

News & Types: Commercial, Competition & Trade Update

Dissatisfied Buyer Loses \$2.7 Million on "Economic Loss" Doctrine

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Child Craft, LLC (also known as Harrison Manufacturing, LLC) manufactured furniture for young children and infants. One of its key suppliers was Summit Forest Products, an assumed name of JMB Manufacturing, Inc.

Child Craft had big plans for a high-end baby furniture line called the "Vogue Line." Summit agreed to supply the raw wood components to Child Craft. For this purpose, Summit had its own supplier in Indonesia. Child Craft knew the ultimate source of the wood components was an Indonesian supplier, but had limited contact with the Indonesian supplier.

In late 2008 and 2009, Child Craft issued several purchase orders to Summit for wood components for around \$90,000. One of the requirements was that moisture content be between 6% and 8%, as a higher moisture content promotes warping and splitting. As it turned out, the wood components did not meet this standard, in spite of the assurances of Summit's owner and president, Ron Bienias. The result was catastrophic for Child Craft, which failed to manufacture any saleable products from the defective wood components. Child Craft burned through the rest of its capital and ceased business in 2009.

Summit was not paid and filed suit against Child Craft. (For procedural reasons, this suit failed.) Child Craft counterclaimed for breach of contract and for negligent misrepresentation against both Summit and its owner-president, Bienias. Child Craft found a sympathetic hearing at the trial level, winning a judgment of \$4 million, later reduced to \$2.7 million. But the 7th Circuit Court of Appeals was not so sympathetic. (*JMB Manufacturing, Inc. v. Child Craft, LLC*, 7th Circuit Court of Appeals, No. 14-3306 & 14-3315, August 24, 2015)

Certainly Child Craft had a sad story to tell – about a small business that failed because of the unreliability and alleged falsehoods of one of its suppliers. Unfortunately, Child Craft lost its damage claim on the "economic loss" doctrine under Indiana law. In earlier Risk Management Updates, we have seen the economic loss doctrine applied to thwart other claims of dissatisfied buyers. See, for example: "Limitation of Liability Contract Provision Enforced – Hotel Owner Loses \$4.1 Million."

Child Craft counterclaimed against Summit and its president, individually, for negligent misrepresentation. After all, Bienias (the president) knew of Child Craft's requirements and provided assurances that the wood components would meet these requirements. But under the economic loss rule, as adopted by Indiana courts, a party to a contract cannot recover in tort for purely economic loss (i.e., pecuniary loss unaccompanied by any

property damage or personal injury, other than the damage to the product or service provided by the defendant).

To Judge Hamilton, who wrote the 7th Circuit opinion, Child Craft's claim was exactly the type of case in which the economic loss doctrine should apply. Said Judge Hamilton,

"Merchants negotiating a contract can allocate between themselves the risk of commercial losses flowing from possible breaches. The economic loss doctrine recognizes this reality and prevents a commercial party from recovering in tort for commercial losses it could have protected itself against through contractual terms such as warranties, indemnification, or provisions for remedies."

The court's decision is not clear on what the parties actually negotiated. The court cited a contractual provision that permitted Child Craft to recover \$30 per hour for re-working defective products. But unlike previous cases applying the economic loss doctrine, the court does not cite any limitation of liability provision negotiated by the parties that would have limited the liability of Summit, the seller.

But for application of the economic loss doctrine, it may not have made a difference. The major portion of Child Craft's claim was based on the negligent misrepresentation claim that Summit and its owner-president represented that the wood components would conform to specifications. On this basis, Child Craft sought more than \$5 million and eventually persuaded the trial court to grant it \$2.7 million. Since negligent misrepresentation is a tort-based claim, it cannot be used to overcome the economic loss doctrine.

There are exceptions to the economic loss doctrine which Child Craft tried, unsuccessfully, to apply to its own case. The court distinguished one case cited by Child Craft that involved a title insurance claim by noting that the plaintiff and defendant were not in contractual privity with one another. So there was no opportunity for the parties to negotiate and allocate the risks and liabilities. Child Craft argued that, although there was a contract with Summit, there was no contract with its owner-president, Bienias. But the court refuted that argument, noting that Bienias was a corporate officer and employee and the statements he made were as agent and on behalf of Summit.

Another exception to the economic loss rule that Child Craft tried to use is one applicable to "professional brokers." But the court felt this exception limited to "special relationships" such as those with lawyers, fiduciaries, and liability insurers. But a corporate representative of a party to a contract does not have such a special relationship with the other party to the contract. Concluded Judge Hamilton:

"Here, one merchant agreed to sell goods to another. Child Craft's losses flowed only from the receipt of non-conforming goods. Indiana's economic loss rule bars its negligent misrepresentation counterclaim against Bienias, who acted and spoke within his authority as an agent to the principal."