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Arizona's Economic Loss Rule: Is It a Defense to Fraud?

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The economic loss rule is a judicially created defense. When it applies, the defense prevents a plaintiff with contract remedies from recovering financial losses under a tort theory unless the plaintiff also suffered personal injury or property damage. Any recovery of economic losses must be based on contract law. The idea is that between contracting parties, the contract's provisions, not tort law, should control.

The rule is most often applied in negligence and product liability cases. In Arizona, it has not been addressed in an appellate decision outside those areas. But in other jurisdictions and in the Arizona trial courts, the rule is a fashionable defense to fraud, fiduciary-breach, and even statutory claims. Its application to these claims has had mixed results. But in most jurisdictions the courts have created exceptions to the rule.

Recent decisions by the California and Florida Supreme Courts are part of a backlash at the rule's expansion. *Robinson Helicopter Co. v. Dana Corp.*, 102 P.3d 268 (Cal. 2004); *Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc.*, 891 So. 2d 532 (Fla. 2004). Both decisions questioned the rule's growth and placed limits on it as a defense. The Florida decision listed professional malpractice, fraudulent inducement, negligent misrepresentation, and statutory causes of action as exceptions to the rule.

The rule presents special challenges when it is asserted as a defense to fraud-based theories of misrepresentation and nondisclosure. These fraud-based torts are designed to provide a remedy for financial losses. For instance, section 552 of the Restatement (Second) of Torts defines negligent misrepresentation as creating "liability for pecuniary loss." Yet the economic loss rule denies recovery for negligently induced pecuniary losses. A confusing conflict thus exists between a defense that bars recovery for economic losses and a branch of tort law that remedies the same losses. A uniform judicial response does not exist, although most courts permit some type of recovery for economic losses caused by intentional or negligent misrepresentation.

Decision yet to come

Arizona's state courts have not analyzed the economic loss rule in a fraud case. But several federal decisions have applied Arizona's rule to bar negligent misrepresentation claims. *E.g., Wojtunik v. Kealy*, 394 F. Supp.2d 1149, 1171-72 (D. Ariz. 2005). None of these decisions attempts to reconcile the conflict between a defense that precludes economic damages and torts intended to permit recovery of the same damages. A definitive decision by an Arizona appellate court has yet to be issued.

But if recent trends are any indication, it is likely a fraud exception of some sort will be recognized. The argument for a fraudulent-inducement exception is especially compelling. The law of fraud prevents one party from misleading another into signing a contract. Parties cannot freely allocate risk if one side is inducing the agreement by deceit. So, to say the economic loss rule shields pre-formation fraud makes no sense. Many courts recognize this. But others have been seduced by the simplicity of treating the economic loss rule as a bright-line doctrine that bars any fraud for which contract remedies exist. The weight of authority, though, is in line with the California Supreme Court's sentiment in holding that "a contract is not a license allowing one party to cheat or defraud the other." *Robinson Helicopter Co., Inc.*, 102 P.3d at 361.

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