THE ECONOMIC LOSS DOCTRINE: WHAT IS "OTHER PROPERTY"?

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Over the last two decades, the Economic Loss Doctrine has received extensive treatment in the U.S. Court System**.** The Economic Loss Doctrine which was first articulated by the Supreme Court of the United States in *East River Steamship Co. v. Transamerica Delaval*, 476 U.S. 858, 106S.Ct. 2295 (1986), stands for the proposition that a manufacturer in a commercial relationship has no duty, under either negligence or strict products-liability, to protect a product from injuring itself. In a nutshell, *East River* precludes recovery for physical damages a defective product causes only to the product itself, unless the product causes personal injury and/or damage to "other property". Although *East River* was decided under maritime law, its reasoning was adopted by a vast majority of the United States jurisdictions. Accordingly, *East River* has had an enormous impact upon products liability law of the United States.

Unfortunately, *East River* provided very little guidance on how to draw the essential distinction between damage to the "product itself", for which recovery is denied, and damage to "other property", for which recovery is allowed. However, the Supreme Court of the United States addressed this very same issue, that is, how to distinguish between damage to the "product itself" and damage to "other property" in *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 878, 117 S.Ct. 1783, 1786 (1997). In that case, the owner of a fishing vessel which caught fire and sank, brought a products liability suit against the builder of the vessel and the designer of the vessel's hydraulic system, alleging that the system was defectively designed. Justice Breyer, who delivered the opinion of the court, summarized the case as involving: "1) A component supplier who 2) provided a defective component (the hydraulic system) to a manufacturer, who incorporates it into a manufactured product (the ship), which 3) the manufacturer sold to an initial user, who 4) after adding equipment and using the ship, re-sold it to a subsequent user (Saratoga Fisher)". *Id.* at 878. The Supreme Court allowed the vessel owner to recover for damages sustained, reasoning that the extra skiff, nets, spare parts and miscellaneous equipment that had been added to the vessel by its original previous owner after his purchase of the vessel constituted "other property". Specifically, the Court held as follows: "[I]tems added by the Initial User are therefore "other property", and the Initial User's sale of the product to a Subsequent User does not change these characterizations. … [E]quipment added to a product after the manufacturer (or distributor selling it in the initial distribution chain) has sold the product to an initial user is not part of the product that itself caused physical harm. Rather in *East River*'s language, it is "other property". Id. at 879-85. Interestingly, Justice Scalia in his dissent discredited the value of the "initial user rule" adopted by the majority, and argued that the "object of the bargain rule" should be applied instead to distinguish between damage to the "product itself" and damage to "other property". Such a rule would focus on what the plaintiff purchased rather than what the defendant agreed to initially provide, and would

define the product itself as the item for which the plaintiff bargained and received. Scalia also referred to a third type of rule: the "seller rule", according to which the "product itself" is the item as is sold by the last seller, ie. one who is in the business of selling such a product.

Notwithstanding the disagreement among its justices, the Supreme Court articulated a plain and unambiguous standard for identifying "other property" for purposes of the Economic Loss Doctrine. Unfortunately, that is not the case for many of the jurisdictions which have adopted the Economic Loss Doctrine. As a result, while it is well-settled in nearly every jurisdiction in the United States that damage to "other property" is an exception to the Economic Loss Doctrine, there is a great deal of confusion on how to distinguish the product itself from "other property".

New York courts, for example, offer very little guidance in this area. There is no case in New York defining how to distinguish the product itself from "other property". *Bocre Leasing Corp. v. GMC*, 84 N.Y.2d 685 (1995) is New York's leading case on the Economic Loss Doctrine. In *Bocre*, the New York Court of Appeals adopted most of the *East River* holding and declared that a plaintiff "has no cause of action in tort against the remote manufacturer for contractually based economic losses, including to the product itself, occasioned by the failure of the product which was the subject of plaintiff's arm's length, negotiated purchase from a subsequent owner". Id. at 687. However, *Bocre* is of limited application for it is silent regarding how to handle a case involving a plaintiff who suffers damages to property other than the product itself. Similarly, while there are numerous lower courts cases in New York applying the Economic Loss Doctrine, none of these cases offer any guidance in resolving the "other property" dilemma. In *Village of Groton v. Tokheim Corporation*, 202 A.D. 728, 608 N.Y.S.2d 565 (1994), the owner of a fuel dispensing facility brought a negligence and strict products liability action against the manufacturer of a regulator used in the fuel dispensing system and the system designer for damages to the fuel dispensing system itself and for injuries to his property caused by the contamination of surrounding soils and ground water. The Third Department allowed the tort action against the manufacturer. Interestingly, in ruling that soil and ground water contamination did not constitute economic loss, the court in effect classified soil and ground water as "other property", distinct from the fuel dispensing system. However, the court did not articulate a standard for identifying "other property". As a result of this lack of direction, federal courts applying New York law have had a hard time trying to define "other property" for the purposes of applying the Economic Loss Doctrine exception. In *Arkwright Mutual Ins. Co. v. Bojoirve*, 1996 WL 361535 (S.D.N.Y. 1996), an allegedly defective governor damaged the generator in which it was housed, as well as adjacent generators, floors, ceilings, furniture, and other items of real and personal property on the floor in which the generators were situated. Although the court was able to assert that New York law did not preclude the action because the items damaged were clearly property other than the governor and the generator, the court was hesitant with respect to whether the governor constituted "other property" in relation to the generator. In fact, that court noted that "New York Court provides scant guidance" on declaring what constitutes "other property." To date, no new cases have clarified this issue.

To some extent, Florida has offered more guidance with respect to case law defining what "other property" is. However, notwithstanding the efforts of the Florida Supreme Court to clarify the various aspects of the Economic Loss Doctrine, confusion still remains on how to accurately distinguish the product itself from the "other property". The Florida Supreme Court adopted the Economic Loss Doctrine in *Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc.*, 620 So.2d 1244 (Fla.1993), a case involving an action by a homeowner against a concrete supplier for damage to condominium units caused by defective concrete walls. In holding that the economic loss rule barred the plaintiffs' action in negligence, the court observed that: "[T]o determine the character of a loss, one must look to the product purchased by the plaintiff, not the product sold by the defendant. … These homeowners bought finished products--dwellings--not the individual components of those dwellings. They bargained for the finished products, not their various components. The concrete became an integral part of the finished product and, thus, did not injure 'other' property." *Id.* at 1247. This is certainly not a clear standard for identifying "other property". It is neither the "initial user rule" adopted by the *Saratoga Fishing* majority, nor the "seller rule" mentioned by Justice Scalia. Instead, it appears that the Florida Supreme Court devised a new test to determine what "other property" is, something in-between the "object of the bargain rule" discussed above and a "finished product" test.

In 2000, the Florida Supreme Court once again discussed the "other property" exception in *Comptech Int'l, Inc. v. Milam Commerce Park, Ltd.,* 753 So.2d 1219 (Fla. 2000). The *Comptech* case involved a tenant suing a landlord for negligent renovations of a warehouse which allegedly caused damage to the computers located therein. Even though the *Comptech* court ultimately held that the Economic Loss Doctrine was inapplicable to the action before it, the court went to great lengths to attempt to clarify the distinction between the product itself and "other property", purposely remarking that the *Casa Clara* opinion was not unanimous with respect to how to characterize "other property". The court observed as follows: "[T]o the extent the warehouse is the object of the contract, the computers in the warehouse are indeed 'other property.' Therefore, recovery for damage to the computers is not precluded under the economic loss rule. … [S]uch a reading of the term 'other property' is supported by the Supreme Court's recent decision in *Saratoga Fishing* ….Even under a *Casa Clara* analysis, the computers are 'other property' and not subject to the economic loss rule. … The 'product' purchased by Comptech was the renovation of the warehouse. The computers placed in the warehouse were not an integral part of the product and were therefore 'other property' under the *Casa Clara* rationale." *Id.* at 1226-27. Once again, by not explicitly adopting the *Saratoga Fishing* "Initial User" test, and not expressly disapproving the *Casa Clara* analysis, the Florida Supreme Court avoided specifying a clear method as to how exactly "other property" should be defined.

Notwithstanding this lack of clarity with respect to what "other property" is for purposes of the Economic Loss Doctrine, there are some states which appear to have articulated a rational standard to distinguish the product itself from the "other property". In *Gunkel v. Renovations Inc.,* 822 N.E.2d 150 (2005), the Supreme Court of Indiana held

that "[w]hether damaged property is 'other property' turns on whether it was acquired by the plaintiff as a component of the defective product or was acquired separately. …. [T]he 'product' is the product purchased by the plaintiff, not the product furnished by the defendant." *Id.* at 150-155. The court reasoned that, because only the supplier furnishing the defective property or service is in a position to bargain with the purchaser for allocation of the risk that the product or service will not perform as expected, if a component is sold to the first user as a part of the finished product, the consequences of its failure are fully within the rationale of the Economic Loss Doctrine. However, property acquired separately from the defective good or service is "other property," whether or not it is incorporated into the same physical object. Notwithstanding that Court's citing *Saratoga* to support its decision, the *Gunkel* court was quick to point out that its holding is not necessarily consistent with the "initial user" test adopted by the Supreme Court of the United States. Indeed the *Gunkel* court specifically pointed out that it was not presented with, and expressed no opinion as to, the issues raised by a sale subsequent to the addition of "other property".

Obviously, the definition of "other property" for purposes of the Economic Loss Doctrine is a question of broad practical importance. Without clear guidance as to how to identify "other property", there is no way to predict which tort actions will be barred by the Economic Loss Doctrine. Clearly, from a manufacturer's point of view, the *Saratoga Fishing* "Initial User" rule is the least favorable. For, under the "Initial User" rule, manufacturers can be liable as a result of items that are added to the product after the sale by the initial purchaser/user as well as any other subsequent user. It is difficult to predict where each state will decide the struggle to identify "other property." While it is possible that state courts will decide to follow the *Saratoga Fishing* "Initial User" rule, others will certainly end up somewhere closer to the "object of the bargain" rule.

REPLACEMENT PARTS

A number of courts dealing with the dichotomy between the product itself and "other property" have addressed the interesting legal issue of whether a replacement part which is integrated into an original product causes the original product to become "other property" relative to the replacement part. Because most machines will inevitably require replacement parts at some point in time, the issue of whether the economic loss rule should be applied to replacement parts plays a significant role in determining a manufacturer's liability in negligence and strict products liability cases.

Take for example the case of a hypothetical helicopter manufacturer, Helix, Inc. Let's assume that Plaintiff P purchased a helicopter from Helix. Five years after this initial sale, P purchases a replacement oil drain valve from Helix, Inc. Thereafter, the P's helicopter malfunctions due to a defect in the oil drain valve, causing only damages to the helicopter itself and no personal injuries. Assuming that the Economic Loss Doctrine applies to this case, is Helix, Inc. liable for the damages to P's helicopter? Put another way, is the helicopter "other property" as compared to the oil drain valve? The United States District Court for the Eastern District of Pennsylvania answered this exact question in *Agrotors, Inc. v. Bell Helicopter Textron, Inc.,* 2004 WL 2039954 (E.D.Pa.). In

Agrotors, the plaintiff commenced an action after one of its aircraft was damaged due to a defective engine valve. Even though the engine valve had been replaced several times, the replacement valve involved in the incident at issue was identical to the original valve and had been manufactured by the same manufacturer defendant as the original valve. The court adopted the "object of the bargain" test to determine whether the helicopter and its engine were property other than the allegedly defective valve and thus observed as follows:

> [E]very component that was the benefit of the bargain should be integrated into the product … [I]t is a common commercial practice for the parties to a transaction to contemplate the integration of replacement parts subsequent to a purchase…Agrotors bargained for a functioning aircraft when it purchased the helicopter … Included within the helicopter were component parts, many of which would inevitably need replacement, including its oil drain valve. Agrotors did not bargain separately for that individual oil drain valve when it purchased the helicopter. If the replacement valve was defective, and that defect caused damage to the engine and the helicopter, then the helicopter itself was defective. If Agrotors was deprived of the benefit of its bargain by getting a defective helicopter, its remedy is based in contract, not tort.

Id. Thus, the Agrotors Court found that the introduction of a replacement part into a product does not create "other property" under the Economic Loss Rule. Similarly, in *Sea-Land Service, Inc. v. General Electric Co.,* 134 F.3d 149 (3rd Cir.1998), the Third Circuit found that the integrated product should encompass replacement parts installed in an engine. Accordingly, the court held that the Economic Loss Doctrine barred recovery in tort for damages to an engine caused by a replacement connecting rod. Texas follows this same approach. As set forth in *Equistar Chemicals, L.P. v. Dresser-Rand Co.,* 123 S.W.3d 584 (2004), the Texas Court of Appeals held that replacement parts provided by the original seller do not make the original product "other property".

Based on the foregoing, it appears that the answer to our query "whether Helix, Inc. is liable for the damages to P's helicopter" would be negative. What if P had purchased the replacement oil drain valve from Valve Co. instead of Helix, Inc.? The United States District Court for the District of Massachusetts addressed this very same issue in *Irish Venture, Inc. v. Fleetguard, Inc.,* 270 F.Supp.2d 84 (2003). In *Irish Venture,* the Plaintiff had purchased a number of replacement filters for its boat's main engine as part of routine maintenance. These filters had been manufactured and sold by defendants Fleetguard and Rose's Oil, respectively. Thereafter, the main engine failed due to a defect in one of the filters causing damage to Plaintiff's boat and its engine. In holding that Plaintiff's claims in tort were not barred by the Economic Loss Doctrine, the court observed that: "The object of [Plaintiff]'s bargain with Rose's Oil was an oil filter. The filter, once installed, caused damage not only to itself … but also to the engine, which was purchased in an entirely separate bargain, and cannot be said to have been any part of the deal struck between [Plaintiff] and Rose's Oil". *Irish Venture,* 270 F.Supp. at 86. Thus, this reasoning, if adopted by other courts could create significant liability for replacement part manufacturers. Likewise, in *Ice Fern Shipping, Co. v. Golten Service*

Co, 2005 U.S.Dist. LEXIS 12200, the United States District Court for the Southern District of Florida drew a distinction between cases involving replacement parts purchased from the original seller and those dealing with replacement parts purchased from someone other than the original seller. In *Ice Fern*, the owner of a vessel entered into a contract with the defendants for repairs to a governor. Thereafter, the governor failed causing substantial damage to the vessel's engine. The court pointed out that the parties' contract covered repairs to the governor only. Accordingly, Plaintiff was allowed to recover for damages to the vessel's engine under a negligence theory.

Based on the foregoing, it would appear that whether or not a replacement part causes an original product to become "other property" depends on whether the replacement part was purchased from the seller of the original product. Accordingly, in our hypothetical, P would only be able to recover for damages to the helicopter if it had purchased the replacement oil drain valve from Valve Co. Interestingly, that means that plaintiffs could circumvent the Economic Loss Doctrine by simply replacing any of their products' parts with a new part purchased by a manufacturer other than the original manufacturer of the part to be replaced. Obviously, such a scheme would only be effective in avoiding the Economic Loss Doctrine in cases where the replacement part caused the damage. For then, the replacement part would be labeled as the product itself while the rest of the product damaged would be regarded as "other property" for which recovery is allowed. This would inevitably result in expanded liabilities for replacement parts manufacturers. However, as a practical matter, it is doubtful that users of product would make their decisions on replacement part purchases based upon Economic Loss Doctrine implications.

Conclusion

Nearly twenty years after the Economic Loss Doctrine was set forth by the East River court, the courts of the United States are inconsistent on how "other property" is defined. With the various methods: "initial user rule", "object of the bargain", or the "seller rule", it is unclear how the definition of "other property" will develop and which rule the majority of U.S. jurisdictions will adopt.

The argument that replacement parts cause original products to become "other property" is certainly plausible. However, based on the case law discussed above, it is evident that the law in this area is, and will remain, very unpredictable and extremely fact-specific, at least until the higher courts of the various U.S. jurisdictions have articulated a plain and unambiguous standard for identifying "other property" for purposes of the Economic Loss Doctrine.