THE ECONOMIC LOSS RULE AND LIABILITY INSURANCE

Ellen S. Pryor*

I. INTRODUCTION

Over the past 25 years, the "economic loss rule" has created a sprawling caselaw, which has elevated it from its once-provincial role in products liability to a dominant argument in all manner of economic harm cases. The rule now is certain to play a key role in any effort to restate the law on torts for pure pecuniary loss. "Restating" the rule would be tricky enough, given its many nuanced but important variations. Other challenges are even more daunting: whether to view the rule as doctrinally mature; whether its normative bases are coherent (both for the rule and for its "exceptions"); and how to set the rule within the conceptual whole of a Restatement.

In defining the boundaries of the economic loss rule and its conceptual underpinnings, the Restatement project will often implicate or draw upon theoretical and doctrinal issues of insurance law for a number of reasons. First, some of the theoretical underpinnings of the economic loss rule relate to considerations that also bear on the insurability of such a loss or the mechanism for its insurance.[1] Second, some tort theories that the Restatement will address are related to causes of actions against insurers, such as the current section on undertakings (which includes the duty to settle)[2] and the section on liability for bad faith. Third, how the Restatement draws the boundaries of the economic loss rule will affect tort liabilities and, therefore, the insurance regime that is structured in

---

* Homer R. Mitchell Professor of Law and University Distinguished Teaching Professor, SMU Dedman School of Law. Associate Provost, Southern Methodist University. B.A. 1978, Rice University; J.D. 1982, University of Texas. This Article is a revised version of a paper originally prepared for the Dan B. Dobbs Conference on Economic Tort Law hosted by the University of Arizona James E. Rogers College of Law in Tucson, Arizona, on March 3–4, 2006. Articles from the Conference are collected in this issue, Volume 48 Number 4, of the *Arizona Law Review*.

1. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 cmt. b (Preliminary Draft No. 2, 2006) (referring to concerns about indeterminate liability, and to the desire to preserve the priority of existing bodies of law, including subrogation).

2. *Id.* § 10(1)(c).

light of those tort liabilities.[3] Finally, how effectively the insurance regime translates the economic loss rule—through coverage language and other doctrines—will affect the fairness and efficiency of the economic tort insurance regime.[4]

This Article identifies, and tries to explain, how the liability insurance regime fails to effectively translate, via insurance language and coverage litigation, the structure and purposes of the economic loss rule. Part II lays some theoretical groundwork, discussing the relationship between liability insurance and pure economic loss. It explains that, for both supply side and demand side reasons, the considerations that underlie the economic loss rule should also affect the shape of the insurance market. Notably, one would find diminished coverage for pure economic loss under general liability policies. And one would expect to find different products tailored for the very different economic losses posed by different service providers and professionals.

Part III turns from the theoretical relationship between liability insurance and economic loss to identify a puzzle: In practice, general liability insurance does not match up with the considerations that, it seems, should guide insurability for pure economic loss. The discussion focuses on insurers' efforts to win "no coverage" rulings on arguments that rest on the economic loss rule. Although insurers have sometimes won these arguments, I explain why they should fail (and why courts often reject them). Part III concludes that the general liability insurers have done a poor job of implementing the economic loss rule through general insuring language. Thus, Part IV considers whether more particular language, which often appears in the form of exclusions, does a better job of narrowing the gap between general coverage and the economic loss rule.

Part V then explains the undesirable consequences that follow when the insurance regime poorly understands or translates the economic loss rule. These consequences can take two forms. First, insurance coverage for economic loss can be too narrow, given both the boundaries of the rule and insurance considerations. Second, and to the contrary, insurance coverage for economic loss can be too extensive. Part VI concludes with thoughts about the sources of, and chances for reducing, the dissonance between the economic loss rule and the liability insurance regime.

---

3. Woven all through the tort law debates, beginning in the mid-1970s with the crisis in medical malpractice affordability, is the connection between the nature and shape of liability rules and the resulting availability, efficiency, and affordability of insurance. The literature disagrees on many topics, such as whether the tort liability system inevitably produces dysfunctional insurance markets. *See* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987). But the existence of a connection between tort law and liability insurance markets cannot be contested. For general discussion of the links, see Randall R. Bovbjerg, *Liability and Liability Insurance: Chicken and Egg, Destructive Spiral, or Risk and Reaction?*, 72 TEX. L. REV. 1655 (1994), and Kent D. Syverud, *On the Demand for Liability Insurance*, 72 TEX. L. REV. 1629 (1994).

4. *Cf.* Ellen S. Pryor, *The Stories We Tell: Intentional Harm and the Quest for Insurance Funding*, 75 TEX. L. REV. 1721, 1739–45 (1997) (discussing whether and when insurance exclusions relating to intentional harm are optimal).

II. THE THEORETICAL RELATIONSHIP BETWEEN LIABILITY INSURANCE AND PURE ECONOMIC LOSS

The economic loss rule rests in part on considerations that also have insurance implications, such as unpredictability about the extent and scope of purely economic ripple effects,[5] and the superior ability that many victims of pure economic loss have to anticipate and prevent the loss or to protect themselves with first-party insurance.[6] Because the economic loss rule rests in part on risk allocation considerations, we can plausibly posit that many of these same considerations will be reflected in the insurance market. This hypothesis reflects both supply side and demand side considerations. On the supply side, some of the reasons for the economic loss rule (unpredictability of the ripple effect of economic losses, ability of the victim to anticipate and prepare for the loss) would affect the availability or types of general liability coverage. [7] On the demand side, insureds with particular exposures to economic losses might have special demands for economic loss coverage.[8]

In many respects, the insurance market bears out these hypotheses. At a broad level, one can see the footprints, in the insurance market, of the concerns

---

5. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 cmt. b (Preliminary Draft No. 2, 2006) (referring to "indeterminate liability when an accident has far flung economic consequences"); Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513 1514–15 (1985) ("[A]n identifiable type of economic loss case raises the specter of widespread tort liability . . . ."). Judge Posner, in an economic loss case, gives the example of *A*, who takes a broken watch to retail store *B* for repair, which sends the watch to *C* for repair; the watch is not adequately repaired and *A* misses an important meeting with creditors, which sends *A* into bankruptcy. "The basic reason why no court (we believe) would impose liability on *C* in a suit by *A* is that *C* could not estimate the consequences of his carelessness, ignorant as he was of the circumstances of *A*, who is *B*'s customer." Rardin v. T & D Mach. Handling, Inc., 890 F.2d 24, 26 (7th Cir. 1989). For trenchant critique of the "floodgates" argument as sufficient to justify the economic loss rule, see Jane Stapleton, *Duty of Care and Economic Loss: A Wider Agenda*, 107 L.Q. REV. 249, 253–58 (1991).

6. *See Rardin*, 890 F.2d at 27 ("[The plaintiff] could have taken measures to protect himself against the financial consequences of unexpected delay. He could have arranged in advance to contract out some of his printing work, he could have bought business insurance, or he could have negotiated for a liquidated-damages clause in his contract . . . ."). For an argument that first-party insurance is usually preferable to liability insurance for spreading the risks of relational pure economic loss, see Ronen Perry, *Relational Economic Loss: An Integrated Economic Justification for the Exclusionary Rule*, 56 RUTGERS L. REV. 711, 766–69 (2004).

7. For instance, if victims are in a better position to know the nature and severity of their purely economic exposure, then this alone could reflect an information asymmetry that, in turn, could create two disincentives for provision of liability insurance: adverse selection and moral hazard. *See* Steven W. Pottier & Robert C. Witt, *On the Demand for Liability Insurance: An Insurance Economics Perspective*, 72 TEX. L. REV. 1681, 1686–87 (1994).

8. Unsurprisingly, then, the insurance market includes many types of insurance that do not fall into the general commercial liability policy, and instead that focus on segments or types of economic risk. These include professional attorney malpractice, professional error and omission coverage, and director and officer liability insurance.

that underlie the economic loss rule. Professionals, who face considerable liability for economic loss, purchase liability coverage other than the general liability coverage sold for personal injury and property damage.[9] These types of coverage, such as director and officer liability policies and error and omissions coverage, contain features and limitations that make sense in light of the economic loss exposure covered under these policies.

As to the general liability market, in theory this should contain limited coverage of purely economic losses, for both demand and supply reasons. On the supply side, combining coverage for pure economic losses into the same coverage as accidental bodily harm would be difficult. Insurers combine uncorrelated risks into risk pools that are sufficiently similar as to represent a relatively narrow range of variation as to that risk. The insurance premium is set as the average level of risk in the pool, and thus the variance between the low end risk of the pool and the high end must not be so great as to cause the lower end risks to drop out of the pool in search of a better price in a narrower risk pool or via some form of self-insurance.[10] To combine coverage for bodily injury and property damage with coverage for pure economic loss exposure would probably create widely varying risk pools. For these same reasons, on the demand side, insureds would not be interested in paying premiums for economic loss coverage when the risk pool would be so disparate and when many insureds could more efficiently protect themselves with contractual remedies than by buying liability insurance.

On a surface level, the general liability market seems to reflect these points. The basic insuring provision of the standard commercial general liability policy covers liabilities arising from bodily injury or property damage, but not pure economic loss. The basic insuring agreement of the "standard" Commercial General Liability Policy (CGL)[11] states, "We will pay those sums that the Insured

---

9. Liability policies for personal injury and property damage are handled through generally standardized insurance policies, based on templates or forms developed by insurance trade associations, especially the Insurance Services Office (ISO). To see that the products offered by this dominant organization generally exclude pure economic loss, see ISO and the Property/Casualty Insurance Industry, http://www.iso.com/about_iso/about09.html (last visited Sept. 1, 2006). Insurance for professionals—such as accountants, corporate directors and officers, and attorneys—is usually less standardized. For instance, as to such insurance, there is no organization comparable to the Insurance Services Office.

10. For explanation of this point as a general matter in liability insurance, see Priest, *supra* note 3, at 1541.

11. Many commercial and personal liability policies are standardized, although some types of liability coverage—such as directors' and officers' insurance—are less standardized. When one sees a reference to a "standard" policy, this does not mean a policy form that is in place without any variation in all states. Rather, the term refers to a form that is widely in use because it behooves the insurance marketplace to standardize the features of many policies. Certain trade organizations, such as the Insurance Services Office (ISO), prepare standardized forms that many insurers use as a basis for their policies. Sometimes, the notion of a standard policy is even tighter, because the policy language might be heavily regulated (as, for instance, personal auto policies) by the state. The reference in the text to the standard CGL policy refers to the ISO form that is one of the most widely used general liability policies. It is created, published, and updated at intervals by ISO. The basic ISO

becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies. We will have the right and duty to defend any 'suit' seeking those damages."[12] Under the "Definitions" section of the CGL, "property damage" is defined as follows: "Physical injury to tangible property, including all resulting loss of use of that property . . . or (b) loss of use of tangible property that is not physically injured."[13]

In several areas, however, the general liability policy arguably does provide coverage for what would qualify, under the economic loss rule, as pure economic loss. These areas include litigation over products and construction. Consider an example of each. In the products context, suppose *D* provides circuit boards to P, which uses these circuit boards in manufacturing scanners. The circuit boards prove to be defective, causing the scanners to fail, and thus forcing *P* to incur substantial costs of replacement.

In the construction context, suppose that *D* builds a house for *P*, and that *S*, a subcontractor, handles the job of compacting the dirt and laying the foundation. Eventually the house is complete, but the foundation has a crack, and moisture seeps in. The house requires repair work that forces *P* to leave the house during the period of repair.

In both of these cases, in most jurisdictions the economic loss rule would apply to disallow a tort cause of action by *P* against *D*.[14] This is also the position articulated in the Restatement (Third): Economic Torts and Related Wrongs.[15] Yet

---

CGL is known as form CG 00 01 10 01. A copy can be found at http://www.lewischester.com/%5Cforms%5CAxisGLPolicy.pdf [hereinafter CGL Policy].

12. The standard CGL policy has two sections of coverage. Section A is for bodily injury and property damage. Section B is for personal injury and advertising injury. This article and its arguments focus on Coverage A, not Coverage B. Coverage B applies, for instance, to damages arising from false imprisonment, libel, and slander, among other items. For an example of the typical CGL provisions in Coverage A, see *Archon Investments, Inc. v. Great American Lloyds Insurance Co.*, 174 S.W.3d 334, 337–38 (Tex. App. 2005).

13. CGL Policy, *supra* note 11.

14. *See* Turbomeca, S.A. v. French Aircraft Agency, Inc., 913 So. 2d 714, 717 (Fla. Dist. Ct. App. 2005) (stating that, for purposes of the economic loss rule, "[c]ourts have refused to bifurcate products into parts where a component part harms or destroys the finished product"); Blahd v. Richard B. Smith, Inc., 108 P.3d 996, 1000–01 (Idaho 2005) (characterizing the foundation, lot, and house as an integrated whole and thus subject to the economic loss rule) (cited in RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 reporter's note f (Preliminary Draft No. 2, 2006)); City of Lennox v. Mitek Indus., Inc., 519 N.W.2d 330, 333 (S.D. 1994) ("When a defect in a component part damages the product into which that component was incorporated, economic losses to the product as a whole are not losses to 'other property' and are therefore not recoverable in tort.").

15. For the products position, see RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 cmt. e (Preliminary Draft No. 2, 2006). This comment references the position already taken in the RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmts. d–e. For the construction example, see RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 cmt. f, illus. 6 (Preliminary Draft No. 2, 2006).

one can make a strong case that, in many products and construction situations, the loss is covered under the CGL.[16]

These scenarios provoke considerable litigation as a matter of *tort law* (the application of the economic loss rule) and also as a matter of *insurance law* (does the CGL policy provide coverage for this). Thus, this area allows a look at the overlap, and proper relationship between, the boundaries of the economic loss rule and the boundaries of insurance coverage. As we will see, the failure to acknowledge the difference between the two notions actually impedes the development of efficient insurance markets for economic loss coverage.

III. DISCREPANCIES BETWEEN THE COVERAGE CONTOURS OF GENERAL LIABILITY INSURANCE AND THE CONCERNS UNDERLYING THE ECONOMIC LOSS RULE

The basic contours of general liability policies do not mesh completely with the concerns and doctrinal boundaries of the economic loss rule. To see this, we will first look at the basic insuring language, and then at exclusions and other provisions in the standard policies.

A. The Basic Insuring Language

The commercial general liability policy is structured with a broad basic insuring agreement, followed by exclusions, conditions, and definitions. Thus, the initial insuring language is only the first step in deciding if the policy covers a particular loss. We should look initially, however, at the insuring language and consider how it aligns with the economic loss rule.

The basic insuring agreement, for our purposes, includes the following. First, it states that "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 insuring agreement also states, "This insurance applies to 'bodily damage' and 'property damage' only if: (1) The 'bodily injury' or 'property damage' is caused by an 'occurrence' that takes place in the 'coverage territory.'"

To flesh out this insuring agreement, the following definitions from the policy are helpful. First, property damage is defined as either (a) "physical injury to tangible property, including all resulting loss of use of that property," or (b) "loss of use of tangible property that is not physically injured."[17] Second, an "occurrence" means "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."[18]

Notice that the basic insuring language refers generally to sums for which the insured becomes "legally obligated," without distinguishing among the

16. The discussion in text following will focus on the construction cases. For a case finding coverage under the CGL in a products case such as the example in text, see *Anthem Electronics, Inc. v. Pacific Employers Insurance Co.*, 302 F.3d 1049, 1055–58 (9th Cir. 2002).

17. CGL Policy, *supra* note 11.

18. *Id.*

possible sources of those obligations. Granted, some of these sources will be dealt with under particular exclusions. But, from the very start, the insuring language does not include a contract/tort distinction—unless, as we will shortly consider, the "caused by an occurrence" requirement is, among other things, a proxy for the contract-tort distinction. And, from the start, the property damage definition includes not just physical damage to property, but "loss of use of tangible property that is not physically injured." Thus, based at least on the insuring language and its definitions, an insured would have coverage if he were "legally obligated" to pay for a purely economic loss in the form, for instance, of loss of use of tangible property. The basic insuring language thus leaves open the chance that an insured will be covered for claims that allege no more than that the insured caused economic loss by failing to live up to a contractual promise. It also leaves open coverage for claims by "strangers" for ripple-effect economic losses.[19] Coverage this broad would seem not to match the concerns reflected in the economic loss rule.

One could envision an easy way to create a match between the insuring language and concerns about purely economic loss. Granted, historical reasons and significant transactional barriers can explain why, in this and in many other areas, the standard insuring language falls short of what might be ideal. The standard clause could be changed to read, "legally obligated to pay, under tort, as damages . . . ." Language of this sort would mean that general liability coverage would match, in each jurisdiction, the boundaries of the economic loss rule. And the matching would evolve as the common law of tort evolved, with each new nuance and development in the economic loss doctrine. The insurance policy language would not have to be revised every time the economic loss doctrine changed. Rather, this same standard language—once approved by state regulators—would perfectly match the liability boundaries of the economic loss rule.

Why has this not occurred? One answer, which we will address in the next section, is that insurers have assumed that other features of general liability coverage—specifically the requirements of occurrence and "bodily injury or property damage"—take care of concerns about purely economic loss. (As we will see, to the extent that this is the assumption, it is mistaken.)

Another possible explanation is that the insurance market does not have reason to care about the concerns that drive the economic loss rule—whether and when it makes sense to allocate, to the tort system, a certain type of purely economic loss. But this explanation is unconvincing. Many of the risk allocation factors that one sees cited in the economic loss cases are relevant to insurance underwriting and pricing decisions—for instance, whether the putative "victim" is best positioned to bear the economic loss, and whether economic losses are unbounded or unpredictable in scope.

Indeed, we can find proof, in the insurance world, that insurers care about these risk allocation factors. In many recent cases, insurers have actually used the

---

19. For general discussion of the economic loss rule in "stranger" versus "nonstranger" contexts, see William Powers, Jr. & Margaret Niver, *Negligence, Breach of Contract, and the "Economic Loss" Rule*, 23 TEX. TECH L. REV. 477, 488–89 (1992).

economic loss rule—and the risk allocation concerns it embodies—to argue against coverage in certain contexts.[20] The insurance community, then, seems to endorse the relevance, to insurance coverage decisions *ex ante*, of the risk-related considerations that underlie the economic loss rule.

Still other factors add to the puzzle of why insurers have not distinguished between "tort" and "contract" liability in the basic insuring clause. As we will see later, many features of the basic insuring clause, and the exclusions to that clause, seem aimed at some of the same considerations that underlie the economic loss rule. An example is the detailed set of exclusions for coverage to property damage. Without getting bogged down in a discussion of those exclusions here, we can say that many of the intricacies of the economic loss doctrine find an echo in the intricacies of the property exclusion.

In sum, we cannot say that the basic insuring language has taken the most direct route to excluding coverage for pure economic loss. Why does insurance language not more forcefully reflect the risk allocation factors that lie behind the economic loss rule? One possible explanation is that while insurers have reason to care about the risk allocation factors relevant to the economic loss rule, they do not need to use the language of the insurance policy to reflect those concerns. Rather, they can count on the economic loss rule itself to knock out tort liability in situations where it should not arise. And, if the underlying tort liability does not exist, then general liability policies will not need to provide coverage for it. Put another way, the liability rules can do the work of implementing risk allocation concerns about economic loss.

This explanation makes sense when we consider some of the liabilities that the coverage language of insurance policies clearly excludes. For instance, the requirement of an "occurrence" and the exclusion for "expected or intended" injury clearly aim to knock out insurance coverage for harm that the insured intentionally caused.[21] In this context, insurers have reason to limit insurability, but cannot count on the underlying liability rules to do so. Because tort claims for intentional harm remain alive and well, insurance policies cannot rely on tort doctrine to limit exposure to intentional harms. Instead, policies need to be articulated in a way that excludes coverage for such harms.

By contrast, in the context of economic losses, the underlying tort law rule itself arguably reflects the considerations that insurers might take into account in limiting coverage. These include the difficulty of predicting the full economic ripple effect of economic loss; and the inaptness of tort law for handling purely contractual disappointments.

---

20. To be sure, one could view these arguments as purely opportunistic, and not reflecting any legitimate *ex ante* concern in the insurance market for the risk allocation factors relevant to the economic loss rule. But this seems unconvincing, because these factors do seem relevant even if the insurers' "no coverage" arguments should be rejected (as I will explain later).

21. For discussion of how and why intentional harm is usually excluded in liability policies, see James M. Fischer, *The Exclusion from Insurance Coverage of Losses Caused by the Intentional Acts of the Insured: A Policy in Search of a Justification*, 30 SANTA CLARA L. REV. 95 (1990); Pryor, *supra* note 4, at 1740–45.

Seen this way, although the insurance market has supply side reasons to limit coverage for economic loss recovery, the underlying tort landscape already embodies that limitation. Thus, perhaps insurers have not perceived a real need to address the limitation specifically through insurance language.

B. "Occurrence" and "Bodily Injury or Property Damage"

Insurers would certainly argue that the basic insuring language does reflect or match the concerns of the economic loss rule. They would point to two parts of the basic insuring language: the requirement of an "occurrence," and the requirement of either "bodily injury or property damage." These provisions, insurers would argue, should knock out coverage for losses that fall within the economic loss rule. If this is correct, then the general liability coverage in the market does match up with the underwriting and risk allocation concerns reflected in the economic loss rule.

Yet insurers are mistaken in this argument. The language of "occurrence" and the requirement of "bodily injury or property damage" do not have the effect of knocking out coverage for claims that fall within the economic loss rule. Insurers have made this argument in numerous cases in recent years, and sometimes it has succeeded. Many other times, however, it has failed.[22] As I will explain, it should fail because it is unconvincing as an insurance interpretation matter.

To see the argument, recall the typical version of an insuring clause in a general liability policy:[23]

> a. 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. We will have the right and duty to defend the insured against any "suit" seeking those damages.
>
> b. This insurance applies to "bodily injury" and "property damage" only if:
>
> (1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"; and
>
> (2) The "bodily injury" or "property damage" occurs during the policy period.

In the "definitions" section, the policy defines "occurrence" as an "accident, including continuous or repeated exposure to substantially the same general conditions." The word "accident" is not further defined. "Property damage" is defined as either "physical injury to tangible property, including all resulting loss of use of that property," or "loss of use of tangible property that is not physically

---

22. For a summary of the split caselaw, see *Lee Builders, Inc. v. Farm Bureau Mutual Insurance Co.*, 137 P.3d 486, 491 (Kan. 2006).

23. The CGL includes one set of coverages known as Part A, and another known as Part B. Part B relates to coverage for "advertising injury," which can include coverage for claims of defamation, negligent misrepresentation, and other torts. Of interest to us, however, is coverage A, which is the one discussed in the text.

injured." (The policy also contains some exclusions and endorsements that we will discuss shortly.)

Some courts have sided with insurers' arguments that these provisions do not provide insurance coverage for purely economic loss. For instance, consider *American Manufacturers Mutual Insurance Co. v. Seco/Warwick Corp.*,[24] a 2003 decision from a federal district court applying Colorado law. The insured had sold commercial furnaces that failed to perform as promised. The damages included costs of modifying the furnaces to become functional, consulting and monitoring costs associated with the repair, and costs of using outside vendors during the period when the furnaces did not work. The court held that "an occurrence does not include the normal expected consequences of poor workmanship."[25]

One can find two somewhat different rationales for this holding. One rationale, which we will call the "underwriting argument," is that the CGL policy should not be interpreted to provide coverage because a different and more appropriate risk allocation device is available—a performance bond.[26] "An occurrence does not arise out of poor workmanship because the 'policy is not intended to serve as a performance bond or a guaranty of goods or services.'"[27]

A second rationale is based on the economic loss rule. The court explained that the underlying loss would fall within the economic loss rule in Colorado, which prevents recovery for negligence "when the duty breached is a contractual duty and the harm incurred is the result of failure of the purpose of the contract."[28] Thus, the court held, the allegation of negligence did not trigger an occurrence.

Numerous courts have considered both the "underwriting" argument and the "economic loss rule" argument. We will evaluate both, beginning with the latter.

---

24. 266 F. Supp. 2d 1259 (D. Colo. 2003).

25. *Id.* at 1266 (quoting Bangert Bros. Constr. Co. v. Am. Ins. Co., No. 94-1412, 1995 WL 539479, at *2 (10th Cir. Sept. 11, 1995)).

26. See Aron J. Frakes, Note, *Surety Bad Faith: Tort Recovery for Breach of a Construction Performance Bond*, 2002 U. ILL. L. REV. 497, 498 (2002) (quoting BRUCE M. JERVIS & PAUL LEVIN, CONSTRUCTION LAW: PRINCIPLES AND PRACTICE 96 (1988)):

> A performance bond is defined as "[a] contract entered into between a contractor (referred to as the 'principal') and a bonding company (referred to as a 'surety') whereby the bonding company guarantees to the project owner (referred to as the 'obligee') the contractor's faithful performance of its contractual duties and completion of the project." From this definition, it is clear that a performance bond involves a tripartite contractual relationship. The surety's contractual obligation to the project owner is limited to the "face amount" of the performance bond.

27. *Am. Mfrs. Mut. Ins. Co.*, 266 F. Supp. 2d at 1266 (quoting Hartford Accident & Indem. Co. v. Pac. Mut. Life Ins. Co., 861 F.2d 250, 253 (10th Cir. 1988)).

28. *Id.* at 1267 (quoting Town of Alma v. Azco Constr., Inc., 10 P.3d 1256, 1261 (Colo. 2000)).

C. The Economic Loss Argument

Initially, we should note that different versions of the economic loss rule exist. Yet, under any version of the economic loss rule, insurers can make and have made no-coverage arguments relying on the economic loss rule. Consider the following versions of the economic loss rule as applied to the above scenario:

> (1) The economic loss rule applies whenever the loss—including damage to other property—was within the scope of bargaining or, put another way, whenever the "occurrence of such damage could have been the subject of negotiations between the parties."[29] Under this version of the economic loss rule, the insurer would argue that no coverage exists in suit against the furnace seller because all the damages alleged in the suit were within the scope of bargaining and could have been the subject of negotiations between the parties.
>
> (2) The economic loss rule applies whenever there is no property loss or the property loss is only to the product itself; in the case of a house or product, the "product itself" includes all damage to the integrated whole, even if a piece of the product (say, the windows) caused damages to another piece (say, the wall and floors). Under this version, the suit against the furnace seller falls under the economic loss rule because all the asserted damages relate to the furnace itself, an integrated whole.

Under either version, the argument against coverage is this: The claims against the insured fall within the economic loss rule; thus, the claims are not for a tort but essentially for disappointed economic expectations; thus, the claims cannot be for an accident, and should not be covered.[30]

To evaluate this economic loss argument, we turn first to the terms "occurrence" and "accident," which are among the most examined provisions in insurance coverage litigation. Major categories of coverage litigation implicate these provisions. These categories include environmental litigation, and tort claims involving both intentional and negligence-based torts—both claims arising from criminal injury and those arising from the failure to prevent it. A variety of other litigation involves the terms accident and occurrence.

Thus, the economic loss insurance coverage cases have arisen, for the most part, *after* the development of an extensive jurisprudence on the definitions of accident and occurrence. To summarize quickly, coverage litigation over the term accident has involved a number of subquestions, discussed below.

If the insured intended the act that caused the injury, is this enough to take the claim outside the definition of accident? The answer is universally, and properly, no. To read the definition of accident so narrowly would exclude all but

---

29. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 175 (Wis. 2005) (quoting Neibarger v. Universal Coops, Inc., 486 N.W.2d 612, 620 (Mich. 1992)).

30. Insurers have made essentially this argument in numerous cases, with mixed results. *Compare* Anthem Elecs., Inc. v. Pac. Employers Ins. Co., 302 F.3d 1049, 1056 (9th Cir. 2002) (rejecting the argument), *with Am. Mfrs. Mut. Ins. Co.*, 266 F. Supp. 2d at 1267–68 (accepting the argument).

inadvertent acts, and would exclude much of the realm of negligent acts causing personal injury.[31]

Next, for purposes of "accidental," is the only relevant state of mind the insured's desire–purpose, or can some level of knowledge as to the injury suffice to render the injury "non-accidental"? Most courts agree, properly, an act can be a non-accident, even absent desire to cause injury, when a certain level of knowledge exists.[32] This is unsurprising, as the law of intentional torts has long held this position.

The final question is the level of knowledge that marks the boundary of accident. Although courts do not use—for coverage purposes—the precise standard used in the law of intentional torts (knowledge with substantial certainty), something like a highly probable result (rather than just foreseeable) is required to take the action out of the accident zone.[33]

Now consider these basic rules as applied to the claim against the furnace seller. It would be difficult to say that the furnace seller acted in a way that created a highly foreseeable failure. So the claim hardly reflects a "non-accident" when considered according to the usual distinction between accidental injury and expected injury.

To succeed on a "non-accident" argument, then, requires something other than the usual ways of distinguishing between expected and accidental injuries. One can find two routes to a "non-accident" characterization. The first is to say that an "accident" simply does not, as an interpretive matter, include the "normal, expected consequences of poor workmanship."[34] The second argument reasons as follows: If the economic loss rule applies (under any version of it), then no tort

---

31. *See, e.g.*, Trinity Universal Ins. Co. v. Cowan, 945 S.W.2d 819, 828 (Tex. 1997) (finding no coverage but rejecting the insurer's argument that, if the insured intends the act itself, this alone is enough to negate a finding of occurrence).

32. *See, e.g.*, *Anthem Elecs.*, 302 F.3d at 1055 ("[A]n occurrence is simply an unexpected consequence of an insured's act, even if due to negligence or faulty work."); Gaylord Chem. Corp. v. ProPump, Inc., 753 So. 2d 349, 354 (La. Ct. App. 2000) (noting that an accident can exist when the insured installed defective products so long as the insured did not know it was doing so).

33. *See, e.g.*, Patrons-Oxford Mut. Ins. Co. v. Dodge, 426 A.2d 888, 892 (Me. 1981) (reversing grant of summary judgment for further proceedings on whether defendant knew that injury to plaintiff was a substantially certain result of his firing a shotgun). For more detailed discussion of the level of knowledge required, see Pryor, *supra* note 4, at 1726 n.13.

34. Reliance Ins. Co. v. Mogavero, 640 F. Supp. 84, 86 (D. Md. 1986). As one court described the insurer's argument (before rejecting it), "the breach of a defined contractual duty was not an 'accident' because it was within the insured's control and management and should not be considered an undesigned or unexpected event." Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co., 104 P.3d 997, 1001 (Kan. Ct. App. 2005). As another court ruled, "defective workmanship, regardless of who is responsible for the defect, cannot be characterized as an accident under Iowa law." Norwalk Ready Mixed Concrete, Inc. v. Travelers Ins. Cos., 246 F.3d 1132, 1137 (8th Cir. 2001).

claim exists; if no tort claim exists, no "accident" can have occurred.[35] This argument depends on the claim that an "accident" can only take the form of tort, and not of contract or warranty.[36]

Both arguments have some intuitive appeal, so it is not surprising that courts have split on the issue. If the person who is remodeling a kitchen cuts a cabinet door, brings it in to the house to fit onto the cabinet, and discovers that it is .25 inches off, we do not normally think "accident." If the same person comes in with a bleeding hand resulting from catching a finger in the electric saw, we think "accident." In addition, we think of an accident as something that can give rise to a tort claim. So it perhaps seems easy to flip the logic and conclude that an accident can never exist apart from a tort claim.

Yet, on even a moment's reflection, we all understand that contracts are broken, many times, for reasons that we would call "accidental." The wrong number of boxes was shipped because someone made a mistake in the counting. The lawsuit was filed in the wrong venue because someone made a mistake when reading the venue statute. As one court explained, "at bottom, an occurrence is simply an unexpected consequence of an insured's act, even if due to negligence or faulty work."[37]

Declaring that a claim is only in contract does not, after all, have a strong intuitive link to the notion of accident. One can plausibly claim that, if no tort claim exists but only a contract claim, then no accident has occurred. But this is far from the only view, and it is actually not very compelling.[38] Thus, relying on "accident" seems not to follow the track of the economic loss rule, after all.

---

35. The insurer seemed to be making this argument, for instance, in *American Family Mutual Insurance Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004). According to the court, the insurer characterized the claim "as one for economic loss rather than property damage, and argues that the economic loss doctrine bars coverage." *Id.* at 75. The court continued, "To the extent that [the insurer] is arguing categorically that a loss giving rise to a breach of contract or warranty claim can *never* constitute 'property damage' within the meaning of the CGL's coverage grant, we disagree." *Id.*

36. This would not turn on which version of the economic loss rule one articulated—that is, a broad "scope of bargaining" rule, or a damage to the own product rule (with or without an incorporation twist).

37. *Anthem Elecs.*, 302 F.3d at 1055. The case involved a claim against a manufacturer of circuit boards for flaws in those boards; the flawed boards, when incorporated into the final product—scanners—caused failure in performance of the scanners. The manufacturer of the scanners sued the circuit board manufacturer, which in turn gave the claim to its two insurers under general liability policies. These insurers denied coverage on the basis of occurrence, no "property damage," and the impaired property exclusion. A number of other courts have agreed that a problem resulting from poor service or construction performance can be an accident and thus an occurrence. *See, e.g.*, Federated Mut. Ins. Co. v. Grapevine Excavation, 197 F.3d 720, 725–26 (5th Cir. 1999) (finding an occurrence when faulty construction caused damage to a parking lot); Kalchthaler v. Keller Constr. Co., 591 N.W.2d 169, 173 (Wis. Ct. App. 1999) (finding an occurrence when faulty workmanship resulted in water leaks that harmed windows and drapes).

38. For a court that explains why the insurance question does not turn solely on whether the claim is for breach of contract, see *Vandenberg v. Superior Court*, 982 P.2d 229, 243–46 (Cal. 1999).

Another argument against coverage is as follows. Any negligence claim stated in the underlying lawsuit would, as a result of the economic loss rule, be a loser. Thus, because no negligence claim of any possible validity is part of the underlying lawsuit, we can ignore that claim for purposes of determining coverage. This argument, though, has big problems. First, the argument bumps up against an important insurance law rule relating to the duty to defend. The insurer has at least a duty to defend—if not to indemnify—whenever the underlying lawsuit states a claim that, if assumed to be valid, would trigger coverage under the policy.[39] Denying coverage on the basis of the economic loss argument comes very close to considering the merits of the underlying claim against the insured—something the insurer is not allowed to do in determining the duty to defend.[40]

Second, even if we accept this argument, it leaves in place the breach of contract claims, warranty claims, or deceptive trade practices claims. And, as explained earlier, one can argue that such claims cannot be an "occurrence" or "accident," but this is just one plausible reading.

D. The Underwriting Argument

The conclusions thus far have been interpretive at the level that insurance law initially requires: Does the language itself suggest a clear meaning? To the points just made, the insurers might respond as follows: If the language is ambiguous, we should consider the underwriting and insurability reasons why a loss covered under the economic loss rule cannot be deemed an accident.

Perhaps a deep link exists between losses covered by the economic loss rule and insurability, so that the qualities associated with those losses make them troublesome for insurability purposes. Indeed, as noted in Part II, the insurance marketplace would have many reasons for using different insurance vehicles to insure pure economic loss. Yet one is hard-pressed to argue that pure economic loss is uninsurable. Perhaps the strongest insurability concern would be moral hazard. If the loss is the failure to live up to the contract's performance obligations, resulting in a diminished value or quality of service, then the presence of insurance could reduce the insured's incentives to live up to the contract.[41]

But the moral hazard argument is unconvincing. The insured is in control of some, but certainly not all, factors that might lead to poor performance. In addition, insurance is available for failures to live up to economic performance promises. Examples of such insurance include errors and omissions coverage, directors and officers coverage, and professional malpractice.

---

39. *See, e.g.*, Lee v. Aetna Cas. & Sur. Co., 178 F.2d 750, 751–52 (2d Cir. 1949); Hecla Mining Co. v. N.H. Ins. Co., 811 P.2d 1083, 1089 (Colo. 1991). For discussion of the duty to defend and its implications, see Ellen S. Pryor, *The Tort Liability Regime and the Duty to Defend*, 58 MD. L. REV. 1 (1999).

40. *See* Pryor, *supra* note 39, at 22–25.

41. Moral hazard refers to the notion that the existence of insurance might decrease insureds' incentives to act in ways that prevent losses or that mitigate losses. For discussion of moral hazard, see KENNETH S. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY 35–36 (1986), and Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996).

There exists a more specific, more convincing insurability argument. This is that another device is available, aside from the CGL, for failure to perform a contractual job—a performance bond.[42] This is the form of risk allocation that is specifically designed and priced to cover failure to live up to the promised performance. The CGL, by contrast, is designed and priced to cover losses that occur to someone else's property or person by an accident resulting from the insured's performance of the job. To illustrate, if a worker drops a piece of machinery from the roof and it damages the tile below in a way that is not discovered until after the house is sold, then the proper coverage is a performance bond. The only harm that has occurred is the failure of the contracted-for item to live up to the promised quality. If, by contrast, the same event occurs—a piece of machinery is dropped from the roof—but the result is an injury to another's property or person (the machinery hits a passerby, causing a head injury, or causing damage to the passerby's laptop, which is on his back in a backpack), then the CGL policy covers this.

As a description of the insurance market and the rationale behind types of coverage, this argument is quite forceful. If we consider the prospective expectations of service providers, builders, manufacturers, and sellers, then this two-level coverage makes a lot of sense. The performance bond is tied to the quality of the delivered product; the CGL is for injury to someone or something else, who then sues.

The logic becomes even stronger when we realize who the respective plaintiffs are under each type of insurance. If the plaintiff is the buyer, then the plaintiff is someone who could and probably did require the seller or builder to procure insurance for its promised performance. Put another way, as to the risk that the buyer faces, *ex ante*, the buyer is in a position to demand that the other party procure insurance against failure of the product or good. The same is not true of third persons—the passersby in our example—who are injured in person or property by the bad performance of the seller. And these two risks will not overlap; they are of distinct natures and have distinct owners. The passerby could care less whether the house he is passing has been built with the right kind of tile, whether the windows of the house leak, or whether the house has black mold resulting from moisture. Conversely, the buyer of the service could care less about the harm that might result to someone else's person or property, except that such harm could result in a lawsuit against him. For that risk, CGL coverage seems perfectly tailored.

Seen this way, the "no CGL coverage" contention as to the poor tile or the leaking windows has force. Notice, though, how poorly designed the language of the CGL policy is to effectuate this conclusion. The basic insuring language turns on the term "occurrence," defined further as an "accident." Yet this language does little or nothing to distinguish between the dropped machine that damages tile, and the dropped machine that injures a passerby. Both are accidents!

---

42. Insurers have made this argument in many cases. *See, e.g.*, Qualls v. Country Mut. Ins. Co., 462 N.E.2d 1288 (Ill. App. Ct. 1984) (citing the argument and denying coverage); L-J, Inc. v. Bituminous Fire & Marine Ins. Co., 621 S.E.2d 33, 36–37 (S.C. 2005) (citing the argument and denying coverage).

In sum, the insurers' "no occurrence" argument is unconvincing. This is true even if we consider the underwriting argument—including the claim that CGL coverage should not be used for handling what should be done via a performance bond. We might agree with this as an underwriting matter, but the CGL language poorly expresses this choice.

E. The CGL's Use of "Occurrence" Does a Poor Job of Allocating Risk for Purely Economic Loss

We can see, then, several problems with how the CGL policy allocates the risk of purely economic loss. First, the CGL coverage is not the optimal way to allocate risk for some forms of economic loss. Yet the policies are drafted in a way that allows plausible arguments for this coverage.

Second, in their efforts to deny coverage, insurers use the economic loss rule in an unsupportable way. The economic loss rule defines the contours of the underlying liability, and the insurance market should respond to those contours with variations in the language, pricing, and types of coverage offered. Instead, the CGL coverages have not changed in relevant ways since the explosion of litigation in the economic loss area. Rather than changing the coverage language, the insurers are using the economic loss rule to deny coverage. One can believe, as the insurers certainly do, that CGL coverage is not the proper vehicle for allocating the risk of poor workmanship. But this is no reason to applaud cases in which insurers win coverage on the basis of the economic loss rule. As an insurance law matter, the cases mix up the proper role of the underlying liability rule and the coverage rules.

Third, the insurers' efforts to deny coverage on the basis of the economic loss rule have potentially hurt the shaping of the market for economic losses. The insurers' partial success in the courts has probably slowed down the efforts to reach a better market solution to the shape of the coverage.

IV. DO STANDARD EXCLUSIONS IN GENERAL LIABILITY COVERAGE BRING ABOUT A BETTER MATCH BETWEEN THE INSURANCE COVERAGE AND THE ECONOMIC LOSS RULE?

The previous section explained why the main insuring requirements—occurrence and property damage—do not craft the grant of coverage in a way that fits the economic loss rule. Rather, the coverage provided by these requirements is considerably broader than the scope of the economic loss rule.

The next step is to inquire whether other standard features of general liability coverage—notably the many exclusions—narrow the scope of coverage in a way that matches the economic loss rule more closely.[43] As we will see, some of the exclusions do not narrow coverage, but instead clarify that the policy covers

43. If so, then one question is answered and another question is raised. If the exclusions tailor coverage to the scope of the economic loss rule, then we can conclude that general liability coverage, as predicted, would reflect concerns similar to the economic loss rule. Yet a question arises: Why have insurers been so aggressively advancing the weak "no coverage" arguments described in the preceding section?

losses that often are excluded under the economic loss rule. Other exclusions do narrow coverage, in some scenarios, to a scope similar to that of the economic loss rule.

This section will discuss two CGL exclusions that often arise in the cases involving arguably pure economic loss.[44] One is exclusion "*l*", which is usually titled "Damage to Your Work." This excludes "'Property damage' to 'your work' arising out of it or any part of it and included in the 'products completed operations hazard.'" The 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."

The other exclusion is exclusion "m," which is for "Damage to impaired property not physically injured." This excludes coverage for:

> "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 your or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.
>
> This exclusion does not apply to 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.[45]

Starting with the first exclusion—the "Your Work" exclusion—the second sentence would actually support finding coverage in one common situation in which the economic loss rule would deny recovery. The provision specifically exempts from the exclusion property damage to someone's work (usually a contractor's work) if the damaged work or underlying work was performed by a

---

44. Several other exclusions have also arisen in these cases involving defective products or defectively performed work. One is an exclusion of property damage to 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." CGL Policy, *supra* note 11, § I(Coverage A)(2)(j)(5), at 4. As with the other exclusions, insurers have made "no occurrence" arguments and the argument that the CGL policy should not be turned into a performance bond. Again, the insurers have had mixed success with this exclusion. For an example of a recent decision denying the insurer's arguments as to the exclusion, and reviewing the mixed caselaw in detail, see *ACUITY v. Burd & Smith Construction, Inc.*, 721 N.W.2d 33, 40–42 (N.D. 2006).

Another exclusion that insurers have often invoked in this type of litigation is the "assumed by contract" exclusion. This applies to any "'[b]odily 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." CGL Policy, *supra* note 11, § I(Coverage A)(2)(b), at 2. Courts have almost uniformly rejected insurers' arguments that this excludes coverage in a case in which the alleged wrongdoing arose out of a contractual (or non-stranger) setting. The exclusion applies only if the loss for which the insured seeks coverage is one that the insured assumed by way of contract—for instance, in an indemnity contract. *See, e.g*, Ferrell v. West Bend Mut. Ins. Co., 393 F.3d 786, 795 (8th Cir. 2005).

45. CGL Policy, *supra* note 11, § I(Coverage A)(2)(m), at 5.

subcontractor.[46] Coverage is retained in this situation.[47] Yet the economic loss rule, as recounted in the Restatement draft, would not allow a tort claim in such situations. A comment to the current Restatement Draft sets out the approach. "[A] tort action is not available for solely pecuniary [loss] resulting from negligent performance of a service contract. . . . When a defendant working upon the plaintiff's property creates a latent physical defect in that property, the manifestation of that defect is not physical harm to that property or to other property that is part of an integrated whole with that property."[48] The draft gives a helpful illustration: Subcontractor compacts fill dirt; Contractor builds house on this; Contractor sells to First Buyer, who then later sells to Second Buyer; Second Buyer notices crack during inspection and other problems created by the crack. "The house, foundation, and fill are considered to be a part of an integrated whole so the harm to the house resulting from the defect in the fill is solely pecuniary harm. There is no negligence action [under the Restatement (Second)]."[49]

The second exclusion cited above—the "impaired property" exclusion—also could allow a finding of coverage in situations when the economic loss rule would knock out a tort action. Consider the illustration given earlier. *D* provides circuit boards to *P*, which uses these circuit boards in manufacturing scanners. The circuit boards prove to be defective, causing the scanners to fail, and thus forcing *P* to incur substantial costs of replacement. The economic loss rule would disallow recovery in tort, yet a court could find that coverage exists because an occurrence took place and because the loss occurred after the product had been put "to its intended use."[50]

V. WHY DOES DISCREPANCY MATTER?

The previous section contended that insurers have incorrectly argued, and perhaps incorrectly assumed, that the requirements of "occurrence" and "bodily injury" knock out insurance coverage for claims of purely economic loss. But is this a problem, and why? The problem can be either too little insurance for economic loss, or too much.

---

46. This second sentence was added to this exception in the revision of the CGL in 1986. For discussion of the change in 1986, see *Limbach Co. v. Zurich American Insurance Co.*, 396 F.3d 358, 362 (4th Cir. 2005), and *American Family Mutual Insurance Co. v. American Girl, Inc.*, 673 N.W.2d 65, 82–83 (Wis. 2004).

47. Insurers have not conceded that this provision of the general liability policy changes their "no-coverage" argument. They have pushed for no coverage in cases such as those set out in the illustration, notwithstanding this language. *See, e.g.*, Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co., 104 P.3d 997, 1001–04 (Kan. Ct. App. 2005). Courts and authorities have frequently sided with the policyholder's contention that this provision would be superfluous if, as insurers argue, the "occurrence" argument simply takes such a situation out of coverage. *Id*. at 1003; *see* Allan D. Windt, 2 INSURANCE CLAIMS AND DISPUTES 73 (4th ed. Supp. 2006).

48. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 cmt. f (Preliminary Draft No. 2, 2006).

49. *Id.* § 8 cmt. f, illus. 6.

50. *See supra* note 48–49 and accompanying text.

Turning to the problem of unduly constricted coverage, suppose that *A* sues *B* on theories that include contract and tort. *B* submits the claim to *B*'s liability insurance carrier, asking for a defense and coverage of any judgment within policy limits. *B*'s insurance carrier denies coverage and a defense. The reason? The carrier says that the liability insurance policy does not cover claims that are purely for breach of contract; that *A*'s claim against *B* is essentially a claim in breach of contract; that the so-called tort claim is, by reason of the economic loss rule, basically a claim for breach of contract; and, thus, that the carrier owes no coverage or defense obligation. In this example, the economic loss rule—a liability rule—would bleed over into the coverage argument and limit insurance coverage. For reasons explained earlier, this argument is incorrect, yet its intermittent acceptance has reduced the availability of coverage for economic losses.

The reverse problem—overly expansive coverage—might be difficult to see. After all, the availability of coverage should be relevant only if the underlying claim is valid. If the underlying claim loses as a result of the economic loss rule, then arguably it does not matter whether the insurance coverage—if tapped—would pay for that judgment. Yet it can matter. Suppose that *A* sues *B* on a claim for breach of contract, and adds a claim of negligent misrepresentation (a tort theory not excluded by the economic loss rule). The misrepresentation theory, however, is substantively a loser, because the facts do not support the prima facie case for negligent misrepresentation. For reasons relating to the insurer's obligations under insurance law, however, the insurer might be limited in its ability to avoid paying out something for the "tort" claim. As a result, insurance doctrines would end up expanding tort liability for economic torts beyond the boundaries of the economic loss rule.

This account, though, underestimates the effect of insurance coverage on the existence of litigation, the contours of that litigation, the cost of litigation, and the chances for obtaining insurance money even in the absence of coverage. First, and most obviously, if insurers believe that their current general liability language excludes coverage for tort claims for pure economic loss, then they are mistaken. Many courts are ruling against insurers on this point,[51] and in some of these cases the economic loss tort claim is allowed to proceed. To the extent this occurs, insurers have underpriced the general liability coverage. And, to the extent this result is uncertain in given jurisdictions—a likelihood given that the coverage cases in this area are still evolving—insurers could overprice coverages on the mistaken assumption that they will be hit, under general liability policies, for economic loss torts.

51. *See* Anthem Elecs., Inc. v. Pac. Employers Ins. Co., 302 F.3d 1049, 1055–60 (9th Cir. 2002); Federated Mut. Ins. Co. v. Grapevine Excavation, 197 F.3d 720, 725–26 (5th Cir. 1999) (finding occurrence when faulty construction caused damage to a parking lot); Kalchthaler v. Keller Constr. Co., 591 N.W.2d 169, 175–76 (Wis. Ct. App. 1999) (finding an occurrence when faulty workmanship resulted in water leaks that harmed windows and drapes). Other cases go the other direction. For a summary of the split caselaw, see *Lee Builders, Inc. v. Farm Bureau Mutual Insurance Co.*, 137 P.3d 486, 491 (Kan. 2006).

Second, even when the claimant considers a tort claim for pure economic loss in a jurisdiction whose economic loss rule makes the success of this claim unlikely, the pleading of this claim can trigger the duty to defend, which in turn can be a beneficial outcome from the plaintiff's lawyers perspective. For various reasons, an insurer that is on the hook for the duty to defend can find itself with an incentive or need to pay some monies for doubtfully covered claims.[52]

VI. CONCLUSION

The economic loss rule is a tort doctrine, not an insurance coverage doctrine, and not a prescription about optimal shapes and types of coverage for economic loss. Yet the tort doctrine is connected to the insurance market in several ways. First, the tort doctrine affects the shape of the insurance market. Conversely, insurers have tried to shape the insurance market, in part, by trying to transform the economic loss rule into a coverage-determinative doctrine. As we have seen, this has been ineffective as a litigation strategy in many cases. And, in the long run, the effort might have distracted attention from the more important effort: creating efficient and coherent insurance coverage for economic loss. Additional problems add to the dissonance between the economic loss rule and insurance coverages. Insightful drafting can narrow and explain the dissonance, but cannot eliminate it. In part, this is the result of insurance markets and their systemic incapacities to reflect, in policy language, the optimal boundaries of insurance given the underlying tort law. In part, this results from the inevitable incentives that generate insurance interpretation disputes after the relevant losses. And, in part, it results from incoherence in the economic loss rule itself.

Despite these influences, an understanding of how insurance doctrines and theory connect to the economic loss rule can help clarify the boundaries of the rule. This deeper understanding might even propel renewed attention, within the insurance world, to the relationship between tort and contract, and how insurance itself can help clarify that relationship.

52. For explanation of this dynamic in another context—litigation over intentionally produced harms—see Pryor, *supra* note 4, at 1731–38.