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## The Economic Loss Rule in NJ and the “Integrated Product” Doctrine Now You See It — Now You Don’t

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As simple as the concept of the Economic Loss Rule appears to be, New Jersey’s interpretation of this well-settled doctrine and its corollary, the “integrated product” doctrine, is not at all predictable. Even though the N.J. Supreme Court and Appellate Division have issued significant decisions addressing the doctrine, its status remains unclear. The confusing and sometimes seemingly contradictory results of the cases on this topic present an area of law which begs for further clarification.

This article addresses the roots of the Economic Loss Rule, its purpose, the policies underlying the rule, the integrated product doctrine, and the varying interpretations accorded these doctrines by the N.J. courts, including the N.J. Supreme Court’s failure to apply the rule under certain facts.

### History and Purpose of the Rule

The Economic Loss Rule, which bars tort remedies in strict liability or negligence when the only claim is for damage to the product itself, evolved as part of the common law, largely as an effort to establish a boundary line between contract and tort remedies. According to the U.S. Supreme Court, “product liability grew out of a public policy judgment that people need more protection from dangerous products than may be afforded by the law of contracts and warranties.” *East River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858, 858 (1986). *Seely v. White Motor Co.*, 403 P. 2d 145 (Cal. 1965), has often been cited as the seminal case establishing the Economic Loss Rule. In *Seely*, a truck malfunctioned and flipped. The plaintiff sought recovery for the cost of repairs, purchase price and lost profits. The *Seely* court held that “[e]ven in actions for negligence, a manufacturer’s liability is limited to damages for physical injuries and there is no recovery for economic loss alone.”

New Jersey adopted the economic loss rule in 1985 in *Spring Motors v. Ford Motor Co.*, 98 N.J. 555 (1985), initially applying it to large-scale commercial transactions between sophisticated purchasers, but later extending its reach to transactions involving individual consumers. *Alloway v. General Marine Indust.*, 149 N.J. 620 (1997). In *Spring Motors*, the court held that commercial buyers “seeking damages for economic loss resulting from the purchase of defective goods may recover from an immediate seller and a remote supplier ... for breach of warranty under the U.C.C., but not in strict liability or negligence.” In *Alloway*, the court commented that “the vast majority of courts across the country likewise have concluded that purchasers of personal property, whether commercial entities or consumers, should be limited to recovery under contract principles.”

Following the N.J. Supreme Court’s adoption of the Economic Loss Rule, the New Jersey approach was embraced by the U.S. Supreme Court in *East River*. *East River* involved damage to oil supertankers from defective turbines. The court held that recovery for a de-

fective product that caused injury solely to itself can be pursued only under contract law. It characterized losses “resulting ... due to repair costs, decreased value, and lost profits” to be “essentially the failure of the purchaser to receive the benefit of its bargain.” Because the buyer can bargain for protection from these types of losses at the time of the contract, contract recovery puts the buyer back in the position it would have been had the product functioned properly. However, this recovery may be insufficient if there is damage to other property, which is an issue addressed by the “other property” exception to the rule—an exception that has caused many courts to wrestle with and reach inconsistent conclusions on the issue of when the rule will be applied in various factual scenarios.

The next year, in 1987, New Jersey codified the Economic Loss Rule in the N.J. Products Liability Act (NJPLA), N.J.S.A. 2A:58C-1b(2). In the NJPLA, the legislature established “one unified, statutorily defined theory of recovery for harm caused by a product, and that theory is, for the most part, identical to strict liability.” *Dean v. Barrett Homes*, 204 N.J. 286 (2010), citing *In re Lead Paint Litig.*, 191 N.J. 405 (2007). The statute defines “harm” as, *inter alia*, “physical damage to property *other than the product itself*” (emphasis added). Case law has held that this definition also excludes from the coverage of the NJPLA “consequential but purely economic losses caused to the consumer because of a defective product.” *Ford Motor Credit Co. v. Mendola*, 427 N.J. Super. 226 (App. Div. 2012). The N.J. Supreme Court has held that the UCC is the “*exclusive source* for ascertaining when a seller is subject to liability for damages if the claim is based on intangible economic loss not attributable to physical injury to person or harm to a tangible thing other than the defective product itself.”

### “Product” vs. “Other Property”

A rule that states that tort recovery is not available for damage to the product itself, but only for damages to other property, necessarily requires a court to define “product” in order to distinguish it from “other property.” This necessitates consideration of where component parts fit into the picture and has led to the so-called “integrated product” corollary. In *Easling v. Glen-Gery Corp.*, 804 F. Supp. 585 (D.N.J.1992), the district court analyzed the issue and determined that, in deciding whether a product has injured only itself, the court must look to the product purchased by the plaintiff and not to the product manufactured by the defendant. In *Easling*, the plaintiffs purchased an apartment complex clad with bricks. After the bricks deteriorated, the plaintiffs filed a strict liability action against the brick manufacturer. The district court held that the plaintiffs had purchased a completed apartment complex, not a load of bricks. Therefore, the only damage was to the product itself, and the NJPLA precluded a tort claim.

In 1997, in *Saratoga Fishing Co. v. J.M. Martinac & Co.*, the U.S. Supreme Court addressed the “other property” issue. *Saratoga Fishing* involved a product that malfunctioned and harmed both itself and component parts that the purchaser had added after the original purchase. The Supreme Court held that these added components were “other property,” and therefore damage to them was recoverable in tort. The “product” was defined as simply what was purchased. Thus, where component parts are added to the original product, they are “other property.” Where they are purchased with the original

product—i.e. are integrated into it—they are not “other property.” Therefore, the Economic Loss Rule bars recovery for damage to them.

### The Integrated Product Doctrine

In recent years, federal courts have begun to expand the Economic Loss Rule through the adoption of the integrated product doctrine. By focusing on whether a product is integrated into a larger one, the federal courts have concluded that “harm to the product itself” includes harm to whatever else the defective product was integrated into. See, e.g., *King v. Hilton-David*, 855 F.2d 1047 (3d Cir. 1988), cert. denied, 488 U.S. 1030, 109 S.Ct. 839 (1989). The federal courts have employed this theory in cases applying New Jersey law: See generally, e.g., *Adams Extract & Spice v. Van De Vries Spice*, 2011 U.S. Dist. LEXIS 147851 (D.N.J. Dec. 23, 2011); *Int’l Flavors and Fragrances v. McCormick & Co.*, 575 F. Supp. 2d 654 (D.N.J. 2008); *Travelers Indem. Co. v. Dammann & Co.*, 592 F. Supp. 2d 752 (D.N.J. 2008).

### The EIFS Story

EIFS (Exterior Insulation and Finish System) is a product used to clad and insulate houses, giving the exterior a stucco-like appearance. It is applied during the building process, and includes a layer of insulation, a layer of reinforced base coat and an exterior layer of a textured, protective finishing coat.

The N.J. Appellate Division considered the integrated product theory in two EIFS cases: *Dean v. Barrett Homes*, 406 N.J. Super. 453 (App. Div. 2009), and *Marrone v. Greer & Polman Constr.*, 405 N.J. Super.288 (App. Div. 2009). In both cases, the Appellate Division applied the integrated product doctrine and held that the EIFS was not separate from the house but was integrated into it, therefore making the EIFS and the house one “product” for purposes of the NJPLA’s definition of harm. As the *Marrone* court explained:

Plaintiffs here did not purchase the EIFS cladding; they bought a house. They cannot maintain a PLA claim by attempting to break the house down conceptually into its component parts and suing in strict liability for defects in the components ... allowing a tort remedy here would subject component manufacturers to potentially unlimited liability. Under plaintiffs’ theory, a buyer who purchased plaintiffs’ house fifty years from now and discovered defects in the EIFS cladding could potentially sue the ... defendants for water damage to the house.

Courts in other jurisdictions have barred homeowners from maintaining tort actions against concrete suppliers to recover for cost of repair and lost value to a house from cracked and broken concrete, rejected tort claims for water damage around windows, and barred recovery for damage to roofs from plywood.

### N.J. Supreme Court's Different Approach

The N.J. Supreme Court disagreed with these analyses in *Dean v. Barrett Homes*. There, the plaintiffs purchased a home from its original owners seven years after it had been built using EIFS. A year later, the plaintiffs claimed they noticed black lines on the exterior that were caused by toxic mold. They eventually had all the EIFS removed and replaced. They sued multiple defendants, including the manufacturer, the home inspection company, the installer and the builder, alleging negligence, breach of warranty, Consumer Fraud Act violations and strict products liability claims. They claimed that EIFS is defective because it does not allow for drainage of moisture that penetrates it, causing the underlying structure to rot or develop mold. Settlements were reached with all of the defendants except the manufacturer, Sto.

In *Dean*, the trial court granted Sto's motion for summary judgment, ruling that the EIFS was an integral part of the home and that the home was the "product." The Appellate Division affirmed.

On appeal to the Supreme Court, the plaintiffs argued that the court should reverse and expand tort recovery because they had no contract remedy available. They also claimed that they should be able to recover in tort not only for damage to the "other product" (the house) but for replacement of the EIFS itself.

The defendant argued that the complex multistep installation of the EIFS exterior wall system effectively integrated it into the house. Therefore, the damage to the house was not "damage to other property" and the economic loss doctrine should preclude any tort recovery. The defense also argued that, if every individual component of a house—plumbing, nails, dishwashers, insulation, boards, windows, whatever—is considered a product separate from the house, then manufacturers of each of these components could be subjected to liability for every house, multifamily house, apartment complex, condominium or other structure in which their products were used, destroying the predictability that commerce requires and the purpose of the limitation on "harm" for economic loss under the NJPLA.

The Supreme Court rejected the arguments of both the defense and the plaintiffs, in part, and reversed the appellate court in a 6-1 decision with a strong dissent by Justice Rivera Soto. The majority likened the EIFS to vinyl siding that, at all times, was distinct from the house and remained a separate product. It held that the EIFS was therefore *not* fully integrated into the structure, and the plaintiffs could still sue in tort for damage that the EIFS caused to the house or its immediate surroundings. The court rejected the plaintiffs' argument that it should allow recovery for the damage that the EIFS caused to itself.

The court also rejected and criticized the plaintiffs' claim that they should be granted a tort remedy simply because they purportedly had none in contract. The court noted that this argument rested on a "fundamental misconception of the Products Liability Act" and a flawed reading of the act's definition of "harm." *Dean* at 304. It said "[T]he [NJPLA] is not

concerned with providing a consumer with a remedy for a defective product *per se*; it is concerned with providing a remedy for the harm or the damage that a defective product causes to people or to property.” It noted that the legislature did not intend the NJPLA to be a catch-all remedy that would fill the gap created when ordinary contract remedies, including breach of contract, statutory causes of action, or express and implied warranty claims were lost or unavailable.

The Supreme Court also cited the host of statutory and contractual remedies available to protect consumers against economic losses, including the UCC; the Consumer Fraud Act; Truth-In Consumer Contract, Warranty and Notice Act, N.J.S.A. 56:12-1 to -18; and the Magnuson Moss Warranty Act, 15 U.S.C.A. §§2301-2312. In addition, although not mentioned by the court, homeowners have other remedies available in the New Home Warranty and Builders’ Registration Act, N.J.S.A. Section 46:3B-1 to -20; the Construction Lien Law, N.J.S.A. §§2A:44-1 to -38; and the Contractors’ Registration Act, N.J.S.A. §§56.8-136-152. They also may have potential claims against builders, installers, home inspectors, sellers, realtors and perhaps others. Nonetheless, the court permitted the *Dean* plaintiffs to recover in tort.

In a strong dissent, Justice Rivera-Soto criticized the majority’s rejection of the integrated product doctrine under the facts of the case as defying “basic common sense.” *Dean* at 307. After describing the multistep process required to install EIFS, Justice Rivera-Soto said that to describe the EIFS as not integrated into the structure is:

so fanciful, so nonsensical, that it beggars the imagination. It is a conclusion that can germinate only in the minds of lawyers and can find root only in the rarified environment of this Court’s decisions; it cannot, however, long survive in the atmosphere of the real world.

Justice Rivera-Soto went on to cite over 30 cases that had adopted the integrated product doctrine to bar tort recovery under similar fact scenarios, including several involving EIFS.

### **What’s Next After *Dean*?**

Significantly, in *Dean*, the Supreme Court did not either adopt or reject the integrated product doctrine. It simply held that “the integrated product doctrine does not apply to the facts before this Court.”

The NJPLA does not define what qualifies as a product. This leaves open the opportunity for defense attorneys to argue under different factual scenarios that New Jersey should formally adopt the integrated product doctrine and apply it to bar future recoveries for apartment complexes, houses, condominiums, or any other “larger” product into which a component has been integrated. It will be interesting to see what future courts choose to do in complex product situations.

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