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## N.C. CONSTRUCTION DEFECTS LAW

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## I. Insurance Issues in Construction

Liability policies are typically premised on the following language: “We will pay those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies.”

The insurance applies only if there has been an “occurrence” (or “accident”) during the policy period which results in “property damage or bodily injury” which the insured is “legally obligated to pay” (or, for which it is found “legally liable”).

### A. Occurrence

An “occurrence” or “accident” was been defined by the North Carolina Supreme Court in Tayloe v. Hartford Accident & Indem. Co., 257 N.C. 626, 127 S.E.2d 238 (1962):

“Accident” is defined as “an unforeseen event, occurring without the will or design of the person whose mere act causes it; an unexpected, unusual, or undesigned occurrence; the effect of an unknown cause, or, the cause being known, an unprecedented consequence of it; a casualty.”

In North Carolina Farm Bureau Mut. Ins. Co. v. Stox (1992), the North Carolina Supreme Court added the following language to the definition regarding intentional acts: “We conclude that where the term ‘accident’ is not specifically defined in an insurance policy, that term does include injury resulting from an intentional act, if the injury is not intentional or substantially certain to be the result of the intentional act.”

The following are some of the principle cases in which an “occurrence” was found:

- Nationwide Mut. Fire Ins. Co. v. Banks, 114 N.C. App. 760, disc. review denied, 337 N.C. 695 (1994) (where insured accumulated debris, resulting in damage to a stream, there was an “occurrence,” as insured intended accumulation but did not intend damage to stream.)
- Washington Housing Authority v. North Carolina Housing Authority Risk Retention Pool, 130 N.C. App. 279 (1998) (“While plaintiff’s actions taken in an attempt to manage and maintain the property with plumbing, pest control and grounds keeping were intentional, the resulting damage to the property

occasioned thereby was not”; conduct alleged was an “occurrence” and insurer had duty to defend.)

- York Indus. Center, Inc. v. Michigan Mut. Liability Co., 271 N.C. 158 (1967) (where insured hired surveyor, who made mistake in determining property line, and cut down adjoining landowner’s trees under belief that they were his, the damage was “caused by an unexpected event or happening.”)

The following are some of the principle cases in which an “occurrence” was not found:

- Henderson v. United States Fid. & Guar. Co., 346 N.C. 741, 749 (1997) (where insured-vendor falsely represented that there were no prior water damages to property, there was no occurrence.)
- Holz-Her U.S. Inc. v. United States Fid. & Guar. Co., 141 N.C. App. 127, 130 (2000) (“The business injuries alleged here were either expected or substantially certain to occur. A refusal to lease equipment to a newly-formed company after already allegedly agreeing to do so, even from the viewpoint of Holz-Her, was substantially certain to cause South Bay delays and other consequential business injuries.”; no occurrence.)
- Smith v. Nationwide Mut. Fire Ins. Co., 116 N.C. App. 134 (1994) (insured which sold lots in subdivision, with restrictive covenant limiting use to residential, and then insured built mini-warehouse facility, and insured was sued by other landowners for breach of covenant, injury was substantially certain to occur.)

In the construction context, there is a developing body of case law addressing whether various construction claims involve an “occurrence.”

North Carolina state courts have scant authority on whether there is an “occurrence” when a contractor’s work fails. The federal courts, however, have addressed some of these issues.

In the leading case, it was held that “defective workmanship does not constitute an ‘occurrence.’” In Wm. C. Vick Constr. Co. v. Pennsylvania Nat’l Mut. Cas. Ins. Co., 52 F. Supp. 2d 569, 584, 585 (E.D.N.C. 1999)., the insured-builder was sued by the property owner for the cost of repairing a roof that leaked and a stucco wall that cracked. The court held that because the damage was the result of faulty or defective workmanship, the damage was not the result of

an “occurrence” or “accident”: “The natural and ordinary consequences of improperly applying a waterproofing membrane and failing to apply fiberglass matting in stucco construction could very well be a leaky membrane and cracked walls.”

However, if the damage that results from defective workmanship caused injury to a person (e.g., if a defectively built ceiling fell on a person and injured him) or caused damage to other property (e.g., if the same ceiling fell and caused damage to office furniture), that subsequent damage would be deemed to have resulted from an event deemed an “accident” because the damage to the person or office furniture was an unforeseen and unexpected event. If the ceiling simply cracked or leaked as a natural result of its having been defectively built, there is no coverage for the repair because the defect did not cause an “accident”; it simply failed because it was poorly constructed.

As with the defectively built ceiling, the courts have found that defects in defectively built cabinets were the natural consequence of the poor workmanship, not the result of an “accident.”

Where a sub-contractor was hired to replace stucco siding with a different siding, and the sub-contractor was sued alleging that “in installing the conventional hard-coat stucco, damaged [owner’s] property including damage to driveways, patios, chimneys, painted walls, stone walkways, slate roofs, air conditioners and landscaping,” but the plaintiff made no allegations concerning how the damage occurred, and its counsel acknowledged at oral argument that part of sub-contractor’s work included the effort customarily associated with cleaning up a worksite following application of hard-coat stucco, and claimant did not show that such damage was not the expected consequence of defective or poor workmanship.

Where, however, the insured's work damages other property (i.e. property not constructed by the insured), then there is an occurrence. Even if the damage to other property was foreseeable, it cannot be said that this resulting damage to other property was intended so as to disqualify the incident as an accident. Thus, where defectively installed windows cause water damage to the owner's carpets, there is an "occurrence." And where the defective construction causes a leak which damages office furniture in the building, or where a ceiling falls and causes injury to an occupant, there is an "accident."

One case has held that there may be an occurrence where the damage to the insured's work or product may be due the errors of other sub-contractors, because the damage is not necessarily "foreseeable," "expected," or "intended" from the standpoint of the insured.

Some cases have held, however, that damage to other property is not covered if that damage is foreseeable, or if that damage was "customarily associated" with the insured's work. For example, it has been held that where the insured was hired to remove stucco, and the owners claimed damage to driveways, patios, walkways, roofs and landscaping, there was no occurrence because "part of [insured's] work included the effort customarily associated with cleaning up a worksite following application of hard-coat stucco," because "an 'accident' does not occur when property damage is caused by defective or poor workmanship, because an insured should foresee and expect the resulting damage." Similarly, when defective cabinets must be replaced, the costs incurred in the replacement process (repair to drywall, repaint walls, reinstall sinks) is not an "accident."

#### B. Property Damage

A mere defect in construction is not "property damage." Thus, an unsafe and improperly constructed dam does not constitute "property damage."

There are no other state cases addressing whether various construction defects and resulting losses constitute property damage, but there is an emerging body of federal case law on this issue.

Where the claim against the insured is simply for deficient work, there is no “property damage.” For example, in Vick, where the builder applied a roofing membrane upside-down, resulting in a pitted area, wrinkling, separation of the membrane from the slab, and water leaks, and where a stucco wall developed cracks (not necessarily the result of the leaks), the claims against the builder did not arise from “property damage.” Where the allegations are that “the subject property was never constructed properly in the first place,” there is no property damage.

Damage to property other than the insured’s work, however, is “property damage.” For example, where the contractor’s defective building causes damage to carpets (an “owner furnished material”), there is property damage. The cost to correct the faulty workmanship, however, is not property damage and is not covered.

In a suit against the general contractor, it has been held that where the negligence of one sub-contractor damages other work, there is “property damage.”

One case has held that where the insured’s work may have failed not due to defective workmanship, but rather due to the actions of others, then there may be “property damage.”

Many policies define “property damage” to include loss of use, indicating that the term means:

- (1) Physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or
- (2) Loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Hobson Constr. Co. v. Great American Ins. Co., 71 N.C. App. 586, 590 (1984).

Where the claimant seeks loss of use arising from the insured's defect work, that is covered.

C. Business Risk and other exclusions

Some policies, including the CGL policy, have several exclusions pertaining to "your work" and "your property." These are commonly referred to as "business risk" exclusions.

North Carolina does not have extensive appellate authority on these provisions.

In Western World Ins. Co. v. Carrington, 90 N.C. App. 520 (1988), the court faced an exclusion for "to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith." The insured had been sued for costs incurred in replacing an allegedly defective waterproofing system installed by the insured. Regarding this provision, the court said:

Exclusion (o) is one of several "work product" exclusions found in standardized liability insurance policies. Since the quality of the insured's work is a "business risk" which is solely within his own control, liability insurance generally does not provide coverage for claims arising out of the failure of the insured's product or work to meet the quality or specifications for which the insured may be liable as a matter of contract. The cases interpreting this kind of exclusion recognize, as we do, that liability insurance policies are not intended to be performance bonds. Consequently, courts have uniformly held that the language of exclusion (o) excludes damages sought for the cost of repairing or replacing the insured's own work or product. Here, the record shows that the damages sought against Carrington are those costs incurred in replacing his allegedly defective waterproofing system with an effective waterproofing system. Therefore, the claim is excluded from the policy's coverage.

Defendants contend that exclusion (o) does not apply and cite several cases, . . . . All of the cases cited by defendants, however, are readily distinguishable since they involve claims for damages other than costs for repairing or replacing the insured's defective work or product. . . . The exclusion has also been held inapplicable where the damages sought are for diminution in value of the property or product of which the insured's work or product is merely a part.

In all of those cases, the damages claimed were for damage to property other than that of the insured, which was caused either by the defective work or product, or the need to

repair or replace that work or product. In this case, from the record before us it is clear that Clancy & Theys is not seeking damages for diminution in the structure's value, or costs for repairing the creaking in the concrete, or costs for any damage to its own property caused by the allegedly defective waterproofing. Clancy & Theys' only claim is for costs incurred in substituting or replacing the protective functions which Carrington's original waterproofing work should have provided. The damages sought are solely for bringing the quality of the insured's work up to the standard bargained for. Consequently, the policy provides no coverage for the claim.

Western World, 90 N.C. App. at 523-525.

Our Supreme Court faced an exclusion for “faulty work you performed” in Barbee v. Hartford Mut. Ins. Co., 330 N.C. 100 (1991), in which the insured was sued for damage to a car engine caused by insured’s mechanic’s error. The court held that the claim was excluded by the exclusion.

The general thrust of cases from other jurisdictions is, in accordance with Western World, that *resulting* damage is covered, but the defects in the insured’s work are not covered.

At least one case, in a different context, has seemingly rejected the distinction between the insured’s work and resulting damage.

1. care, custody, control exclusions

Many CGL policies have exclusions for “Property damage’ to (4) Personal property in your care, custody or control.” (Exclusion j.(4)) These provisions are narrowly construed. Most of these cases hold that the exclusion applies only if the item was in the sole possession of the insured.

2. real property, during operations

Many CGL policies have exclusions for “Property damage’ to (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the ‘property damage’ arises out of those operations.” (Exclusion j.(5))

3. real property, after operations

Many CGL policies have exclusions for "Property damage to (6) That particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." "This exclusion does not apply to 'property damage' included in the 'products-completed operations hazard.'"

4. damage to your product arising from it

Many CGL policies have exclusions for "Property damage to 'your product' arising out of it or any part of it." (Exclusion k.) This is similar to the exclusion in Western World Ins. Co. v. Carrington, 90 N.C. App. 520 (1988), for "property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith." The Western World court held that pursuant to this provision, a claim to repair defective construction by the insured is excluded.

For the purpose of this exclusion, a building is a "product."

For this exclusion ("property damage to the named insured's products arising out of such products or any part of such products"), the product of a sub-contractor is deemed to be the work of the contractor.

5. damage to your work arising from it

Many CGL policies exclude "Property damage to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" These further state, "This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." (Exclusion l.)

Regarding this exclusion, it has been held to not apply if the true cause of the property damage is in doubt (i.e. if another sub-contractor's errors may have caused the damage).

An exclusion for “property damage to work performed by the named insured arising out of such work or any portion thereof, or out of such materials, parts or equipment furnished in connection therewith,” excludes claims are based solely on repairing faulty workmanship. Where the insured erects a building with a defective roof (resulting in leaks) and with a stucco wall that cracks, the claims against the builder for repairing the roof and cracks is excluded by this provision.

6.      impaired property

Many CGL policies have an exclusion for “impaired property,” excluding:

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

- (1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work", or
- (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms. (Exclusion m).

The term "impaired property" is defined as follows:

"Impaired property" means tangible property, other than "your product" or "your work", that cannot be used or is less useful because:

- a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or
- b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

- a. The repair, replacement, adjustment or removal of "your product" or "your work"; or
- b. Your fulfilling the terms of the contract or agreement.

This exclusion may have an exception for “the loss of use of other property arising out of sudden and accidental physical injury to ‘your product’ or ‘your work’ after it has been put to its intended use.”

This exclusion does not apply where the mere repairing, replacing of the insured’s work will not restore the owner’s “impaired property.”

An exclusion for damage to "that particular part of any property . . . the restoration, repair or replacement of which has been made or is necessary by reason of faulty workmanship thereon by or on behalf of the insured," applies where the insured-contractor hired a sub-contractor to perform roofing work, which was done improperly resulting in leaking, because the work by a sub-contractor is done “on behalf of” the insured-contractor, and where the repairs complained of were the result of the faulty workmanship.

#### D. \_\_\_\_\_ pollution exclusion

Many policies contain a “pollution exclusion.” Some policies have an exclusion for pollution, with an exception for “sudden and accidental” pollution. These policies are enforced as written, and provide coverage only where the pollution is sudden and accidental. Where the pollution was gradual, the exclusion applies.

Some policies do not limit the pollution exclusion to “sudden and accidental” releases, and these are enforced. For example, where fumes escape from a gas station, causing losses and emotional distress to a nearby restaurant, the exclusion applies.

North Carolina has adopted a rule that the exclusion applies only to “environmental” discharges of pollutants, even where the policy does not have this requirement.

#### E. \_\_\_\_\_ Contractual liability exclusion

There are different types of “contractual” liability which may arise against the insured that raise coverage issues under a CGL policy.

The policy specifically excludes coverage for “liability assumed in a contract.” This generally refers to an assumption of liability by the insured. The provision may state that it excludes “‘Bodily injury’ or ‘property damage’ for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages ... assumed in a contract or agreement that is an ‘insured contract’.” “Insured contract” may be defined as “that part of any other contract . . . under which you assume the tort liability of another party to pay for ‘bodily injury’ . . . to a third person or organization.”

Where the insured is legally required to make a payment, such an exclusion will not preclude recovery by the insured for payments so made.

The provision generally does not exclude the insured’s liability arising from failure to properly perform under a contract. In Bruce-Terminix, the insured was sued for damages arising from his failure to properly detect or remove termites from the claimant’s house, resulting in damage. The Court of Appeals explained that the insured’s liability was not excluded simply because it arose from a contract, stating:

With regard to the claim for breach of contract/warranty, Zurich cites a policy clause which excludes liability coverage for property damage “which the insured is obligated to pay . . . by reason of the assumption of liability in a contract or agreement.” This exclusion is followed by a limitation which states that the exclusion does not apply to liability “the insured would have in the absence of the contract or agreement.” . . . In addition, if the exclusion is interpreted to apply to any liability resulting from contracts between Terminix and its clients, it is contrary to the primary objective of a commercial general liability policy.

Bruce-Terminix Co. v. Zurich Ins. Co., 130 N.C. App. 729, 736 (1998) (emphasis added).

#### 1. Note on Liability arising from Contracts

Many persons in the insurance industry often draw a dichotomy between “negligence” claims and “contract” claims, asserting that negligence claims are covered and contract claims are not. In fact, the policy does not draw this distinction.

A claim for breach of contract, and claims arising from breach of contract, can be covered, as long as the claims have the requisite elements (e.g. bodily injury).

It should be noted, however, that many such contract actions will not contain the essential coverage requirements. For example, there may be no “property damage,” or no “occurrence.”

The second inquiry (assuming that the claim meets the basic coverage requirements) is whether the contract claim is excluded. There are several exclusions which are implicated in these claims. These are often referred to as the “business risk” exclusions.

#### F. Manifestation

Where the injury begins during a policy period, and continues into another policy period, North Carolina has held that only the first policy provides coverage in an occurrence-based policy. This is true even though the insured does not discover the damage until later. Further, coverage under the first policy is provided for the entire loss. North Carolina has thus rejected the “continuous trigger” theory. These issues were decided in the leading case on the trigger of coverage in North Carolina, Gaston Dye. In Gaston Dye, a “pressure vessel” leaked, causing damage to products being made by Sterling Pharmaceuticals on Date A (June 21, 1992). The damage continued until it was discovered on Date B August 31, 1992). One insurer provided coverage on the date of the first injury (Date A); another insurer provided coverage on the date of subsequent injuries and on date of discovery (Date B). The Court held that only the first insurer provided coverage, as follows:

Under the insurance policies at issue in this case, coverage is triggered by "property damage" when the property damage is caused by an "occurrence" and when the property

damage occurs during the policy period. The property damage alleged in this case was the contamination of sixty tons of Iohexol, a contrast media dye used for diagnostic medical imaging, valued in excess of \$20 million. . . .

. . . Stated differently, the "injury-in-fact" in this case can be determined with certainty because the cause of the property damage occurred and property damage resulted on 21 June 1992. Therefore, the 1 July 1991 to 1 July 1992 policy period is triggered, even though the contamination continued until discovery of the leak on 31 August 1992. . . .

. . . [W]here the date of the injury-in-fact can be known with certainty, the insurance policy or policies on the risk on that date are triggered.

Gaston County Dyeing Machine Co. v. Northfield Ins. Co., 351 N.C. 293, 303 (2000).

Where the date of injury is not known, it is not clear whether North Carolina has a manifestation date of discovery, or another rule (e.g. continuous trigger). Gaston Dye overruled some aspects a previous case, which said, "The 'general' rule is that, for insurance purposes, property damage 'occurs' when it is manifested or discovered."

Nevertheless, the reasoning of the previous (that property damage "occurs" upon manifestation or discovery and not upon actual injury) has taken hold in other cases. Some of these are even post-Gaston Dye.

It should also be noted that one case has recently held that where the construction defects that caused the water damage were built outside the policy period, then the claim is not covered.

## II. Statutes of Limitation and Repose.

Construction claims are subject to a statute of limitations and also a statute of repose. This section addresses these two limitations on actions. If the action is not brought within the applicable statute of limitations and statute of repose, then the action is barred in its entirety.

### A. Statute of Limitations.

In North Carolina, an action for breach of contract and an action for negligence have a three year statute of limitations.

The statute of limitations generally begins to accrue (i.e. begin) from the date of the breach or the date of the negligent act. Where the action is not brought within three years, it is barred.

G.S. § 1-52(16) sets forth a discovery rule, stating:

Unless otherwise provided by statute, for personal injury or physical damage to claimant's property, the cause of action, except in causes of actions referred to in G.S. 1-15(c), shall not accrue until bodily harm to the claimant or physical damage to his property becomes apparent or ought reasonably to have become apparent to the claimant, whichever event first occurs.

Further, in the context of improvements to real property, G.S. § 1-50(a)(5)f. states:

For purposes of the three-year limitation prescribed by G.S. 1-52, a cause of action based upon or arising out of the defective or unsafe condition of an improvement to real property shall not accrue until the injury, loss, defect or damage becomes apparent or ought reasonably to have become apparent to the claimant. (Emphasis added).

The statute of limitations is effectively extended, however, where the damage or defect is not readily discoverable. Pursuant to statute, when the damage or defect is not readily discoverable, the statute does not begin to run until the owner of the property knows, or in the exercise of reasonable diligence should know, of the defect or damage.

Many of the appellate cases addressing the statute of limitations focus on whether the claimant knew or should have known of the defect. The cases are somewhat difficult to reconcile.

In one case, for example, the owner sued the builder for defects in glass panels in the building. The building owner's maintenance superintendent supervisor, however, wrote memo

stating that he was “very concerned about this, and rightly so” more than three years before suit was filed. The court held that the claim was barred.

In another case, a building owner became aware of a leaking roof in 1973, but did not file suit until 1981. Pembee Mfg. Corp. v. Cape Fear Constr. Co., 313 N.C. 488, 329 S.E.2d 350 (1985). The Superior Court granted the defendant’s Motion for Summary Judgment, and the Court of Appeals and Supreme Court affirmed. The Court held that the claim accrued in 1973, and was time-barred. The plaintiff attempted to distinguish the initial damage in 1973 (leaking roof) from subsequently discovered damage in 1980 (blistering to roof) in order to save its claim.

The Court rejected this argument as follows:

As soon as the injury becomes apparent to the claimant or should reasonably become apparent, the cause of action is complete and the limitation period begins to run. It does not matter that further damage could occur; such further damage is only aggravation of the original injury.

Pembee, 313 N.C. at 493 (emphasis added). The court also stated, “The fact that further damage which plaintiff did not expect was discovered does not bring about a new cause of action, it merely aggravates the original injury.” Id. at 494.

The Court of Appeals decision, which was affirmed, stated “That further evidence of the defective nature of the roof was discovered in 1980 does not permit plaintiff to circumvent the bar of the statute of limitations.” And, “G.S. 1-52(16) . . . does not change the fact that once some physical damage has been discovered the injury springs into existence and completes the cause of action.”

Other cases holding that claims are barred by the three year statute are as follows:

- suit against builder for moisture retention causing mildew and staining was barred by G.S. 1-52 where forecast of evidence shows that plaintiffs were aware of problems more than three years before action was filed; summary judgment affirmed;

- summary judgment as to contract and negligence claims affirmed where plaintiff admitted that parking deck surface was peeling and water was leaking in 1987, and plaintiff filed suit in 1992;
- "Evidence that New Bern's roof began leaking in 1975 was uncontradicted at the hearing for summary judgment. Thus, its cause of action for injuries arising from the alleged defects accrued in 1975.";
- Defendant built a gymnasium for the plaintiff, and complained to the builder of water leaking from the roof in 1977. The builder attempted to repair the roof, but the leaks did not ultimately stop. "These complaints clearly show that plaintiff knew its roof was defective at least as early as sometime in 1977, even if it was not aware of the extent of the damage. Knowing of the leaks, plaintiff was obligated to inform itself of the nature and extent of the roof's defects.";
- Where house was struck by lightning, claim (against insurer) runs from that date, when walls were scorched and bricks were cracked, and not from notice of cracks in mortar discovered years later, after statute had expired;
- Where the owner know of some damage in 1992, his claim in 1999 was barred, because "Any further damage discovered in 1999, does not permit [the owner] to circumvent the bar of the statute of limitations." "Once some physical damage has been discovered, the [damage or] the injury springs into existence and completes the cause of action."

On the other hand, there are cases coming out the other way. Some cases hold that where the plaintiff had only a suspicion of a problem, the statute did not begin to run. For example, where the plaintiff landowners stopped using the water from their well, but they had not been officially told that their well water was contaminated, and owners were assured by agents of the state on several occasions that their water was not contaminated by gasoline, and owners were doing everything that they could do to get NRCD to continue to test their water, the claim did not begin until they were officially notified of the problem later, because "Prior to the determination by the ACHD that their water was contaminated, the Hills and the Wilsons did not know that they had a cause of action for contamination of their water."

Similarly, even though a well owner noticed the water tasted bad and smelled funny and he did not use the water for drinking or cooking, where he attributed the taste and odor of the

water to the presence of lime in the well, and he was initially told that the water was "okay for use," his claim did not accrue until he received formal notification that his well water was contaminated with benzene. "[A] mere suspicion of contamination will not begin the statute of limitations period."

In the buyer's suit against the seller for water damage, even though plaintiff discovered water intrusion in the garage and living room, and plaintiff hired a painter who inspected the house and notified the buyer that he had worked on the exterior of the house previously, at which time he had painted the exterior of the house, cleaned the roof, and sealed the roof with a "special sealer," and told plaintiff that he had found rot on certain windows and that he had pointed this out to the seller, and that he had noticed seller doing "repair work on the windows quite often," and that, as a result, "he was under the impression that quite a number of windows had water problems," "the evidence . . . allows at least an inference that the alleged damage was not apparent, and should not reasonably have been apparent, to plaintiffs 'based on this information'," where they contend "that they did not discover that their home suffered significant water intrusion damage and construction defects until" later, and that "they did not realize the nature of the defects and the extent of the damage until" later.

B. Statute of Repose.

In actions "arising from damage to real property," there is a six-year statute of repose. If the claim is not brought within this period, then it is barred in its entirety. G.S. § 1-50(a)(5)a. states, "No action to recover damages based upon or arising out of the defective or unsafe condition of an improvement to real property shall be brought more than six years from the later of the specific last act or omission of the defendant giving rise to the cause of action or substantial completion of the improvement."

The first determination is whether the action arises from an “improvement to real property.” In a case involving the construction of a house, this statute of repose will usually apply. There is a “gray zone” in cases where, for example, a fixture is installed into a residence or attached to real property. The general test in determining whether the action arises from an improvement to real property is the intent of the parties. For example, an action arising from the redesign and repair of a chairlift at a ski business is subject to the real property statute. And claims against a manufacturer of floor coverings was subject to this statute.

“When the rights of a third party, who is unconnected to the land or the original transaction involving the annexation of the chattel, are concerned, the question is how the intent of the parties to the transaction is manifested to the third party through ‘physical facts and outward appearances.’” Wilson v. McLeod Oil Co., 327 N.C. 491, 516 (1990) (quoting from ski lift case).

When the statute applies, the six-year period begins to run from the date of substantial completion. Many cases addressing this statute address what constitutes substantial completion.

This term has been defined as follows:

For purposes of this subdivision, ‘substantial completion’ means that degree of completion of a project, improvement or specified area or portion thereof (in accordance with the contract, as modified by any change orders agreed to by the parties) upon attainment of which the owner can use the same for the purpose for which it was intended. The date of substantial completion may be established by written agreement.

G.S. § 1-50(a)(5)(c).

“An owner of a residential dwelling may use it as a residence when the appropriate government agency issues a final certificate of compliance.” Nolan v. Paramount Homes, Inc., 135 N.C. App. 73, 518 S.E. 2d 789, 791 (1999).

Where the action is not brought within six years, the claim is barred.

Some claims may be subject to the products liability statute of repose. For example, a claim relating to underground storage tanks have been held to not be subject to the statute, where the tanks were removed from the land at the termination of the contract and were not a part of the real property at the time this action was filed.

Where the claim is deemed to be a “product liability” action, the statute of repose is six years running from the date of “initial purchase for use or consumption.” G.S. § 1-50(6). Where component parts are purchased by a manufacturer, this is not the “initial purchase for use” of the parts; rather, that occurs when the buyer purchases the manufactured item.

Where the sub-contractor applied synthetic stucco, the statute began to run on the owner’s claim against the manufacturer, rather than when plaintiffs purchased their house. “The EIFS begins to perform this function at the moment of application. The EIFS, therefore, was first ‘purchased for use or consumption,’ by the subcontractor who applied the EIFS to the plaintiffs’ residence. Once the applicator applied the EIFS, it was ‘consumed,’ that is, ‘utilized in the construction process,’ which use resulted in its transformation . . . and the destruction of its original form . . . .” Henderson v. Park Homes, Inc., 147 N.C. App. 500, 504 (2001).

The statute of repose is said to be “absolute.” The owner cannot, unlike with the statute of limitations, effectively extend the statute of repose based on his or her lack of knowledge of the defect. In fact, with respect to a statute of repose, a claim can theoretically be barred even before the injured party is aware of his or her damage.

#### 1. Control Exception

G.S. § 1-50(a)(5)d. states:

The limitation prescribed by this subdivision shall not be asserted as a defense by any person in actual possession or control, as owner, tenant or otherwise, of the improvement at the time the defective or unsafe condition constitutes the proximate cause of the injury or death for which it is proposed to bring an action, in the event such person in actual

possession or control either knew, or ought reasonably to have known, of the defective or unsafe condition.

The “control exception” applies only if the defendant (the defendant raising the repose defense) was in control of the improvement at the time of the injury.

Where the defendant was in control of the property at the time of the injury, the control exception prevents him from raising the statute of repose.

## 2. Fraud or willful and wanton exception

G.S. § 1-50(a)(5)e. states:

The limitation ...shall not be asserted as a defense by any person who shall have been guilty of fraud, or willful or wanton negligence in furnishing materials, in developing real property, in performing or furnishing the design, plans, specifications, surveying, supervision, testing or observation of construction, or construction to an improvement to real property, or a repair...or to any person who shall conceal any such fraud, or willful and wanton negligence.

### C. Common Law Exceptions to Doctrines

As with most defenses, claimants are sometimes able to circumvent the literal and strict application of the rule. Courts have recognized several doctrines to allow a claimant to pursue a claim which would otherwise be barred by the statute of limitations or the statute of repose.

One such doctrine is a doctrine of fraudulent concealment. The cases are not clear on whether this is a viable response to a statute of limitations defense. It has been held that the fraudulent concealment doctrine cannot toll the statute of repose.

A plaintiff can also argue that the defendant is equitably estopped from raising the statute of limitations defense. For example, where the plaintiff hired the defendant construction company to erect a building, and before construction was completed, the clients complained of defects, and the defendant said, "We have found the trouble and made the necessary corrections. . . . My company will be entirely responsible and we will remedy the situation, if it should

occur," and the plaintiff relied upon the promise and did not sue while efforts to correct the structural errors were under way, the builder by its promises, invited the delay and should not complain that the invitation was accepted." *Nowell v. Great Atlantic & Pacific Tea Co.*, 250 N.C. 575, 579 (1959).

The defendant can also apparently be estopped from raising the statute of repose defense. There is, however, a high standard for the plaintiff to meet to invoke this doctrine. Thus, where the builder promised that all windows and doors were inspected and properly flashed, but in fact the windows and doors in the entire house had not been flashed, and the doors and windows did not reveal the presence of any sealant, as required by the manufacturer, but plaintiffs did not offer evidence regarding defendant's knowledge or experience with EIFS, the trial court's determination that estoppel did not apply was affirmed. "Plaintiffs' affidavits . . . failed to show that defendant's actions constituted a 'conscious and intentional disregard of . . . the rights and safety of others.' Plaintiffs failed to produce evidence to raise a genuine issue of material fact to survive summary judgment." *Moore v. F. Douglas Bidby Constr., Inc.*, 161 N.C. App. 87, 93 (2003).

In an action for breach of warranty, it has been held that "A statute of limitations is tolled during the time the seller endeavors to make repairs to enable the product to comply with a warranty." *Haywood St. Redevelopment Corp. v. Harry S. Peterson, Co.*, 120 N.C. App. 832, 837-838 (1995) (where defendant, who waterproofed parking deck, continued to attempt to repair the waterproofing through 30 November 1990 and this action was filed in 1992, well within the three year statute).

The statute of repose for an improvement to real property does not apply to willful and wanton conduct. G.S. § 1-50(a)(5) states:

e. The limitation prescribed by this subdivision shall not be asserted as a defense by any person who shall have been guilty of fraud, or willful or wanton negligence in furnishing materials, in developing real property, in performing or furnishing the design, plans, specifications, surveying, supervision, testing or observation of construction, or construction of an improvement to real property, or a repair to an improvement to real property, or to a surety or guarantor of any of the foregoing persons, or to any person who shall wrongfully conceal any such fraud, or willful or wanton negligence.

See also Forsyth Memorial Hosp. v. Armstrong World Indus., 336 N.C. 438, 446 (1994).

It is not clear what constitutes willful or wanton conduct so as to avoid this provision.

There is generally a high standard to invoke this provision. Thus, where a home owner sued the contractor and drywaller for moisture intrusion from the application of a synthetic stucco product, the evidence was insufficient to preclude the six year statute of repose.

It should also be noted that with respect to the claims of a minor or incompetent person, those claims are “tolled” until the minor attains the age of majority (18 years) or until the incompetent person becomes competent, or until either of them is represented by a guardian.

Another argument which is sometimes made is that the defendant’s conduct was “continuous,” such that the statute of limitations or repose is effectively tolled or extended. The doctrine was initially applied to the malpractice area, in which the courts held:

The continued course of treatment rule, however, applies to situations in which the doctor continues a particular course of treatment over a period of time. The theory is that "so long as the relationship of surgeon and patient continued, the surgeon was guilty of malpractice during that entire relationship for not repairing the damage he had done and, therefore, the cause of action against him arose at the conclusion of his contractual relationship."

Ballenger v. Crowell, 38 N.C. App. 50, 58 (1978).

The courts have been reluctant to apply these doctrines in the construction context.

Where the contractor returns to the structure to make a repair, the statute of repose does not start

running again. In Monson v. Paramount Homes, Inc., 133 N.C. App. 235, 515 S.E.2d 445 (1999), the court said:

To allow the statute of repose to toll or start running anew each time a repair is made would subject a defendant to potential open-ended liability for an indefinite period of time, defeating the very purpose of statutes of response such as N.C. Gen.Stat. 1-50(5).

“A ‘repair’ does not qualify as a ‘last act’ under N.C.G.S. § 1-50(5) unless it is required under the improvement contract by agreement of the parties.”

In Monson, subsequent owners of a synthetic stucco home brought an action against Paramount Homes, a general contractor, for defective construction. Paramount filed a third-party complaint against Carolina Builders Corporation ("CBC") seven years and two months after the house was completed. CBC had repaired and replaced several of the windows and doors at the plaintiff's request four years after the house was completed. CBC moved to dismiss the third-party complaint on the grounds that Paramount's claims were time-barred under the statute of repose.

In another case, addressing the six year limitation but not directly addressing the “control exception,” the Court of Appeals rejected an argument that the developer-builder of a condominium had a “continuing duty” toward the unit owners and association due to continued ownership in units which were not at issue in the suit.

Where there is a re-newing trespass, those claims for damages occurring more than three years before the filing of the complaint are barred, but the claims for damages occurring within three years of the filing of the complaint are still actionable.

### III. Nature of Claim Against Contractor (and Manufacturers)

There are several claims which can arise against a general contractor. This article does not address those claims between the contractor and subcontractors for payment for services, and does not address the lien statutes (such as the materialmen's lien). The contractor can be sued by various parties, including the property owner, a third party who sustained an injury, and by a subcontractor.

A. Suit by Property Owner

The owner of the property can sue the general contractor for any defects in the contractor's work.

1. Express Contractual Term

The most obvious defect would be if the general contractor were to simply fail to meet the terms of the express agreement. For example, if the contractor did not complete construction on time, or if it did not use the appropriate materials, then it would be liable in damages for breach of contract to the owner. Determining whether such a breach occurred will generally involve a detailed examination of any plans and specifications, and any subsequent modifications or subsequent work orders that were prepared.

However, where the general contractor complied with the owner's architect's specifications, it cannot be liable. “[W]here a contractor is required to and does comply with the plans and specifications prepared by the owner or the owner's architect, the contractor will not be liable for the consequences of defects in the plans and specifications.” Burke County Public Schools Bd. of Education v. Juno Constr. Corp., 50 N.C. App. 238, 241 (1981) (also stating: “Where the contractor does not comply with the plans and specifications provided by the owner, notwithstanding the fact that they are defective, the contractor proceeds at his peril, assuming the risk of any deviations from the plans and guaranteeing the suitability of the work.”). Thus,

where a roof fails not due to the contractor's breach, but due to the architect's poor design, then the contractor is not liable. Burke County.

Similarly, where the owner hires an architect to plan the project and to assure compliance with those plans, and the architect and the owner sign a Certificate of Completion stating that the work was completed in accordance with the requirements of the plans, and the wiring was done in accordance with the plans, and a fire later destroys a portion of the project, the claim against the general contractor alleging a loose connection in the busway joint that the contractor constructed and installed was properly dismissed because the general contractor had followed the plans. There was no breach of contract, and moreover any breach could have been discovered by the owner in the exercise of reasonable diligence. The architects and the engineer were agents of the client and their knowledge, including observation of the work as it progressed, was imputed to the client.

In a related vein, where work is accepted by the owner with knowledge that it has not been done according to the contract or under such circumstances that knowledge of its imperfect performance may be imputed, the acceptance will generally be deemed a waiver of the defective performance. But this rule does not apply to latent defects.

The builder is liable for any express warranties it made to purchasers.

Where the express warranty limits recovery under the warranty, those limitations are enforced. For example, where the warranty provides that the contractor will repair the defects, the owner is limited to that recovery, and is not entitled to recover the cost of repair. Similarly, a time limitation for submitting a claim for an express warranty is binding.

In order to create an express warranty, the terms must be sufficiently clear. Where, for example, the seller of real property states that water found in crawl space under a newly

constructed house was "probably" left over from construction and that it "should" dry up in a short time, that everything had been covered over and that water "couldn't get in there any more" and that the contractor was a "good contractor" and built "good homes" that were "substantial," it did not create an express warranty either that house would be constructed in workmanlike manner when completed or, specifically, that water in the crawl space would create no problems. Griffin v. Wheeler-Leonard & Co., Inc., 290 N.C. 185, 225 S.E.2d 557 (1976). On the other hand, where the builder said he was "a builder of high quality homes," that "this home was to be a Parade home," that this house was intended for display, that "The lumber was nice and clean, very little knots," and "the quality of the home in Hope Valley was exactly the same as the quality of the home" they bought "in materials and workmanship," there was sufficient evidence of a breach of express warranty. Lindstrom v. Chesnutt, 15 N.C. App. 15, 24-25 (1972).

In order for the buyer to recover, he is generally required to show that he relied on the express warranty.

A claim based on express warranty may extend beyond the original parties to the warranty.

## 2. Implied Contractual Term

The other type of contractual claim which can arise is for an implicit contract term. In many contexts, courts will sometimes impose implied terms where it is equitable to do so. In the context of commercial construction, there are not many North Carolina cases addressing implicit terms on the general contractor relating to its work. The parties will generally be bound by the terms of the agreement.

In the residential context, our courts have held that the contractor impliedly warrants that the house is constructed in conformity with the building code.

In the commercial context, however, the cases do not use this terminology. They do say, however, that it is “negligence per se” for the builder to not build in conformity with the code. As indicated earlier, however, the owner’s claim against the builder will usually be for contract, and not for negligence, and hence it is not clear how a building code violation affects the owner’s claim.

It would seem, however, that the builder impliedly warrants that the structure is built in conformity with the code, such that a code violation is actionable. “[T]he Code imposes liability on any person who constructs, supervises construction, or designs a building or alteration thereto, and violates the Code such that the violation proximately causes injury or damage.” Olympic Products Co., Div. of Cone Mills Corp. v. Roof Systems, Inc., 88 N.C. App. 315, 329 (1988) (discussing owner’s contributory negligence, where owner hired defendant to build roof, which failed, leaked and ultimately collapsed; citing case pertaining to owner’s liability).

“However, to impose liability for such a violation it must be established that the violation was a proximate cause of the alleged injury.” Federated Mut. Ins. Co. v. Hardin, 67 N.C. App. 487, 489 (1984) (owner’s failure to obtain permit was not proximate cause of fire; rejecting contractor’s argument that presence of county inspector would have prevented defect).

a) Implied Warranty New Home

In the context of residential construction, our courts have adopted an implied warranty of habitability. The leading case on this issue in North Carolina is Hartley v. Ballou. In that case, the Court essentially held that when a person in the business of constructing homes builds a new home for a consumer, the builder-vendor impliedly warrants that the house is free from major structural defects. The court stated:

In every contract for the sale of a recently completed dwelling, and in every contract for the sale of a dwelling then under construction, the vendor, if he be in

the business of building such dwellings, shall be held to impliedly warrant to the initial vendee that, at the time of the passing of the deed or the taking of possession by the initial vendee (whichever first occurs), the dwelling, together with all its fixtures, is sufficiently free from major structural defects, and is constructed in a workmanlike manner, so as to meet the standard of workmanlike quality then prevailing at the time and place of construction; and that this implied warranty in the contract of sale survives the passing of the deed or the taking of possession by the initial vendee.

Hartley v. Ballou, 286 N.C. 51, 62, 209 S.E.2d 776, 783 (1974).

Numerous cases have had to address what constitutes a breach of this implied warranty. In Ballou, the evidence was sufficient to support a finding that the builder-vendor breached an implied warranty that the house had “been sufficiently waterproofed, in accordance with the standards of workmanlike quality then prevailing in that area, to prevent water leakage under normal weather conditions.” The plaintiff could recover for inconvenience during the time that the defendant conducted repairs to the property, but not for the time subsequent repairs were made for damage that resulted from a hurricane. “[S]uch implied warranty falls short of an absolute guarantee that the waterproofing was sufficient to protect the basement area from damage by water in the event of hurricanes or other extreme weather conditions.”

It is not clear what is encompassed within the implied warranty of habitability. For example, a house can breach the warranty even where it is livable. This doctrine is applied on a case-by-case basis.

North Carolina cases have held as follows regarding implied warranties:

- The implied warranty includes a warranty that there will be an “adequate supply of usable water,” which is “absolute essential utility to a dwelling house.”
- The septic tank comes within the implied warranty.
- A fireplace and chimney must adequately remove smoke.

- Where the foundation is not sufficiently waterproofed, and the window sashes of several windows failed to stay up properly and water passed under the garage door whenever it rained “fairly hard,” there was a breach.
- A defective air conditioning system is a major structural defect.
- Where there were numerous cracks in the interior and exterior of house, including cracks in the floor, foundation wall, and sheetrock, and foundation did not conform to the minimum requirements of the building code and plans, the construction of the foundation created a “major structural defect.”
- Synthetic stucco cladding (EIFS) which did not resist moisture may constitute a breach of implied warranty.

“The implied warranty of the builder-vendor does not extend to defects of which the purchaser had actual notice or which are or should be visible to a reasonably prudent man upon an inspection of the dwelling.” *Griffin v. Wheeler-Leonard & Co., Inc.*, 290 N.C. 185, 200-01, 225 S.E.2d 557, 567 (1976).

One of the other issues that our courts have not thoroughly fleshed out all is the issue of time. Our courts have held that the implied warranty of habitability extends to a “newly constructed dwelling” for a “reasonable” time, but they have not set forth any clear guidelines on what is a “reasonable” time. “Among some of the factors which may be considered in determining this question are the age of the building, the use to which it has been put, its maintenance, the nature of the defects and the expectations of the parties.” *Gaito v. Auman*, 313 N.C. 243, 250, 327 S.E.2d 870, 876 (1985). An air conditioner which was installed four and one-half years prior to sale may be covered by the warranty.

Also, our courts have recently stated that it is possible, in certain circumstances, to disclaim an implied warranty: If parties to a contract desire to disclaim the implied warranty, they may do so, but the disclaimer must be made with clear, unambiguous language that reflects the fact that the parties fully intended to disclaim the implied warranty. The exclusionary

language must be very specific; e.g., even the following language failed: “Other than the Expressed Warranties contained herein, there are no other warranties expressed or implied including Implied Warranty of Merchantability or Implied Warranty for Particular Purpose, which implied warranties are specifically excluded,” “This language does not clearly and unambiguously show that both parties intended to exclude the implied warranty of habitability or workmanlike quality of construction.”

In the commercial context, the law seems to recognize the right of the parties to waive implied warranties.

#### b) Privity Issues

As discussed in a later section, a claim for implied warranty generally requires that the parties be in privity. Therefore, as a general rule, the home owner can sue the builder for implied warranty only if he is in privity with the builder. As noted in the negligence section, however, North Carolina recognizes a negligence action against the builder by a subsequent purchaser.

#### 3. Defenses

If a defect or nonconformity is shown by the plaintiff, the defendant may, of course, raise various defenses. The defendant would obviously be entitled to a statute of limitations or statute of repose defense in an appropriate case. Similarly, the defendant may be able to raise as a defense a breach of contract by the plaintiff, such as a non-payment by the plaintiff.

#### 4. Damages

If a breach of contract is shown, the contractor is liable for the damages resulting from the breach of contract. In the context the implied warranty for a new home, it has been said:

Where, however, there is a breach of the implied warranty, the vendee can maintain an action for damages for such breach “either (1) for the difference

between the reasonable market value of the subject property as impliedly warranted and its reasonable market value in its actual condition, or (2) for the amount required to bring the subject property into compliance with the implied warranty.”

Griffin v. Wheeler-Leonard & Co., Inc., 290 N.C. 185, 200-01, 225 S.E.2d 557, 567 (1976)

(quoting Ballou).

The general measure of damages for a non-conforming construction project would be the cost to render the project in conformity with the contractual terms. The only exception to this is where the repair would require that “a substantial portion of the work completed be destroyed. In such case, the diminution in value method may be the better measure of a party's damages.”

Kenney v. Medlin Constr. & Realty Co., 68 N.C. App. 339, 344 (1984).

It should be noted that where the owner has a claim for negligence (such as where the contractor's work damages other property), then the normal measure would be diminution in value. "In cases where the injury [to real property] is completed or by a single act becomes a fait accompli, and which do not involve a continuing wrong or intermittent or recurring damages, the correct rule for the measure of damages is the difference between the market value of the property before and after the injury." Paris v. Aggregates, Inc., 271 N.C. 471, 157 S.E. 2d 131 (1967).

The plaintiff/owner is also under a duty to mitigate his damages. The burden is on the defendant to show those damages which could have been avoided if the plaintiff had taken appropriate steps to minimize his losses.

a) Consequential Damages

The plaintiff may also seek recovery beyond the mere repair of its structure. It may, for example, assert a claim for lost profits or loss of use arising from the non-conformity. The

general measure for these damages is whether these damages were within the “contemplation of the parties” at the time the contract was entered.

[W]hen the action is for a breach of contract, the damages recoverable are such as naturally flow from the breach, and such special or consequential damages as are reasonably presumed to have been within the contemplation of the parties at the time they made the contract, as the probable result of a breach of it. In ascertaining what damages come within the rule, it is proper to examine, not only the terms of the contract, the subject-matter, etc., but also to inquire whether such circumstances or conditions as produced special damages were communicated to the defendant. We apprehend that the same rule prevails when an action in the nature of tort is brought for the breach of a duty arising out of contract, . . .

Story v. Stokes, 178 N.C. 409, 413 (1919).

Similarly, other losses, such as clean-up costs resulting from a breach, are recoverable.

In a case for breach of contract, the plaintiff would be entitled to pre-judgment interest at the rate of 8% per year, running from the date of the breach.

#### b) Bodily Injury

An individual homeowner may also have a claim for personal injuries arising from the breach of contract. For example, we are now seeing sporadic claims by homeowners alleging that they have sustained bodily injury as a result of mold in their residences, due to a defect in construction which has allowed the penetration of water. Our courts have not thoroughly addressed the extent to which a homeowner may assert a claim for bodily injury based on a breach of contract by the contractor.

#### 5. Negligence.

The owner (i.e. the first person owning the property, who contracted with the contractor) will sometimes assert a claim of “negligence” against the contractor. Our courts have, however, severely limited the extent to which an owner can sue the person with whom he contracted in negligence. The leading case on this issue in North Carolina is Ports Authority v. Lloyd A. Fry.

In this case, the North Carolina Supreme Court essentially held that where two parties contract for the construction of a structure, the owner cannot sue the contractor for defects under a theory of negligence, unless the case falls into one of four categories. As stated by our Supreme Court, “Ordinarily, a breach of contract does not give rise to a tort action by the promisee against the promisor.” In Ports Authority, the plaintiff hired the defendant-general-contractor to build two buildings. The general contractor hired a sub-contractor to build the roofs. The plaintiff then sued the general contractor and the sub-contractor for leaks in the roof. The Supreme Court affirmed summary judgment for the General Contractor against the plaintiff on the negligence claims, stating:

In the present case, according to the complaint, Dickerson contracted to construct buildings, including roofs thereon, in accordance with agreed plans and specifications. It is alleged that Dickerson did not so construct the roofs. If that be true, it is immaterial whether Dickerson's failure was due to its negligence, or occurred notwithstanding its exercise of great care and skill. In either event, the promisor would be liable in damages. Conversely, if the roofs, as constructed, conformed to the plans and specifications of the contract, the promisor, having fully performed his contract, would not be liable in damages to the plaintiff even though he failed to use the degree of care customarily used in such construction by building contractors. Thus, the allegation of negligence by Dickerson in the second claim for relief set forth in the complaint is surplusage and should be disregarded. Consequently, the only basis for recovery against Dickerson, alleged in the complaint, is breach of contract and the Court of Appeals was in error in its view that the complaint "alleges an action in tort" against Dickerson.

Id., 294 N.C. at 83, 240 S.E.2d at 351.

Regarding the exceptions to the doctrine, the Court wrote:

[T]here are many decisions of this and other courts holding a promisor liable in a tort action for a personal injury or damage to property proximately caused by his negligent, or wilful, act or omission in the course of his performance of his contract. However, such decisions by this Court, which have been brought to our attention, appear to fall into one of four general categories:

- (1) The injury, proximately caused by the promisor's negligent act or omission in the performance of his contract, was an injury to the person or property of someone other than the promisee.

(2) The injury, proximately caused by the promisor's negligent, or wilful, act or omission in the performance of his contract, was to property of the promisee other than the property which was the subject of the contract, or was a personal injury to the promisee. See: Insurance Co. v. Sprinkler Co., supra (promisee's merchandise damaged by water as the result of negligence in the installation of a sprinkler system); Jewell v. Price, supra (promisee's house burned as the result of negligence in the installation of a furnace); Toone v. Adams, supra (baseball umpire injured by an irate spectator allegedly due to the Club owner's failure to supply adequate protection); Shearin v. Lloyd, supra (medical malpractice).

(3) The injury, proximately caused by the promisor's negligent, or wilful, act or omission in the performance of his contract, was loss of or damage to the promisee's property, which was the subject of the contract, the promisor being charged by law, as a matter of public policy, with the duty to use care in the safeguarding of the property from harm, as in the case of a common carrier, an innkeeper or other bailee. See: Insurance Co. v. Parker, 234 N.C. 20, 65 S.E. 2d 341 (1951) (automobile stolen from a parking lot inviting public patronage).

(4) The injury so caused was a wilful injury to or a conversion of the property of the promisee, which was the subject of the contract, by the promisor. See: Williamson v. Dickens, supra (conversion of notes by a bailee for collection); Simmons v. Sikes, 24 N.C. 98 (1841) (conversion or wilful destruction of a canoe by a bailee).

It may well be that this enumeration of categories in which a promisor has been held liable in a tort action by reason of his negligent, or wilful, act or omission in the performance of his contract is not all inclusive. However, our research has brought to our attention no case in which this Court has held a tort action lies against a promisor for his simple failure to perform his contract, even though such failure was due to negligence or lack of skill.

North Carolina State Ports Authority v. Lloyd A. Fry Roofing Co., 294 N.C. 73, 81-83 (1978).

This doctrine has been applied to a claim where the plaintiff sued the defendant for negligence in the construction and installation of a mobile home. Similarly, where the builder was sued for damages arising from the presence of beetles in wood, the negligence claim was dismissed.

Further, it has been held that a violation of the building code does not give rise to a tort claim by the owner.

Thus, in a routine construction case, where there is no damage to other property, and where there is no bailment or no common carriage of goods or persons, the courts generally restrict the owner's theory to one of breach of contract.

In those cases in which the general contractor can be sued for negligence, one will have to consider the issues peculiar to that claim, such as whether the negligence of a sub-contractor is imputed to the general contractor. This issue is discussed in a succeeding section.

Also, the plaintiff-owner may be contributorily negligent. For example, where the buyer of a house is signed a synthetic stucco disclosure, and prior to closing they received a copy of an inspection report that disclosed at least one area of high moisture intrusion and two areas of medium moisture intrusion, their failure to engage the services of a qualified inspector to inspect the synthetic stucco before they purchased the townhouse constituted contributory negligence as a matter of law, barring their negligence claim against the seller. Also, where the owner should detect a violation of the building code, it will be negligent per se, negating its claim against a contractor.

#### a) Damages

With regard to negligent damage to property, the rule has been stated as follows:

With regard to the plaintiffs' claim for negligent damage to real property, the general rule is that where the injury is completed (as opposed to a continuing wrong) the measure of damages "is the difference between the market value of the property before and after the injury." Nonetheless, replacement and repair costs are relevant on the question of diminution in value and when there is evidence of both diminution in value and replacement cost, the trial court must instruct the jury to consider the replacement cost in assessing the diminution in value.

Huberth v. Holly, 120 N.C.App. 348, 353, 462 S.E.2d 239, 243 (1995).

The Plaintiff can also recover those damages proximately caused by the negligence, including lost profits in an appropriate case.

Notwithstanding the “economic loss rule” discussed *infra* regarding claims against manufacturers, which generally prohibits a party from suing the maker of a product for damages to that product for negligence, there is one North Carolina case which seems to allow for recovery for damage to the house against the builder of the house upon a negligence theory.

In Oates v. Jag, Inc., 314 N.C. 276, 277, 333 S.E.2d 222, 223-24 (1985), the court stated, “The precise issue to be answered in this appeal is whether an owner of a dwelling house who is not the original purchaser has a cause of action against the builder and general contractor for negligence in the construction of the house, when such negligence results in economic loss or damage to the owner. We conclude that such a cause of action exists.” This ironic because the initial purchaser would not have had a negligence action. In Warfield v. Hicks, et al., 91 N.C. App. 1, 370 S.E.2d 689 (1988), the Court of Appeals strictly limited the range of Oates to subsequent home purchases and upheld the general rule that claims of a contractual nature cannot be brought as tort actions:

In Oates, the Court did recognize, without discussing Ports Authority, that such a cause of action exists in favor of an owner who is *not the original purchaser*. However, nothing in that decision suggests an intent to overrule the Court's earlier holding in Ports Authority with respect to claims by the initial purchaser. We therefore presume that the Court intended to leave that holding intact, and to merely recognize a means of redress for those purchasers who suffer economic loss or damage from improper construction but who, because not in privity with the builder, have no basis for recovery in contract or warranty. (emphasis in original)

Id. at 10, 370 S.E.2d at 694.

Furthermore, the Oates court went on to establish the existence of a negligence claim for the plaintiff based on the defendant’s actions outside of any contractual obligations owed to the

plaintiff, i.e., the court found that the defendant breached general duties owed irrespective of contractual duties, which allows for a negligence claim irrespective of the contract claim.

Note that in a recent unpublished opinion, the Court of Appeals has upheld both the general rule that a tort action does not arise out of contractual obligations or duties (versus common law duties, such as in Oates) and that the economic loss rule bars tort actions.

#### 6. Negligent Misrepresentation.

A contractor (or sub-contractor) may also be sued for negligent misrepresentation.

Regarding such a claim in this context, our courts have adopted the Restatement position, which states:

One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if

(a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting, and

(b) the harm is suffered

(i) by the person or one of the class of persons for whose guidance the information was supplied, and

(ii) because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.

Davidson and Jones, Inc. v. New Hanover County, 41 N.C.App. 661, 669, 255 S.E.2d 580, 585 (1979).

In order to prevail, the plaintiff must have reasonably relied upon the information.

#### 7. Fraud

Similarly, homeowners sometimes assert a claim in fraud against the contractor. The elements of fraud are:

(1) That defendant made a representation relating to some material past or existing fact; (2) that the representation was false; (3) that when he made it, defendant knew that the representation was false, or made it recklessly, without any knowledge of its truth and as a positive assertion; (4) that defendant made the representation with intention that it should be acted upon by plaintiff; (5) that plaintiff reasonably relied upon the representation, and acted upon it; and (6) that plaintiff thereby suffered injury. A false representation is material when it deceives a person and induces him to act.

Keith v. Wilder, 241 N.C. 672, 675 (1955).

Thus, where the seller of land misrepresents the tobacco allotment on the land, the buyer has a claim for fraud.

In a more recent case involving residential construction, the builder warranted that the homes were built in accordance with the plans, but there was evidence that they were not, and the houses developed cracks. The lower court found that the builder "falsely represented to . . . Plaintiffs that [Plaintiffs' house] had been constructed in substantial conformity with plans and specifications approved [for the house]." The jury found that the builder committed fraud, and the appellate court affirmed, stating:

In this case, Plaintiffs presented evidence regarding cracks in approximately thirty other houses constructed by Roberts Construction between 1994 and 1996. These other houses were constructed using the same slab on grade method used by Roberts Construction to construct Plaintiffs' house, and Wilson testified these houses contained cracks in their foundations and floors that were similar to the cracks found in Plaintiffs' house. Additionally, Wilson testified that, similar to Plaintiffs' house, these other houses did not meet various building code standards for average PSI, concrete thickness, and compaction below the slab. Based on this evidence of cracks in the floors and foundations of these other houses, a reasonable person could find Roberts Construction had actual knowledge of structural defects in Plaintiffs' house at the time Plaintiffs purchased their house. Accordingly, the trial court properly denied Defendants' motion for a directed verdict on the issue of fraud.

Allen v. Roberts Constr. Co., 138 N.C. App. 557, 567-568 (2000).

Where there is no evidence of an intent to deceive, there is not a fraud claim. For example, where the builder-vendor said that there would not a problem with wooden

beams infested with beetles, “the plaintiffs' evidence taken in the most favorable light shows merely that Mr. Hicks made a general unspecific statement of opinion about the potential future consequences of using beetle infested beams and does not support a reasonable inference that he intended to deceive or mislead the Warfields.” Warfield v. Hicks, 91 N.C. App. 1, 8 (1988)

Many cases, however, deny a fraud claim where the plaintiff's reliance is not reasonable.

#### 8. Unfair and Deceptive Acts or Practices

Some plaintiffs also allege that the contractor's conduct constitutes unfair and deceptive acts and practices, in violation of Chapter 75 of the North Carolina General Statutes. A violation of this statute would entitle the plaintiff to treble damages, in addition to potentially recovering their attorney's fees. This law has been summarized as follow:

N.C. Gen. Stat. Sec. 75-1.1(a) . . . declares unlawful "unfair or deceptive acts or practices in or affecting commerce." . . . A "practice is unfair when it offends established public policy as well as when the practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers." In essence, "[a] party is guilty of an unfair act or practice when it engages in conduct which amounts to an inequitable assertion of its power or position." The concept of "unfairness" is broader than and includes the concept of "deception." An act or practice is deceptive "if it has the capacity or tendency to deceive." The facts surrounding the particular transaction and the impact the practice has in the marketplace determine whether a particular act is unfair or deceptive. Further, "[i]n determining whether a representation is deceptive, its effect on the average consumer is considered.

Warfield v. Hicks, 91 N.C. App. 1, 8-9 (1988).

In the Warfield case, the builder informed the buyers that the beetle infestation of the ceiling beams would pose no problems other than a little sawdust. In fact, the house could not pass a pest inspection and that, as a consequence, it potentially would be difficult for them or future buyers to obtain financing on the house, and house had diminished value.

Further, the buyers contested some of the change orders at trial, contending that certain items were included in the original plans and should not have been denominated "extras," that the buyers felt coerced into signing the orders by financial pressures and fear of delays in construction, and that some of the punchlist items were never completed and that various other defects or problems discovered during the warranty period were not remedied by the builder, despite his representations that they would be. The court held that the Chapter 75 claim was properly dismissed:

In the present case, the Warfields presented testimony of Mr. Butts that he had told both defendant Hicks and the Warfields that the beams "had been infested at one time or another" with beetles. Mr. Warfield testified that when he asked Hicks about the matter, Hicks merely responded that he had had an old piece of furniture in his house for years that had dust beetles in it, that they just made a little bit of sawdust, and that the beetles were not a problem. Applying the foregoing criteria to these facts, we find that the alleged representation by Mr. Hicks simply does not rise to the level of oppressive, unscrupulous, or deceptive conduct which would constitute an unfair or deceptive act or practice within the intended purview of N.C. Gen. Stat. Sec. 75-1.1. Nor does our review of the record disclose the existence of any other facts which would establish a violation of the statute.

Warfield v. Hicks, 91 N.C. App. 1, 9 (1988).

In Allen v. Roberts Constr. Co., 138 N.C. App. 557, 569 (2000) ("Proof of fraud necessarily constitutes a violation of the prohibition against unfair and deceptive acts"), the court held that where the builder's actions constituted fraud, they also constituted a violation of chapter 75. In the same case, the court held that the Chapter 75 judgment against the individual (owner of general contractor) was supported where he "conceal[ed] material facts relevant to [Plaintiffs' house] from . . . Plaintiffs which he knew at the time of purchase that . . . Plaintiffs could not discover in the exercise of due diligence" and "falsely represented to . . . Plaintiffs that [Plaintiffs' house] had been constructed in substantial conformity with plans and specifications approved [for the house]."

## 9. Indemnity

The owner may also have a claim against the contractor for indemnity. Where, for example, the owner incurs liability to a third person arising from a defect on the property, then the owner theoretically should have a common-law indemnity claim against the contractor. Unfortunately, our North Carolina case law is not very well developed on this point. In addition, the owner may have a contractual indemnity provision in his contract with the contractor. These provisions, however, have generally been struck down by our courts as violating G.S. § 22B-1.

### B. Claims by Third Person.

A “third party” may also have a claim against the contractor. In this section, third party refers to any person other than the parties originally contracting for the construction of the structure.

#### 1. Bodily Injury Claims by Third Persons.

A person who sustains an injury on the property will sometimes assert a claim against the contractor.

A persons injured by a contractor can sue the contractor for negligence even notwithstanding the absence of a contract with the contractor. “[P]rivity of contract is not required in order to recover against a person who negligently performs services for another and thus injures a third party.” Olympic Products Co., Div. of Cone Mills Corp. v. Roof Systems, Inc., 88 N.C. App. 315, 322 (1988). Thus, a pedestrian may have a claim for injuries arising from the contractor’s work.

#### a) Completed and Accepted Doctrine

Where the work has been completed by the contractor and accepted by the owner, a claim by a third person will generally be barred by the “Completed and Accepted” Doctrine. Pursuant

to this doctrine, where the contractor builds a structure, and the owner accepts the structure without any objection, then the contractor is relieved of any further potential liability. The theory is that beyond this transaction, the contractor had no control over the property. This doctrine has been described as follows:

In North Carolina, the "completed and accepted work" doctrine provides that "an independent contractor is not liable for injuries to third parties occurring after the contractor has completed the work and it has been accepted by the owner." [T]he contractor is not liable even if the contractor "was negligent in carrying out the contract." There are exceptions by which a contractor may be liable even after it has turned over the completed work. Among the exceptions is the so-called "imminently dangerous" work exception. Plaintiff argues that defendant remains liable here because it turned over work to the State that was "imminently dangerous." . . . "contractor is liable . . . where the work done and turned over by him is so negligently defective as to be imminently dangerous to third persons, provided, . . . the contractor knows, or should know, of the dangerous situation created by him, and the owner or contractee does not know of the dangerous condition or defect and would not discover it by reasonable inspection". Our Supreme Court has stated that an object is "imminently dangerous" if injury will reasonably occur when the object is used for its declared purpose. Other courts have stated that to be imminently dangerous, "'there must be knowledge of a danger, not merely possible, but probable.'" Black's Law Dictionary defines an "imminently dangerous article" as "one that is reasonably certain to place life or limb in peril."

Nifong v. C.C. Mangum, Inc., 121 N.C. App. 767, 769 (N.C. App. , 1996).

In Nifong, an injured party filed suit against the contractor after sustaining an injury as a result of a vehicle accident on a road constructed by the contractor pursuant to a state contract. The injured party's expert witness testified that the contractor turned over work that was imminently dangerous because it created a hazardous hydroplaning condition. The court affirmed summary judgment for the contractor, as follows:

Regardless of whether defendant knew or should have known of a difference between the road as constructed and the road as designed, plaintiff has failed to present any forecast of evidence to show that defendant's work was imminently dangerous. Don Moore's opinion that the difference in the transition of the curve created a hazardous hydroplaning condition does not show that defendant turned over to the State work that was imminently dangerous. Because we have

determined that plaintiff failed to forecast evidence to bring her claim within the "imminently dangerous" work exception to the "completed and accepted work" doctrine, we conclude that defendant owed no legal duty to plaintiff under the "completed and accepted work" doctrine.

Nifong v. C.C. Mangum, Inc., 121 N.C. App. 767, 770 (1996).

This doctrine does not necessarily apply beyond the true construction context. For example, where the defendant supplied ice to a grocery store, and in doing so left water on the floor, even though the grocery store had accepted the work and product of the ice delivery company, a person injured by slipping on the water could nevertheless maintain an action against the ice delivery company.

#### b) Third-Party Beneficiary

A plaintiff may sometimes argue that he or she is a "third-party beneficiary" of the original contract, such that he or she can sue for breach of the construction contract. In general, our courts have rejected this argument.

In Matternes v. City Of Winston-Salem, 286 N.C. 1, 15 (1974), accident victims filed an action against defendant (a city), seeking to recover damages for injuries when an automobile skidded on an accumulation of snow and ice and plunged off a bridge. The defendant had a contract with the Board of Transportation to maintain the highway. The court held that the plaintiffs were merely incidental beneficiaries of the contract and could not maintain an action against the city for breach of its terms.

#### c) Liability for Subcontractors' Work

The general contractor will generally not be liable in negligence for the acts of its independent contractors. As discussed in more detail in the next section, a general contractor is generally not liable for the torts (i.e. negligence) of a subcontractor.

## 2. Claims by Workers During Construction.

Where the general contractor is negligent and injures a worker, it may be held liable to the sub-contractor's employee. Thus, where it provides a ramp which does not comply with OSHA, the worker may sue the contractor.

The contractor's own employee cannot sue the employer due to the workers compensation laws, unless the employer was "grossly negligent."

a) Liability for Subcontractor's Negligence

"Generally, one who employs an independent contractor is not liable for the independent contractor's negligence unless the employer retains the right to control the manner in which the contractor performs his work." Woodson v. Rowland, 329 N.C. 330, 350, 407 S.E.2d 222, 234 (1991). The Court in Woodson relied on Mack v. Marshall Field & Co., 218 N.C. 697, 12 S.E.2d 235, 236 (1940), which held that the property owner "was in nowise liable for the negligence of either of [the independent contractors], and was liable only for such of its own negligence, if any, as contributed to the death of the plaintiff's intestate," which was caused by an electrical wire on the jobsite.

"If the negligence which caused the injury was that of the injured person's own employer, and it is found as a fact that his employer was an independent contractor, the general contractor is not liable for the injury unless he or his own employees participated in the negligent act." Rivenbark v. Atlantic States Constr. Co., 14 N.C. App. 609, 611 (1972). Where a plaintiff was injured when a ditch caved in on him while working for his employer (sub-contractor), and general contractor had no control over the manner or work methods used to perform this job, contractor was entitled to summary judgment. And where the contractor hired a subcontractor to string television cable, and the subcontractor's employee was killed when a truck struck a cable

the employee had been stringing, the contractor was entitled to summary judgment because there was no showing it participated in the negligent act that caused the employee's death.

(1) Exceptions

In Woodson v. Rowland, 329 N.C. 330, 407 S.E.2d 222 (1991) the Court stated the general rule that one who employs an independent contractor is not liable for the independent contractor's negligence but recognized exceptions when: (1) the employer retains the right to control the manner in which the contractor performs his work and (2) the independent contractor is employed to perform an inherently dangerous activity, in which case the duty is non-delegable.

(a) Right to Control

It is not clear what constitutes “right to control the manner in which the contractor performs his work.” Woodson cited to a case in which a landowner was held liable for the injury to sub-contractor’s employee who sustained an electrical injury on the land, because the owner exercised dominion over the land and was required to turn it over in a reasonably safe condition to the contractor and was therefore liable for any negligence in failing to elevate, remove, or warn against the wires. Many cases find that the general does usually not retain the right to control the manner of the subcontractor’s work.

(b) Non-Delegable Duty

Regarding a non-delegable duty, the cases are fairly stringent on what constitutes this activity. Woodson noted that some activities have been held non-delegable (maintaining an open trench in a heavily populated area, blasting, and installing electrical wires), and others have been held delegable (sign erection, building construction).

Some cases seem to make the non-delegable duty dependent on the contractor's control. For example, where the contractor hired a subcontractor to string television cable, and the subcontractor's employee was killed when a truck struck a cable the employee had been stringing, the contractor was entitled to summary judgment under the nondelegable duty exception because it did not exercise dominion and control of the workplace at the time of the accident.

(c) Oversight, Selection of Subs

The general contractor is probably liable for failing to use due care in hiring a competent sub-contractor. It has been recognized that the owner may be liable under this theory.

Similarly, the general contractor is probably liable in negligence for failing to oversee the sub-contractors. A GC owes the buyer "a duty to supervise the construction of the house."

Allen v. Roberts Const. Co., Inc., 138 N.C.App. 557, 570, 532 S.E.2d 534, 542 (2000)

In a case where the builder was sued for breach of warranty and negligence for various defects in a house, the appellate court affirmed the following jury instruction:

As contractor and seller of the house, Mr. Chesnutt and his company would be responsible for any actions of his subcontractors either in failing to use good quality materials or to construct in a workmanlike manner, or any negligent conduct on their part, if he knew or reasonably should have known as general contractor or builder of the house of those conditions. He is not to be responsible for any such things which a reasonable man in his position as builder and contractor of the house would not have discovered, but the mere fact that work was done by a subcontractor does not relieve the contractor of responsibility if he by the exercise of reasonable care knew or should have known of the existence of those conditions.

Lindstrom v. Chesnutt, 15 N.C.App. 15, 23, 189 S.E.2d 749, 755 (1972).

In Sullivan v. Smith, 56 N.C.App. 525, 525, 289 S.E.2d 870, 871 (1982), "Defendant Smith was the general contractor on a house which plaintiffs purchased from his original vendees." The house was destroyed in a fire, and the evidence, including a building code

violation which was negligence per se, “permitted a finding that the masonry subcontractor, defendant Hooker, negligently constructed the fireplace, and that this negligent construction proximately caused the fire. The case could go to the jury against the general contractor, defendant Smith, however, only if the evidence permitted a finding that he too violated some duty.” The court held that there was sufficient evidence of a breach by the GC, stating:

Plaintiffs presented evidence which permitted a jury finding that defendant Smith, as a reasonably careful and prudent contractor under the circumstances, knew or should have known of the defective workmanship of his subcontractor, defendant Hooker. Defendant Hooker testified that he "saw [defendant Smith] on the job from time to time during the two weeks that [he] built [the] chimney and fireplace," but that he "never saw him looking at the work [Hooker] was doing." He further testified that the exterior brick work was visible while it was under construction; that the exterior and interior bricks "go [up] together"; that other contractors "usually [went] up and look[ed] at the work outside of the fireplace and chimney that they [could] see" when he first did a job for them; and that this was the first job he had done for defendant Smith.

Sullivan v. Smith, 56 N.C. App. 525, 528-529 (1982).

### 3. Claims by Subsequent Purchasers.

Another set of persons who may attempt to sue the general contractor (other than the party with the original contract) is a subsequent purchaser of the property. Under traditional privity rules, a subsequent purchaser of property is not in “privity of contract” with the contractor. For that reason, she is generally not able to sue the contractor for breach of contract or warranty. “Our courts, as a general rule, have continued to require that one seeking to recover on an implied warranty prove privity of contract.” Jones v. Clark, 36 N.C.App. 327, 330, 244 S.E.2d 183, 185 (1978).

The North Carolina Supreme Court has now held that a subsequent purchaser of property may, however, sue the general contractor in negligence. In Oates v. Jag, Inc., 314 N.C. 276, 277, 333 S.E.2d 222, 223-24 (1985), the court stated, “The precise issue to be answered in this appeal

is whether an owner of a dwelling house who is not the original purchaser has a cause of action against the builder and general contractor for negligence in the construction of the house, when such negligence results in economic loss or damage to the owner. We conclude that such a cause of action exists.”

The JAG case has left many issues unresolved in North Carolina. For example, it is not clear what constitutes “negligence” by a general contractor, especially when he or she initially built the structure pursuant to a contract presumably with specific contract terms (i.e. can the general contractor be liable for negligence where it completely complies with the terms of its contract with the original owner?) As indicated earlier, the general contractor may be negligent in using an incompetent sub-contractor, or in failing to supervise his sub-contractor, Sullivan.

Another issue which is not resolved by the *JAG* case is the effect of a limitation or waiver given by the original owner. If, for example, the original owner sufficiently waived any implied warranties, and took the property “as is,” then it would seem that the general contractor should not be liable to a subsequent purchaser for any alleged defects or negligence. Under the *JAG* case, however, it is not clear whether these waivers and concessions would bind a subsequent purchaser.

Where the builder returns for follow-up work at the residence, a subsequent purchaser does not have a negligence claim based on the follow-up work.

### C. Subcontractors.

The subcontractor may also have a claim against the general contractor. Where, for example, the sub-contractor’s liability arises from the general contractor’s plans and specifications, the sub-contractor may obtain indemnity against the general contractor. Where

the sub was under the direct supervision and control of the general contractor, and was instructed by the GC to install damaged glass, the sub has an indemnity claim.

"in situations wherein one party controls or instructs another party and an accident results, the controlling party may be held actively negligent and the obeying party passively negligent. This obtains even though the obeying party actually committed the act which caused the injury." "[A]ction or movement, under some circumstances, could be passive negligence." [Illinois case] The Illinois court further stated that "[c]ategorizing negligence as active or passive, involves making a 'qualitative distinction between the negligence of two tortfeasors.

Hartrick Erectors, Inc. v. Maxson-Betts, Inc., 98 N.C. App. 120, 124 (1990).

#### IV. Other Claims

##### A. Claims against Owner

Sometimes the owner of a structure is sued for damages arising from the construction or building. Generally, the owner is not liable for the acts of his independent contractors. For example, where the plaintiff sued a defendant-landowner for negligence of the defendant's independent contractor in cutting down a tree, which resulted in personal injury, the defendant's negligence should not have been submitted to the jury. "Generally, one who employs an independent contractor is not liable for the independent contractor's negligence." Kinsey.

In general, where an owner erects a structure, the builder's acts are not imputed to the owner, and the duties of construction are delegable. In one case, the owner hired the defendant to build a roof, and the defendant who built the roof argued that the owner was contributorily negligent based on the roof defects, and that the construction duties were non-delegable, and hence could not recover. The court rejected this argument as follows:

Defendant Carlisle argues that Olympic was under a nondelegable duty to ascertain whether its building would support the new roof because reroofing a building is intrinsically dangerous. If Olympic was under a nondelegable duty to

check the roof support, any negligence in failing to adequately determine the support would be imputed to Olympic, if it were a proximate cause of Olympic's damage, whether the negligence was on the part of a servant or independent contractor. However, our Supreme Court has found that the erection of a building is not "inherently dangerous" and does not fall within those activities considered nondelegable in nature. We similarly conclude that the reroofing of a building is not within the purview of "inherently dangerous" or "specially hazardous" work. Furthermore, we find no other grounds for a nondelegable duty on Olympic arising from the reroofing project.

Olympic Products Co., Div. of Cone Mills Corp. v. Roof Systems, Inc., 88 N.C. App. 315, 334 (1988).

An owner will be liable in negligence for a building code violation only if it knew of the violation.

Another "exception" to the general rule (that a contractor is not liable for the acts of a sub-contractor) is for "failing to use due care in securing a competent contractor if the contractor is negligent and proximately causes injury or damage." Olympic Products.

An employer is subject to liability for physical harm to third persons caused by his failure to exercise reasonable care to employ a competent and careful contractor (a) to do work which will involve a risk of physical harm unless it is skillfully and carefully done, or (b) to perform any duty which the employer owes to third persons."

Page v. Sloan, 12 N.C. App. 433, 439 (1971).

#### B. Claims against Architect, other Professionals

The architect can be liable for negligence to the owner. Further, the homeowner may sue an architect with whom he is not in privity. Further, a general contractor who sustained economic loss in a construction project that was proximately caused by supervising architect's negligent performance has a cause of action against architect despite lack of privity of contract.

This liability may extend to other professionals, such as soil inspectors. Our courts have discussed a claim against such a professional, based on negligent representation, as follows:

One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if

(a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting, and

(b) the harm is suffered

(i) by the person or one of the class of persons for whose guidance the information was supplied, and

(ii) because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.

Davidson and Jones, Inc. v. New Hanover County, 41 N.C.App. 661, 669, 255 S.E.2d 580, 585 (1979). In this case, a contractor and the sub-contractors were allowed to sue engineers for their soil investigative report causing injury to them. "Such liability [of a surveyor or engineer] is based on negligence, and lack of privity of contract does not render [engineers] immune from liability to the general contractor or the subcontractors for damages proximately resulting from submitting a bid or conducting work in reliance on negligently prepared soil test reports."

### C. Claims against sub-contractor

In general, the owner does not have a claim against a sub-contractor. In the Ports Authority case, the plaintiff hired a contractor to erect a warehouse, and the contractor hired a subcontractor for the roofing work, which ultimately failed. The Court held that the owner did not have a claim against the subcontractor, as follows:

There was also no error in dismissing the action against Scott [subcontractor]. Scott asserted in its answer the defense that the complaint fails to state a claim upon which relief may be granted against it. In this, Scott was correct. Although the complaint states that the plaintiff seeks recovery against Scott "in tort for the negligent installation of the roofs on these two buildings," it alleges that the defendant Scott was the roofing subcontractor of Dickerson, the general contractor, and that Scott failed properly to apply the roofing material, in consequence of which failure the roofs leaked. This is simply an allegation that

Scott did not properly perform its contract with Dickerson and, for the reasons above set forth, does not allege a cause of action in tort in favor of the plaintiff against Scott.

As Scott asserts in its answer, it "did not enter into any contract with the plaintiff for the construction of the roofs and there exists no privity of contract between this answering defendant and the plaintiff." The plaintiff may not sue Scott for the breach of Scott's contract with Dickerson on the theory that the plaintiff is the third party beneficiary thereof, it being only an incidental beneficiary of such contract.

North Carolina State Ports Authority v. Lloyd A. Fry Roofing Co., 294 N.C. 73, 87 (1978). The

Court also cited to a case from another jurisdiction, stating that in that case:

[A] contractor employed a subcontractor to perform certain required cement work. The work was improperly done by the subcontractor, due, it is alleged, to his negligence. In a suit by the owner against both the general contractor and the subcontractor, the court held that the subcontract was not made for the owner's benefit and, consequently, the owner had no action against the subcontractor for the defective performance of the work.

North Carolina State Ports Authority v. Lloyd A. Fry Roofing Co., 294 N.C. 73, 89

(1978).

#### D. Claims against Manufacturer (and other Sellers)

The owner may have various claims against the manufacturer of portions of his home or structure. The primary claims are for implied warranty and negligence.

##### 1. Implied Warranty

###### a. Nature of Warranty

The UCC provides that "a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind."

Merchantable is defined as meaning that the goods:

- (a) pass without objection in the trade under the contract description; and
- (b) in the case of fungible goods, are of fair average quality within the description; and

- (c) are fit for the ordinary purposes for which such goods are used; and
- (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
- (e) are adequately contained, packaged, and labeled as the agreement may require; and
- (f) conform to the promises or affirmations of fact made on the container or label if any.

G.S. § 25-2-314.

A home owner may have an implied warranty claim against the manufacturer of a component of the house. This raises, however, privity issues, discussed below.

b. Privity Requirement

Where the owner attempts to sue the builder or a manufacturer for implied warranty, his claim may be precluded a the privity requirement. “Except where the barrier of privity has been legislatively or judicially removed, the absence of a contractual relationship between the seller or manufacturer of an allegedly defective product and the person injured by it continues to preclude products liability actions for breach of express and implied warranties.” Crews v. W. A. Brown & Son, Inc., 106 N.C. App. 324, 331 (1992) (child’s suit against vendor of freezer, alleging breach of implied warranties in sale of freezer to church, was properly dismissed; implied warranty did not extend to child, since child was not a buyer and was not in family etc. of buyer).

Where, however, privity has been abolished, a claimant can recover for implied warranty.

(1) Economic Loss Rule

A small handful of cases have applied the privity rule discussed above (i.e. that the plaintiff cannot sue a manufacturer of an item for implied warranty absent privity with the manufacturer), but have stated more specifically, and more narrowly, that “economic losses” are

not recoverable against a manufacturer under an implied warranty theory absent privity. It should be noted, at the outset, that it is unclear why these cases emphasize that “economic losses” are not recoverable under an Implied Warranty theory absent privity, because, in general, all losses (economic and otherwise) are not recoverable under an Implied Warranty theory absent privity.

One case using this language has said “a purchaser cannot recover for economic loss from a component supplier under breach of the implied warranty of merchantability.” Moore v. Coachmen Indus., 129 N.C. App. 389, 400 (1998) (using this reasoning to conclude that remote supplier of component parts is protected by limitations in vehicle manufacturer’s warranty, requiring that they be brought within a certain time). The reasoning given in Moore for the rule is that “component part suppliers cannot effectively disclaim implied warranties, and purchasers have no expectation that component part suppliers will respond to defects in finished products.”

Another case has said: “[O]utside the exceptions created by G.S. Chapter 99B [products liability], the general rule is that privity is required to assert a claim for breach of an implied warranty involving only economic loss.” Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 144 (1992) (home buyer’s claim against manufacturer of door is barred). Thus, “the general rule is that privity is required to assert a claim for breach of an implied warranty involving only economic loss.” Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 144 (1992).

For example, one case states, “the general rule is that privity is required to assert a claim for breach of an implied warranty involving only economic loss.” Energy Investors Fund, L.P. v. Metric Constructors, Inc., 351 N.C. 331, 338 (2000) (claim for loss of investment, arising from alleged breaches of implied warranty in construction of facility, was properly dismissed).

In our opinion, these cases erroneously recognize an “economic loss” rule in Implied Warranty cases, when the true “economic loss” rule applies only to a negligence action. For example, the EIF case from our Supreme Court cited to Watermark Asso. v. Celotex Corp., 784 F.2d 1183, 1186 (4th Cir. 1986) in support of its statement regarding Economic Loss. In fact, the Watermark case applies the true economic loss rule, but holds only that it bars the negligence claim, stating, “a negligence action cannot be maintained for an intangible economic loss.” Watermark in fact recognized that the plaintiffs’ claims for economic loss (in fact described as “intangible economic loss”) based on defective shingles could proceed on the implied warranty theory, stating “we remand for a new trial on the implied warranty claim alone.”

In general, the true “economic loss” rule operates to bar a negligence claim (in a “products liability” action for damage to product itself), but does not affect an implied warranty claim. See Terry’s Floor Fashion v. Georgia-Pacific Corp., 1998 U.S. Dist. Lexis 15392 (E.D.N.C. 1998) (economic loss rule barred negligence claim against manufacturer and seller of floor products, but claims for express and implied warranty survived motion to dismiss; focusing only on notice requirement).

None of the cases applying the Economic Loss rule to an Implied Warranty case provide much guidance for what constitutes “economic loss.” In a succeeding section, regarding claims for “negligence,” this article provides further analysis of what constitutes “economic loss” in those cases.

## (2) Exceptions to Privity Requirement

North Carolina has recognized some common law exceptions to the privity requirement.

### (a) Common Law

North Carolina has abolished the common law privity rule for a person sustaining bodily injury where the manufacturer advertised the product. Tedder v. Bottling Co., 270 N.C. 301, 154 S.E. 2d 337 (1967) (plaintiff allegedly injured by a contaminated soft drink may maintain an implied warranty action against the manufacturer). It is not clear, however, how far the rule has been abolished. In Williams v. General Motors Corp., 19 N.C. App. 337, 340 (1973), the court recognized the general privity requirement and noted that “The slight erosion in this State of the privity requirement in breach of warranty actions appears to have been limited to cases involving food, drink and insecticides in sealed containers, which had warnings on the label which reached the ultimate consumer.”

There is some suggestion that the UCC, and not common law rules, determine whether a plaintiff can sue for certain economic losses. “The U.C.C. is generally regarded as the exclusive source for ascertaining when the seller is subject to liability for damages if the claim is based on an intangible economic loss and not attributable to physical injury to person or to a tangible thing other than the defective product itself.” Reece v. Homette Corp., 110 N.C. App. 462, 466 (1993) (citing *Prosser*; finding that manufactured home buyer’s claim for defective home is limited to warranty, and not tort, and that warranty claim is time-barred).

Even in claims for bodily injury, however, the privity requirement seems to remain alive and well at common-law. Crews (child injured in freezer cannot sue manufacturer for implied warranty because he was not in privity); Williams (person borrowing vehicle cannot sue manufacturer for implied warranty for personal injuries).

#### (b) UCC privity rules

The UCC, although not using the term “privity,” states:

“A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.” N.C. Gen. Stat. § 25-2-318. The UCC applies only to the “sale” of a “good.” The term “buyer” is specifically defined also. Thus, a claimant not in privity with the defendant may have an implied warranty claim against the “seller” if he fits within these exceptions and if he has “person[al] injur[y].”

#### (c) Products Liability Rules

Chapter 99B also abolished the privity requirement in certain circumstances, stating, “(b) A claimant who is a buyer, as defined in the Uniform Commercial Code, of the product involved, or who is a member or a guest of a member of the family of the buyer, a guest of the buyer, or an employee of the buyer may bring a product liability action directly against the manufacturer of the product involved for breach of implied warranty; and the lack of privity of contract shall not be grounds for the dismissal of such action.” N.C. Gen. Stat. § 99B-2.

This rule therefore allows the buyer, his guest, employee etc. to sue the manufacturer. This is more expansive than the privity relaxation in the UCC in several ways. First, extends the warranty to an employee. Second, it does not require that it be “reasonable to expect that such person may use, consume or be affected by the goods.” Third, it does not require “injur[y] in person.” And fourth, it allows suit against the manufacturer (whereas the UCC provision only allows the person injured to sue the seller).

This rule applies only to a “products liability” action, defined as: “includes any action brought for or on account of personal injury, death or property damage caused by or resulting

from the manufacture, construction, design, formulation, development of standards, preparation, processing, assembly, testing, listing, certifying, warning, instructing, marketing, selling, advertising, packaging, or labeling of any product.” G.S. § 99B-1(3).

The Act is inapplicable to claims "where the alleged defects of the product manufactured by the defendant caused neither personal injury nor damage to property other than to the manufactured product itself." Reece v. Homette Corp., 110 N.C. App. 462, 465, 429 S.E.2d 768, 769 (1993) (act inapplicable to buyer’s claim against manufacturer of home). AT&T Corp. V. Medical Review Of North Carolina, Inc., 876 F. Supp. 91, 95 (D.N.C., 1995) (Act inapplicable because “MRNC does not allege the defects in the Meridian Voice Mail System resulted in any physical injury or property damage. It has only alleged economic loss.”; thus, claim for economic loss fails where there is no privity).

## 2. Negligence

A manufacturer’s liability in tort has been described as follows: “As a general rule a manufacturer is under a duty to make an article carefully where its nature is such that it is reasonably certain to place life and limb in peril when negligently made, and he is liable to a third person for an injury resulting from a failure to perform this duty." Corprew v. Geigy Chemical Corp., 271 N.C. 485, 492 (1967).

In general, a negligence action may proceed in the absence of a contract with the defendant, even in a products liability case. Brendle v. General Tire & Rubber Co., 304 F. Supp. 1262, 1264-1265 (D.N.C. 1969) (“It seems now that Corprew has abolished any requirement for privity in negligence cases that might still exist.”). Where there is contractual privity, the negligence claim may be barred by the Ports Authority issue, discussed above in the section regarding negligence claims by the owner against the contractor.

North Carolina does, however, recognize the “economic loss rule,” which operates to bar certain negligence actions against manufacturers.

a) Economic Loss Rule

Some cases, however, have stated that “North Carolina has adopted the economic loss rule, which prohibits recovery for economic loss in tort.” Moore v. Coachmen Indus., 129 N.C. App. 389, 401 (1998). And “Our state courts have not decided whether, in the context of a products liability suit, purely economic losses can be recovered in an action for negligence. The majority of courts which have considered this question have held that purely economic losses are not ordinarily recoverable under tort law.” Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 432 (1990) (adopting rule).

The Metric Constructors case, for example, cited Watermark Asso. v. Celotex Corp., 784 F.2d 1183, 1186 (4th Cir. 1986). (Metric Constructors actually cited to Watermark erroneously for the proposition that “economic losses” are not recoverable under an implied warranty theory. In fact, Watermark expressly allowed the warranty theory to proceed for economic losses.) Watermark held “a negligence action cannot be maintained for an intangible economic loss.”

The application of this rule, however, is problematic. There are issues as to (i) when the doctrine applies to a tort action, (ii) what constitutes “economic loss.”

(1) when doctrine applies

The statement in Moore (“the economic loss rule . . . prohibits recovery for economic loss in tort”) is overly broad. There are clearly cases where a person can sue for “economic loss” in tort.

As a general rule, a person injured by the negligence of another is entitled to all damages flowing from the negligence. This includes compensation for items such as lost profit. Champs

Convenience Stores, Inc. v. United Chemical Co., 329 N.C. 446, 462 (1991) (in action against supplier of chemical for negligence, when improper chemical caused store to close, store entitled to recover lost profits, in addition to rent and note payments while building was being repaired; “In a tort action the general rule in North Carolina is that a plaintiff is ‘entitled to recover an amount sufficient to compensate . . . for all pecuniary losses sustained . . . which are the natural and probable result of the wrongful act and which . . . are shown with reasonable certainty by the evidence.’”); Howell v. Fisher, 49 N.C. App. 488, 495 (1980) (“An action for negligent misrepresentation by third persons lacking privity to recover economic loss has only recently gained acceptance, but it now appears to be the prevailing American law.”).

The “economic loss rule,” preventing the recovery of “economic losses” in a negligence claim, seems to be limited to some sort of products liability claim. The rationale for this rule has been stated as follows:

The rationale for the economic loss rule is that the sale of goods is accomplished by contract and the parties are free to include, or exclude, provisions as to the parties' respective rights and remedies, should the product prove to be defective. To give a party a remedy in tort, where the defect in the product damages the actual product, would permit the party to ignore and avoid the rights and remedies granted or imposed by the parties' contract.

Moore v. Coachmen Indus., 129 N.C. App. 389, 402 (1998).

Language from other cases suggest that the doctrine is limited to claims arising from a defective product. Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 432 (1990) (“Our state courts have not decided whether, *in the context of a products liability suit*, purely economic losses can be recovered in an action for negligence.”); Reece v. Homette Corp., 110 N.C. App. 462, 466 (N.C. Ct. App., 1993) (“The U.C.C. is generally regarded as the exclusive source for ascertaining when the seller is subject to liability for damages if the claim is based on an intangible economic loss and not attributable to physical injury to person or to a tangible

thing other than the defective product itself.”; plaintiff’s claim for mobile home is limited to UCC action). AT&T Corp. v. Medical Review of N.C., Inc., 876 F.Supp. 91 (E.D.N.C. 1995) (“with respect to what losses are recoverable in a products liability suit, North Carolina follows the majority rule and does not allow the recovery of purely economic losses in an action for negligence.”).

Our courts have also recognized tort actions against various professionals by persons not in privity with the professional. Alva v. Cloninger, 51 N.C. App. 602, 277 S.E.2d 535 (1981) (home buyer not in contractual privity with appraiser may recover damages for “economic loss” proximately caused by negligence in the performance of a real estate appraisal.; the plaintiff in *Alva* alleged that he had suffered economic loss by relying on defendant's appraisal which indicated that the home purchased by plaintiff was in good condition when in fact the house contained serious defects). Accord HBS Contrs. v. National Fire Ins. Co., 129 N.C. App. 705, 712-713 (1998) (where architect has general supervisory power, such that he has the final authority to determine compliance with the contract [between the owner and the contractor], and he negligently performs a contractual duty, a third party general contractor, who may foreseeably be injured or sustain an economic loss [as a result of the architect's negligence], has a cause of action against the alleged negligent architect). Davidson & Jones, Inc. v. County of New Hanover, 41 N.C. App. 661, 255 S.E.2d 580 (1979) (economic loss foreseeably resulting from breach of an architect's common law duty of due care in performing his contract with the owner); Shoffner Industries, Inc. v. W. B. Lloyd Constr. Co., 42 N.C. App. 259; 257 S.E.2d 50 (1979). But see McKinney Drilling Co. v. Nello L. Teer Co., 38 N.C. App. 472, 476 (1978) (in the absence of privity of contract, the supervising engineer could not be liable for negligent

performance of the contract with the general contractor to supervise the excavation caisson shafts).

(2) what constitutes “economic loss”

In those cases where the “economic loss rule” applies, (i.e. products liability cases alleging negligence against a manufacturer), the rule prevents only the recovery of “economic losses.” Our cases, however, have not clearly defined what constitutes “economic loss.”

The defective product is clearly encompassed within this rule. “The courts have construed the term ‘economic losses’ to include damages to the product itself.” Moore v. Coachmen Indus., 129 N.C. App. 389, 401 (1998) (purchaser of RV could not sue seller or manufacturer in negligence for loss of RV). Accord Reece v. Homette Corp., 110 N.C. App. 462, 466 (1993) plaintiff’s claim for defects in mobile home is limited to UCC action); Terry’s Floor Fashion v. Georgia-Pacivic Corp., 1998 U.S. Dist. Lexis 15392 (E.D.N.C. 1998) (in action against manufacturer-vendor of floor underlayment, claim for replacing defective replacement, which damaged flooring, was barred by economic loss rule; note that presence of privity does not affect application of doctrine).

It is not clear, however, what constitutes “economic loss” beyond this initial rule. In other contexts, it is generally held that “economic loss” is anything other than bodily injury or disability. Finkel v. Finkel, 590 S.E.2d 472, 474 (2004) (in equitable distribution proceeding, “non-economic losses” are “personal suffering and disability,” as distinguished from “economic loss”).

One case states that there may be differing tests as to what constitutes “economic loss.” A federal court applying North Carolina law recognized that some cases define economic loss as loss resulting from a failure of the product to perform as intended (as opposed to resulting from

“some peripheral hazard”), and other cases define it as loss other than “physical harm” (defined as “physical injury to a person or to a tangible thing other than the defective product itself”). AT&T Corp. v. Medical Review of N.C., Inc., 876 F. Supp. 91 (E.D.N.C. 1995) (action by purchaser of phone system against manufacturer for phone charges incurred due to alleged defects in security of phone and system; finding that under either theory, purchaser’s losses constitute “economic loss” and are barred).

The economic loss rule, however, does not apply to consequential damage to property other than the product itself. In Coachmen, the Court stated that the “other losses” are recoverable in tort. Moore v. Coachmen Indus., 129 N.C. App. 389, 402 (1998) (“Where a defective product causes damage to property other than the product itself, losses attributable to the defective product are recoverable in tort rather than contract.”; claims for contents of RV would generally be recoverable in tort; claims are, however, barred by provision in express warranty limiting recovery of consequential damages). Accord Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423 (1990) (where pressure vessel exploded, damaging fabric and chemicals used in manufacturing process, plaintiff buyer could sue manufacturer in negligence for damage to fabric and chemicals); Reece v. Homette Corp., 110 N.C. App. 462, 466 (1993) (limiting plaintiff’s claim in negligence arising from defective product to “physical injury to person or to a tangible thing other than the defective product itself.”).

It should be noted, however, that in some instances, the “economic loss” rule bars not only a claim for the product itself, but to resulting damage. In Gregory v. Atrium Door, the plaintiff homeowner sued the manufacturer of a defective door which leaked and caused damage to the floor. The court applied the economic loss rule to bar a claim for implied warranty. Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 144 (1992) (“The general rule is

that privity is required to assert a claim for breach of an implied warranty involving only economic loss.”; “The trial court's findings reflect that only economic loss resulted from the alleged breach in the form of malfunctioning and deteriorating doors, along with some water damage to flooring.”). The appellate court reversed the judgment for the plaintiff. Although Gregory involves “economic loss” in the context of an Implied Warranty claim, it presumably has application in a tort case in determining what constitutes “economic loss.”

A couple of federal cases have construed Gregory, and have attempted to clarify its holding. In Wilson v. Dryvit Systems, Inc., 206 F. Supp. 2d 749 (E.D.N.C. 2002), the home owner sued the manufacturer of the house’s cladding in negligence, alleging that the siding was defective and allowed water to enter the structure, resulting in damages for the cost of replacing the siding and for damage to the sheathing, windows, doors, and sub-flooring. The court held that the owner’s negligence action was subject to the economic loss rule, and hence the owner could not recover for the cost of replacing the cladding. The court stated a rule that “when a component or part of a system or product injures the rest of the product or the system, only economic loss has occurred.” It held that “Dryvit’s EIFS cladding is an integral component of plaintiffs’ house. The damage caused by the allegedly defective Fastrak therefore constitutes damage to the house itself.” Accord Higginbotham v. Dryvit Systems, Inc., 2003 Lexis 4530 (2003) (home owner’s negligence claim against manufacturer of stucco siding barred by economic loss rule; rejecting attempts to distinguish case involving house from other economic loss rule cases; absence of privity does not preclude application of rule).

One case, however, has imposed some limitation on this rule. In Terry’s Floor Fashion v. Georgia-Pacivic Corp., 1998 U.S. Dist. Lexis 15392 (E.D.N.C. 1998), the plaintiff-retailer bought a floor underlayment from the defendant-manufacturer. The underlayment was allegedly

defective and resulted in damage to the flooring, ultimately requiring the retailer to repair his customers' floors, including replacing the underlayment and the flooring. The plaintiff-retailer then sued the defendant-manufacturer for negligence. The federal court held that the economic loss rule barred the plaintiff's recovery for the cost of replacing the underlayment under the negligence action. Regarding the floor covering, however, which was not the defendant's product, but rather was a resulting damage, the court held that this aspect of the negligence claim was "other property," and was distinct from the underlayment. It should be noted, however, that the court had another twist on its analysis, and concluded that the "other property" (i.e. the flooring) did not belong to the plaintiff (but rather belonged to the home owner), and hence was not subject to recovery as a negligence action (because under e.g. Ports Authority a person has negligence action in the presence of a contract only if his other property is damaged).

One case holds that the economic loss rule bars recovery for the cost of replacing a defective item. Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423 (1990) (where pressure vessels were installed in plant, and one exploded, and it was discovered that approximately three-quarters of the pressure vessels had not been manufactured in accordance with the ASME Code, and plaintiff replaced all the defective cans, "[A]s a matter of law, the plaintiff's recoverable damages must be limited to actual damage to property resulting from the alleged negligence of the defendants and cannot include economic or pecuniary losses such as the costs to replace property not damaged by the explosion described in the complaint."; cost of inspecting and replacing defective pressure vessels not recoverable in negligence).

In a similar vein, costs and damages incurred in replacing the defective item are encompassed with the EL rule, and are generally not recoverable in tort. 2000 Watermark Asso. v. Celotex Corp., 784 F.2d 1183, 1186 (4th Cir. 1986) (rejecting argument that when shingles are

removed, felt paper is damaged, creating actual property damage, because “The cost of replacing the old felt is an incidental expense which may be recoverable in a warranty action, but it will not support an action for negligence.”).

A claim for bodily injury is clearly not “economic loss.” Some cases recognize the need to permit these claims to proceed, as follows:

The distinction that the law makes between recovery in tort for physical injuries and recovery in warranty for economic loss is hardly arbitrary. It rests upon an understanding of the nature of the responsibility a manufacturer must undertake when he distributes his products. He can reasonably be held liable for physical injuries caused by defects by requiring his products to match a standard of safety defined in terms of conditions that create unreasonable risks of harm or arise from a lack of due care. This is reasonable because the cost of injury may be an overwhelming misfortune to the person injured. It is a needless misfortune since the risk of that injury can be insured by the manufacturer and distributed among the public as a cost of doing business. This rationale, however, does not justify requiring the consuming public to pay more for their products so that the manufacturer can insure against the possibility that some of his products will not meet the business needs of his customers.

2000 Watermark Asso. v. Celotex Corp., 784 F.2d 1183, 1186 (4th Cir. 1986) (S.C. Law; cited by North Carolina cases; “Watermark has never alleged that these shingles actually leaked. The damage alleged is economic and aesthetic. Watermark charges that the blisters have shortened the life expectancy of the roof and destroyed its aesthetic appeal”; “The central question in this products liability case is whether, under South Carolina law, a plaintiff can recover in negligence for an intangible economic loss.”; “a negligent act is not in itself actionable and only becomes so when it results in actual physical damage.”).