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SJC rejects 'economic loss rule' in condo construction suits

But bar doesn't expect flood of cases to result

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The Supreme Judicial Court has eliminated an obstacle that has long stymied condominium associations seeking to sue developers over construction defects.

Ruling in a case of first impression, the SJC found that the economic loss doctrine does not bar negligence claims in the context of such suits.

In an attempt to force litigants to recover under the provisions of their contracts with one another, the doctrine bars tort damages stemming from defective products absent a showing of personal injury or damage to other property. In the case before the SJC, the defendant developer unsuccessfully argued that the economic loss rule should preclude all of the plaintiff condo association's claimed damages.

"The problem arises when the party exclusively responsible for bringing litigation on behalf of the unit owners for the negligent construction of the common areas (here, the trustees) has no contract with the builder under which it can recover its costs of repair and replacement, that is, its economic losses caused by defective construction," Justice Robert J. Cordy wrote for the unanimous court. "We agree with the Appeals Court that 'the rule does not require a court to leave a wronged claimant with no remedy,' and that '[t]he fundamental purpose of the rule is to confine the indeterminacy of damages, not to nullify a right and remedy for a demonstrated wrong and its harm.'"

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>
> **— Thomas O. Moriarty, Braintree**

The SJC further overturned Superior Court Judge Paul A. Chernoff's decision to reduce damages by 20 percent to reflect what the costs would have been at the time of the negligent construction.

The 18-page decision is *Wyman, et al. v. Ayer Properties LLC,* Lawyers Weekly No. 10-120-14. The full text of the ruling can be found at masslawyersweekly.com.

'Big deal'

Plaintiffs' counsel Thomas O. Moriarty, of Marcus, Errico, Emmer & Brooks in Braintree, said the decision is a "big deal" for condominium associations and properly expands the recovery available to them in construction-defect suits.

Clive D. Martin, who represents both condo associations and developers but was not involved in *Wyman*, agreed.

The economic loss rule, combined with the hybrid nature of condominium ownership, had created a Catch-22 for residents who encounter construction problems with building common areas, Martin said. If the rule is applied, only contract damages are allowed. But while the owners have contracts for the purchase of their units, only the condominium association, which does not have a contract with the building developer, can bring lawsuits pertaining to common areas.

"I don't say that's a bad doctrine; it serves a very good purpose," said Martin, who practices at Robinson & Cole in Boston. "But it was really taking away a remedy to tell the trustees they don't have a case in negligence. … Even the most zealous advocate of a developer's position has to agree that there's a huge amount of unfairness in applying a doctrine designed to cover industrial equipment, let's say, to a home in a hybrid condominium ownership model."

Though he had argued for application of the rule, defense counsel Thomas H. Hayman said he was still pleased with other outcomes in the case. The final award, $256,240, was just a quarter of the damages sought by the plaintiffs, he said. In a pre-trial memorandum, the plaintiffs claimed the evidence would show damages of at least $1 million.

"The SJC's decision is not what we desired," said Hayman, who practices at Boston's Nelson, Mullins, Riley & Scarborough. "But in the grand scheme of things, from our perspective, the developer's position was largely vindicated by the trial court in terms of refuting the plaintiffs' damages claims. The SJC did not disturb the trial court's findings in that regard."

And, while he conceded that a potential obstacle to a defect case by an organization of unit owners has been removed, Hayman said he also was glad to see the SJC make clear that it was not invalidating the economic loss rule in other contexts. The Appeals Court's suggestion that the doctrine might not be a viable defense in Massachusetts at all was a key motivating factor behind the defendant's decision to seek further appellate review, according to Hayman.

Moriarty said the rule has a long history and clearly applies in Massachusetts.

"The argument was simply in this circumstance … it shouldn't apply," he said.

One purpose of the economic loss rule is to prevent unforeseeable and unpredictable damages. Invalidating the doctrine in the context of a condominium building's construction defects is unlikely to undermine that purpose, Martin said, because it is not difficult to pinpoint the cost of repairs.

Diane R. Rubin, a lawyer at Boston's Prince, Lobel, Tye, said the economic loss rule may have prevented some smaller condo associations from proceeding with legitimate claims and that the SJC decision provides a more level playing field.

"The developers have been able to use that as a procedural shield to avoid responsibility for their shoddy workmanship," she said.

Still, none of the lawyers interviewed expected a wave of condominium-construction defect lawsuits to result from the decision. Martin said it simply removes one hurdle from the track. Time a lawyer spent figuring a way around the economic loss rule can now be devoted to all the other challenges a case presents, he said.

"It makes things easier, but don't expect a flood," Moriarty agreed.

The SJC also sided with the plaintiffs on the question of whether it was appropriate for the trial judge to reduce damages by 20 percent to reflect what the costs would have been at the time of negligent construction.

"It was a surprise to us, I think it's fair to say, that there have been no published decisions on the point in time damages should be assessed," he said. "It made sense to identify the point in time."

While applauding the strategy, Moriarty said the outcome would be unfair if the judge's methodology had been allowed to stand.

"It was a novel argument that got some traction," he said. "But the association doesn't have the ability to go back in time, obviously. You've got to fix things in present-day dollars, and if you can't do that, you're necessarily unable to be made whole."

CASE: *Wyman, et al. v. Ayer Properties LLC,* Lawyers Weekly No. 10-120-14

COURT: Supreme Judicial Court

ISSUE: Does the economic loss rule bar a condominium association's negligence claim against a developer for construction defects?

DECISION: No

An 'integrated product'

The defendant developer, Ayer Properties, acquired a 150-year-old, four-story mill building on Market Street in Lowell in 2002. Ayer converted the structure into condominiums and transferred control and ownership to a newly appointed board of trustees in 2004.

The trustees of the Market Gallery Condominium Trust sued Ayer Properties in 2005 seeking damages for the negligent construction of some building elements. The trustees alleged that a negligently constructed roof, window frames and exterior brick masonry had damaged common areas and individual units.

Judge Chernoff agreed that the elements were negligently constructed, but declined to award damages for the masonry. Chernoff ruled that the economic loss rule applied because defects were limited to the masonry itself and there was no damage to the individual units resulting from it.

To the extent he awarded damages, Chernoff reduced them by 20 percent "to reflect what the costs would have been at the time of the negligent construction rather than at the time of the actual expenditure for repair and replacement."

On appeal, the developer argued that the condominium building was an "integrated product" and that the economic loss rule should preclude any damages.

In addition to affirming the damages Chernoff awarded for the roof and window frames, the Appeals Court ruled that the economic loss rule should not have applied to the masonry defects either and awarded an additional $64,000 to the plaintiffs. The Appeals Court said Chernoff's 20 percent damages reduction "fell well within the range of reasonable alternative calculations."

'Nature of condo unit ownership'

"We are largely in agreement with the Appeals Court, and conclude that the economic loss rule is not applicable to the damage caused to the common areas of a condominium building as a result of the builder's negligence, and that recovery for damages resulting from the defective masonry should have been awarded to the trustees," Cordy wrote.

The decision notes that the rule was created to limit tort damages for the simple economic losses resulting from a defective product.

"Essentially, where the negligent design or construction of a product leads to damage only to the product itself, the recovery for economic loss is in contract, and the economic loss rule bars recovery in tort," Cordy wrote.

The SJC had previously made clear that the rule applied to newly constructed homes, but had never had a chance to consider whether it applied to the common areas of a condominium building.

"The nature of condominium unit ownership supports our conclusion that claims such as those raised here do not fit into the rubric of claims intended to be covered by the rule," Cordy wrote, adding later that, "[t]he rational for applying the rule is made even weaker where the trustees seek damages that are finite and foreseeable."

In another issue of first impression, the SJC considered Chernoff's damages calculation and "whether or when it is proper for … damages to be reduced to account for the lower costs of repair and replacement that would have been incurred had they been done closer in time to the negligent construction."

Here, the SJC ruled narrowly that Chernoff's reduction was unreasonable, but did not decide whether such a calculation is ever appropriate. The SJC said Chernoff's rationale for the reduction was "largely unexplained and unsupported by any evidence," with the exception of his statement that it was "especially appropriate" given the statutorily mandated interest the plaintiffs would receive on their judgment.

"We agree with the trustees that the awarding of interest 'is not within the purview of the fact finder,'" Cordy wrote, "and conclude that reducing the damages for the purpose of preventing aggrieved plaintiffs from receiving interest that the Legislature intended they receive is unreasonable."