

Arizona Supreme Court Re-Affirms Economic Loss Doctrine

By P. Douglas Folk, Attorney

Arizona's Supreme Court has published a favorable decision upholding the economic loss doctrine in *Flagstaff Affordable Housing L.P. v. Design Alliance, Inc.*, 2010 WL 476683 (Arizona, February 12, 2010). ACEC Arizona, AIA Arizona and ASFE joined in filing an *amicus curiae* brief to the Arizona Supreme Court. We wrote the brief and participated in oral argument in this case before the Court on behalf of these professional associations.

The Supreme Court has held design professionals may use the economic loss doctrine as a legal defense in claims brought by their clients. The Supreme Court decision went even farther than we thought it might, and it leaves no uncertainty that a design professional's client is limited to its contract remedies when a design defect causes economic loss but no physical injury to persons or other property.

This new ruling gives even greater weight to the contract terms agreed between a design professional and its client. If the contract limits the professional scope of services or responsibility, or it specifies a performance standard, the client cannot ignore the contract and argue that the professional standard of care imposes a greater liability on the design professional. This ruling forces clients to negotiate with design professionals over how much risk will be assumed under the contract, what compensation must be paid for assuming that risk, and the remedies available to both parties in the event of a claim or dispute. If the contract also incorporates other risk mitigation measures—such as a limitation on liability or waiver of consequential damages—those protections cannot be circumvented by a professional negligence claim.

In the *Flagstaff* case, the developer of an apartment complex sued its architect for the cost of curing violations of the Americans with Disabilities Act and Fair Housing Amendments Act. The developer claimed that the architect and contractor's violation of accessibility standards under federal disability rights laws authorized the developer to sue for damages under either contract or negligence law. The architect and contractor obtained a dismissal of their respective contract or warranty claims, which were barred by Arizona's eight-year statute of repose, Ariz.Rev.Stat. § 12-552. The architect also convinced the trial court to dismiss the owner's professional negligence claim under the economic loss doctrine, because the owner sought money damages unrelated to personal injury or property damage. The Arizona Court of Appeals reversed this decision on appeal, and held that the economic loss doctrine was not available to design professionals. That ruling left the architect exposed to a tort claim even though the client could no longer sue for a breach of contract.

The Arizona Supreme Court vacated the Court of Appeals decision, holding that the economic loss doctrine applies across the board in construction defect cases. A property owner is "limited to its contractual remedies when an architect's negligent design causes economic loss but no physical injury to persons or other property." (We believe this rule protects all design professionals or contractors, regardless of their professional discipline or occupation.) The term "economic loss" is defined in the decision to mean "pecuniary or commercial damage, including any decreased value or repair costs for a product or property that is itself the subject of a contract between the plaintiff and defendant, and consequential damages such as lost profits."

Reiterating its recent decision on contractual limitations of liability, *1800 Ocotillo, LLC. v. The WLB Group, Inc.*, 219 Ariz. 200, 196 P.3d 222 (2008) (in which we also submitted an *amicus curiae* brief on

behalf of ACEC Arizona, AIA Arizona, the Arizona Professional Land Surveyors Association and ASFE), the Supreme Court held “in construction defect cases involving only pecuniary losses related to the building that is the subject of the parties’ contract, there are no strong policy reasons to impose common law tort liability in addition to contractual remedies.” To hold otherwise, the Court reasoned, would undermine the contract and upset the expectations of the contracting parties.

The Supreme Court’s decision in *Flagstaff* also includes these additional holdings that will be binding in future cases against design professionals:

- If a design professional’s client wants to preserve a tort remedy in addition to its contract rights, it must write a contract that explicitly says so. If the contract is silent on this point, the presumption is that the economic loss doctrine will bar all tort claims seeking only economic loss.
- This rule does not bar a tort claim when economic loss is accompanied by physical injury to persons or other property.
- Violation of a legal duty imposed by statute, such as a building code, does not override the economic loss doctrine; a client’s tort claim will still be barred.
- The design professional’s legally-imposed duty of care also does not displace the general policy that “parties to construction-related contracts should structure their relationships by prospectively allocating the risks of loss and identifying remedies.”
- There is no reason under Arizona law to distinguish design professionals from contractors (or anyone else) for purposes of applying the economic loss doctrine.

Soon after its decision in the *Flagstaff* case, the Arizona Supreme Court accepted review of another recent Court of Appeals decision, *Hughes Custom Building, LLC. v Davey, et al.*, 221 Ariz. 527, 212 P.3d 865 (App. 2009), in which a third party sued a civil engineer with whom it did not have a contract for economic loss damages when there was no personal injury or damage to other property. The Supreme Court sent the *Hughes* case back to Division Two of the Arizona Court of Appeals, with instructions to reconsider the case in light of the new *Flagstaff* precedent. The *Hughes* decision after reconsideration will address how and when the economic loss doctrine will apply to third party claims against design professionals. We recommend that the design professions join together in filing an *amicus curiae* brief in *Hughes* when it is reconsidered by the Court of Appeals as this case will have even greater significance than *Flagstaff* because it sets limits on the rights of third parties—persons other than clients—to sue design professionals.

If you have any other questions about this important new ruling, please contact me. This is a great decision for design professionals and proof that much can be accomplished when the design professions take an active role as *amicus curiae* in key cases.

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