be recovered through tort law. The policy reasons are primarily based on safety concerns and appropriate risk allocations. The Restatement (Third) of Torts has further expanded tort liability for non-economic loss by deleting the unreasonably dangerous standard for products with manufacturing defects. This expresses an important policy statement that, in case of doubt, courts should favor tort coverage over contract coverage. In virtually every circumstance where a defective product causes non-economic loss, economic loss will also be present. In such a case, tort law is available to recoup both losses. There are, however, two circumstances where non-economic loss is not recoverable in tort. The first is where the non-economic loss is too *de minimis* to engage tort concerns. The second is where the non-economic loss is considered to be the result of the product's disappointed performance. Finally, cases decided under commercial general liability policies are helpful in distinguishing economic loss from non-economic loss. The standard policy defines property damage as "physical injury to tangible property." This is admittedly an unambiguous definition that proves useful when joined with the integrated system rule.

In conclusion, a defensible and understandable definition of economic loss can be assembled from the various sources. Economic loss as understood under the economic loss doctrine includes (1) loss of product value due to the product's failure to meet its contractual promises or warranties; (2) physical injury to the product itself or its integrated system; and (3) any incidental or consequential damages that flow from (1) or (2). Non-economic loss, of course, is any loss that is *other than* described above.