

Dean v. Barrett Homes, Inc.: A Crack in the 'Economic Loss' Rule for 'Integrated Products'

Product Liability Advisory

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In *Dean v. Barrett Homes, Inc.*, A-15, New Jersey Supreme Court (November 15, 2010), the New Jersey Supreme Court significantly narrowed the "economic loss rule" and its corollary, the "integrated product doctrine," when it adopted the decidedly minority view concerning the applicability of these principles in a consumer context. Given the leading role that New Jersey courts have played in this area of jurisprudence, the case has potentially broad implications for both product liability and construction cases throughout the country.

The economic loss rule was established by the New Jersey Supreme Court in 1985 in a commercial contract dispute involving defective trucks. (*Spring Motors Distributors, Inc., v. Ford Motor Co.*, 98 N.J. 555 (1985).) The court held that when a claimant seeks recovery for injury to the product itself, the proper remedy should be sought in contract, not tort. The U.S. Supreme Court soon adopted the rule in an admiralty matter involving the purchase of defective turbines aboard several ships that led to lost revenues during repairs. (*East River Steamship Corp., v. Transamerica Delaval Inc.*, 476 U.S. 858 (1986).) Later, in *Alloway v. Gen. Marine Indus., L.P.*, 149 N.J. 620, 642 (1997), the New Jersey Supreme Court extended the economic loss rule to consumers when it held that the U.C.C. "amply protects all buyers – commercial purchasers and consumers alike – from economic loss arising out of the purchase of a defective product." *Alloway* involved a consumer's purchase of an allegedly defective boat and sought the cost of repairs and loss of value. Thus, even in the consumer context, the court sought to recognize the separate interests protected by tort and contract law.

The integrated product doctrine has been recognized by many courts, including appellate courts in New Jersey, as an extension of the economic loss rule. The doctrine precludes tort-based recovery "when a defective product is incorporated into another product which the defective product then

damages." (*Dean v. Barrett Homes, Inc.*, A-15, slip op. at 16.) It has been applied in the majority of cases to preclude homeowners' tort remedies caused by defective products that were considered integral parts of the house and caused damage only to the house itself. The Appellate Division opinion in *Dean* surveyed the majority holdings (*Dean v. Barrett Homes, Inc.*, 406 N.J. Super. 453, 467-468 (App. Div. 2009)) as did Justice Rivera-Soto in his separate opinion (*Dean v. Barrett Homes, Inc.*, A-15, New Jersey Supreme Court, slip op. concurring in part and dissenting in part at fn. 2.) In *Dean*, the New Jersey Supreme Court adopted the minority view.

The plaintiffs in *Dean* purchased a home from homeowners who had purchased it new from the builder. The home was clad with an Exterior Insulation and Finish System commonly known as "EIFS," which is often described as synthetic stucco. In fact, it is a system made up of several layered components that provide both insulation and an exterior wall finish. Purported defects in EIFS products have been litigated extensively throughout the country over the past 20 years. In some systems, when water infiltrates behind the system and cannot escape, that defect leads to leaks in the home, rotting of sheathing and framing and growth of mold. The home inspector for the plaintiffs in *Dean* advised them of risks associated with the EIFS, and their insurance company declined to transfer their coverage to the new home because of the EIFS, but the plaintiffs secured alternate insurance and proceeded with the sale. A year later they noticed black lines on the exterior, and upon investigation they found extensive damage to structural members behind the EIFS. The Deans removed and replaced the EIFS entirely and made extensive repairs to the home.

The plaintiffs filed suit against several defendants, including the EIFS manufacturer Sto Eastern, Inc., for claims sounding in negligence, breach of warranty, consumer fraud and strict liability. Sto moved for summary judgment and the trial court dismissed the strict liability claim, finding that the plaintiffs had sustained economic loss only, so their claim could not be brought in tort. (*Dean v. Barrett Homes, Inc.*, 406 N.J. Super. at 459.) The Appellate Division affirmed, and noted that it had recently held in another case with virtually identical facts that the plaintiffs could not sue in tort for economic damage to the house itself caused by an EIFS failure. (See, *Marrone v. Greer & Polman Construction, Inc.*, 405 N.J. Super. 288, 290-91 (App. Div. 2009).) The Appellate Division in *Dean* carefully outlined the rationale of the economic loss rule and pointed to other state and federal cases, including Third Circuit Court of Appeals law, in which courts found that defective parts of

homes were considered part of the home, so that the economic loss rule precluded any tort remedy for damage to the home caused by the defective part. The Appellate Division concluded that: "Here, plaintiffs purchased a house, not exterior siding, and the exterior siding was an integrated component of the finished product of that house." (*Dean v. Barrett Homes, Inc.*, 406 N.J. Super. at 469.)

The New Jersey Supreme Court reversed. First, it noted that the New Jersey Products Liability Law (NJPLA), which replaced all common law tort actions involving products, explicitly adopted the economic loss rule in its definition of "harm" from a product. Harm is limited, in part, to "physical damage to property, *other than the product itself*" and certain personal injuries. N.J.S.A. 2A:58C-1b(2) (emphasis added). The court then traced the development of the economic loss rule and how it arose from the distinction between tort and contract remedies as the concept of strict liability became distinguished from breach of warranty. (*Dean v. Barrett Homes, Inc.*, A-15, slip op. at 13-14.) Finally, the court noted the recent extension of the rule through the adoption of the integrated product doctrine, which "preclude[s] tort-based recovery when a defective product is incorporated into another product which the defective product then damages." (*Id.* at 16.)

The court then turned to the specific questions before it, which it summarized as "whether this [c]ourt will adopt the integrated product doctrine to address whether a product, like EIFS, which causes damages to the house, falls within the economic loss rule, thus barring recovery." (*Id.* at 22.) That response would turn on "whether the EIFS was sufficiently integrated into the home to become part of the structure for purposes of broadly applying the economic loss rule." (*Id.*) The court pointed to cases allowing tort recovery for asbestos contamination and more directly to a California Supreme Court decision that rejected the integrated product doctrine and allowed plaintiffs to recover in tort for damage that defective windows caused to other parts of the house. (*Id.* at 23.) Adopting a similar rationale, the court concluded that "the EIFS was affixed to the exterior walls to create a moisture barrier, much like exterior vinyl siding. As such, it did not become an integral part of the structure itself, but was at all times distinct from the house." (*Id.* at 24.)

Nevertheless, the court held that the economic loss rule still applied to preclude the plaintiffs from recovering in tort for damage to the EIFS itself. Their tort damages were limited to damages that the

EIFS caused to the house structure or its environs. (*Id.*) The court then rejected the plaintiffs' argument that they had no other remedy to recover the costs of replacing the EIFS. It pointed to the limited nature of the remedies provided by the NJPLA: "[O]ur [L]egislature 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." (*Id.* at 26.)

The court in *Dean* did not reject the integrated product doctrine outright, but its decision invites trial courts to decide on a case-by-case basis whether a product is "integrated" into another product. At the same time, it provides little meaningful guidance on how to make the decision. The court cites to a comment in the Restatement (Third) of Torts: Product Liability observing that if a product "is deemed to be an integrated whole, courts treat such damage as harm to the product itself." (*Id.* at 22.) The court also stated: "Particularly in the case of houses, a product that is merely attached to or included as part of the structure is not necessarily considered to be an integrated part thereof." (*Id.*) These pronouncements provide scant guidance for evaluating when a product is "integrated," leaving substantial discretion in trial courts. The scathing dissent of Justice Rivera-Soto found the majority opinion to be "hairsplitting" and "nonsensical." (*Id.*, Slip op., Rivera-Soto concurring in part and dissenting in part at 5,6.)

The *Dean* decision presents housing consumers with new opportunities for claiming tort remedies against remote builders and product suppliers where the plaintiffs' contract or home warranty claims are nonexistent. Under the court's loose rationale, for example, roof shingles, plumbing fixtures and HVAC systems may arguably be considered separate products because they are "merely attached to or included as part of the structure." Although the opinion will have its most significant effect on construction or housing defect claims in the short run, it potentially has broad impact in areas of product liability by providing plaintiffs or defendant manufacturers of products with an opportunity to allege that components are separate products and not integrated parts of a whole product. That mere allegation may allow plaintiffs or co-defendants to defeat a motion to dismiss by component manufacturers, who under a more clearly defined integrated product rule, would have a strong motion for failure to state a claim. Now those parties will more likely need to present substantive evidence, perhaps including expert opinion, to demonstrate that their component products were

"fully integrated" into the product itself. It is therefore reasonable after *Dean* to expect significant efforts by litigants to try to diminish the integrated products doctrine and expand tort remedies in various product liability contexts, both in New Jersey and other jurisdictions.

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