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Roger Bernhardt

Golden Gate University School of Law, rbernhardt@ggu.edu

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The economic loss rule:
Robinson Helicopter v Dana (2004)
Roger Bernhardt

Economic-loss rule does not bar tort recovery (compensatory and punitive damages) in claim for intentional misrepresentation or fraud independent of claim for breach of contract.

Robinson Helicopter Co. v Dana Corp. (2004) 34 C4th 979, 22 CR3d 352

Robinson Helicopter Co., which manufactures helicopters, purchased sprag clutches from Dana Corp. The clutches had to conform to the “type certificate” for the helicopters issued by the Federal Aviation Administration (FAA). Between July 1996 and October 1997, Dana changed the manufacture of the clutches; the newly produced clutches did not conform to the FAA certificate requirements. Dana did not notify Robinson or the FAA of the change, and Dana continued to provide written certification that the clutches had been manufactured in conformity with the certificate requirements. During the change, the clutches experienced a failure rate of almost 10 percent, as compared to an almost zero failure rate before and after. At its own expense, Robinson replaced almost 1000 defective clutches.

Robinson sued Dana for breach of contract, breach of warranty, and negligent and intentional misrepresentations. The jury awarded Robinson \$1,533,924 in compensatory damages and \$6 million in punitive damages. The jury based its punitive damages award on Dana’s false misrepresentations of fact and knowing misrepresentation or concealment of material facts with the intent to defraud. The court of appeal reversed the punitive damage award, holding that, based on the economic-loss rule, Robinson could not recover tort damages because it suffered only economic losses.

The California Supreme Court reversed, holding that the economic-loss rule did not apply to Robinson’s independent claims for intentional misrepresentation or fraud based on Dana’s provision of false certificates of conformance. The court explained that these tort claims existed independently of Dana’s breach of contract. The court opined that public policy favored its holding, because Robinson advanced the public interest in punishing Dana’s intentional misrepresentations and in deterring such misrepresentations in the future.

The court rejected Dana’s argument that the fraud and misrepresentation claims were simply part of the alleged breach of contract, pointing out that a contracting party could not rationally calculate the possibility that the other party will deliberately misrepresent critical terms. The court stated that public policy did not support the implied consequence of Dana’s argument: the increased uncertainty in contractual relationships that would result from encouraging fraudulent conduct at the expense of an innocent party.

Justice Werdegar dissented, opining that the majority gave new life to the moribund doctrine of bad faith breach of contract.

THE EDITOR’S TAKE: Although an impressive roster of attorneys appeared in this case—showing its obvious importance to many economic factors in this state—I couldn’t help but note that no real estate interests attempted to get involved in the matter. Although

the parties actually involved in the case had nothing to do with real estate, the rule dictating the outcome could have a major impact on construction litigation. (Indeed, the three precedents most discussed by the court—*Jimenez v Superior Court* (2002) 29 C4th 473, 127 CR2d 614; *Aas v Superior Court* (2000) 24 C4th 627, 101 CR2d 718; and *Erlich v Menezes* (1999) 21 C4th 543, 87 CR2d 886—all involved building contractors sued for construction defects by real estate purchasers.)

It is not hard to see how the court's creation of an exception to the economic-loss rule for independent fraud could play out in a construction context. The manufacturer in *Robinson* was guilty not only of selling defective clutches (the contract claim), but also of falsely misrepresenting their condition to the buyer (the tort claim); and because that fraud was a tort, independent of the contract breach, the buyer was able to recover punitive tort damages as well as compensatory contract damages. I find that quite similar to claims made against a building contractor who installed defective windows while at the same time assuring the purchaser that they were in very good shape.

Although the court majority takes pains to emphasize the narrowness of its decision and its confidence that trial courts will enforce strict pleading requirements in cases of alleged fraud, Justice Werdegar's fears that plaintiffs' attorneys will start piggybacking tort claims onto all their breach-of-contract claims certainly seems real when realty is involved. In fact, attorneys would be derelict in not trying to do so. (Even though I share Justice Werdegar's apprehensions about the potential uncontrollable scope of the rule, that does not put me in agreement with her substantive position, which appears to deny any recovery for fraud whenever there was only economic loss, *i.e.*, in the normal case. In fact, I wish our statutory measure of damages for fraud went the opposite way and covered benefit-of-the-bargain damages as well as out-of-pocket loss.) See Bernhardt, *On Making and Breaking Contracts*, 27 CEB RPLR 12 (Jan. 2004).

However, we should not forget that defective construction in homes is now governed by SB 800 (CC §§895–945.5), which took effect last year. See Gerrish & Marks, *Construction Defect Litigation: The Playing Field Has Changed—A Navigational Guide to Senate Bill 800*, 26 CEB RPLR 106 (May 2003). The statute subjects construction defects to special treatment, different from other products liability cases. Economic losses, including cost of repairs (and lost income when the home was used as a principal place of a business), are covered by it. See CC §944. (Miller & Starr opine that the new statutory measure of recovery is one “thereby curtailing part of the California Supreme Court decision in *Aas v Superior Court*,” although I do not quite know what they mean by that, since *Aas* dealt with tort, not contract law.)

And the statutory measure prevails where it applies. Civil Code §896 declares that a defendant is “liable for,” and the homeowner's cause of action is “limited to,” violation of the new statutory standards, which gives the statute a kind of universality and exclusivity. However, there is an “except as specifically set forth in this title” clause in that section, which is repeated in CC §943(a) (as “except as provided in this title”):

Except as provided in this title, no other cause of action for a claim covered by this title or for damages recoverable under Section 944 is allowed. In addition to the rights under this title, this title does not apply to any action by a claimant to enforce a contract or express contractual provision, or any action for fraud, personal injury, or violation of a statute.

The statute thus contemplates an independent cause of action for fraud, the same as the court has allowed in *Robinson Helicopter*. Indeed, CC §931 adds that nonstatutory causes of action, including “fraud-based claims,” should be “administered according to” the SB 800 scheme, specifically adding that, “As to any fraud-based claim, if the fact that the property has been repaired under this chapter is deemed admissible, the trier of fact shall be informed that the repair was not voluntarily accepted by the homeowner” (whatever that means). Because the new Act does not cover all forms of real estate, we appear to be destined to live in uncertainty about how this new economic-loss carve-out will operate for residential real estate (under SB 800) and for commercial real estate (under *Robinson Helicopter*). Will some brave construction litigation expert please write an article for us?—*Roger Bernhardt*