FILED
SEP 14 2010
SUPREME COURT CLERK

SUPREME COURT OF KENTUCKY
NO. 2009-SC-485 AND NO. 2009-SC-825

GIDDINGS & LEWIS, INC., ET AL. — **APPELLANTS/ CROSS-APPELLEES**

v.

ON APPEAL FROM THE COURT OF APPEALS
No. 2007-CA-002163-MR

INDUSTRIAL RISK INSURERS, ET AL. — **APPELLEES/ CROSS-APPELLANTS**

COMBINED RESPONSE AND REPLY BRIEF OF APPELLANTS GIDDINGS & LEWIS, INC., ET AL.

John L. Tate
Jamie K. Neal
STITES & HARBISON, PLLC
400 West Market Street, Suite 1800
Louisville, KY 40202-3352
Telephone: (502) 587-3400
Counsel for Appellants/Cross-Appellees

CERTIFICATE OF SERVICE

This certifies that copies of appellants/cross-appellees' brief were served by first class mail on the 13th day of September, 2010, on:

Richard C. Roberts, Whitlow, Roberts, Houston & Straub, Old Nat'l Bank Bldg., 300 Broadway, P. O. Box 995, Paducah, KY 42002-0995; Edward M. Kay, James J. Bigoness, Kimberly A. Hartman, Clausen Miller P.C., 10 South LaSalle St. Chicago, IL 60603; Hon. Timothy C. Stark, Graves Circuit Court, and Mr. Sam Givens, Clerk, Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601.

This further certifies that appellants/cross-appellees did not withdraw the record on appeal.

John L. Tate

STATEMENT OF POINTS AND AUTHORITIES

ARGUMENT 1

I. The so-called "calamitous event" or "destructive occurrence" exception to the Economic Loss Rule is illogical and unworkable 2

A. A majority of courts reject exceptions to the Economic Loss Rule based on the speed at which the event occurs 2

East River Steamship Corp. v. Transamerica Delaval, 476 U.S. 858 (1986) 2

Wellcraft Marine v. Zarzour, 577 So.2d 414 (Ala. 1990) 2

Airport Rent-A-Car v. Prevost Car, Inc., 660 So.2d 628 (Fla. 1995) 2

In re Cessna 208 Series Aircraft Prods. Liab. Litig., 591 F. Supp. 2d 1161 (D. Kan. 2008) 2

Test Drilling Serv. Co. v. Hanor Co., 322 F. Supp. 2d 965 (C.D. Ill. 2004) 2

Koss Const. v. Caterpillar, 960 P.2d 255 (Kan. 1998) 2

Sebago v. Beazer East, 18 F. Supp. 2d 70 (D. Mass 1998) 2

S.J. Groves & Sons Co. v. Aerospatiale Helicopter Corp., 374 N.W.2d 431 (Minn. 1985) 2

Hapka v. Paquin Farms, 458 N.W.2d 683 (Minn. 1990) 2

Sharp Bros. Contracting Co. v. American Hoist & Derrick Co., 703 S.W.2d 901 (Mo. 1986) 2

National Union Fire Ins. Co. v. Pratt & Whitney Canada, 815 P.2d 601 (Nev. 1991) 2

Lockheed Martin Corp. v. RFI Supply, 440 F.3d 549 (1st Cir. 2006) 2

Boyes v. Greenwich Boat Works, 27 F. Supp. 2d 543 (D.N.J. 1998) 2

Alloway v. Gen. Marine Indus., 695 A.2d 264 (N.J. 1997) 3

Utah Int'l, Inc. v. Caterpillar Tractor Co., 775 P.2d 741 (N.M. App. 1989) 3

Cooperative Power Ass'n v. Westinghouse Elec. Corp., 493 N.W.2d 661 (N.D. 1992) 3

Aloe Coal Co. v. Clark Equip. Co., 816 F.2d 110 (3rd Cir. 1987) 3

STATEMENT OF POINTS AND AUTHORITIES
(continued)

Isla Nena Air Services, Inc. v. Cessna Aircraft Co., 449 F.3d 85 (1st Cir. 2006) 3

Lincoln Gen. Ins. Co. v. Detroit Diesel Corp., 293 S.W.3d 487 (Tenn. 2009) 3

Mid-Continent Aircraft Corp. v. Curry County Spraying Serv., 572 S.W.2d 308 (Tex. 1978) 3

General Cas. Co. v. Ford Motor Co., 592 N.W.2d 198 (Wisc. 1999) 3

Continental Ins. v. Page Eng'g Co., 783 P.2d 641 (Wyo. 1989) 3

Trans State Airlines v. Pratt & Whitney Can., Inc., 682 N.E.2d 45 (Ill. 1997) 3

Prosser & Keeton on the Law of Torts § 101(3), at 709 (5th ed. 1984) 3

Restatement (Third) of Torts: Products Liability § 21 4

B. Kentucky precedent does not support the "calamitous event" or "destructive occurrence" exception to the Economic Loss Rule 4

Falcon Coal Co. v. Clark Equipment Co., 802 S.W.2d 947 (Ky. App. 1990) 4, 5, 6

Real Estate Marketing v. Franz, 885 S.W.2d 921 (Ky. 1994) 4, 5, 6, 7

Louisville Gas & Elec. Co. v. Continental Field Sys., 420 F. Supp. 2d 764 (W.D. Ky. 2005) 5

Gooch v. E.I. Du Pont de Nemours & Co., 40 F. Supp. 2d 863 (W.D. Ky. 1999) 5

Mt. Lebanon Personal Care Home v. Hoover Universal, 276 F.3d 845 (6th Cir. 2002) 5, 6, 7

C. Public policy does not support adoption of the calamitous event exception to the Economic Loss Rule 7

Lincoln Gen. Ins. Co. v. Detroit Diesel Corp., 293 S.W.3d 487 (Tenn. 2009) 8

Trans State Airlines v. Pratt & Whitney Can., Inc., 682 N.E.2d 45 (Ill. 1997) 8

II. Only those negligent misrepresentation and fraud claims that do <u>not</u> arise from the character of the contracted goods should be exempt from the Economic Loss Rule 8

A. Presnell does not implicate the Economic Loss Rule, much less dictate exceptions for negligent misrepresentation or fraud 8

Presnell Construction v. EH Construction, 134 S.W.3d 575 (Ky. 2004) 8, 9

Mt. Lebanon Pers. Care Home v. Hoover Universal, 276 F.3d 845 (6th Cir. 2002) 8

Louisville Gas & Electric v. Continental Field Systems, 420 F. Supp. 2d 764 (W.D. Ky. 2005) 9

B. An exception to the Economic Loss Rule for negligent misrepresentation or fraud claims cannot be based on the quality or character of goods sold 10

Coursey v. Westvaco Corp., 790 S.W.2d 229 (Ky. 1990) 10

Mt. Lebanon Pers. Care Home v. Hoover Universal, 276 F.3d 845 (6th Cir. 2002) 10, 11

East River Steamship Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986) 10, 11

Werwinski v. Ford Motor Co., 286 F.3d 661 (3d Cir. 2002) . 10, 11

Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 223 F.3d 873 (8th Cir. 2000) 10

Huron Tool & Eng. Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541 (Mich. App. 1995) 10

All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862 (7th Cir. 1999) 11

Presnell Construction v. EH Construction, 134 S.W.3d 575 (Ky. 2004) 12

Govaerts v. Suntec Indus., Inc., 2010 U.S. Dist. LEXIS 52467 (W.D. Ky. May 26, 2010) 12

Barton Brands, Ltd. v. O'Brien & Gere, Inc., 550 F. Supp. 2d 681 (W.D. Ky. 2008) 12

C. The Insurance Companies' fraud and negligent misrepresentation claims relate to nothing more than the quality and character of the goods sold by G&L 12

STATEMENT OF POINTS AND AUTHORITIES
(continued)

Werwinski v. Ford Motor Co., 286 F.3d 661 (3d Cir. 2002) 12

Huron Tool & Eng. Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541 (Mich. App. 1995) 12

III. What constitutes "other property" for purposes of the Economic Loss Rule is a question of law. 13

Onsite/Molkai Ltd. Ptrshp. v. GE, 838 F. Supp. 1390 (D. Haw. 1992) 13

Exxon Shipping Co. v. Pacific Resources, 835 F. Supp. 1195 (D. Haw. 1993) 13

Petroleum Helicopters, Inc. v. Avco Corp., 930 F.2d 389 (5th Cir. 1991) 14

American Towers Owners Ass'n v. CCI Mech., 930 P.2d 1182 (Utah 1996) 14

Mt. Lebanon Personal Care Home, Inc. v. Hoover Universal, Inc., 276 F.3d 845, 847 (6th Cir. 2002) 14

Barton Brands v. O'Brien & Gere, Inc., 550 F. Supp. 2d 681, 689 (W.D. Ky. 2008) 14, 15

Commonwealth v. Jones, 217 S.W.3d 190, 199 (Ky. 2006) 15

Cemex v. LMS Contracting, Inc., 2009 U.S. Dist. LEXIS 89052 (W.D. Ky. Sept. 28, 2009) 15

CONCLUSION 16

ARGUMENT

Not surprisingly, the Insurance Companies agree that Kentucky should formally adopt the Economic Loss Rule. The Insurance Companies do not dispute the importance of maintaining the line between contract and tort law and enforcing contracts agreed to by sophisticated commercial entities. Because they are in the business of insuring against property damage losses—and paying their insureds for covered losses—insurance companies generally benefit from the Economic Loss Rule's limitation on the scope of claims.

But, in an argument tainted by their financial stake in this particular case, the Insurance Companies here urge adoption of an illogical "calamitous event" exception to the Rule. Numerous courts—including the U.S. Supreme Court—have determined that an exception to the Economic Loss Rule based on the manner in which a product fails is untenable and unworkable. The line between contract and tort must be drawn somewhere, and it makes the most sense—and is most consistent—to draw that line based on the damage the plaintiff actually sustained, not based on the manner in which the product was damaged or the potential risk created by product malfunction.

Again motivated by their financial stake here, the Insurance Companies argue for negligent misrepresentation and fraud exceptions that would all but swallow the Rule. Allowing exceptions for negligent misrepresentation and fraud claims based on the character of the goods sold is bad public policy, however, because it would turn every breach of warranty claim into a tort claim.

And, finally, the Insurance Companies ask that this court delegate to a jury the contractual interpretation of "other property." Courts uniformly hold that this is a question of law, and it should stay a question of law.

I. The so-called "calamitous event" or "destructive occurrence" exception to the Economic Loss Rule is illogical and unworkable.

A. A majority of courts reject exceptions to the Economic Loss Rule based on the speed at which the event occurs.

As the U.S. Supreme Court made crystal clear, there is no logic in letting the speed at which an event occurs dictate the application of economic loss principles. *East River Steamship Corp. v. Transamerica Delaval,* 476 U.S. 858, 870 (1986). Damage to a product "may be qualitative, occurring through gradual deterioration or internal breakage" or it "may be calamitous," but "either way, since by definition no person or other property is damaged, the resulting loss is purely economic." *Id.* Thus, even when the product is damaged "through an abrupt, accident-like event, the resulting loss due to repair costs, decreased value, and lost profits is essentially the failure of the purchaser to receive the benefit of its bargain—traditionally the core concern of contract law." *Id.*

The Court of Appeals agreed with the U. S. Supreme Court. (Court of Appeals' Opinion ("*Op.*") at 16, attached as Ex. 4 to G&L's initial brief.) And, not surprisingly, the majority of other jurisdictions also agree and reject the so-called "calamitous event" or "destructive occurrence" exception to the Rule.[1]

---

[1] *See, e.g.,* **Alabama:** *Wellcraft Marine v. Zarzour*, 577 So.2d 414, 416, 418 (Ala. 1990); **Florida:** *Airport Rent-A-Car v. Prevost Car, Inc.* 660 So.2d 628 (Fla. 1995); **Idaho:** *In re Cessna 208 Series Aircraft Prods. Liab. Litig.*, 591 F. Supp. 2d 1161, 1167 (D. Kan. 2008) (predicting Idaho law); **Illinois:** *Test Drilling Serv. Co. v. Hanor Co.*, 322 F. Supp. 2d 965 (C.D. Ill. 2004); **Kansas:** *Koss Const. v. Caterpillar*, 960 P.2d 255 (Kan. 1998); **Maine and Massachusetts:** *Sebago v. Beazer East*, 18 F. Supp. 2d 70 (D. Mass. 1998) (Maine and Massachusetts law); **Minnesota***:* *S.J. Groves & Sons Co. v. Aerospatiale Helicopter Corp.*, 374 N.W.2d 431, 433-35 (Minn. 1985), overruled on other grounds by *Hapka v. Paquin Farms*, 458 N.W.2d 683 (Minn. 1990); **Missouri:** *Sharp Bros. Contracting Co. v. American Hoist & Derrick Co.*, 703 S.W.2d 901 (Mo. 1986); **Nevada:** *National Union Fire Ins. Co. v. Pratt & Whitney Canada*, 815 P.2d 601 (Nev. 1991); **New Hampshire:** *Lockheed Martin Corp. v. RFI Supply*, 440 F.3d 549 (1st Cir. 2006) (New Hampshire law); **New Jersey:** *Boyes v. Greenwich Boat Works*, 27 F. Supp. 2d 543 (D.N.J. 1998);

For example, the Tennessee Supreme Court recently concluded, on certification of this issue from the U.S. District Court, that Tennessee law does not recognize an exception to the Economic Loss Rule for an "unreasonably dangerous" product or one that "causes damage by means of a sudden, calamitous event." *Lincoln Gen. Ins. Co. v. Detroit Diesel Corp.*, 293 S.W.3d 487, 492 (Tenn. 2009) (collecting cases on this issue from other jurisdictions).[2] In *Lincoln General*, a bus caught fire, allegedly due to an engine defect, while traveling south on Interstate 65. *Id.* at 488. Fortunately, only the bus was damaged. *Id.* In holding that Tennessee does not recognize the calamitous event exception, the court explained that "the owner of a defective product that creates a risk of injury and was damaged during a fire, a crash, or other similar occurrence is in the same position as the owner of a defective product that malfunctions and simply does not work." *Id.* at 491. Thus, the remedies available to these "similarly situated product owners" should be the same and "should derive from the parties' agreements, not from the law of torts, lest we disrupt the parties' allocation of risk." *Id.* (citing *Prosser & Keeton on the Law of Torts* § 101(3), at 709 (5th ed. 1984)).

The line between contract and tort must be well drawn and defensible. The only consistently dependable line is based on the "harm the plaintiff actually sustains" rather than based on "the degree of risk and the manner in which the product was damaged."

Alloway v. Gen. Marine Indus. 695 A.2d 264 (N.J. 1997); **New Mexico:** *Utah Int'l, Inc. v. Caterpillar Tractor Co.*, 775 P.2d 741, 743-44 (N.M. App. 1989); **North Dakota:** *Cooperative Power Ass'n v. Westinghouse Elec. Corp.*, 493 N.W.2d 661 (N.D. 1992); **Pennsylvania:** *Aloe Coal Co. v. Clark Equip. Co.*, 816 F.2d 110 (3rd Cir. 1987); **Puerto Rico:** *Isla Nena Air Services, Inc. v. Cessna Aircraft Co.*, 449 F.3d 85 (1st Cir. 2006); **Tennessee**: *Lincoln Gen. Ins. Co. v. Detroit Diesel Corp.*, 293 S.W.3d 487, 492 (Tenn. 2009); **Texas:** *Mid-Continent Aircraft Corp. v. Curry County Spraying Serv.*, 572 S.W.2d 308 (Tex. 1978); **Wisconsin:** *General Cas. Co. v. Ford Motor Co.*, 592 N.W.2d 198 (Wisc. 1999); **Wyoming:** *Continental Ins. v. Page Eng'g Co.*, 783 P.2d 641, 647-48 (Wyo. 1989).

[2] The Insurance Companies cite an earlier Tennessee federal court opinion for the proposition that Tennessee recognizes the calamitous event exception, but *Lincoln General* conclusively establishes that it does not. (Appellees' Brief at 16.) The Insurance Companies also point to Illinois as a jurisdiction that embraces the exception, but the Illinois Supreme Court clarified that it does not. *See Trans State Airlines v. Pratt & Whitney Can., Inc.*, 682 N.E.2d 45, 53 (Ill. 1997).

Id. The latest authoritative statement on product liability law agrees: the calamitous event exception does not appear in RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21. (*See*, comment d & Reporter's Notes noting that such tort recovery is barred under the Restatement and collecting cases from the "strong majority" of jurisdictions rejecting the "destructive occurrence" exception).

B. Kentucky precedent does not support the "calamitous event" or "destructive occurrence" exception to the Economic Loss Rule.

The Kentucky Court of Appeals implicitly rejected the calamitous event exception in *Falcon Coal Co. v. Clark Equipment Co.*, 802 S.W.2d 947 (Ky. App. 1990). In *Falcon Coal*, plaintiff's front-end loader caught fire and was destroyed. Only the front-end loader was destroyed; no other property or person was damaged. *Id.* at 948. Despite the sudden, destructive, and potentially life-threatening occurrence of a fire, the court concluded that the owner of the front-end loader could not pursue damages in tort against the manufacturer for the purely economic losses. *Id.* at 948.

The Insurance Companies rely heavily on a subsequent Kentucky Supreme Court decision, *Real Estate Marketing v. Franz*, 885 S.W.2d 921 (Ky. 1994), characterizing it as having "expressly rejected" the holding in *Falcon Coal* and its "limitation on the recovery of economic damages." (Appellees' Brief at 13.) The Insurance Companies are not being fair to the *Franz* decision. In *Franz*, the Supreme Court dismissed a homeowner's negligent construction claims against the homebuilder. After so holding, the Court held the *Falcon Coal* decision at arm's length, commenting: "We do not go so far as the Court of Appeal's opinion in *Falcon Coal v. Clark Equipment Co.* limiting recovery under a products liability theory to damage or destruction of property 'other' than the product itself." *Id.* at 926.

Taken out of the context of the Economic Loss Rule, the *Franz* court's statement is unremarkable. Normally in a products liability case, *i.e.*, in the absence of a negotiated contract between sophisticated commercial entities that limits the recovery of economic damages, damages are *not* limited to the product itself. The *Franz* court's reference to *Falcon Coal* is misleading, however, because the *Franz* case, unlike *Falcon Coal*, had nothing to do with the Economic Loss Rule. Indeed, *Franz* never discussed or mentioned the Economic Loss Rule because the Rule could not have been an issue in the case. By definition, the Economic Loss Rule only applies as between parties to a contract. In *Franz*, the homeowners never had a contract with the homebuilder. *Id.* at 923.

In addition, unlike the case at bar, *Franz* did not involve a transaction between a sophisticated commercial buyer and a sophisticated commercial seller with equal bargaining power, which is the province of the Economic Loss Rule. *See Louisville Gas & Elec. Co. v. Continental Field Sys.*, 420 F. Supp. 2d 764, 770 (W.D. Ky. 2005) (acknowledging that Kentucky, in the least, had adopted the Economic Loss Rule "in its classic definition"); *Gooch v. E.I. Du Pont de Nemours & Co.*, 40 F. Supp. 2d 863, 875 n.5 (W.D. Ky. 1999) (distinguishing *Franz* because the case did not involve a "transaction between a commercial buyer and seller."). Instead, the Court merely held that, to proceed on a tort claim—in this case, negligent home construction—the plaintiff has to have suffered some "damaging event" rather than merely a perceived diminution in the value of their home. As the Court said, "tort recovery is contingent upon damage from a destructive occurrence as contrasted with economic loss related solely to diminution in value…." *Franz*, 885 S.W.2d at 926.[3]

[3] Compare *Mt. Lebanon Pers. Care Home v. Hoover Universal*, 276 F.3d 845, 849 (6th Cir. 2002) ("While the Kentucky Supreme Court agreed with the trial court that the Franzes could not sustain a negligence

The Insurance Companies seize on this passage in *Franz* as evidence that this Court recognizes a calamitous event exception to the Economic Loss Rule, but they push too far. The only application of this passage in *Franz* is that one cannot recover in tort simply because a product is alleged to be defective; there has to be an accident causally connected to the alleged defect that causes actual, out-of-pocket damages. In other words, as applied to the case at bar, had there been no accident at Ingersoll that caused out-of-pocket damages, Ingersoll and the Insurance Companies would not be entitled to seek recovery on the basis that the Diffuser Cell System's allegedly excessive RPM's diminished its perceived value.

Of course, the parties here are beyond arguing causation; there is no dispute that an accident occurred that caused out-of-pocket damages. The issue before this Court is different from the issue in *Franz*. The issue here is whether a party to a contract can recover actual out-of-pocket—and purely economic—damages in tort when a contract bars recovery of those same damages. On this question, the answer is clear: The Economic Loss Rule bars recovery, and the *Franz* case does not alter the outcome.

Significantly, every federal court interpreting Kentucky law has applied the Economic Loss Rule without regard to the manner in which the product was damaged or the threat posed by the product. Most notably, in *Mt. Lebanon Personal Care Home v. Hoover Universal*, 276 F.3d 845, 852 (6th Cir. 2002), the plaintiff urged the Sixth Circuit to recognize an exception to the Economic Loss Rule when "the injury to the product created a serious risk of injury to a person or property."

---

claim, it did so because there was no 'damaging event,' not because their claim was barred by the economic loss doctrine. Indeed, in its decision, the Kentucky Supreme Court expressly refused to extend *Franz* to a Kentucky Court of Appeals decision [*Falcon Coal*] which had adopted the economic loss doctrine.").

The court first noted that courts recognizing this exception were in the minority. *Id.* at 853. The court then observed that both the U. S. Supreme Court and the authoritative Third Restatement of Torts reject this exception. Based on all relevant evidence, the court concluded that the Kentucky Supreme Court would also reject the minority position: "We therefore predict that the Kentucky Supreme Court would reject a serious risk of injury exception to the economic loss rule." *Id.* Notably, the Sixth Circuit decided the *Mt. Lebanon* case eight years *after* this Court decided *Franz*. The Sixth Circuit did not find the *Franz* case to be an obstacle to declining to apply the exception, and neither should this Court.

C. Public policy does not support adoption of the calamitous event exception to the Economic Loss Rule.

The Insurance Companies disingenuously claim that the calamitous event exception to the Economic Loss Rule promotes public safety (Appellees' Brief at 14), suggesting that without a calamitous event exception manufacturers would not be motivated to produce safe products.

It is difficult to take this argument seriously. Along with ubiquitous safety standards promulgated by industry groups and generated by agencies, product liability law is the vehicle for product safety in America. The advent of the Economic Loss Rule in 1965 certainly has not led to a flood of unsafe products by manufacturers who no longer fear liability. Even without an exception for calamitous events, manufacturers are subject to workplace, design, and manufacturing safety standards, and tort law exists to insure that manufacturers remain subject to liability for personal injuries and damage caused by their products. The calamitous event exception simply does not play a role in product safety—especially since it is applied in a small minority of jurisdictions.

Contrary to the Insurance Companies' arguments, recognition of the calamitous event exception to the Economic Loss Rule will *not* strengthen manufacturers' incentive to create safe products—or rather, more accurately, to create products that fail with a whimper instead of a bang. Indeed, the manner in which the loss might occur is too indefinite to shape how manufacturers structure their business behavior. *See Lincoln General Ins.*, 293 S.W.3d at 491; *Trans State Airlines*, 682 N.E.2d at 53. Regardless of whether a product fails with a bang (in which case the exception would apply) or whether a product fails with a whimper (in which case the exception would not apply), manufacturers have an undiminished incentive to sell safe products.

II. Only those negligent misrepresentation and fraud claims that do *not* arise from the character of the contracted goods should be exempt from the Economic Loss Rule.

A. *Presnell* does not implicate the Economic Loss Rule, much less dictate exceptions for negligent misrepresentation or fraud.

The Insurance Companies echo the Court of Appeals in pointing to the concurring opinion by Justice Keller in *Presnell Construction v. EH Construction*, 134 S.W.3d 575 (Ky. 2004), as establishing an exception to the Economic Loss Rule for negligent misrepresentation and fraud claims. (Appellees' Brief at 21-23; *Op.* at 15-16.) The majority *Presnell* decision, however, *never* mentioned the Economic Loss Rule, and the facts of the case did not implicate the Rule.

In *Presnell*, the negligent misrepresentation claim was between two parties who did not have a contract. *Presnell*, 134 S.W.3d at 576. The Economic Loss Rule, of course, only operates when the claim arises between parties to a contract. The purpose of the Economic Loss Rule is to protect contract law, which "gives the parties to a venture the freedom to allocate risk as they see fit." *Mt. Lebanon Pers. Care Home v. Hoover*

Universal, 276 F.3d 845, 848 (6th Cir. 2002) (citation omitted). Because the parties in *Presnell* did not have a contract, the Economic Loss Rule did not apply. *Presnell* also did not involve the sale of a product; it was provision of a service—construction supervision. The Economic Loss Rule traditionally applies only to sale of products. *See Louisville Gas & Electric v. Continental Field Systems,* 420 F. Supp. 2d 764, 769 (W.D. Ky. 2005).

The *Presnell* decision, therefore, must be viewed in the context of the facts giving rise to the litigation. *Presnell* recognized for the first time the tort of negligent misrepresentation. *Id.* at 580, 582. The concurring opinion, however—on which the Insurance Companies and the Court of Appeals rely—merely set out the policy wishes of two Justices; it was not a majority opinion designed to be relied on as authority. And it was off the mark in suggesting that the Economic Loss Rule was implicated by the facts of the case. For this reason, other courts have looked past the concurring opinion. *Louisville Gas & Elec.*, 420 F. Supp. 2d at 769 ("[The parties in *Presnell* were not] in privity nor maintained a contractual relationship. Consequently, the economic loss rule, which bars tort claims among those in a contractual relationship for the sale of goods, by definition, could not apply.").

Ultimately, the Insurance Companies miss the point when they argue that just because the torts of negligent misrepresentation and fraud exist in Kentucky, they should apply here. The existence of these causes of action is not the debate. The issue is whether the Economic Loss Rule can be eviscerated by simply restating a claim that is otherwise barred in terms of negligent misrepresentation and fraud. On this issue, *Presnell* is silent.

B. An exception to the Economic Loss Rule for negligent misrepresentation or fraud claims cannot be based on the quality or character of goods sold.

Absent controlling precedent on the issue, this Court should look to well-reasoned authority from other jurisdictions. *Coursey v. Westvaco Corp.*, 790 S.W.2d 229, 231 (Ky. 1990). In doing so, it is helpful to recall the three primary policy considerations supporting the Economic Loss Rule: (1) "it maintains the historical distinction between tort and contract law," (2) "it protects parties' freedom to allocate economic risk by contract," and (3) it encourages the party in the best position to assess the risk of the economic loss, typically the purchaser, "to assume, allocate, or insure against that risk." *Mt. Lebanon Personal Care Home*, 276 F.3d at 848; *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 872-73 (1986).

With those underlying purposes in mind, there is no logical basis for an exception to the Economic Loss Rule for fraud or misrepresentation claims "that ultimately concern the quality of the products sold" because commercial parties can use warranties to protect themselves from the risk of economic loss from defective or failing products. *Werwinski v. Ford Motor Co.*, 286 F.3d 661, 676 (3d Cir. 2002); *Marvin Lumber & Cedar Co. v. PPG Indus., Inc.*, 223 F.3d 873, 885 (8th Cir. 2000). As aptly explained in one of the cases on which the Insurance Companies rely, when the only alleged misrepresentation "concerns the quality or character of the goods sold, the other party is still free to negotiate warranty and other terms to account for possible defects in the goods." *Huron Tool & Eng. Co. v. Precision Consulting Servs., Inc.*, 532 N.W.2d 541, 545 (Mich. App. 1995).

And that is exactly what happened here. G&L and Ingersoll negotiated a warranty that dealt with possible defects in the goods:

> WARRANTY: All goods furnished by Seller and any services or installation relating thereto pursuant to this order shall be warranted to be of the best quality of their respective kinds and *to be free of defects in design,* workmanship, or material and when known to Seller suitable for their intended purposes. In the event of breach, the Seller shall take all necessary action, at Seller's expense, to correct such breach in the most expeditious manner possible. This warranty shall also inure to the benefit of Buyer's customer or user of the goods.

(R. 243, attached as Ex. 6 to G&L's initial brief (emphasis added).)

Allowing the Insurance Companies to make an end run around negotiated warranties with a negligent misrepresentation or fraud claim would turn every breach of warranty claim into a tort. *Werwinski*, 286 F.3d at 678; *All-Tech Telecom, Inc. v. Amway Corp.*, 174 F.3d 862, 866 (7th Cir. 1999) (noting that the "function of the economic-loss doctrine in confining contract parties to their contractual remedies is particularly well illustrated by cases involving product warranties...."). It would significantly unsettle contracts and contract law, which is exactly the result the Economic Loss Rule is designed to avoid. *See Mt. Lebanon Personal Care Home*, 276 F.3d at 848; *East River Steamship Corp.*, 476 U.S. at 872-73.

The Insurance Companies do not offer any reason why their fraud and negligent misrepresentation claims should negate the Economic Loss Rule. They merely argue that G&L's alleged misrepresentations relate not to "mere performance problems" but to "an extremely dangerous product defect." (Appellees' Brief at 23.) Thus, the Insurance Companies imply that their fraud and negligent misrepresentation claims should be given special consideration in their favor because of so-called safety concerns but, as already shown, the manner of the alleged product failure does not impact the Economic Loss Rule analysis.

The Insurance Companies also argue that G&L relies on outdated Kentucky federal court decisions rendered before the *Presnell* decision. (Appellees' Brief at 23-24.) But at least one Kentucky federal court has decided—after this court's *Presnell* decision—that Kentucky law does not embrace an exception to the Economic Loss Rule for fraud claims based on representations regarding the quality or character of the goods sold. *Govaerts v. Suntec Indus., Inc.*, 2010 U.S. Dist. LEXIS 52467 at *16 (W.D. Ky. May 26, 2010). And another Kentucky federal court, specifically addressing the *Presnell* decision, recognized a distinction for purposes of the Economic Loss Rule between a "simple fraudulent inducement" claim, which is essentially a claim that the defendant failed to meet the plaintiff's commercial expectations, which would be barred, and a fraud claim separate from the contracting process or the character of the goods sold, which would not be barred. *Barton Brands, Ltd. v. O'Brien & Gere, Inc.*, 550 F. Supp. 2d 681, 686 (W.D. Ky. 2008).

C. The Insurance Companies' fraud and negligent misrepresentation claims relate to nothing more than the quality and character of the goods sold by G&L.

To determine whether fraud or negligent misrepresentation claims relate to the "quality or character of the goods sold" and are actually breach of warranty claims, courts look to: (1) whether the fraud claims are undergirded by the same factual allegations as the breach of contract claims, and (2) whether the alleged fraud caused harm indistinct from that caused by the alleged breach of contract. *Werwinski*, 286 F.3d at 678; *Huron Tool & Eng. Co.*, 532 N.W.2d at 545.

Both factors show that the Insurance Companies' fraud and negligent misrepresentation claims actually duplicate their abandoned breach of warranty claims. The Insurance Companies' fraud, negligent misrepresentation, and breach of warranty

claims all rest on the same factual allegation that the VTL could not safely operate as designed because, at its maximum turning speed, the VTL lost clamping pressure and released the pallet, chuck, and associated parts.[4] (Amen. Compl., Count III (Breach of Contract/Warranty of Merchantability) ¶¶ 16, 17; Count V (Breach of Express Warranty) ¶¶ 14, 15; Count VI (Negligent Misrepresentation) ¶¶ 14-18; Count VII (Fraud by Ommission) ¶¶ 15-18.) And the Insurance Companies allege identical damages resulting from each claim. (Amen. Compl., Count III (Breach of Contract/Warranty of Merchantability) ¶ 18; Count V (Breach of Express Warranty) ¶ 16; Count VI (Negligent Misrepresentation) ¶ 19; Count VII (Fraud by Ommission) ¶ 19.)

The Insurance Companies' negligent misrepresentation and fraud claims do not arise independently of the contract but instead are nothing more than restatements of the breach of warranty claim. As such, the Economic Loss Rule bars both claims.

III. What constitutes "other property" for purposes of the Economic Loss Rule is a question of law.

Because the Economic Loss Rule bars recovery of economic losses arising solely from the destruction of the "product" purchased under contract, most courts applying the Rule assess as a matter of law what constitutes the contracted for "product."

Relying on an opinion of the District of Hawaii, the Insurance Companies argue that this is a question of fact. (Appellees' Brief at 28-29 (citing *Onsite/Molkai Ltd. Ptrshp. v. GE,* 838 F. Supp. 1390 (D. Haw. 1992).) But, as the District of Hawaii clarified, what constitutes the "product" is primarily a question of contractual interpretation and an issue of law for the court. *Exxon Shipping Co. v. Pacific Resources*, 835 F. Supp. 1195, 1200 (D. Haw. 1993) (noting that in certain situations the court does

[4] Notably, Ingersoll specified a higher than normal turning speed for its VTL so that it could produce parts faster. (R. 175.)

not immediately have enough information to make the legal determination); *see also Petroleum Helicopters, Inc. v. Avco Corp.*, 930 F.2d 389, 393 (5th Cir. 1991); *American Towers Owners Ass'n v. CCI Mech.*, 930 P.2d 1182, 1189 (Utah 1996) (abrogated on other grounds by *Davencourt at Pilgrims Landing Homeowners Assoc. v. Davencourt at Pilgrims Landing, LC*, 221 P.3d 234, 239 (Utah 2009)). In fact, most courts consider this issue so elementary that they do not even discuss it, simply reaching a legal conclusion as to whether "other products" were involved in the incident. *See, e.g., Mt. Lebanon Personal Care Home, Inc. v. Hoover Universal, Inc.*, 276 F.3d 845, 847 (6th Cir. 2002).

Federal courts predicting Kentucky law hold that the "product" for "economic loss rule purposes includes the entire unit for which a party to a complex commercial transaction has the ability to distribute risk by contract and insure against loss." *Barton Brands v. O'Brien & Gere, Inc.*, 550 F. Supp. 2d 681, 689 (W.D. Ky. 2008). Here, the final, bargained-for product was the entire Diffuser Cell System, including all components used with that system. (*See* G&L's initial brief at 17-21.)

The Insurance Companies do not offer an alternative rule for assessing what constitutes the "product." They do assert that they are "not arguing that machines be broken down to [their] simplest parts—metal, nuts, bolts, screws, etc.," but they appear to argue for some intermediate breakdown that would be equally unworkable. (Appellees' Brief at 30.)

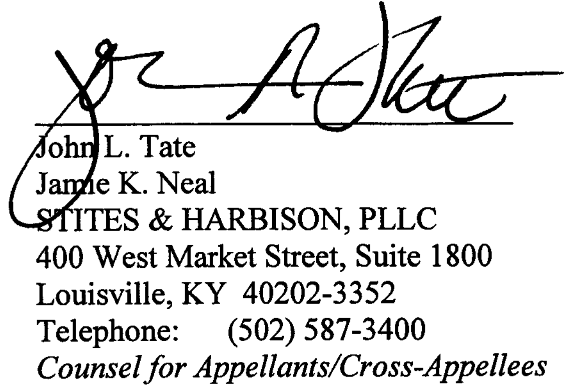
The Insurance Companies also argue for the first time to this court that property other than that sold to Ingersoll by G&L was damaged in the incident. (Appellees' Brief at 11.) In the trial court and the Court of Appeals, the Insurance Companies argued that the VTL should be considered the "product" for purposes of the Economic Loss Rule, not

the Diffuser Cell System. (Pls.' Mem. of Law in Opp. to Defs.' Mot. for Summary Judgment at 11, included in the Record on Appeal but not numbered; Ins. Companies' Brief to Court of Appeals at 24, 25.) But they acknowledged that the Diffuser Cell System consisted of "the VTL, two machinery centers, a transport system, a computer center, and additional pallets and chucks," and that "the transport systems, a chuck and pallet on the systems and a machining center"—all parts of the Diffuser Cell System—were damaged. (Pls.' Mem. of Law in Opp. to Defs.' Mot. for Summary Judgment at 11.) The facts have not changed, so the court may ignore this new argument. *Commonwealth v. Jones*, 217 S.W.3d 190, 199 (Ky. 2006).

Nonetheless, there is no factual or legal support for their other property argument. The service record to which the Insurance Companies cite is largely illegible and does not establish that any items other than parts of the Diffuser Cell System were damaged. Moreover, courts hold that property stored in or located in the immediate vicinity of the contracted-for "product" are considered components of the product for purposes of the Economic Loss Rule. *See, e.g., Barton Brands*, 550 F. Supp. 2d at 689 (holding that property supplied by a third-party, but stored in the contracted-for "product," were not "other property" and that the Economic Loss Rule applied); *Cemex v. LMS Contracting, Inc.*, 2009 U.S. Dist. LEXIS 89052 at * (W.D. Ky. Sept. 28, 2009) (holding that land and walls adjacent to the "product," a construction project, were not "other property" for purposes of the Economic Loss Rule). The trial court correctly determined, as a matter of law, that no "other property" was damaged.

CONCLUSION

G&L asks that the Court formally adopt the Economic Loss Rule and, based on that Rule, reinstate the trial court's order granting summary judgment to G&L and dismissing the Insurance Companies' claims in their entirety.



John L. Tate
Jamie K. Neal
STITES & HARBISON, PLLC
400 West Market Street, Suite 1800
Louisville, KY 40202-3352
Telephone: (502) 587-3400
Counsel for Appellants/Cross-Appellees