No. 2009-SC-485 and 2009-SC-825

Supreme Court of Kentucky

GIDDINGS & LEWIS, INC., et. al., *Appellants/Cross-Appellees,*

v.

On Appeal from the Court of Appeals
No. 2007-CA-002163-MR
(Civil Action No. 99-CI-240)

INDUSTRIAL RISK INSURERS, et. al., *Appellees/Cross-Appellants.*

BRIEF OF APPELLEES/CROSS-APPELLANTS, INDUSTRIAL RISK INSURERS, et al.

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C.R. 76.12 Certifications

The undersigned does hereby certify that copies of this brief were served upon the following named individuals by Federal Express Overnight Delivery on July 12, 2010: Mr. Sam Givens, Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; The Honorable Timothy C. Stark, Graves County Circuit Court, 100 E. Broadway, Mayfield, Kentucky 42066; and John L. Tate, Jamie K. Neal, Stites & Harbison, PLLC, 400 West Market Street, Suite 1800, Louisville, Kentucky 40202. The undersigned does also certify that the appellees/cross-appellants did not withdraw the record on appeal.

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INTRODUCTION

This case arises out of a catastrophic workplace accident that occurred when an industrial machine malfunctioned and threw 5,000 pounds of spinning metal, damaging the machine itself, as well as nearby equipment and other property. This appeal and cross-appeal raise the question as to whether, and to what extent, the economic loss rule should be applied to shield the manufacturer from tort liability for its negligence, strict products liability, negligent misrepresentations and fraud.

STATEMENT CONCERNING ORAL ARGUMENT

Appellees/Cross-Appellants, Ingersoll-Rand Company and its insurers (collectively "IRI"), request oral argument in this matter. It is believed that a hearing will assist the Court in understanding the underlying facts and deciding the complex legal issues.

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COUNTERSTATEMENT OF THE CASE

Appellants' Statement of the Case is incomplete in that it fails to advise the Court of any of the evidence related to IRI's negligent misrepresentation and fraud by omission counts. It is misleading in that it incorrectly states that the parties do not dispute a critical issue in this appeal: that "other" property was damaged in the accident. And it is argumentative to the extent that it includes a three page allegation that the subject accident was the result of a "naïve consumer's. . . deplorable operating and maintenance conditions." Such arguments are neither accurate nor relevant to the sole question before this Court—whether and to what extent the economic loss rule should be adopted by Kentucky—and their inclusion in the Statement of the Case can only be meant to prejudice the Court against IRI. For these reasons, IRI provides the following Statement of the Case for the Court's consideration:

The Parties

IRI sued Giddings & Lewis, Inc. and its parent company, United Dominion Industries (collectively "G&L"), seeking damages resulting from the sudden and destructive malfunction of a vertical turning lathe ("VTL").[1]

IRI Hired G&L To Design And Manufacture Multiple Pieces Of Machining Equipment, Sold As Part Of A "Diffuser Cell System"

IRI is a sophisticated commercial entity in the business of manufacturing construction and mining equipment. It does not, however, design or manufacture the equipment necessary to cut and shape the metal used in its production. For this, it turned to G&L, one of the world's largest machine tool companies. (R. Plfs.' Memo. in Opp. to

[1] Also referred to as a vertical turning center or "VTC."

Defs.' Motion for Summary Judgment, Exh. B)[2] IRI contracted with G&L for the purchase of a "diffuser cell system" of machining equipment, including one VTL, two vertical machining centers ("VTMs"), and a material handling unit. (R. Memo, Exh. C; R. 109-11) "The total system [was] to be managed by a cell controller [which was also provided] from which part programs for individual machines [were] distributed." (R. Memo, Exh. C, p.1)

Prior to entering into the contract, IRI provided G&L with specifications for the requested VTL, VTMs and control unit. (R. Memo, Exh. C, p.2) G&L bid on the project, and subsequently designed and manufactured the machines. The equipment, including the VTL and VTMs, were produced under separate product lines overseen by different engineering supervisors. (R. Memo, Exh. D, p. 25) The machines were independent products that could be operated separately or together. At deposition, James A. Spannbauer, an engineering supervisor at G&L, testified:

> Q. Are VTLs always part of a cell or a larger group of machines?
> A. No.
> Q. They can be stand-alone machines?
> A. Yes.
>
> * * *
>
> Q. Now, the VTL is a stand-alone machine. How about the two machining centers which were part of this cell, are they also stand-alone type machines?
> A. They could also be a stand-alone machine.
>
> * * *
>
> A. It's two different machine types put together in one cell, yes.

(R. Memo, Exh. H, pp.8-9) Although the VTL, VTMs, material handling unit and control unit were purchased together, each machining tool had its own serial number, sales number, description and price. (R. 111)

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[2] Plfs.' Memo of Law in Opposition to Defs.' Motion for Summary Judgment is found in a separate folder at the end of the paginated Record. References to this document are cited as "R. Memo" in this brief.

The Vertical Turning Lathe

G&L states that it produces VTLs which are "unique machine[s], customized according to [the] customer's instructions." (R. 45) The subject VTL was no exception. G&L built the machine using hundreds of parts; it was a complex piece of equipment covered by numerous patents. (R. 47-48). Like any other VTL, it was operated with a chuck designed to hold a workpiece (metal to be shaped) affixed to a pallet on the VTL's rotating table. The VTL spun the pallet and workpiece while hard metal or diamond tools cut and shaped the metal. (R. Memo, Exh. C) The subject VTL was designed to rotate at a speed of up to 690 RPMs[3] (*id.*), in contrast to the usual maximum speed of 400 RPMs. (R. Memo, p. 5) G&L has never before or since designed a VTL of like size to turn at 690 RPMs. (R. Memo, Exh. D, p. 28) According to G&L's engineer, Hans-Udo Von Tresckow, "a machine of this type is inherently dangerous." (R. Memo, Exh. E, p. 60)

G&L's Prior Knowledge of the VTL's Clamping Defect

At deposition, Kenneth J. Campshure ("Campshure"), a manager of mechanical engineering at G&L, testified that IRI's request that the VTL operate at speeds up to 690 RPMs was higher than what the standard machines offered. (R. Memo, Exh. D, p. 21) The requested speed produced an "engineering issue" with respect to centrifugal force—keeping the material on the pallet. (*Id.* at pp. 22-23) Campshure explained, "[t]he faster you spin the part, the more force is exerted on the material in on outward direction, tending to tear it apart." (*Id.*)

Walt McGuire ("McGuire"), a VTL supervisor at G&L, performed an analysis of the proposed VTL. (*Id.* at pp. 25-26) Because of its high operational speed, the bearings, transmissions and materials had to be considered. McGuire submitted his findings to

[3] Revolutions per minute.

Campshure, although no written report has been found. (*Id.*) G&L sales engineer, Robert Hansen ("Hansen"), also reviewed the VTL's specifications. He issued an internal "Rush Special Engineering Request." (*Id.* at pp. 27-28) Campshure testified that he received the Memo and that its purpose was to "make sure or to suggest that somebody from engineering address the issue of speed relative to gearing, the transmission and so on, to make sure that it was feasible and safe." (*Id.*) The Memo states:

> I am in the process of writing up the order for the cell which will contain this 36" VTL, which is quoted to operate at up to a maximum RPM of 690. *As this exceeds our 400 RPM maximum by a considerable amount, I believe it is proper to get a disclaimer from Ingersoll-Rand Company against operating this machine under unsafe conditions.*
>
> As this machine is going to operate using 38" dia. plain pallets, the maximum peripheral speed of the pallets will be approximately 7,000 surface feet when operating at maximum RPM. *This may create unsafe conditions due to loss of clamping pressure due to centrifugal force or loss of clamping force due to the forces created by unbalanced work pieces, fixtures and/or the machine itself.*

(R. Memo, p. 5)(*emphasis added)* Ultimately, G&L decided that the requested speed of the VTL was a "doable project." (R. Memo, Exh. D, p. 28) G&L's safety concerns regarding the VTL's design, including loss of clamping function, were never relayed to IRI.

The Accident

Charles S. Allen ("Allen") and David B. Fowler ("Fowler") were operating the subject VTL at IRI's Mayfield, Kentucky plant when the machine suddenly lost clamping pressure. (R. 71-72) The workpiece, chuck and pallet were sent flying off of the VTL, ripped through the surrounding enclosure, and collided with other machinery in the area. (R. Memo, Exh. F, pp. 22-23, 76-78, 115) The chuck weighed approximately 3400 lbs.,

the pallet 1500 lbs., and the workpiece 300 lbs. (R. Memo, Exh. G) Allen testified that he was talking to Fowler, heard the equipment being thrown, and started running. He did not look back. (R. Memo, Exh. F, pp. 22-23)

The VTL, VTL enclosure, adjoining VTM, workpiece and material handling unit were all damaged. In addition, the thrown chuck struck and damaged another chuck, pallet, nearby equipment and other property, cables and the concrete floor. (R. Memo, pp. 6-7, Photographs 3 and 5) Allen and Fowler narrowly avoided the accident without injury. (R. Memo, Exh. F, pp. 22-23)

IRI Sustained $2.7 Million Dollars In Damages As A Result Of The Accident

IRI incurred approximately $2,700,000.00 in damages as a direct and proximate result of the accident. (R. 274) Its damages include the "reasonable costs to rebuild the VTL, to repair other equipment, costs associated with contracting work which was to be performed by the VTL to outside companies, purchase of temporary equipment, in-house overtime and other miscellaneous costs." (*Id.*)

The First Amended Complaint

IRI sued G&L for negligence, breach of contract, strict products liability, negligent misrepresentation and fraud by omission. (R. 144-166) IRI alleged, *inter alia*, that G&L negligently designed, manufactured, sold, inspected, installed and repaired the defective VTL in a manner that caused the VTL to malfunction, resulting in the accident and IRI's damages. (*Id.*) IRI also alleged that G&L negligently and fraudulently failed to advise it that the VTL's operating speed could result in loss of clamping pressure and destabilization of the pallet thereby causing the type of destructive accident that occurred. (*Id.*)

G&L's Motion For Summary Judgment

G&L moved for summary judgment, alleging that IRI's entire action was barred by the economic loss rule. (R. 91-125) IRI responded that the doctrine has not been adopted by this State, and did not apply to any of the tort claims alleged. (R. Memo, pp. 1-16)

The trial court originally denied G&L's motion for summary judgment. (R. 248-253) The court believed that the economic loss rule would ordinarily bar IRI's tort claims, but held that the destructive occurrence exception applied. (*Id.*) The court explained:

> [T]here are two primary reasons for this exception. A destructive event being more sudden and unexpected is a type of event that cannot be as easily be [sic] planned for in allocating risk. Allocation of risk is one of the primary purposes of the Economic Loss Rule, so when there is a calamitous type destruction it would be harder to prospectively deal with that type of loss. Further, the Plaintiffs point out to the Court that dangerous equipment should not be placed in the stream of commerce. The occurrence of a calamitous event indicates danger. In this case, pieces of metal that would be equivalent to two compact cars were flying around the operating area, and it is fortunate that the operators of the machines were not killed.

(R. 251) G&L moved for reconsideration (r. 257-63), which was opposed (r. 263-78). The trial court reversed itself and granted summary judgment for G&L on the basis that the "destructive occurrence [exception to economic loss rule was] a minority position." (R. 415-417) IRI moved for reconsideration (r. 421-32), which was opposed (r. 435-46). On September 27, 2007, the trial court denied IRI's motion for reconsideration. (R. 447-49) It held that: (1) it was not "inclined" to apply the destructive occurrence exception; and (2) IRI's negligent misrepresentation and fraud claims were a "recasting" of its tort claims which were barred by the economic loss rule. (*Id.*)

The Court Of Appeals Opinion

IRI appealed the trial court's order granting G&L's motion for summary judgment. (R. 450-52) The issues were briefed, oral argument was presented, and the Court of Appeals issued its opinion on July 2, 2009, affirming in part, reversing in part, vacating in part and remanding. (Slip Opinion, No. 2007-CA-002163-MR) The appellate court held, in pertinent part, that the economic loss rule applies to negligence and warranty claims in Kentucky, irrespective of whether damages arise out of a destructive or calamitous event. (*Id.* at pp. 16-17) But it also held that the rule does not apply to negligent misrepresentation or fraud counts or claims for damage to "other" property. (*Id.* at pp. 17-18 and 20-21) These claims were thus reinstated and the case remanded back to the trial court. (*Id.* at 21)

Supreme Court Review

G&L petitioned the Supreme Court to review the appellate court's decision. The Court granted that motion, as well as IRI's cross-motion for discretionary review.

SUMMARY OF THE ARGUMENT

Charles Allen said it best: "It was [by] the grace of God that somebody wasn't killed." (R. Memo., Ex. F, p. 34) Indeed, there is no question that IRI's employees were extremely lucky to have avoided the VTL's sudden malfunction and ejection of 5,000 pounds of spinning metal; a scene the trial court described as the "equivalent of two compact cars [] flying around the operating area." (R. 251) The flying metal struck, crushed and otherwise damaged the VTL, nearby equipment and other property in the area. The accident was so explosive that it left multiple gouges in the concrete floor. (R. Memo, Ex. G)

G&L now seeks to hide behind the economic loss rule—a doctrine which Kentucky has yet to recognize—to avoid any and all tort liability for the accident. It thereby argues that the rule—which typically prohibits tort recovery for purely economic damages in the absence of injuries to person(s) or "other" property—should apply to bar IRI's negligence, strict liability, negligent misrepresentation and fraud by omission claims. It takes this position based upon an erroneous conclusion that the accident described above involved nothing more than a product that failed to meet a customer's expectations. On this flawed basis, G&L urges this Court to limit IRI's remedies to those of the parties' expired contract and warranty agreement.

Contrary to G&L's arguments, this case is not so simple. IRI's tort claims are not based solely upon a product's failure to perform. They are also premised upon G&L's negligent and intentional conduct in designing and selling IRI a defective and unreasonably dangerous piece of industrial equipment that placed IRI, its employees and its property in grave peril. As stated by the trial court, the resulting accident and "damage was fairly spectacular." (R. 248) IRI's negligent misrepresentation and fraud by omission claims are additionally premised upon evidence that G&L sold the defective machine to IRI, despite actual knowledge that operation of the equipment could create unsafe conditions and cause the type of accident that occurred here. (R. Memo, p. 5) These allegations and the supporting evidence of record demonstrate that IRI's claims do not sound solely in contract, but also present a classic tort action. IRI accordingly requests that this Honorable Court: (1) reverse the Court of Appeals' partial application of the economic loss rule; and (2) reinstate and remand IRI's negligence, strict liability, negligent misrepresentation and fraud by omission claims.

ARGUMENT

I. Standard of Review: *De Novo*

Summary judgment is a drastic remedy that should only be used "to terminate litigation when, as a matter of law, it appears that it would be impossible for the respondent to produce evidence at the trial warranting a judgment in his favor and against the movant." *Steelvest, Inc. v. Scansteel Svc. Center, Inc.*, et. al., 807 S.W.2d 476, 483 (Ky. 1991)(*quoting Paintsville Hosp. Co. v. Rose*, 683 S.W.2d 255 (Ky. 1985). It is not enough for the movant to show that there is an absence of evidence to support an essential element of plaintiff's case. Rather, "the movant must convince the court, by the evidence of record, of the nonexistence of an issue of material fact." *Id.* at 482.

Review of a decision to grant or deny summary judgment is *de novo* "without deference to decisions of the courts below." *Sprint Commc'n Co., L.P. v. Leggett, III*, 307 S.W.3d 109, 113 (Ky. 2010).

II. The Economic Loss Rule—Even In Its "Classic" Or Broadest Form—Does Not Apply Here, Where The Defective Product Damaged "Other" Property

The economic loss rule is a judicially created doctrine that, "[i]n its broadest formulation. . . prohibits tort recovery in negligence or products liability absent physical injury to a proprietary interest." *Presnell Constr. Mgrs, Inc. v. EH Constr., LLC*, 134 S.W.3d 575, 583-84 (Ky. 2004)(*concurring opinion*, Keller, J.)(*internal citations omitted*). "Under this sweeping rule, recovery of economic loss is foreclosed when a product or service falls short of an expected level of quality yet causes no personal injury or property damage." *Id.* Under such circumstances, a manufacturer's liability for defective goods is limited by the parties' contract and/or warranty law. *Id.* at 585. This is a buyer beware—you get what you pay for—situation.

When, however, a manufacturer creates a product that results in an unreasonable risk of harm that causes damage to persons or property other than the product itself, the protections of tort law still apply. A manufacturer can thus be held liable for physical injuries cased by defects in his goods which do not match a reasonable standard of safety. *Id.* The rationale for imposing this type of liability on manufacturers—regardless of negligence—is discussed in *East River*, a United States Supreme Court case advocated by G&L. *See East River Steamship Corp., et. al. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986). *East River* emphasizes that "public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market." *Id.* at 866 (1986)(*internal citations omitted*) For similar reasons of safety, a manufacturer also has a duty to protect against property damage. *Id.* at 867. "Such damage is considered so akin to personal injury that the two are treated alike." *Id.*

G&L urges this Court to follow *East River* and adopt the economic loss rule in its "classic"—*i.e.*, original and broadest—form. It claims that the rule, if adopted, would bar all of IRI's tort claims. Its argument, however, overlooks a critical and dispositive difference between the facts of *East River* and the facts here. In *East River*, the defective products—turbine parts—damaged the product itself, the turbines, but caused no physical injury or damage to "other" property. *Id.* at 867. Because there were no personal or "other" property damages, the Court held that the plaintiffs were merely seeking to recoup the benefit of their bargain—a loss governed by the parties' contract and warranty law. *Id.* at 867-68. In contrast, there is undisputed evidence here that the sudden

malfunction of the VTL caused extensive damage to both the VTL and "other" property.[4] Regardless of what constitutes the defective product itself, it is undisputed that the accident also damaged a remote Q stand, chucks, cables and the concrete floor. (R. Memo, Ex. G) None of this property was designed, manufactured or sold to IRI as part of the diffuser cell equipment. These physical injuries clearly constitute damage to "other" property, making the economic loss rule—even in its "classic" or broadest form—inapplicable to the instant action. All of IRI's tort claims (negligence, strict liability, negligent misrepresentation and fraud by omission) should therefore survive any economic loss rule adopted by this Court. Counts I, II, VI and VII of the First Amended Complaint should therefore be reinstated and remanded for a trial on the merits.

III. Kentucky's Strong Products Liability Law Supports The Rejection Of The Economic Loss Rule Here, Where IRI's Damages Arose Out Of A Destructive And Damaging Event

This State's strong products liability law further supports the rejection of the economic loss rule here. The sudden and catastrophic accident that occurred at IRI's Mayfield, Kentucky plant is exactly the type of loss that negligence and strict products liability law is meant to prevent and protect against. In a recently de-published opinion cited by G&L in its opening brief, the Court of Appeals discussed its displeasure over the potential expansion of the economic loss rule into negligence law. *Hack v. Lone Oak Develop., Inc.*, 2008 WL 2388651, *3 (Ky. App. 2008). The court commented that "left without exception, the economic loss rule could be interpreted to abolish a massive wedge of traditional tort law on the premise of a doctrine rooted in contract law." *Id.*

[4] In its opening brief, G&L states that IRI has "acknowledge[ed] that only components of the Diffuser Cell System were damaged." (See Appellants' Opening Brief, p. 19) Its supporting citation, however, reveals that the opposite is true. In the document referenced, IRI clearly states that it purchased "separate and distinct equipment" that was damaged in the accident along with "other property." (R. Memo, p. 11)

The recovery of purely economic damages in a products case was first addressed by Kentucky's highest court in *C.D. Herme, Inc. v. R.C. Tway Co.*, 294 S.W.2d 534 (Ky. 1956). There, plaintiff purchased a semi-trailer manufactured by defendant and sold by a third-party dealer. *Id.* at 536. The first time the semi-trailer was used, the king-pin connector broke, causing the semi-trailer to come loose and upset in a ditch. *Id.* Plaintiff sued the manufacturer for its economic damages, alleging that the king-pin was made of defective steel and that the defect could have been discovered by tests made in the exercise of reasonable care. *Id.* In permitting plaintiff to recover its damages, *C.D. Herme* adopted the negligence standard set forth in section 395 of the Rest. (First) of Torts, which imposes a duty of reasonable care on manufacturers, measured by the "end to be achieved, namely, *a reasonably safe product.*" *Id* at 536-38 (*emphasis added*). Although "duty" under § 395 spoke in terms of the foreseeability of "bodily harm," the court held that "if the duty has been violated, the mere fact that the actual injury in the particular case happens to be *property* only, does not relieve the offender from liability." *Id.* at 537 (*emphasis in original*).

Several years later, *Dealers Transp. Co., Inc. v. Battery Distrib. Co.*, 402 S.W.2d 441 (Ky. 1965), adopted the strict liability standard of care set forth in § 402A of the Rest. (Second) of Torts which provides, in pertinent part:

> One 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. . .

Id. at 446. Plaintiff there had purchased acetylene tanks which ignited and exploded, causing extensive property damages. Plaintiff sued the tank manufacturer for breach of an implied warranty, alleging defective tanks. *Id.* at 443-45. Although there was no

privity of contract between the parties, the Court recognized that the plaintiffs in *Dealers Transp.*, like *C.D. Herme*, could seek economic damages resulting from a defective product under § 402A. *Id.* at 445, 447.

Twenty five years later, the recovery of economic damages caused by a defective product was addressed by the Court of Appeals in *Falcon Coal Co. v. Clark Equip. Co.*, 802 S.W.2d 947 (Ky. App. 1990). Plaintiff there sought to recover damages for the destruction by fire of a front-end loader. *Id.* at 947. Relying upon §402A, *Falcon Coal* held that there could be no recovery for harm caused only to the product itself. *Id.* at 948. The Court reasoned that the recovery available under § 402A for "his property" did not include "any product"—*i.e.*, the defective product itself. *Id.* This limitation on a manufacturer's liability is similar to the economic loss rule urged by G&L here.

The Kentucky Supreme Court, however, expressly rejected *Falcon Coal*'s limitation on the recovery of economic damages in *Real Estate Marketing, Inc. v. Franz*, 885 S.W.2d 921 (Ky. 1994). In determining when economic damages in tort are recoverable for a defective product—there, a home—the Court recognized "that tort recovery is contingent upon damage from a destructive occurrence as contrasted with economic loss related solely to diminution in value, even though, as to property damage, both may be measured by the cost of repair." *Id* at 926. The Court then emphasized that tort recovery for a defective product is not contingent on the type of damages sustained:

> We do not go so far as the Court of Appeals' opinion in *Falcon Coal Co. v. Clark Equipment Co.*, limiting recovery under a products liability theory to damage or destruction of property "other" than the product itself. But we recognize that to recover in tort one cannot prove only that a defect exists; one must further prove a damaging event.

Id. at 926 (*internal citations omitted*). The Supreme Court's rejection of *Falcon Coal*, a products liability case between two parties in privity of contract, is a clear rejection of the economic loss rule in products cases involving a destructive or damaging event. Although some federal courts have attempted to limit the scope of the rejection to consumer cases, *Falcon Coal* involved an action between two sophisticated commercial entities. *Franz*' rejection of *Falcon Coal* therefore applies equally to disputes between consumer and commercial parties. IRI should thus be permitted to pursue all of its damages, including loss of the defective product itself, because the "destructive" and "damaging" nature of the VTL's malfunction means that the protections and remedies of tort law apply.

IV. If Adopted, The Economic Loss Rule Should Contain An Exception For Destructive Or Calamitous Events

In accordance with *Franz*, any adoption of the economic loss rule should be limited by a "destructive" or "damaging" event exception. Such an exception, commonly referred to as the destructive or calamitous event exception, provides a more reasoned method for drawing the line between contract and tort law. The exception seeks to differentiate between "the disappointed users. . . and the endangered users," and permits only the latter to sue in tort. *East River*, 476 U.S. at 869-70 (*internal citations omitted*). Although federal courts have predicted that Kentucky would reject this exception, largely based upon *East River*'s refusal to adopt it, such cases fail to explain how the safety concerns of negligence and strict products liability law are adequately protected by contract and warranty law. *East River* itself provides no such explanation, probably because the product failures there concerned a loss of operating capacity and did not involve a destructive or calamitous event. 476 U.S. at 862. Nevertheless, borrowing

from the words of the *East River*, the exception should apply here, where G&L caused the "kind of harm against which public policy requires manufacturers to protect, independent of any contractual obligation." *Id.* at 866.

The destructive or calamitous event exception is one of the most common limitations to the economic loss rule. Nearly 1 in every 3 states that have adopted the rule also recognize the exception, chipping away at what G&L calls the "classic" version of the doctrine. *See e.g.* **Alaska**: *N. Power & Eng'g. Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324, 329 (Alaska 1981)(economic loss rule does not apply "when a defective product creates a situation potentially dangerous to persons or other property"); **Arizona**: *Salt River Project Agric. Imp. & Power Dist. v. Westinghouse Elec. Corp*, 694 P.2d 198, 208 (Ariz. 1984)(*abrogated on other grounds*)(*en banc*)("a sudden calamity or an extraordinary event- an 'accident'- ordinarily marks the invocation of tort law"); **Arkansas**: *Farm Burea Ins. Co. v. Case Corp.*, 878 S.W.2d 741, 743 (Ark. 1994) (economic tort damages are recoverable for unreasonably dangerous products); **Georgia**: *Vulcan Materials Co., Inc. v. Driltech, Inc.*, 306 S.E.2d 253, 257 (Ga. 1983)(economic loss rule does not apply to damages arising out of an accident); **Illinois**: *Moorman Mfg. Co. v. Nat'l. Tank Co.*, 435 N.E.2d 443, 449 (Ill. 1982)(recognized an accident exception to the economic loss rule); **Iowa**: *Am. Fire & Cas. Co. v. Ford Motor Co.*, 588 N.W.2d 437, 439 (Iowa 1999)(tort damages are generally available when the harm results from "a sudden or dangerous occurrence"); **Maryland**: *A.J. Decoster Co. v. Westinghouse Elec. Corp*, 634 A.2d 1330, 1333 (Md. 1994)(economic losses are recoverable if they arise out of "a dangerous condition creating a risk of death or personal injury"); **Nebraska**: *Hilt Truck Line, Inc. v. Pullman, Inc.*, 382 N.W.2d 310, 312 (Neb. 1986)(damages to a

defective product are recoverable if there is "proof that a sudden, violent event occurred which aggravated the inherent defect [in the product] or caused it to manifest itself"); **New Jersey**: *Consumer Power Co. v. Curtiss-Wright Corp.*, 780 F.2d 1093, 1098-99 (3rd Cir. 1986)(economic loss rule did not preclude utility company's recovery for "accidental" damages to turbine); **New York**: *Trs. of Columbia Univ. v. Gwathmey Siegel & Assoc. Architects*, 192 A.D.2d 151, 155 (N.Y. App. Div. 1993)(economic loss rule did not apply where damage was the result of a "sudden precipitous" event); **Oregon**: *Russell v. Ford Motor Co.*, 575 P.2d 1383, 1387 (Or. 1978)(economic losses are recoverable if a product endangers the consumer); **Tennessee**: *Corporate Air Fleet of Tenn., Inc. v. Gates Learjet, Inc.*, 589 F.Supp. 1076, 1084 (M.D. Tenn. 1984)("[a]n action is one in tort, not contract, when it is established that there was an accident, caused by a defective product that is unreasonable dangerous to the user or to his property"); **Washington**: *Washington Water Power Co. v. Graybar Elec. Co.*, 774 P.2d 1199, 1209 (Wash. 1989)(*en banc*)(the economic loss rule adopted in *East River* "unjustifiably dismisses the safety concerns attendant to product injuries caused by hazardous defects"); and **West Virginia**: *Capitol Fuels, Inc. v. Clark Equip. Co.*, 382 S.E.2d 311, 313 (W. Va. 1989)(economic loss rule does not apply to the recovery of property damages resulting from a "sudden calamitous event").

These cases are cited, not for the purpose of counting heads, but because they illustrate how the destructive or calamitous event exception has gained traction around the country. More importantly, they explain why products liability law—negligence and strict liability—is uniquely suited to prevent and redress harm caused by defective

products. For example, *Capitol Fuels, Inc. v. Clark Equip. Co.*, 382 S.E.2d 311 (W.Va. 1989) explained:

> [W]ith all deference to the view of the United States Supreme Court, its opinions on product liability law are not binding on the states. The *East River* decision does not persuade us that tort liability should not be extended to a manufacturer whose defective product creates a potentially dangerous situation to persons or property and results in the sudden destruction of the product itself.

Id. at 313. Accordingly, the Court held that:

> *The front-end loader was not merely an ineffective product which failed to meet the customer's expectations.* A defect in the front-end loader caused an abrupt fire which continued to burn until the loader destroyed. The operator of the loader escaped without injury. *The defect in the front-end loader created a potentially dangerous situation and the risk associated with the defect was not one ordinarily contemplated by a purchaser.* Clearly, this is the type of property damage resulting "from a sudden calamitous event" which is recoverable [under West Virginia law].

Id. (*emphasis added*).

Washington Water Power Co. v. Graybar Elec. Co., 774 P.2d 1199, 1209 (Wash. 1989)(*en banc*), likewise rejected *East River*, believing that "[i]f manufacturers can contract successfully around liabilities for product injuries, a principal deterrent to unsafe practices- the threat of legal liability- will be lost." *Id* at 1209. The court reasoned:

> *The Court's analysis in East River, we believe, unjustifiably dismisses the safety concerns attendant to product injuries caused by hazardous defects.* For this reason, we find *East River*'s approach to economic loss unsuited to what the Legislature intended under the [Washington Product Liability Act]. Product injuries, the [*East River*] Court says, do not raise safety concerns, but are "essentially" a performance problem. It does not say why this is so, however. Also unsupported is the Court's assertion that "[t]he tort concern with safety is reduced when the injury is only to the product itself." *Listing the types of losses product injury generates, and remarking that "[l]osses like these can be insured," the Court says nothing to explain why safety concerns are not implicated.*

Id. at 1209-10 (*emphasis added*)(*citations omitted*).

N. Power & Eng'g. Corp. v. Caterpillar Tractor, Co., 623 P.2d 324, 329 (Alaska 1981) held that "when a defective product creates a situation potentially dangerous to persons or other property, and loss occurs as a result of that danger, strict liability in tort is an appropriate theory of recovery, even though damage is confined to the product itself." The Court agreed that contract law was concerned with the "fulfillment of reasonable economic expectations," where strict products liability was concerned with "the safety of products and the corresponding quantum of care required by a manufacturer." *Id.* at 328. Later, *Pratt & Whitney Can., Inc. v. Sheehan*, 852 P.2d 1173 (Alaska 1993) further explained that "[b]y focusing on consumer safety- through a test that hinges on the *danger* presented by a defective product- our rule remains faithful to [the] distinction between contract law and tort law." *Id.* at 1178 (*emphasis in original*).

Vulcan Materials Co., Inc. v. Driltech, Inc., 306 S.E.2d 253, 257 (Ga. 1983) recognized the sudden or calamitous exception to the economic loss rule, agreeing that:

> [T]he benefit-of-the bargain approach of warranty law is ill-suited to correct problems of hazardous products that cause physical injury. . . *Accordingly, tort law imposes a duty on manufacturers to produce safe items, regardless of whether the ultimate impact of hazard is on people, other property, or the product itself.*

Id. at 387 (*quoting Pa. Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.Supp. 1165, 1172 (3rd Cir. 1981)(*emphasis in original*). *Vulcan* held that the economic loss rule would apply when the defective product merely resulted in loss of value or breach of the benefit of the bargain, but not when damages to the defective product resulted from an accident. *Id.*

As discussed in the above out-of-state cases, contract and warranty law is ill-suited to protect against and compensate for the destructive and calamitous malfunction

of a product. This principal was recognized by the Supreme Court in *Williams v. Fulmer*, 695 S.W.2d 411, 414 (Ky. 1985), which held that a manufacturer's "universal duty of reasonable care owed to all [is] separate from contractual duty." *See also Montgomery Elevator Co. v. McCullough by McCullough*, 676 S.W.2d 776, 782 (Ky. 1984)(held that a "manufacturer has a non-delegable duty to provide a product reasonably safe for its foreseeable uses").

Here, contrary to G&L's assertions, IRI never waived its right to pursue a tort action against G&L in the event of an accident involving the VTL. Indeed, the parties' contract and warranty agreement is silent as to any waivers of liability, which under Kentucky law, must be clearly and unambiguously worded. (R. 243-44) *See Community Trust Bancorp, Inc. v. Mussetter*, 242 S.W.3d 690, 694 (Ky. App. 2007)(held that an indemnification clause that relieved a party from any liability to an unlimited class of persons was "simply too broad" and "against public policy"). G&L has thus failed to present any evidence to support its contention that IRI agreed to pay a lower price for the VTL in exchange for a cheaper product and limited warranty. If anything, IRI paid a premium when it paid G&L nearly $2.5 million dollars for the diffuser cell equipment. IRI's products liability claims therefore do not signify an attempt to circumvent or extend the warranty period in the parties' contract. Instead, these claims arise in addition to any other rights owed by contact or warranty. This does not expose manufacturers to unlimited liability to an unlimited class of people. Instead, it merely respects the existing and well-established products liability law of this State, which permits the recovery of economic damages caused by unreasonably dangerous products.

In this case, IRI, its employees and property, were exposed to a highly defective product. The deadly nature of the defect was not reasonably foreseen by IRI. Indeed, there is no evidence to support an allegation that IRI should have anticipated the VTL's sudden loss of clamping function resulting in 5000 lbs. of spinning metal being thrown about its operating room. In contrast, G&L, the manufacturer who accepted the multi-million dollar contract to design and build the VTL and other diffuser cell equipment, was in the best position to predict, protect and/or warn against the unsafe product. G&L did in fact anticipate the danger, which ultimately materialized, but concealed the design defect from IRI. (R. Memo, p. 5 and R. Memo, Exh. D) The resulting accident, which the trial court called "fairly spectacular," caused damages in excess of $2.7 million dollars. (R. 248) It was by sheer luck that no one was killed. Clearly, this is not a case of a "disappointed" consumer, but instead involved an "endangered" consumer. Under these facts and circumstances, the underlying tort principles of products liability law overwhelmingly favor recognition of the destructive or calamitous event exception to the economic loss rule in this case.

V. Any Economic Loss Rule Adopted By This Court Should Contain An Exception For Negligent Misrepresentation And Fraud Claims

Kentucky permits the recovery of economic damages sounding in negligent misrepresentation and fraud. The economic loss rule is no defense to these torts, which arise independent of contract and warranty law. *Hanson v. Am. Nat'l Bank & Trust Co.*, 865 S.W.2d 302, 309 (Ky. 1993)(*abrogated on other grounds*), aptly explained that "[t]he idea that any person or industry or enterprise would be immune from liability for fraud and deceit is not acceptable."

A. The Tort Of Negligent Misrepresentation Arises Out Of A Breach Of A Duty Owed Independent of Contract Upon Which Economic Damages Are Recoverable

Presnell Const. Mgrs., Inc. v. Eh Const., LLC, 134 S.W.3d 575 (Ky. 2004) expressly recognized the tort of negligent misrepresentation. There, a contractor alleged that a construction manager, with whom it had no privity of contract, "supplied faulty information and guidance . . . to the contractors working on the Project." *Id.* at 578. In determining that the contractor had stated a claim for negligent misrepresentation, the *Presnell* Court adopted § 552 of the Rest. (Second) of Torts, which provides, in pertinent part:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Id. at 580. The court then clarified that the duty owed under § 552 arises independent of any contractual obligations which require privity. It was very clear in this regard: "[T]he tort of negligent representation defines an *independent* duty for which recovery in tort for economic loss is available."[5] *Id.* at 582 (*emphasis added*). IRI's negligent misrepresentation claim thus alleges a breach of a duty owed in tort, not contract.

B. The Tort Of Fraud By Omission Arises Out Of A Breach Of A Duty Owed Independent Of Contract Upon Which Economic Damages are Recoverable

Kentucky has long recognized a claim for fraud based upon the active concealment and/or nondisclosure of material facts in the sale of property. To establish a

[5] In the concurring opinion, Justice Keller, without objection, summarized: "With this Court's adoption today of Restatement (Second) of Torts, Sect. 552, we have created the independent tort action of negligent misrepresentation which is not barred by the economic loss rule." *Id.* at 590.

cause of action for fraud based upon the suppression of fact(s), IRI must demonstrate: (1) that G&L had a duty to disclose a material fact; (2) which it failed to disclose; (3) that the non-disclosure induced IRI to act; and (4) that IRI suffered damages as a result. *Smith v. GM Corp.*, 979 S.W.2d 127, 129 (Ky. App. 1998). Although mere silence is not fraudulent absent a duty to disclose, such a duty may arise where "one party to a contract has superior knowledge and is relied upon to disclose same." *Id.* (*citations omitted*). *Smith* held that a car dealership had a duty to disclose material defects and prior repairs to a "new" car, of which the dealership had prior knowledge, in connection with the vehicle's sale. *Id. Smith* found that "material issues of fact exist[ed] as to Smith's common law fraud claim [for economic damages], thus precluding summary judgment." *Id. See also, United Parcel Service Co. v. Rickert*, 996 S.W.2d 464, 469 (Ky. 1999)("Fraud may be committed either by intentionally asserting false information or by willfully failing to disclose the truth. . . by intentionally failing to tell [plaintiff] *all* the material facts")(*emphasis added*).

The duty described in *Smith* and *Rickert*, not to intentionally provide false information" in a business transaction, clearly concerns the same type of independent tort duty not to make negligent misrepresentations that was discussed in *Presnell.* It therefore only makes sense to extend the negligent misrepresentation exception to the economic loss rule to fraud claims.

C. IRI's Negligent Misrepresentation And Fraud By Omission Claims Are Not Based Upon G&L's Breach Of Contract And Warranty

G&L concedes that the economic loss rule does not bar tort claims that are "truly independent of [an] underlying contract." (*See* Appellants' Opening Brief, p. 13) Despite this admission, G&L nevertheless asserts that the rule bars IRI's negligent

misrepresentation and fraud by omission claims because they are allegedly "interwoven" with IRI's time-barred contract and warranty claims. G&L's arguments are unpersuasive for a number of reasons. *First*, *Presnell* unequivocally holds that the tort of negligent misrepresentation arises independent of contract. *Id.* at 582. The protections and remedies associated with IRI's negligent misrepresentation and fraud by omission claims must therefore be considered separate and distinct from any contract/warranty analysis.

Second, G&L's argument is primarily based upon an unpublished federal court case, *Strathmore Web Graphics v. Sanden Machine, Ltd.*, 2000 U.S. Dist. LEXIS 22618 (W.D. Ky. 2000), which was decided four years before *Presnell*. In addition to being expressly outdated, *Strathmore* is factually inapposite. It provides no persuasive authority here, as it involved a product that merely "failed [the buyer's] commercial expectation[s]" regarding the "quality" and "character" of the goods sold. *Id.* at *3. In contrast to *Strathmore*, the misrepresentations and fraud perpetrated by G&L did not concern mere performance problems, but also involved G&L's negligent and fraudulent deceit and concealment of an extremely dangerous product defect that was not reasonably contemplated by IRI or the parties' contract.

Third, G&L's footnote cases are outdated, non-binding and not relevant in light of *Presnell*. (*See* Appellants' Opening Brief, p. 14, fns. 4 and 5) For example, *Millers's Bottled Gas v. Borg-Warner Corp.*, 955 F.2d 1043 (6th Cir. 1992); *Ohio Cas. Ins. Co. v. Vermeer Mfg. Co.*, 298 F.Supp. 2d 575 (W.D. Ky. 2004); *General Elec. Co. v. Latin Am. Imports,* 214 F.Supp.2d 758 (W.D. Ky. 2002); *Highland Stud Int'l v. Baffert*, 2002 U.S. Dist. LEXIS 27989 (E.D. Ky. 2002); *Duquesne Light Co. v. Westinghouse Elec. Corp.*, 66 F.3d 604, 620 (3rd Cir. 1995); and *Werwinski v. Ford Motor Co.*, 286 F.3d 661 (3rd

Cir. 2002) were all decided before *Presnell*. These cases therefore provide no useful analysis post-*Presnell*. G&L's reliance on *Westlake Vinyls, Inc. v. Goodrich Corp.*, 518 F.Supp.2d 955 (W.D. Ky. 2007)—the only other federal Kentucky case cited by G&L—is likewise misplaced. There, the plaintiff alleged breach of contract and fraud claims related to defendant's alleged inflated billing for services. *Id.* at 965. The two counts were so "intertwined" that there was no dispute that plaintiff's fraud claim "mirror[ed] the underlying breach of contract claim." *Id.* at 968. The court therefore held that the economic loss rule applied equally to both claims. *Id.* at 969. The same analysis is inapplicable here, where IRI's negligent misrepresentation and fraud claims arise out of conduct that G&L committed independent of the contract, to induce the parties' agreement. These claims clearly arise independently of G&L's contractual obligations to perform/satisfy the parties' contract and warranty agreement.

Fourth and finally, the negligent misrepresentation and fraud exceptions to the economic loss rule recognized by *Presnell* and the Court of Appeals below has gained popular support across the nation. *See e.g.* **Arkasas**: *Willman v. Riceland Foods, Inc.*, 630 F.Supp.2d 999, 1002-03 (E.D. Ark. 2007)(economic losses for negligent misrepresentation and fraud are recoverable even without a claim for "other" damage); **California**: *Robinson Helicopter Co., Inc. v. Dana Corp.*, 102 P.3d 268, 270 (Cal. 2004) (economic loss rule does not bar a claim for fraudulent inducement or intentional misrepresentation); **Florida**: *Comptech Int'l, Inc. v. Milam Commerce Park, Ltd.*, 753 So.2d 1219, 1225 (Fla. 1999)(economic loss rule does not apply to cases of fraud or negligent misrepresentation); **Hawaii**: *Bronster v. U.S. Steel Corp.*, 919 P.2d 294, 307 (Haw. 1996)(economic loss rule does not bar claims for negligent misrepresentation or

fraud); **Illinois**: *Moorman Manufacturing Co. v. Nat'l Tank Co.*, 435 N.E.2d 443, 442 (Ill. 1982)(an exception to the economic loss rule exists "where one intentionally makes false representations" and "where one who is in the business of supplying information for the guidance of others in their business transactions makes negligent misrepresentations"); **Maryland**: *Cooper v. Berkshire Life Ins. Co.*, 810 A.2d 1045, 1070-71 (Md. Ct. Spec. App. 2007)(economic loss rule did not bar plaintiff's negligent misrepresentation and fraud claims); **Massachusetts**: *Cumis Ins. Society, Inc. v. BJ's Wholesale Club, Inc.*, 918 N.E.2d 36, 48 (Mass. 2009)(economic loss rule does not bar recovery for financial harm resulting from negligent misrepresentation); **Michigan**: *Huron Tool & Eng'g Co. v. Precision Consulting Services, Inc.*, 532 N.W.2d 541, 545 (Mich. Ct. App. 1995)(economic loss rule does not apply to fraud in the inducement claims); **Minnesota**: Minn. Stat. Ann. 604.101(4)(West Supp. 2010)(economic loss statute does not bar a common law misrepresentation claim where the misrepresentation is made intentionally or recklessly); **Nebraska**: *Streeks, Inc. v. Diamond Hill Farms, Inc.*, 605 N.W.2d 110, 122 (Neb. 2000)(purchaser's misrepresentation claim was not limited to the contract); **Nevada**: *Terracon Consultants W., Inc. v. Mandalay Resort Group*, 206 P.3d 81, 88 (Nev. 2009)(economic loss rule does not bar a claim for negligent misrepresentation); **New Hampshire**: *Plourde Sand & Gravel v. JGI Eastern, Inc.*, 917 A.2d 1250, 1257-58 (N.H. 2007)(recognized an exception to the economic loss rule where a party provides false information with knowledge that another will rely on it); **Ohio**: *Ferro Corp. v. Blaw Knkox Food & Chem. Co.*, 700 N.E.2d 94, 98 (Ohio Ct. App. 1997)(economic loss rule did not bar plaintiff's claims for fraud and negligent misrepresentation); **Pennsylvania**: *Excavation Technologies, Inc. v. Columbia Gas Co. of*

Penn, 985 A.2d 840, 841-42 (Pa. 2009)(recognized an exception to the economic loss rule for negligent misrepresentation claims brought under § 552 of the Rest. (Second) of Torts); **South Dakota**: *Northwestern Public Svc. v. Union Carbide Corp.*, 115 F.Supp.2d 1164, 1167-69 (D.S.D. 2000)(predicted that the economic loss rule does not bar fraud claims under South Dakota law); and **Virginia**: *City of Richmond v. Madison Mgmt. Group, Inc.*, 918 F.2d 438, 447 (4th Cir. 1990)(plaintiff's fraud claim was not barred by Virginia's economic loss rule). As illustrated above, there is broad support among the states for the type of negligent misrepresentation and fraud exceptions to the economic loss rule advocated by IRI here.

In sum, IRI's negligent misrepresentation and fraud by omission claims are not a mere recasting of IRI's time-barred contract/warranty claims. They are not based upon failed contractual expectations—what G&L refers to as an allegation that "*You failed to tell us* the product is defective." (*See* Appellants' Opening Brief, p. 15) Instead, these two claims are based upon G&L's intentional acts in misleading and deceiving G&L regarding the deadly propensity of the VTL to malfunction and throw spinning metal at high rates of speed. This tortuous conduct, which was committed before the parties entered into a contract, does not relate to the performance or satisfaction of the parties' agreement. The Court of Appeals was therefore correct in holding that the economic loss rule did not apply to IRI's negligent misrepresentation and fraud by omission.

D. Disputes Of Material Facts Exist Regarding G&L's Deception, Concealment And Omission Of Information Regarding The Unreasonably Dangerous Quality Of The VTL

Because the economic loss rule does not apply to IRI's negligent misrepresentation and fraud by omission claims, the only remaining question is whether

G&L can prove that it would be impossible for IRI to prevail on these claims at trial. This is a burden that G&L has not and cannot meet at the summary judgment stage. The record here includes deposition testimony and documentation regarding G&L's prior knowledge and conscious concealment of information regarding the dangerous design and nature of the VTL. For example, Campshure, a G&L engineer, testified that the VTL's specifications were unique in that the requested operational speed of 690 RPMs was higher that usual. (R. Memo, Exh. D, pp. 21-23) G&L had not previously designed or manufactured a VTL that could operate at that speed. (*Id.*) Hansen, a G&L sales engineer, issued an internal Memo warning that the RPM of 690 "exceeds our 400 RPM maximum by a considerable amount . . . it is proper to get a disclaimer from Ingersoll-Rand Company against operating [the] machine under unsafe conditions." (R. Memo, p.5) Hansen further reported that "[t]his may create unsafe conditions due to loss of clamping pressure due to centrifugal force or loss of clamping force due to the forces created by unbalanced work pieces, fixtures and/or the machine itself." (*Id.*) IRI was not forewarned, and Hansen's ominous prediction did in fact came to fruition.

As illustrated above, disputes exist as to G&L's alleged knowledge of the VTL's product defects and whether the same proximately caused IRI's damages. Resolution of these factual questions is inappropriate on summary judgment. Instead, a trial on the merits is necessary. The Court of Appeals was therefore correct when it reinstated and remanded IRI's negligent misrepresentation and fraud by omission counts back to the circuit court.

VI. All Of IRI's Tort Claims Survive The Economic Loss Rule, At Least To The Extent That IRI Claims Damages To "Other" Property

G&L admits that "[t]here is no disagreement that the Economic Loss Rule permits recovery of damages to 'other property.'" (Appellants' Opening Brief, p. 17) The typical formulation of the rule, however, is quite broader, and permits the recovery of all damages that occur when a defective product injuries a person or his property. (*See* Argument II, pp. 9-11) *See also Kodiak Electric Assoc., Inc. v. Delaval Turbine, Inc.*, 694 P.2d 150, 153 (Alaska 1984)(loss of the product itself is recoverable when other property is damaged); and *Salt River Project Agric. Improvement & Power Distr. v. Westinghouse Elec. Corp.*, 694 P.2d 198, 207-11 (Ariz. 1984)(*abrogated on other grounds)*(damage to the product itself is recoverable if there is damage to other property). IRI accordingly reiterates its argument that the economic loss rule does not apply to any of its torts claims, all of which arose out of an accident that caused external damage to "other" property.

In the event, however, that this Court determines that a plaintiff can never recover in tort for a defective product itself, an analysis of what constitutes the failed product in this case becomes necessary. Because Kentucky has not adopted the economic loss rule, there is no precedent for how to determine this fact-oriented question. Although not binding on this Court, the U.S. District Court for the District of Hawaii's Opinion in *Onsite/ Molkai Ltd. Ptrshp. v. GE*, 838 F.Supp. 1390 (D. Hawaii 1992) provides a useful analysis under analogous facts. Plaintiff there bought a generator with component parts and systems, manufactured by GE. More than four years after it was originally purchased, the generator failed. Plaintiff sued GE for strict liability, breach of warranty and negligence. GE moved to dismiss, alleging *inter alia*, that the type of damages

sought were not recoverable under the economic loss rule. *Id.* at 1394. Plaintiff contended that the generator and brushless exciter, both of which were damaged, were two separate products. GE, on the other hand, argued that the brushless exciter was an integral part of the generator. *Id.* at 1394. The Court found that plaintiff had presented a reasonable argument that the generator and brushless exciter were two separate products, namely because the brushless exciter came with a separate instruction manual. *Id.* The court held that:

> Because the court cannot, at this point, make the factual determination as to whether the brushless exciter and generator were one "product," the court will *not* grant summary judgment to the effect that all damages claimed under plaintiff's tort and strict liability theories are barred by the doctrine of economic loss.

Id. (*emphasis in original*).

Similarly, in the case *sub judice*, there is more than sufficient evidence to raise a factual question as to whether property "other" than the defective VTL was damaged in the accident. Although the VTL was sold as part of a "cell" system, it was a stand-alone machine that could be used independently or in conjunction with other equipment. (R. Memo, Exh. H, pp. 8-9) It had its own serial number, sales number and invoice price. (R. 109-11) Notably, G&L designed and manufactured the VTL under a different product line than the VTMs and other equipment sold to IRI. (R. Memo, Exh. H, p. 25) This all supports a finding that damage to the VTL's enclosure, VTM, workpiece, material handling unit, chuck, pallet, remote Q stand, other nearby equipment, cables and the concrete floor all constitute damage to property "other" than the VTL. The "other" machines and equipment that were damaged were not simply component parts or options added to the VTL, but instead were separate products that, at the time of the accident,

were being used in conjunction with the VTL. As in *Onsite/ Molkai Ltd. Ptrshp.*, the factual disputes regarding whether and to what extent "other" property was damaged in the subject accident, cannot be resolved by summary judgment.

Notably, G&L's cases do not support a contrary resolution. Both *Bowling Green Municipal Utils. v. Thomasson Lumber Co.*, 902 F. Supp. 134 (W.D. Ky. 1995) and *Mt. Lebanon Personal Care Home v. Hoover Universal*, 276 F.3d 845 (6th Cir. 2002) concerned actions involving the application of a chemical product to wood property. There, the courts determined that the defective "product" was not just the chemicals but the chemically treated property. The cases did not involve a factual question regarding what constituted the original product sold to the plaintiffs—the chemicals. Instead, the cases concerned a legal question regarding what constituted the "finished product" after the chemicals were applied to plaintiff's property. The cases are not relevant to the factual question before this Court: whether the equipment sold by G&L were individual products consisting of a defective VTL and "other" property.

G&L's footnote cases are similarly deficient and factually inapposite. (*See* Appellants' Opening Brief, p. 18, fns. 7 and 8) For example, *East River* held that defective turbine parts were component parts of the product itself, the turbine. The Court reasoned that "[s]ince all but the very simplest of machines have component parts, [a contrary] holding would require a finding of [other] 'property damage' in virtually every case where a product damages itself." 476 U.S. at 867. The same component parts analysis does not apply here because IRI is not claiming that the component parts of the VTL are not part of the VTL itself. Indeed, it is not arguing that machines be broken down to its simplest parts—metal, nuts, bolts, screws, etc. But it does urge this Court to

reject G&L's unsupported assertion that the separately designed and manufactured machines that constitutes the "cell diffuser system" must be considered one product as a matter of law.

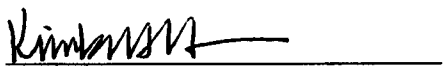
G&L's component parts argument is additionally flawed because it is based upon two faulty assertions: (1) that IRI considered the cell diffuser system to be one product under the warranty; and (2) that the diffuser cell system was one product because the entire system was insured. *First*, G&L claims that the warranty's failure to reference individual components of the diffuser cell system means that IRI considered the entire system to be one product. The warranty, however, did not define coverage in terms of the diffuser cell system, it covered "[a]ll goods furnished by Seller." (Appellants' Appendix, Exh. 4) Thus, the actual language of the warranty confirms the sale of goods, not the sale of a single product. *Second*, the fact that Ingersoll-Rand had purchased insurance which covered all of its damages does not imply that the diffuser cell system was one product. Ingersoll-Rand did not have insurance for a diffuser cell system as a single product; it had general property insurance which covered the accident.

In sum, a material dispute exists regarding whether and to what extent "other" property was damaged in the subject accident. This is clearly a factual dispute, which must be resolved by the trier of fact. This Court should therefore affirm the Court of Appeals' remand of IRI's claims for damage to "other" property. All of IRI's tort claims should accordingly be reinstated, at least to the extent that recovery is sought for damage to property other than the defective product itself.

CONCLUSION

Even if this Court adopts an economic loss rule, the doctrine should not apply to IRI's tort claims, which are based upon damage to the defective product itself as well as to "other" property. The rule should be deemed further inapplicable here, based upon the destructive or calamitous event and negligent misrepresentation and fraud exceptions. Finally, the rule should not bar any of IRI's tort claims, at least to the extent that damages to "other" property has been alleged and may be established. For these reasons, and upon the authorities cited, IRI respectfully requests that this Court reinstate and remand IRI's negligence, strict products liability, negligent misrepresentation and fraud by omission claims for a trial on the merits.

Respectfully submitted,



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