

December 22, 2020

## NEW YEAR'S RESOLUTION 2021

The Supreme Court of North Carolina handed down a landmark decision last Friday, December 18, 2020, that affirmed a Business Court ruling that the Economic Loss Rule bars contractually-based tort claims by an owner against a subcontractor on commercial projects.

*Crescent University City Venture, LLC v. Trussway Manufacturing, Inc. and Trussway Manufacturing, LLC* involved the construction of a student apartment complex in Charlotte. Trussway, a designer and manufacturer of trusses, provided floor trusses pursuant to a purchase order with a framing subcontractor on the project. During a party attended by approximately one hundred college students in one of the apartment units, the floor trusses in that unit failed. Crescent, the owner and developer of the apartment complex, asserted a negligence claim against Trussway, a second-tier subcontractor, alleging defective manufacturing of floor trusses.

The key issue was whether Crescent could assert a tort claim of negligence against Trussway when the two parties did not have a contract and thus were not in contractual privity with each other. The Court held that Crescent's negligence claim, which alleged purely economic losses, was a contractual claim in disguise since it was based on Trussway's obligations in its purchase order with the framing subcontractor. Crescent therefore could not recover on this theory.

The Court explained that the Economic Loss Rule, as established by the seminal *Ports Authority* case, requires that a plaintiff's claims fall under one of the four exceptions to the doctrine, which were not at issue here, or be based upon the violation of an extra-contractual duty imposed by operation of law that is separate and distinct from the duties owed under the contract. At the same time, the Court also recognized that parties generally do not owe each other a duty of care to prevent economic loss. Quoting the United States Supreme Court, the North Carolina Supreme Court explained that the purpose of the Economic Loss Rule is to prevent "contract law [from] drown[ing] in a sea of tort." The Court reasoned that a manufacturer in a commercial relationship has no duty under either a negligence or a strict products-liability theory to prevent a product from injuring itself. Here, Trussway, as a second-tier subcontractor, did not owe any extra-contractual duty to Crescent, as owner. Instead, Trussway's duties, as a second-tier manufacturer and supplier of trusses, were limited to those imposed upon it by its contract with the first-tier framing subcontractor.

The Court reasoned that as a sophisticated commercial developer, Crescent had the opportunity, and bargaining power, to allocate economic risk in its contract with the general contractor. According to the Court, Crescent negotiated with the general contractor with the full knowledge of and power to control acquisition and engagement of subcontractors having various roles within the greater construction scheme on the project. Crescent could not circumvent a bargained-for agreement that

had the power to address its economic expectations and prevent against losses by bringing an action in negligence against another party on the project. Because Crescent suffered only economic losses, it has to look to the general contractor and the contract it has with the general contractor for relief.

The Court stressed that its decision was specific to the commercial real-estate development context and did not affect rulings in two prior cases, which held: (1) that a homeowner could bring negligence claims against a first-tier subcontractor for manufacturing and supplying defective trusses on a residential construction project and (2) that homebuyers could bring negligence claims against a residential homebuilder despite not being in contractual privity.

**How does this decision affect your business moving forward? When negotiating contracts, examine and address the full scope of risk—from the owner, to the general contractor, to subcontractors, to material suppliers. Make sure the parties within your chain of contract do not unreasonably limit their duties, liabilities, or risks with others in their contract chain for work on the project. Also, contracts should include appropriate and valid protective provisions, such as indemnities and warranties. If you have questions about how to best allocate your risk and preserve your claim rights, give our Construction **Litigation** Practice Group a call at **704-332-1181**.**