

LIABILITY ISSUES IN CONSTRUCTION DEFECT CASES

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INTRODUCTION

This paper addresses the principle liability issues which arise when products used in construction result in defects and failures. Many construction cases involve allegations of defects and poor quality workmanship. It is difficult to avoid the slippery slope and simply provide broad stroke comments about construction litigation in general. While such a discussion might provide a useful primer on some aspects of construction law, it would miss the focus of this CLE. The focus is the liability of various parties if a particular material or product utilized in construction is allegedly defective and fails. This subject is distinguished from an analysis of the *defective workmanship* of a particular party, even though the legal theories involved will invariably overlap.

Construction defects and failures can take many forms.¹ It is the rare construction dispute, regardless of the size, that does not involve allegations of product failure. If these claims are lumped in with the rest of the law suit the analysis is often not materially different from the typical construction dispute. However, there are a number of cases in North Carolina which focus on specific construction defects. This paper will focus on the various claims that plaintiffs assert for construction defects and the various defenses that are typically asserted by general contractors and by the manufacturers of the defective building materials. Each section will focus on a particular parties' point of view. As all attorneys are aware, often the same case can be interpreted several different ways depending on your perspective. The paper will address the applicable statutes of limitation and repose, as these defenses are often the Achilles Heel for plaintiffs in construction defect litigation.

The paper will also provide a detailed discussion of the current state of the economic loss rule in North Carolina. Simply put, this rule bars tort claims in cases where the plaintiffs are only asserting economic losses, such as repair costs, lost profits, etc. The rule can be an effective sword in certain situations, but has exceptions which arguably eviscerate its effectiveness in many construction disputes.

COMMON CLAIMS OF PLAINTIFFS IN CONSTRUCTION DEFECT CASES

Typical claims asserted by plaintiffs in construction defect cases are breach of contract, breach of express warranty, breach of various implied warranties, negligence, negligent misrepresentation, unfair and deceptive trade practices, and fraud.

1. Plaintiffs' Claim for Breach of Contract:

The elements of this cause of action are: (a) a contract; (b) a breach; (c) causation; and (d) damages. Plaintiffs should only assert this claim against parties with whom they are in privity of contract. Standard contracts, such as those promulgated by the American Institute of Architects ("AIA") and the Association of General Contractors ("AGC"), as well as custom contracts, often contain representations that the materials being utilized on the construction project are of good quality, new or similar representations.² and equipment. These representations

¹For example, defective concrete, defective windows or curtain wall, defective claddings (i.e. EIFS), defective piping, defective and leaky roofs, etc.

² See, i.e., Section 3.5.1 AIA A201 (1997) which provides that:

“the contractor warrants to the owner and architect that materials and equipment furnished under the contract will be of good quality and new unless otherwise required or permitted by the contract documents, that the work will be free from defects not inherent in the quality required or permitted, and that the work will conform to the requirements of the contracted documents. Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective. The contractor's warranty excludes remedy for damage or defect caused by abuse, modifications not executed by the contractor, improper or insufficient maintenance, improper operation, or

are often contained in provisions outside the typical warranty provisions of the contract. The addenda of the contract, specifications, and architectural drawings are also useful documents to determine what representations have been made regarding the quality and types of components and products to be used on the project. Accordingly, pleading this claim is simply a brief description of the provision in the contract which requires “quality” or “new” or a certain type of component, and the allegation that said component has failed.

A sampling of cases which hold the general contractor responsible to the owner for construction defects and workmanship deficiencies are as follows: Earls v. Link, Inc., 38 N.C. App. 204, 247 S.E.2d 617, 619 (1978) (general contractor liable for fireplace and attached chimney which failed to adequately remove smoke); Lyon v. Ward, 28 N.C. App. 446, 221 S.E.2d 727 (1976) (general contractor liable for failure to provide useable water supply); Sims v. Lewis, 374 So.2d 298 (Ala. 1979) (contractor responsible for defective septic tank); Carpenter v. Donahoe, 154 Colo. 78, 388 P.2d 399 (1964) (contractor responsible for cracks in basement wall); Weeks v. Slavick Builders, Inc., 24 Mich. App. 621, 180 N.W.2d 503, *affirmed*, 384 Mich. 257, 181 N.W.2d 271 (1970) (contractor responsible for leaky roof); Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314 (1965) (contractor responsible for failure to install boiler valve which regulated temperature for water used for domestic purposes); Waggoner v. Midwestern Development, Inc., 83, S.D. 57, 154 N.W.2d 803 (1967) (contractor responsible for water seepage in basement); Humber v. Morton, 426 S.W.2d 554 (Tex. 1968) (contractor responsible for fireplace and chimney defects); Langley v. Helms, 12 N.C. App. 620, 184 S.E.2d 393 (1971) (the court held that an agreement to construct a house in a good and workmanlike manner did not exclude undertaking to protect the purchaser against the use of bad and unsuitable material in doing the work undertaken); Delly v. Lehtonen, 21 Ohio App.3d 90, 486 N.E.2d 251 (1984) (the court upheld an owner’s suit against the general contractor based on the subcontractor’s improper installation of drain tile, which resulted in water damage in the basement. The contractor chose the subcontractor and was responsible for the poor workmanship of the sub.); Shaw v. Bridges-Gallagher, Inc., 174 Ill. App.3d 680, 528 N.E.2d 1349 (1988) (The general contractor was responsible for the work of the roofing contractor.); Rivnor Properties v. Herbert O’Donnell, Inc., 633 So.2d 735, 744 (La. Ct. App. 1994) (court held against the general contractor who was charged by contract with the sole responsibility for all construction means, methods, techniques, sequences and procedures and for coordinating all portions of the work under the contract. Thus, his duty to the owner was to conduct periodic inspections as needed to assure all work was performed properly, resulting in a building free from defects); Point East Condominium v. Cedar House, 663 N.E.2d 343 (Ohio App. 1995) (the contractor was responsible for the work of his subcontractor); Brooks v. Hayes, 395 N.W.2d 167 (Wis. 1986) (delegation of performance of masonry work did not relieve general contractor of liability for breach of construction contract when mason, and independent contractor, negligently performed that part of general contractor’s contractual obligation).

normal usage. If required by the architect, the contractor shall furnish satisfactory evidence as to the kind and quality of materials

2. Plaintiffs' Claim for Breach of Express Warranties:

In any construction defect case, plaintiffs' counsel should immediately and carefully review the contract, contract specifications and architectural drawings for *any reference* about the quality of the construction materials and components being utilized. Too often general contractors naively think that a specific express warranty provision in the contract, such as, "one year", is the only express warranty made. Typically these types of express warranty provisions pertain to a contractor's obligation to correct or perform repair work itself, which is separate from other express warranties within the contract. However, a careful review of the construction contract will reveal other express warranties, not just those related to the contractors' obligation to correct or repair work. Courts have held in the A201 context that repair warranties are in addition to, and not in lieu of, defect-free warranty obligations. See McDevitt & Street Co. v. K-C Air Conditioning Serv., 203 Ga. App. 640, 418 S.E.2d 87 (Ga. App. 1992); All Seasons Water Users Ass'n v. Northern Improvement Co., 399 N.W.2d 278 (N.D. 1987).

Generally, in the construction industry, an express warranty is a promise, statement or representation in reference to the character or quality of work, goods, or services which becomes a part of the bargain. Burke County Public Schools Board of Education v. Juno Constr. Corp., 50 N.C. App. 238, See J. Acret Construction of Litigation Handbook, Section 14/01 (1986); Daniel L. Brawley, Pleading Considerations-Claims, Cross-Claims and Counterclaims that arise in Construction Litigation. These express warranties may arise in the contract documents, by oral statements or by statute. As for statutory warranties, N.C. Gen. Stat. § 25-2-313 provides:

- (1) Express warranties by the seller are created as follows:
 - (a) Any affirmation of fact or promise made by the seller to the buyer which relates to goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
 - (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
 - (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.
- (2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

Although this UCC statute typically only applies to goods, it has also been applied to construction projects. Westover Products, Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989); Russell v. Baity, 95 N.C. App. 422, 382 S.E.2d 217 (1989).

Generally, the essential elements of a claim for breach of express warranty are:

- (1) Existence of a warranty to the damaged party;
- (2) Breach of the warranty; and
- (3) Damage caused thereby.

13 Am Jur.2d, Building and Construction Contracts, § 115.

A sampling of relevant cases include: Elmore v. Blume, 31 Ill. App.3d 643, 334 N.E.2d 431. (Builder-vendor's oral assurance to purchasers that after "rainy season" basement would be dry constituted express warranty and subsequent water problems in basement resulted in breach of express warranty as well as breach of implied warranty of habitability); Leggette v. Pittman, 268 N.C. 292, 150 S.E.2d 420 (1966) (failure to correct cracks and squeaks in flooring violated express warranty) Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co., 330 F. Supp 906 (E.D.N.C. 1970) (roofing contractor's failure to obtain uniform color in violation of express warranty to do so); Russell v. Baity, 95 N.C. App. 422, 382 S.E.2d 217 (1978) (failure of heating system to "meet state and local codes" is a breach of express warranty); Haywood Street Redevelopment Corp., Inc. v. Peterson, 120 N.C. App. 832, 463 S.E. 2d 564 (1995), *cert. denied*, 342 N.C. 655 (1996) (a breach of warranty continues as a new breach every day that the work fails to comply with the express warranty).

In conclusion, plaintiffs will think very broadly when alleging breach of express warranties. If a particular building material or component failed within the applicable statutory limitations period, an express warranty was breached. The builder's counsel will attempt to narrowly construe any alleged express warranty. It is important to carefully review the contract documents in this regard. Moreover, oral representations made by the builder about the quality of construction provide a basis to assert this course of action.

3. Plaintiffs' Claim of Breach of Implied Warranties:

In residential construction, the implied warranty of habitability that accompanies new dwellings is seemingly harsh for builders. In Medlin v. FYCO, Inc., 139 N.C. App. 534, 541, 534 S.E.2d 622, 627 (2000), North Carolina's appellate courts held a builder to "strict liability" for a construction defect. The court held irrelevant the fact that the builder did not know of the product defect at the time of installation. However, the implied warranty of habitability first discussed in Hartley v. Ballou, 286 N.C. 51, 209 S.E.2d 776 (1974) does not apply to commercial buildings. Dawson Indus., Inc. v. Godley Constr. Co., 29 N.C. App. 270, 224 S.E.2d 226 (1976).

But it has long been recognized in North Carolina that a contractor impliedly warrants the quality of his work:

It is the duty of the builder to perform his work in a proper and workmanlike manner . . . This means that the work shall be done in an ordinarily skillful manner, as a skilled workman should do it . . . There is an implied agreement such skill as is customary will be used. In order to meet this requirement, the law exacts ordinary care and skill only.

Moss v. Best Knitting Mills, 190 N.C. 644, 130 S.E. 635, 637 (1925); see also Cantrell v. Woodhill Enterprises, Inc., 273 N.C. 490, 160 S.E.2d 476 (1968)(The elements for this claim are (1) a construction contract; (2) failure to perform in a workmanlike way or failure to possess the skills necessary to perform the work; and (3) damage resulting from the failure). The contractor's duty to construct in a workmanlike manner extends to materials used in the construction. Langley v. Helms, 12 N.C. App. 620, 184 S.E.2d 393, 397 (1971). Accordingly, an owner may assert a warranty claim against a contractor for defects in workmanship or materials even though the contract may not contain an express warranty to that effect. Id. In addition, a contractor is 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 the general contractor knew or reasonably should have known of those conditions. Lindstrom v. Chestnut, 15 N.C. App. 15, 189 S.E.2d 749, 754 (1972).

Manufacturers are subject to UCC implied warranties for all products they supply to the project. See N.C. Gen. Stat., Section 25-2-314. However, manufacturers will argue that owners do not satisfy the definition of a "buyer" under the UCC. See, N.C. Gen. Stat., Section 25-2-103. In addition, manufacturers will argue that the defective product or "good" becomes realty once installed on the project, and that the UCC no longer applies. See, N.C. Gen. Stat., Section 25-2-105(1) for a definition of goods.

4. Plaintiffs' Claim for Negligence:

As discussed in the section of this paper discussing the Economic Loss Rule, plaintiffs' strong preference in any construction defect claims is to assert a negligence claim against the general contractor, responsible subcontractor and manufacturer of the defective building component, if possible. However, the economic loss rule is often an annoying impediment in that regard. The defense argument is that parties to a construction project ought to be able to allocate risk via contractual provisions and warranties without fear of the broad liability that can be asserted in a tort action.

Actionable negligence presupposes the existence of a legal relationship between parties by which the injured party is owed a duty by the other. Pinnex v. Toomey, 242 N.C. 358, 362, 87 S.E.2d 893, 897 (1955). A duty of care may arise out of a contractual relationship, "the theory being that accompanying every contract is a common law duty to perform with ordinary care, the thing agreed to be done, and that a negligent performance constitutes a tort as well as a breach of

contract.” Olympic Products v. Roof Systems, Inc., 88 N.C. App. 315,363 S.E.2d 367, 371 (1988) (citing Pinnex, 242 N.C. at 362, 87 S.E.2d at 898). Thus, if a defective product is used, the argument can be made against the contractor that the contract has been “negligently performed.”

In addition, there is ample case law that violation of the North Carolina Building Code constitutes negligence *per se*. Olympic Products, *supra*.; *see also* Lindstrom v. Chesnutt, 15 N.C. App. 15, 189 S.E.2d 749, 754 (1972) (Court held that violation of building code is negligence *per se* and that purpose is “to establish **minimum** standards, materials, designs, and construction of buildings for the safety of the occupants . . .”); Oates v. JAG, Inc., 314 N.C. 276, 333 S.E.2d 222, 225 (1985); Drum v. Bisaner, 252 N.C. 305, 113 S.E.2d 560 (1960); Sullivan v. Smith, 56 N.C. App. 525, 289 S.E.2d 870, *cert. denied*, 306 N.C. 392, 294 S.E.2d 220 (1982) and cases cited therein.

Therefore, in construction defect cases, plaintiffs should seek out building code provisions which are applicable to the failed or defective building components. In addition to searching for prescriptive provisions, the building code often has performance based provisions which may be applicable. For example, a contractor under the building code has the responsibility to construct a building which prevents the harmful intrusion of water. If the building leaks, from whatever failed or defective building component, the building code has been violated. Thus, while it is often easy to impale a contractor on a negligence claim, manufacturers are more difficult because of the typical lack of contractual privity.

North Carolina case law sets forth that a manufacturer’s failure to exercise reasonable care renders it liable in negligence. City of Thomasville v. Lease-Afex, Inc., 300 N.C. 651, 268 S.E.2d 190 (1980). It is also well established that a manufacturer may be held liable, absent privity, for harm resulting to foreseeable plaintiffs. *See*, Corprew v. Geigy Chemical Corporation, 271 N.C. 485, 157 S.E.2d 96 (1967) (No privity requirement in actions by remote purchasers against a product manufacturer). The Court of Appeals has further held that manufacturers in construction cases owe a duty of care to the property owner, even absent privity, because a reasonable manufacturer would understand that if it does not use reasonable care in its conduct, it will cause injury to the ultimate purchaser of that product. *See*, Westover Products, Inc. v. Gateway Roofing Co., Inc., et al. 94 N.C. App.163, 175, 380 S.E.2d 375 (N.C. App. 1989) (Manufacturer owes a duty to owner of building, even absent contractual privity, because a reasonable person would understand that failure to use reasonable care in the construction of the roof would cause injury to the owner of the building upon which roof is installed); *see also*, Olympic Products, *supra*.

Manufacturers, however, typically argue that owners’ injuries constitute “economic loss,” and that the “economic loss” doctrine bars homeowners from recovering in tort.³ In North Carolina, the “economic loss” doctrine prevents a plaintiff from recovering for losses due to a product defect if the damage suffered is to the product itself. *See*, Terry’s Floor Fashions, Inc. v. Georgia-Pacific Corp., 1998 WL 1107771, 36 UCC Rep. Serv. 2d 680 (No. 5:97-CV-683-BR(2)(E.D.N.C.1998). Manufacturers will contend that the plaintiffs’ damages are purely economic because the “product” which was damaged was the entire project, and that the

³ See Section on the Economic Loss rule for a more detailed discussion in this regard.

allegedly defective product lost its identity as a separate product when it was integrated into the project. In short, the argument is that the project damaged itself.

This argument can be defeated by alleging damage to property other than the allegedly defective products. For example, the defective windows caused water intrusion problems with the walls. North Carolina law clearly provides that the “economic loss” doctrine bars recovery only for damage to the defective product itself and not for damages where the injury was to other property. Ports Authority v. Roofing Co., 294 N.C. 73, 81, 240 S.E.2d. 345 (1978).

5. Plaintiffs’ Claim for Negligent Misrepresentation:

In a nutshell, this claim can be effective if a plaintiff can prove that one of the parties involved with the defective product, knew or should have known, of its defective nature, and failed to inform the plaintiffs. Focused discovery of the manufacturer’s file may reveal a past history of problems with the defective component, or perhaps a general contractor that has experienced problems on earlier projects.

The North Carolina Court of Appeals has stated that the rules set forth in Restatement (Second) of Torts § 552 (1977), represents the soundest approach to liability for negligent misrepresentation. Raritan River Steel Company v. Cherry, Bekaert & Holland, 322 N.C. 200, 367 S.E.2d 609 (1988). Under the Restatement, as applied by the North Carolina Supreme Court, a defendant who (1) during the course of a business, profession or employment, or in any other transaction in which the defendant has a pecuniary interest, (2) supplies false information for the guidance of others, in their business transaction, (3) is subject to liability for pecuniary loss caused to them, (4) by their justifiable reliance upon the information, (5) if the defendant fails to exercise reasonable care or competence in obtaining or communicating information. Restatement (Second) of Torts § 552(1) (1977). The plaintiffs need to prove defendants knowledge of reckless falsity. Id.

In accepting the Restatement (Second) of Torts, the North Carolina Supreme Court in Raritan River Steel Company rejected three other tests. One of these tests restricted liability to those in privity with the contract, which the court rejected as too restrictive. A test of liability to anyone who was “reasonably foreseeable” was rejected as being too expansive. A third test, which had been applied by the Court of Appeals, was also rejected because it required an assessment of “moral blame” and a policy of preventing future harm, which the Supreme Court thought would be too difficult to apply. See Day and Morris, § 27.50, fn. 72.

The issue of negligent misrepresentation is a question for the jury. In Forbes v. Par Ten Group, Inc., 99 N.C. App. 587, 595, 394 S.E.2d 643, 648 (1990), the North Carolina Court of Appeals stated:

It is, in general, a matter of the care and competence that the recipient of the information is entitled to expect in the light of the circumstances and this will vary according to a good many factors. The question is one for the jury, unless the facts are so clear as to permit only one conclusion.

The particulars in which the recipient of information supplied by another is entitled to expect the exercise of care and competence depend upon the character of the information that is supplied. When the information concerns a fact not known to the recipient, he is entitled to expect that the supplier will exercise that care and competence in its ascertainment which the supplier professes to have by engaging it. Thus, the recipient is entitled to expect that such investigations as are necessary will be carefully made and that his informant will have normal business or professional competence to form an intelligent judgment upon the data obtained.

Id. (emphasis omitted). As negligence cases are not “normally” or “ordinarily susceptible to summary adjudication,” it is rare that a negligent misrepresentation case will be dismissed by means of summary judgment motion. Id.

Both the corporation and its agents may be held liable for negligent misrepresentation. A corporation is liable for negligence through the doctrine of respondeat superior if its agents are negligent. Id. “A corporation is liable for the torts and wrongful acts or omissions of its agents or employees acting within the scope of their authority or the course of their employment.” Raper v. McCrory-McLellan Corp., 259 N.C. 199, 205, 130 S.E.2d 281, 285 (1963).

The following conduct has been held to support a claim for negligent misrepresentation:

(a) Developer of property provided potential builder with information indicating that property was suitable for building and neglected to provide information showing property might not be suitable. Stanford v. Owens, 76 N.C. App. 284, 332 S.E.2d 730, cert. denied, 314 N.C. 670, 336 S.E.2d 402 (1985); and

(b) Soil engineer hired by owner provided negligently prepared soil report to the general contractor. Davidson & Jones v. County of New Hanover, 41 N.C. App. 661, 255 S.E.2d 580, cert. denied, 298 N.C. 295, 259 S.E.2d 911 (1979). See also 49 N.C. App. 488, 272 S.E.2d 19 (1980), cert. denied, 302 N.C. 218, 408 S.E.2d 198 (1981).

6. Plaintiffs’ Claim for Unfair and Deceptive Trade Practices:⁴

This statutory action is sui generis, apparently sounding in tort, but neither wholly tortious or wholly contractual in nature. See Bernard v. Central Carolina Truck Sales, Inc., 68 N.C. App. 228, 230, 314, S.E.2d 582, 584 (1984). A brief explanation of the history of North Carolina’s Unfair and Deceptive Trade Practices Act is helpful to understand that the Act was intended to establish new rights that encourage ethical behavior in the marketplace and provide redress to those wronged by unscrupulous behavior. In the 1960’s, the consumer protection movement became a potent political force. The doctrine of caveat emptor, which had arisen in

⁴ This section is a general discussion because the viability of this claim is extremely fact specific.

the days of personal transactions with merchants with whom one had a long-term relationship, obviously was inappropriate for modern consumer transactions.

Consumer protection regulations traditionally had been vested at the federal level with the Federal Trade Commission. Thus, the starting point in any study of this developing area is the 1914 Federal Trade Commission Act (“FTCA”). 15 U.S.C. § 45(a)(1). The key language and core concepts of “unfairness,” “deception,” and methods of “competition” and their relationship with “commerce” or “business” are found in Title 15 § 45(a)(1) of the United States Code as follows: “Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce are declared unlawful.” *Id.* Unfortunately, the FTCA was of little consolation to the typical victim of unscrupulous practices because it was construed to vest enforcement solely with the Federal Trade Commission and granted no private right of action to individuals. Individual consumers simply were unprotected because, when they brought traditional common law statutory claims against unscrupulous practitioners, the claims were often defeated by a barrage of effective technical defenses. Accordingly, the Federal Trade Commission encouraged the states to adopt legislation similar to the FTCA, which commonly are referred to as “little FTCA Acts,” since they are identical to Section 5 of the FTCA. *See* Richard D. Conner, Cynthia A. Hatfield, Carmen J. Stuart, Unfair and Deceptive Trade Practices in Construction Litigation and Arbitration, 40 S.C. L. Rev. 977, 979 (1980).

In 1967, the North Carolina legislature, with the support of then Attorney General Robert Morgan, passed the initial version of N.C. Gen. Stat. § 75-1.1. The North Carolina Unfair and Deceptive Trade Practices Act adopted language identical to that contained in the FTCA as to unfair methods of competition and unfair and deceptive acts. *See* N.C. Gen. Stat. § 75-1.1(a) (1999). Using federal precedents which are applicable to state causes of action under the North Carolina Unfair and Deceptive Trade Practices Act, Lindner v. Durham Hoisery Mills, 761 F.2d 162 (4th Cir. 1985); Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. 247, 266 S.E.2d 610 (1980), North Carolina’s appellate courts have recognized the Unfair and Deceptive Trade Practices Act’s broad remedial sweep. As is demonstrated below, the Act has been interpreted so as not to be laden with the numerous pitfalls that plagued the traditional common law statutory claims in this area of law.

A. The Wide Breadth of North Carolina’s Unfair and Deceptive Trade Practices Act

The traditional common law statutory claims that combated unfair and deceptive business acts have often required a multitude of onerous elements and were subject to numerous defenses. The North Carolina Supreme Court has identified these pitfalls as the legislative purpose behind North Carolina’s “little FTC Act:”

Such legislation was needed because common law remedies have proven often ineffective. Tort actions for deceit in cases of misrepresentation involve proof of scienter as an essential element and were subject to the defenses of “puffing.” Proof of actionable fraud involved a heavy burden of proof, including a showing of intent to deceive. Actions alleging breach of express and implied

warranties in contracts also entailed burdensome elements of proof. A contract action for rescission or restitution might be impeded by the parole evidence rule where a form contract disclaimed oral representations made in the course of a sale. Use of a product after discovery of a defect or misrepresentation might constitute an affirmation of the contract. Any delay in notifying a seller of an intention to rescind by foreclosing an action for rescission.

Marshall v. Miller, 302 N.C. 539, 543, 276 S.E.2d 397,400 (1981). In order to combat this inequity, our courts broadly have construed the North Carolina statute on a case-by-case basis. In Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. at 247, 266 S.E.2d at 621, the North Carolina Supreme Court stated, “the broad language of the statute indicates that the scope of its concept and application is not limited to precise acts and practices which can be readily cataloged.”

B. The Three Factor Analysis

North Carolina courts apply a three factor analysis to determine whether a claim for unfair trade practices is sufficient. First, there must be a practice, act, or representation that falls within the definition of “unfair” or “deceptive.” Our courts generally have described a practice as

“unfair” when it offends established public policy as well as when the practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers. Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. at 263, 263 S.2d at 621. An act is “deceptive” if it has the capacity or tendency to deceive. Id. at 265, 263 S.E.2d at 622.

Second, North Carolina courts require the act or practice to have an impact on the marketplace. Usually, an act has been found to impact the marketplace either because it was part of a larger pattern, or because the act was so strongly against public policy that the court’s failure to redress the behavior threatened consumers in general. See Conner, Unfair and Deceptive Trade Practices in Construction Litigation and Arbitration, 40 S.C.L. Rev. at 93. In light of numerous court rulings, defendants cannot claim that construction contracts do not fall within the “in or affecting commerce” requirement. See Love v. Keith, 95 N.C. App. 549, 239 S.E.2d 674 (1989); Quate v. Caudle, 95 N.C. App. 80, 381 S.E. 2d 842, cert. denied, 325 N.C. 709, 388 S.E.2d 462 (1989).

Third, and finally, North Carolina courts require that the act or practice have an adverse impact on the aggrieved individual or entity in the form of actual damages. See Miller v. Ensley, 88 N.C. App. 686, 691, 365 S.E.2d 11, 14 (1988).

C. Deceptive Acts

The concept of deception relative to N.C. Gen. Stat. § 75-1.1 is quite broad. See Noel L. Allen, North Carolina Unfair Business Practice, § 19-1.

Deception can be best understood as a continuum ranging from outright fraud (a *per se* violation of Section 75-1.1) to statutory

misrepresentation (misrepresentation made illegal by statute without regard to intent of the representor. Misrepresentation, constructive fraud, negligent misrepresentation and representations having only the capacity or tendency to deceive though literally true also qualify as deception).

Relying on decisions interpreting the FTCA, the North Carolina Supreme Court has held that an act is deceptive if it has “the capacity or tendency to deceive.” Johnson v. Phoenix Mutual Life Insurance Company, 300 N.C. 247, 266, 266 S.E.2d 610, 629 (1980). To be actionable, representations need not be affirmative, but may also be an omission. See Winant v. Bostic, 5 F.3d 767 (4th Cir. 1993) (developer’s omissions of material facts concerning permits was found to be an unfair and deceptive trade practice).

D. Unfair Acts

The North Carolina Supreme Court has approved the following definition of “unfair:”

While an act or practice which is unfair may also be deceptive, or vice versa, it need not be so for there to be violation of the Act.

...

The concept of unfairness is broader than and includes the concept of “deception.” A practice is unfair when it offends established public policy as well as when the practice is immoral, unethical, oppressive, or unscrupulous or substantially injurious to consumers . . .

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.

Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. at 263-64, 266 S.E.2d at 621-22.

Thus, it is clear that unfairness is far broader than “deception” and encompasses more actions than those which have a “tendency or capacity to deceive.” These actions have included intentional torts (Love v. Pressley, 34 N.C. App. 503, 239, S.E.2d 574 (1977), cert. denied, 299 N.C. 441, 241 S.E.2d 843 (1978); coercion (Wilder v. Squires, 68 N.C. App. 310, 315 S.E.2d 63, cert. denied, 311 N.C. 769, 321 S.E.2d 158 (1984); and conspiracy (Pedwell v. First Union National Bank of North Carolina, 51 N.C. App. 236, 275 S.E.2d 565 (1981).

E. Few Defenses

Very few defenses are available under the Unfair and Deceptive Trade Practices Act. Scierter is not an element, and it is not necessary to show fraud, bad faith, or intentional deception. See Overstreet v. Brookland, 52 N.C. App. At 444, 279 S.E.2d at 1. It also is not necessary that actual deception has occurred, but only that the action has a tendency or capacity to deceive. See Bailey v. Lebeau, 318 N.C. 411, 348 S.E.2d 524 (1986); Forbes v. Par Ten

Group, Inc., 99 N.C. App. 587, 394 S.E.2d 643 (1990); Love v. Keith, 95 N.C. App. 549, 383 S.E.2d 674 (1989). It is irrelevant whether the defendants made their representations negligently and in good faith, and in ignorance of their falsity, and without intent to mislead. See Marshall v. Miller, 302 N.C. 539, 276 S.E.2d at 397; Forbes v. Par Ten Group, Inc., 99 N.C. App. at 601, 394 S.E.2d at 651. In fact, even truthful statements may be deceptive if it has the capacity or tendency to deceive. Pearce v. American Defender Life Ins. Co., 316 N.C. 461, 471, 343 S.E.2d 174, 180 (1986). When dealing with unfairness, actual misstatements are not required because a technically accurate representation may be in some circumstances, considered to have a tendency to deceive. See Davidson v. Knauff Ins. Agency, Inc., 93 N.C. App. 20, 376 S.E.2d 488, rev. denied, 324 N.C. 577, 381 S.E.2d 772 (1980).

Claims for unfair and deceptive trade practices in construction defect litigation, as with any litigation, can be potent given the broad scope of the statute. The key will be showing knowledge of the defective product prior to installation.

7. Plaintiff's Claim for Fraud:

North Carolina courts have deliberately failed to fix a definition of fraud lest the definition itself turn into an avenue of escape by the crafty and unscrupulous. Roberson v. Williams, 240 N.C. 696, 83 S.E.2d 811 (1954). However, it is axiomatic that owner/plaintiffs are entitled to recover for fraud when they establish the following elements: (1) false representation or concealment of a material fact; (2) reasonably calculated to deceive; (3) made with the intent to deceive; (4) which does, in fact, deceive; and (5) resulting in damage to the injured party. Terry v. Terry, 302 N.C. 77, 273 S.E.2d 674, 677 (1981).

A. False Representation Or Concealment Of A Material Fact

The first maxim of fraud requires a definite and specific representation that is materially false. North Carolina courts have interpreted this principle to include concealments and statements about third persons' actions. See Griffin v. Wheeler-Leonard & Co., 290 N.C. 185, 225 S.E.2d 557, 565-566 (1976); Leake v. Sunbelt Ltd., 93 N.C. App. 199, 377 S.E.2d 285, 288-289, rev. denied, 324 N.C. 578, 381 S.E.2d 774 (1989). A representation is material when it induces a person to act. Cofield v. Griffin, 238 N.C. 377, 78 S.E.2d 131, 133 (1953). A fact is considered material if it is a contingency upon which a conditional contract is based. Bolick v. Townsend Co., 94 N.C. App. 650, 381 S.E.2d 175, 178 rev. denied, 325 N.C. 545, 385 S.E.2d 495 (1989).

When a defendant has a duty to speak, the concealment of a material fact is equivalent to an affirmative fraudulent misrepresentation. Griffin v. Wheeler-Leonard and Co., 290 N.C. at 198, 225 S.E.2d at 565; First Citizens Bank & Trust Co. v. Akelaitis, 25 N.C. App. 522, 214 S.E.2d 281, 284 (1975). When changes occur that affect the conditions of affairs, making previous statements false, the party making those statements has a duty to disclose the change in conditions. Childress v. Nordman, 238 N.C. 708, 78 S.E.2d 757, 761 (1953).

The general rule is that silence, to be actionable fraud, must relate to a material matter known to the party that has a legal duty to communicate to the other party. Brooks v. Ervin

Constr. Co., 253 N.C. 214, 116 S.E.2d 454 (1960); New Bern Pool & Supply Co. v. Graubart, 94 N.C. App. at 619, 381 S.E.2d at 156; Brickell v. Collins, 44 N.C. App. 707, 262 S.E.2d 387, rev. denied, 300 N.C. 194, 269 S.E.2d 622 (1980). The legal duty to speak may arise from a confidential or fiduciary relationship, from trust, from inequality of conditions, or from one who knows material facts, or from other circumstances. See Libby Hill Seafood Restaurants, Inc. v. Owens, 62 N.C. App. 695, 303 S.E.2d 565, rev. denied, 309 N.C. 321, 307 S.E.2d 164 (1983). A duty to disclose arises when one party to a transaction has knowledge of a latent defect in the subject matter or the transaction about which the other party is ignorant. Harton v. Harton, 81 N.C. App. 295, 344 S.E.2d 117, disc. rev. denied, 317 N.C. 703, 347 S.E.2d 41 (1986). Under these conditions, silence will constitute fraud as it is an affirmation that a state of affairs exists which, in reality, does not exist. Setzer v. Old Republic Life Ins. Co., 257 N.C. 396, 126 S.E.2d 135, 137 (1962).

A partial disclosure of a material fact may also be actionable. It is well established that when there is a duty to speak, disclosure must be complete. See Ragsdale v. Kennedy, 286 N.C. 130, 209 S.E.2d 494, 501. Even if no duty exists, when one begins to speak, he must make a full and fair disclosure as to the matters he discusses. Id. at 139, 209 S.E.2d at 501.

Actions for fraud in construction litigation are quite common. See, e. g. Rowan County Board of Education v. United States Gypsum Co., 332 N.C. 1, 418 S.E.2d 648 (1992); J.M. Westfall & Co. v. Windswept View of Asheville, Inc., 97 N.C. App. 71, 387 S.E.2d 67, cert. denied, 327 N.C. 139, 394 S.E.2d 175 (1990) (false statements concerning bond).

B. Scienter, Or Conduct Reasonably Calculated To Deceive And Made With The Intent To Deceive

Two elements of fraud comprise the tort's scienter requirement. First, the culpable party must have knowledge about the representation's falsity. The Defendants need not have actual knowledge that the representation was false. Instead, the Court should deem this element satisfied when the defendant made the representation with reckless indifference as to the representation's truth or falsity. Atkinson v. Charlotte Builders, Inc., 232 N.C. 67, 59 S.E.2d 1 (1950). But See Myers & Chapman, Inc. v. Thomas G. Evans, Inc., 323 N.C. 559, 568-69, 374 S.E.2d 385, 391-92 (1988), reh'g denied, 324 N.C. 117, 377 S.E.2d 235 (1989), and the criticism in Robert G. Byrd, Misrepresentation in North Carolina, 70 N.C.L. Rev. 323, 326-330 (1991). The Myers & Chapman case has come under severe scrutiny, and most commentators agree that it should be overturned.

A plaintiff must also establish that a representation was made with the intent to deceive in order to recover on a fraud claim. Myers & Chapman, Inc. v. Thomas G. Evans, Inc., 323 N.C. at 559, 374 S.E.2d at 385. The defendant must have made the representation with the intent to induce the innocent party to act or to refrain from acting in reliance upon the representations.

Plaintiffs in these cases may also proceed under a constructive fraud theory. To show constructive fraud, a Plaintiff must allege facts and circumstances that created a relationship of trust and confidence. Watts v. Cumberland County Hospital Systems, Inc., 317 N.C. 321, 345 S.E.2d 201 (1986); Lowry v. Lowry, 99 N.C. App. 246, 393 S.E.2d 141 (1990). A confidential

or fiduciary relationship exists in all cases where there has been a special confidence reposed in those who, in equity or good conscience, are bound to act in good faith and with due regard to the interests of one reposing confidence. See Speck v. North Carolina Dairy Foundation, Inc., 311 N.C. 679, 319 S.E.2d 139 (1984). Constructive fraud differs from actual fraud in the intent to deceive, or scienter, is not an element, but is presumed to exist. See Link v. Link, 278 N.C. 181, 179 S.E.2d 697 (1971).

C. Conduct Which Does, In Fact, Deceive

The innocent party must have acted in reliance on the Defendants' misrepresentation, and the reliance must have been reasonable. Myers & Chapman, 323 N.C. at 568, 374 S.E.2d at 391. A plaintiff is entitled to rely on a positive and definite representation when the representation is of a character to induce a person of ordinary prudence to act to his damage. See Douglas v. Doub, 95 N.C. App. 505, 383 S.E.2d 423, 427 (1989). The failure to make inquiry will not preclude an action for fraud when there is nothing which would put a reasonable man on notice of the necessity for additional inquiry. See Keith v. Wilder, 241 N.C. 672, 86 S.E.2d 444 (1955).

In Douglas v. Doub, 95 N.C. App. at 505, 383 S.E.2d at 423, the court refused to grant defendant's motion for directed verdict that was based upon the contention that Plaintiff's reliance was not justified because he failed to investigate. Id. at 512, 383 S.E.2d at 426-427. The court stated: "One to whom a positive and definite representation has been made is entitled to rely on such representation if the representation is of a character to induce action by a person of ordinary prudence, and is reasonably relied upon." Id. at 512, 383 S.E.2d at 427 (emphasis in original) (citations omitted).

D. Conduct Which Results In Damage To The Injured Party

Plaintiffs also must demonstrate that Defendants' fraudulent actions damaged the plaintiffs. Damages can be established by the cost to replace or repair the defective components or materials on the project.

CONTRACTOR'S DEFENSES

1. Contractor's Defense to Breach of Contract:

The contractor's grounds for summary judgment or directed verdict on an owner's breach of contract claim are varied depending on the specific contractual relationship between the parties in each case. As discussed in the plaintiffs' claims section of this paper, construction contracts often provide express representations of quality. Without proof that the construction failed to comply with those express representations, owners should not be able to prevail on their breach of contract claim.

Similarly, when an owner hires a general contractor to construct a project in accordance with plans provided by the owner or an architect retained by the owner, the general contractor cannot as a matter of law be held liable for any damages arising from his required compliance with those plans:

[W]hen a contractor is required to and does comply with 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 Board of Education v. Juno Construction Co., 50 N.C. App. 238, 273 S.E.2d 504, 506-07 (1981), review allowed, 302 N.C. 396, 279 S.E.2d 350, review dismissed as improvidently granted, 304 N.C. 187, 282 S.E.2d 778 (1981). Moreover, the contractor may face liability if he does not comply with the architect's plans, even if they were defective. Id. at 507 ("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."). Accordingly, if a general contractor is required to follow plans provided by the owner and those plans call for use of particular product or material, then the contractor will argue that it cannot be held liable for defects resulting from the required use of the product or material.

2. Contractor's Defense to Breach of Express Warranty:

Owners advancing breach of express warranty claims must reply upon written warranties, as no oral representations may be relied upon to alter the terms of the parties' written contract. Under North Carolina law, "[t]he parol evidence rule excludes prior or contemporaneous oral arguments which are inconsistent with a written contract if the written contract contains the complete agreement of the parties." Tar River Cable TV, Inc. v. Standard Theatre Supply Co., 62 N.C. App. 61, 302 S.E.2d 458, 460 (1983). In cases involving a written construction contract, both the North Carolina Court of Appeals and the Supreme Court have held that the parol evidence rule excludes evidence of oral statements or representations concerning the construction projects at issue. See, e.g., Dixon v. Sedgefield Realty Co., 42 N.C. App. 650, 257 S.E.2d 466, 468 (1979) (noting that "parol testimony of prior or contemporaneous negotiations or conversations inconsistent with the writing, or which tend to substitute a new and different contract from the **one** evidenced by the writing, is incompetent"), review denied, 298 N.C. 567, 261 S.E.2d 121 (1979); Robbins v. C.W. Myers Trading Post, Inc., 253 N.C. 474, 117 S.E.2d 438 (1960) (finding error in the admission of alleged oral promises to use "good materials" and "first class materials" because "the parties are presumed to have inserted in the contract all provisions by which they intend to be bound"). Accordingly, without a written warranty apart from the parties' contract, general contractors will argue that they are entitled to judgment as a matter of law on homeowners' express warranty claims.

Contractors often present owners with a written one-year limited warranty agreement. The language of those warranty documents generally limits the responsibility of the general contractor to repairing latent defects discovered during a one-year warranty period often beginning from the date of substantial completion. If the owner does not inform the general contractor of the alleged problems that are the subject of the defective material, within the requisite time period, the general contractor will argue that, in accordance with the plain language of the parties' express warranty agreement, the material-related complaints are not the responsibility of the general contractor. See, e.g., Moore, 1998 WL 2371283 at *5 (affirming a

grant of summary judgment based on a limited one-year warranty that “was effective to bar as untimely any claims for breach of express or implied warranties” that arose outside of the one-year warranty period).

3. Contractor’s Defense to Claim of Breach of Implied Warranties:

As discussed early in this paper, the recent case of Medlin, *supra*, is a lethal sword against contractors for claims of breach of implied warranty of habitability in residential cases. Because of the court’s expressly invoking strict liability against the contractor, a contractor’s best defense is to attack and minimize damages. If done at the time of contracting, the implied warranty of habitability also can be disclaimed. See Griffin v. Wheeler-Leonard & Co., Inc., 290 N.C. 185, 225 S.E.2d 557 (1976). However, the disclaimer must be with clear, unambiguous language reflecting that the parties fully intended such a result.

With regard to commercial cases, a contractor’s best defenses to claims for breach of implied warranties is to effectively disclaim them. Even though there are ample arguments that goods (building components) become realty once installed, a contractor should comply with the disclaimer requirements of N.C. Gen. Stat. § 25-2-316. Thus, if the disclaimer is conspicuous, etc., a contractor has legally done everything possible to limit its liability in this regard.

4. Contractor’s Defense to Claim for Negligence:

See section of plaintiffs’ claims for negligence and section on the Economic Loss Rule for a discussion in this regard.

5. Contractor’s Defense to Claim for Negligent Misrepresentation:

The North Carolina Court of Appeals recently examined the requirements for recovery under a negligent misrepresentation claim in the context of a real estate transaction:

Plaintiff’s alternative claim for negligent misrepresentation also fails. In Powell v. Wold, 88 N. C. App. 61, 67, 362 S.E.2d 796, 799 (1987), this court stated North Carolina has adopted the Restatement of Torts definition and requirements for negligent misrepresentation:

‘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 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.’

Id. (quoting Restatement (Second) of Torts § 552 (1977)).

Helms v. Holland, 124 N.C. App. 629, 635, 478 S.E.2d 513, 517 (1996).

Owners generally cannot present evidence that their general contractor negligently misrepresented the nature of an allegedly defective product or omitted to disclose the potential problems with its use for one simple reason – there will be no evidence that the general contractor knew or should have known of the potential problems at the time the project was constructed.

6. Contractor’s Defense to Claim for Unfair and Deceptive Trade Practices:

Owners will have difficulty establishing that a general contractor’s use of a defective product on a project constituted an unfair trade practice, as North Carolina law provides that “[a]n unfair trade practice is one that offends established public policy, is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.” Blackwell v. Dorosko, 93 N.C. App. 310, 377 S.E.2d 814, 817-18 (citations omitted), withdrawn in part on other grounds on rehearing, 95 N.C. App. 637, 383 S.E.2d 670 (1989). Accordingly, “[a] party is guilty of an unfair act or practice [only] when it engages in conduct that amounts to an inequitable assertion of its power or position.” C.F.R. Foods, Inc. v. Randolph Development Co., 107 N.C. App. 584, 421 S.E.2d 386, 389 (citing Libby Hill Seafood, 303 S.E.2d at 569, (affirming a dismissal of an unfair and deceptive trade practice claim based on the plaintiff’s failure to present evidence of an inequitable assertion of power), rev. denied, 333 N.C. 166, 424 S.E.2d 906 (1992); Love v. Keith, 95 N.C. app. 549, 383 S.E.2d 674, 678 (1978) (noting that coercive tactics constitute an unfair practice), overruled in part on other grounds, Custom Molders, Inc. v. American Yard Products, Inc., 342 N.C. 133, 463 S.E.2d 199 (1995). Use of a defective product can rarely satisfy these legal requirements because a general contractor will never intentionally use defective products.

The North Carolina Court of Appeals examined fraud and unfair and deceptive trade practice claims against a builder in Warfield. In Warfield, a builder knowingly “refused to install ‘heavy hand-hewn beams’ as called for in the original specifications but offered to substitute old beams from a tobacco barn.” 370 S.E.2d at 691. During construction, when the plaintiffs became aware of the possibility that the beams were infested with beetles, they asked the builder if the beetles would be a problem, and the defendant assured them that the beetles would not be a problem for them. After closing, the plaintiffs experienced problems with

sawdust and scratching noises caused by an active infestation of beetles. The plaintiffs then learned that the beetle infestation would cause the home to fail a pest inspection, making it potentially difficult for them or future buyers to obtain financing on the home, and brought suit against the builder for fraud and unfair and deceptive trade practices.

Examining the plaintiffs' fraud and unfair and deceptive trade practice claims, the court noted that "the plaintiffs' evidence taken in the most favorable light shows merely that [the builder] made a general, unspecific statement of opinion about the potential future consequences of using beetle-infested beams and [did] not support a reasonable inference that he intended to deceive or mislead the [plaintiffs]." *Id.* at 693. The court further noted that the builder's actions "simply [did] not rise to the level of oppressive, unscrupulous, or deceptive conduct which would constitute an unfair or deceptive act or practice." *Id.* Finding the evidence unable to support the elements required to recover on the claims of fraud and unfair and deceptive trade practices, the North Carolina Court of Appeals held that these claims should not have been submitted to the jury.

7. Contractor's Defense to Claim for Fraud:

North Carolina Civil Procedure Rule 9(b) requires that fraud be alleged with particularity. Owner/plaintiffs "bear the burden of proving all elements of a cause of action for fraud in their forecast of evidence." *Johnson v. Beverly-Hanks & Associates, Inc.*, 328 N.C. 202, 400 S.E.2d 38, 42 (1991). Owners often cannot prove a number of the elements of their fraud claims against general contractors because pursuant to North Carolina law,

[t]o make out a case of actionable fraud, [plaintiffs] must show that: (1) [the defendant] made a representation relating to some material past or existing fact; (2) the representation was false; (3) [the defendant] knew it was false or made it recklessly and as a positive assertion; (4) [the defendant] made the representation with the intention that it be acted upon by the [plaintiffs]; (5) [the plaintiffs] reasonably relied upon the representation and acted upon it; and (6) they suffered injury.

Warfield, 370 S.E.2d at 693.

For example, owners often cannot present any evidence that the general contractor knowingly made a false statement concerning the allegedly defective product, or that builders and others in the local and national construction industry did not and could not have known of the problems at the time the project was constructed.

In addition, and importantly, plaintiffs alleging fraud must prove an intent to deceive. *Myers & Chapman, Inc. v. Thomas G. Evans, Inc.*, 323 N.C. 559, 374 S.E.2d 385 (1988). Owners generally cannot prove that the general contractors made any statement with the specific intent to defraud:

Without the element of intent to deceive, the required scienter for fraud is not present. The term "scienter" embraces both knowledge

and an intent to deceive, manipulate or defraud.

Myers & Chapman, Inc. v. Thomas G. Evans, Inc., 323 N.C. 559, 374 S.E.2d 385, 391 (1988) (citing Black's Law Dictionary 1207 (5th ed. 1979) (additional citations omitted). Moreover, the North Carolina Supreme Court has specifically disavowed any "cases [that] omit the essential element of the intent to deceive in a definition of fraud."

MANUFACTURER'S DEFENSES

1. Manufacturer's Defense to Claim of Breach of Contract:

This is typically not a viable claim for owner/plaintiffs in construction defect cases because of the lack of contractual privity. It is the rare owner/plaintiffs who has a contract with the manufacturer that supplied the defective component or material. Thus, owner/plaintiffs must look to other legal theories to proceed against manufacturers.

2. Manufacturer's Defense to Claim of Breach of Express Warranty:

Manufacturers often issue an express warranty that is intended to be delivered to the owners. There is often an issue of fact as to whether the owner ever received that warranty. However, it is not uncommon for the general contractor or responsible subcontractor to not apply for or obtain a readily available express warranty from the manufacturer. That issue of fact is immaterial, however, because regardless of whether they received the warranty, plaintiffs typically cannot establish a claim for breach of express warranty.

Initially, plaintiffs' express warranty claims often fail by the terms of the express warranty. The typical express warranty issued by manufacturers provides that "[N]o warranty whatsoever is made for damage caused in whole or in part by defective or improper workmanship by the subcontractor." Often, the manufacturer will have ample evidence of an installation deficiency that caused the problem or defect.

In addition, manufacturer warranties typically limit plaintiffs' remedy to the cost of the materials. This amount is often modest, particularly when labor and installation changes are not included. This type of damage limitation is authorized by the Uniform Commercial Code. See Billings v. Joseph Harris Co., 290 N.C. 502, 226 S.E.2d 321 (1976).

Finally, manufacturers often argue that an express warranty claim under the UCC requires evidence that (a) the seller made specific affirmations or promises that were the "basis of the bargain" between the seller and buyer, and (b) the buyer relied on those affirmations or promises in deciding to purchase the product. As N.C.G.S. § 25-2-313 provides:

- (A) Express warranties by the seller are created as follows:
 - (1) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express

warranty that the goods shall conform to the affirmation or promise.

- (2) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
- (3) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

N.C. Gen. Stat. § 25-2-313(1) (1999) (emphasis added); Westover Products Inc. v. GatewayRoofing, Co., Inc., 94 N.C. App. 63, 72, 380 S.E.2d 369, 375 (1989) (reliance is a central aspect of “basis of the bargain”). Of course, manufacturers will argue that no representations or actions were taken by it which was a “basis of the bargain” in plaintiffs’ discussions on the project.

3. Manufacturer’s Defense to Claim of Breach of Implied Warranties:

Manufacturers argue that warranties are creatures of statute, necessarily limited to their enabling language. The Uniform Commercial Code does not recognize plaintiffs as having received any warranties from a manufacturer merely by having constructed a project utilizing their particular defective product. See N.C. Gen. Stat. §§ 25-2-313 - 318.

Initially, warranties may be made only by a “seller” to a “buyer” as part of a contract for sale. See N.C. Gen. Stat. §§ 25-2-313, 314, 315. While it is typically easy to establish that a manufacturer was the “seller” of the defective product, as defined by N.C. Gen. Stat. § 25-2-103(1)(d), it is more difficult to fit the typical project/owner into the statutory definition of buyer. A “buyer” is defined as “a person who buys or contracts to buy goods,” See N.C. Gen. Stat. § 25-2-103(1)(a) (1999). Plaintiffs are typically not “buyers” under that definition. Plaintiffs also typically do not qualify as “buyers” by operation of N.C. Gen. Stat. § 25-2-318. While it is often undisputed that plaintiffs paid the contractor to construct the project, the project is not a “good” under the Commercial Code:

[Goods are defined as] all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than money in which the price is to be paid, investment securities (article 8) and things in action. ‘Goods’ also includes the unborn young animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty.

N.C. Gen. Stat. § 25-2-105(1) (1999). Because a construction project is not a “good,” plaintiffs cannot receive an implied warranty from a manufacturer under the UCC regarding their project.

In addition, plaintiffs are typically not in privity with a manufacturer, and seek recovery only for economic loss. Under North Carolina law, plaintiffs may not sue for breach of implied warranty in the absence of privity where damages are purely economic. See Gregory v. Atrium Door and Window Co., 106 N.C. App. 142, 144, 415 S.E.2d 574, 575 (1992). In Gregory, plaintiffs contracted with a construction company to build a house. The doors purchased did not function properly, causing deterioration to the doors and water damage to the flooring. Plaintiffs brought suit against, *inter alia*, defendant Atrium for breach of implied warranty. The trial court found that Atrium had given Plaintiffs implied warranties of merchantability and fitness for particular purpose and breached them.

The Court of Appeals reversed, explaining that the trial court's findings showed that "only economic loss" resulted from the alleged breach in the form of malfunctioning and deteriorating doors, along with some water damage to flooring." Id. (emphasis added). The Court continued, "Outside the exceptions created by G.S. Chapter 99B, the general rule is that privity is required to assert a claim for breach of an implied warranty involving only economic loss." Although Plaintiffs were in privity with the door retailer, they were not in privity with defendant manufacturer Atrium. Thus Plaintiffs were not entitled to assert an action for breach of implied warranty. See Id.

4. Manufacturer's Defense to Claim of Negligence:

North Carolina's economic loss rule provides that recovery in negligence is permissible only where there is physical injury to person or property other than the purchased property itself. See Reece v. Homette Corp., 110 N.C. App. 462, 429 S.E.2d 768 (1993). Often plaintiffs will fall into the trap of not alleging personal injuries or damage to other property. As such, plaintiffs negligence claims will be barred by operation of the economic loss rule. See AT&T Corp. v. Medical Review of N.C., Inc., 876 F. Supp. 91, 93-95 (E.D.N.C. 1995).

Manufacturers strenuously argue that damage caused to a project/property by an integrated component, albeit allegedly defective, is only damage to the project/property itself; and thus simply economic loss for which recovery in negligence is barred. See, Moore v. Coachman Industries, Inc., 129 N.C. App. 389, 499 S.E.2d 772 (1998) (damage to recreational vehicle caused by faulty component was economic loss in action against component manufacturer); Gregory v. Atrium Door and Window Co., 106 N.C. App. 142, 144, 415 S.E.2d 574, 575 (1992) (damage to flooring of a house was economic loss in action against manufacturer of doors which leaked); Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 431-32, 391 S.E.2d 211, 216-217 (1990) (damage to drying ranges caused by explosion of component pressure vessels was economic loss and was not recoverable in negligence in an action against the manufacturer of the component pressure vessels or in an action against an inspector of the pressure vessels).

Moore, supra, also aptly demonstrates application of the economic loss rule. In Moore, plaintiffs purchased a recreational vehicle that burned because of a malfunction of an electrical component within the vehicle. The Court of Appeals ruled that because plaintiffs had purchased a recreational vehicle, the entire vehicle was the applicable "property" for economic loss rule purposes – even for purposes of plaintiffs' claim against the manufacturer of the defective

electrical component. See Moore, 129 N.C. App. at 401-402, 499 S.E.2d at 780. The Court reasoned:

North Carolina has adopted the economic loss rule, which prohibits recovery for economic loss in tort. Instead, such claims are governed by contract law – in this case, the UCC. The courts have construed the term “economic loss” to include damages to the product itself. *See Ports Authority v. Roofing Co.*, 294 N.C. 73, 240 S.E.2d 345 (1978); *Reece*, 110 N.C. App. 462, 429 S.E.2d 768. 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. *See Reece*, 110 N.C. App. at 466-67, 429 S.E.2d at 770. Where a defective product caused damage to property other than the product itself, losses attributable to the defective product are recoverable in tort rather than contract. *Id.* at 467, 420 S.E.2d at 770.

Id. Thus, plaintiffs were barred from recovering in negligence for damage to the recreational vehicle.

Manufacturers also argue that damage to a house caused by a faulty component of the house is clearly economic loss. See Gregory v. Atrium Door and Window Co., 106 N.C. App. 142, 144, 415 S.E.2d 574, 575 (1992). In Gregory, Plaintiffs contracted with a construction company to build a residence. Plaintiffs purchased doors manufactured by defendant Atrium Door and Window Co. (“Atrium”) for installation in the residence. These doors did not function properly, causing water damage to the flooring of the house as well as deterioration to the doors. Plaintiffs brought suit against defendant Atrium for breach of implied warranty. On appeal, the key issue was whether Plaintiffs suffered purely economic loss. The Court of Appeals found that “only economic loss had resulted from the alleged breach in the form of malfunctioning and deteriorating doors, along with some water damage to the flooring.” Id. (emphasis added).

Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 431-32, 391 S.E.2d 211, 216-17 (1990), records another application of the economic loss rule. In Chicopee, plaintiff Chicopee, Inc. was a textiles manufacturer that contracted with defendant American Tool and Machine Company to manufacture two drying ranges and to install them in Chicopee’s manufacturing plant. Each drying range was to contain forty pressure vessels as components, and American Tool subcontracted with Sims Metal Works for the manufacture of the eighty pressure vessels. Several years later, one of the pressure vessels exploded, causing damage to fabrics and chemicals used in the manufacturing process. Upon investigation, Chicopee discovered that most of the remaining pressure vessels had not been manufactured in compliance with the applicable manufacturing code, and replaced all of the defective vessels.

Chicopee brought a negligence action against American Tool, Sims, and the insurance company hired to inspect the pressure vessels for compliance with applicable manufacturing codes. Chicopee sought recovery for the damage to fabric and chemicals as well as the cost of inspecting and replacing all of the defective pressure vessels. Defendants filed a motion for partial summary judgment on the basis that plaintiffs' damages should be limited to the value of the other property (fabrics and chemicals) damaged by the explosion. The trial court granted this motion, saying that plaintiffs' damages "cannot include economic or pecuniary losses such as the costs to replace property not damaged by the explosion described in the Complaint." *Id.* The Court of Appeals affirmed:

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 to have held that purely economic losses are not ordinarily recoverable under tort law. 2000 Watermark Ass'n Inc. v. Celotex Corp., 784 F.2d 1183, 1185 (4th Cir. 1986), and cases cited therein. We adopt this rule and find no error in Judge Brewer's order.

Id.; See also North Carolina Ports Authority v. Lloyd A. Fry Roofing Co., 294 N.C. 73, 240 S.E.2d 345 (1978) (negligence action generally does not lie against promisor for simple failure to perform a contract).

5. Manufacturer's Defense to Claim for Negligent Misrepresentation:

As discussed in prior sections of this paper, to prove negligent misrepresentation, plaintiffs must show that a manufacturer (a) knew and intended that plaintiffs would rely on its opinions, (b) supplied false information to plaintiffs for their guidance in business transactions; and (c) failed to exercise reasonable care or competence in obtaining that information. Plaintiffs must also prove that (d) plaintiffs justifiably relied on the information and suffered pecuniary loss proximately caused by this reliance. See Helms v. Holland, 124 N.C. App. 629, 478 S.E.2d 513 (1996) (citing Restatement (Second) of Torts § 552).

Manufacturers argue that Helms demonstrates the necessity of proof regarding justifiable reliance and proximate causation. In Helms, purchasers of property brought a negligent misrepresentation claim against their broker for failure to disclose that the county health department would not approve the property for use as a family care facility. The trial court granted summary judgment in defendant's favor. The Court of Appeals affirmed, holding that the plaintiffs did not reasonably rely on any alleged misinformation because plaintiffs were already in the business of operating family care facilities and plaintiffs clearly knew, by experience and by the contract's very terms, that they should make inspections of the property prior to closing to ensure compliance with state inspection guidelines. The Court concluded that "Plaintiffs reliance upon this information was unreasonable and therefore [the negligent misrepresentation] claim must fail. Justifiable reliance is an essential element of . . . negligent misrepresentation." *Id.* at 635, 478 S.E.2d at 517.

Manufacturers argue that Alva v. Cloninger, 51 N.C. App. 602, 277 S.E.2d 535 (1981), demonstrates the necessity of proof regarding justifiable reliance and proximate causation. In Alva, the purchasers of a home sued their appraiser for economic loss suffered by their purchase of a house with serious structural defects. The appraiser had failed to uncover these defects prior to their purchase. The trial court granted a directed verdict in defendants favor, but the Court of Appeals reversed. The Court found that there was specific evidence that “warrants an inference that plaintiffs actually relied upon the defendant’s appraisal report to [bank] and that defendant’s failure to discover and disclose the alleged defects in the house was a proximate cause of plaintiffs’ injury.” Id. at 611, 277 S.E.2d at 541. The plaintiffs had testified that his purchase contract was conditioned upon obtaining financing, that absent financing the contract was null, and that financing was conditioned upon the appraisal report. A bank officer also testified that indeed, any repair work recommended in the appraisal report would have to be done or the bank would have denied the loan application. See Id.

In summary, a manufacturer will vigorously attack plaintiff’s claims for negligent misrepresentation unless the plaintiff can point to specific representations or information from the manufacturer upon which plaintiff “justifiably relied.” This is often difficult if the owner/plaintiffs had no dealings with the manufacturer.

6. Manufacturer’s Defense to Claim of Unfair and Deceptive Trade Practices:

Manufacturers will argue that under North Carolina law, the requirement of justifiable reliance is the same in unfair and deceptive trade practices as in negligent misrepresentation. See Helms, 124 N.C. App. at 635-36, 478 S.E.2d at 517-18 (dismissing Chapter 75 and negligent misrepresentation claims for lack of justifiable reliance); Libby Hill Seafood Restaurants, Inc. v. Owens, 62 N.C. App. 695, 700-01, 303 S.E.2d 565, 569 (1983).

Manufacturers will also be prepared to rebut the argument that representations made to the construction industry or to the general public about their allegedly defective product through advertising or some other means, is sufficient to satisfy the justifiable reliance argument. Indeed, manufacturer’s product advertisements are frequently not aimed towards owners; but rather, for design professionals. Manufacturers will also disagree that any reliance by unidentified design professionals is sufficient. Plaintiffs would be borrowing a federal securities law concept if they make this argument. See Basic v. Levinson, 485 U.S. 224 (1988) (enunciating the “fraud on the market” theory). In federal securities law, “fraud on the market” is an exception to the general rule that a plaintiff must prove direct reliance on a material omission or misstatement in order to hold a defendant liable, under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder, for material misrepresentations or omissions in connection with the sale of stock. Id. at 230-31, 241-50. Rather, a victim who relied upon a security’s market price as an accurate reflection of the security’s worth has established a presumption of reliance on the original misstatement and need not show actual reliance in order to make a prima facie case of securities fraud. Id.

Manufacturers also argue that a “fraud on the market” theory cannot apply to a situation where representations made by a manufacturer affected different users of its products differently,

so that the effect of any alleged misrepresentations is a fact specific determination. Moreover, construction defect cases are not a federal securities case. Plaintiffs are bound by the common law definition of reliance. Under the law, plaintiffs must show affirmative evidence that they in fact relied upon specific misrepresentations made to plaintiffs by the manufacturers of the allegedly defective material. However, see, Rowan County Bd. Of Educ. V. U.S. Gypsum Co., 103 N.C. App. 288, 407 S.E.2d 860 (1991)(Court allowed fraud claim against manufacturer).

Defendants will also argue that a separate reason why plaintiffs' unfair and deceptive trade practices claims may fail, as to manufacturers, is that the claim is essentially an ordinary breach of warranty claim recast into a claim for treble damages and attorneys' fees. Under North Carolina law, evidence of breach of warranty is insufficient to support an unfair trade practices claim. See Whitehurst v. Crisp R.V. Center, Inc., 86 N.C. App. 521, 526-27, 358 S.E.2d 542, 546 (1987). Moreover, a Chapter 75 must be dismissed in the absence of facts to establish "substantial aggravating circumstances" surrounding defendant's actions. See Ace Chemical Corp. v. DSI Transports, Inc., 446 S.E.2d 100, 115 N.C. App. 237 (1994); Terry's Floor Fashions v. Georgia-Pacific Corp., 1998 WL 1107771, 36 UCC Rep. Serv. 2d 680 (E.D.N.C. 1998). Defendants will also contend that marketing and selling an allegedly defective product is simply not enough to support an unfair trade practices claim, even when it is alleged that defendant knew the product was defective and misrepresented the characteristics of the product. See Russell v. Baity, 95 N.C. App. 422, 426, 383 S.E.2d 217, 220 (1989); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Terry's Floor Fashions, supra. Manufacturers will always argue that plaintiffs have failed to allege, much less establish, the required presence of substantial aggravating circumstances. See Bartolomeo v. S.B. Thomas, Inc., 889 F.2d 530, 535 (4th Cir.1989) ("Plaintiff must show substantial aggravating circumstances attending the breach to recover under the Act [for unfair trade practices] . . .").

Warren discusses the concept of substantial aggravating circumstances where the claim is based on breach of representations in a written warranty. In Warren, the manufacturer of a roofing product allegedly promised that the roof would not leak. Plaintiff in that case obtained brochures about the roofing produce which read, "Simply translated, GUTTANIT means "not a drop of water" or "weather proof." GUTTANIT is our brand of corrugated asphalt roofing and siding that has our 25 year warranty against leakage and backs it up." Plaintiff decided to use the roofing product. Defendant said that it could not offer a warranty unless the product was applied by a specific individual, whom plaintiff used to install the roof. The roof leaked. Defendant claimed that the roof leaked because the materials were installed improperly and that the roof was too flat to allow water to run off. See Id. at 104, 317 S.E.2d at 8. Plaintiff filed claims for breach of warranties and unfair trade practices. The basis for the unfair trade practices claim was that the representations of defendant Guttanit's agents concerning its roofing product, were fraudulent. See Id. at 116, 317 S.E.2d at 14. The trial court also found that defendant Guttanit breached express and implied warranties of fitness. See Id. at 106, 317 S.E.2d at 8. The trial court found that the roofing materials, not the installation, were defective. See Id. Yet the trial court also found that the facts did not give rise to an unfair trade practices claim. The Court of Appeals affirmed, even though almost all factual issues were found in Plaintiffs' favor. See Id. at 116, 317 S.E.2d at 14.

The Court of Appeals reached a similar result in Russell. In Russell, a breach of warranty case involving a water stove system, the defendants had stated in a written contract that the stove “would meet state and local codes.” A jury found that defendants breached implied and express warranties created by the written contract because the stove did not meet the applicable codes. The Court held that, while the evidence was clearly sufficient to support a finding that defendants breached express and implied warranties, mere breach of warranty alone did not support a claim for unfair and deceptive trade practices. Russell, 95 N.C. App. at 426, 383 S.E.2d at 220.

Terry’s Floor Fashions, supra, is yet another case demonstrating that the mere breach of warranty, even if proved, does not constitute unfair or deceptive trade practices. In Terry’s Floor Fashions, plaintiff was a seller and installer of vinyl flooring. The plaintiff sued the manufacturer of a plywood underlayment for such flooring alleging negligence, breach of warranty, and unfair and deceptive trade practices. Before purchasing the plywood underlayment, plaintiff specifically inquired whether the underlayment would conform to its needs, particularly whether the underlayment would cause discoloration of vinyl flooring. Defendant informed plaintiff that the underlayment would meet its needs and would not cause discoloration. Plaintiff sought damages for unfair and deceptive trade practices based on defendant’s allegedly deliberate misrepresentations about the traits and qualities of its products. Plaintiff claimed that defendant knew or should have known its product was unsuitable for its intended use. Plaintiff argued that defendant deceptively induced plaintiff to enter into the contract for purchase of the plywood underlayment by making false representations about its product’s characteristics.

The federal court, applying North Carolina law, dismissed the unfair and deceptive trade practices claim on the basis that the facts supporting plaintiffs’ unfair trade practices claims were indistinguishable from those of plaintiffs’ breach of warranty claims. Terry’s Floor Fashions, 1998 WL 1107771 at *8-9. The court also found that plaintiff did not assert any additional facts to demonstrate substantial aggravating circumstances as required by North Carolina law. See Id.; See also Bartolomeo v. S.B. Thomas, Inc., 889 F.2d 530, 535 (4th Cir. 1989) (“Plaintiff must show substantial aggravating circumstances attending the breach to recover under the Act [for unfair trade practices] . . .”); Branch Banking and Trust Co. v. Thompson, 107 N.C. App. 53, 62, 418 S.E.2d 694, 700 (1992) (defendant’s breach of promissory note and loan agreement was not an “aggravating circumstance” for purposes of plaintiffs’ unfair trade practice claim.).

Thus, manufacturers will argue that Terry’s Floor Fashions makes clear that selling a defective product without more does not support a claim for unfair and deceptive trade practices, even if the manufacturer knows of prior product failures.

7. Manufacturer’s Defense to Claim for Fraud:

A manufacturer’s defense of a fraud claim will focus on the lack of representations made directly to the plaintiffs with the intent to deceive. As with all fraud actions, establishing an intent to deceive is often difficult. Whitlock v. Duke University, 829 F.2d 1340, 1342 (4th Cir. 1987)(in order for defendant to prevail as a matter of law, it need not negate every element of fraud – if defendant effectively refutes even one element, summary judgment is proper).

Further, manufacturers will argue that the failure of a manufacturer to warn a plaintiff about the known defective nature of a product does not rise to the level of fraud. N.C. Gen. Stat., section 99B-1 defines a products liability action to include 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; instruction; marketing; selling; advertising; packaging or labeling of product. N.C. Gen. Stat. § 99-B-1 (1999).

N.C. Gen. Stat. § 99B-5 codifies claims based on inadequate warnings or instructions. It requires proof that a manufacturer or seller acted unreasonably in not providing a warning or instruction, and that the failure to provide the warning or instruction was the proximate cause of the harm, and either: (1) when the product left control of the manufacturer, it knew or should have known that the product posed a substantial risk of harm to a reasonably foreseeable user or consumer and the manufacturer failed to take reasonable steps to give adequate warning or instruction, or failed to take other reasonable action. N.C. Gen. Stat. § 99B-5 (1999); see also Corprew v. Geigy Chemical Corp., 271 N.C. 485, 157 S.E.2d 98 (1967); Smith v. Selcon Products, Inc., 96 N.C. App. 151, 385 S.E.2d 173 (1989), rev. denied, 326 N.C. 598, 393 S.E.2d 883 (1990); Wells v. French Broad Elec. Membership Corp., 68 N.C. App. 410, 315 S.E.2d 316, rev. denied, 312 N.C. 498, 322 S.E.2d 565 (1984); Lee v. Crest Chemical Co., 583 F. Supp. 131, 133 (M.D.N.C. 1984).

Thus, manufacturers will argue that a failure to warn claim is expressly contemplated by North Carolina statute. Therefore, a manufacturers failure to disclose known problems with a product does not support a claim for fraud. Of course, success in this regard should remove the potential for punitive damages or an award of attorneys' fees.

8. Product Liability Defenses Available to Manufacturers:⁵

North Carolina's Product Liability Act (N.C. Gen. Stat., Chap. 99B-1 *et seq.*) covers "all actions brought on account of, caused by or resulting from the manufacture, construction, design, formulation, development of standard, preparation, processing, assembly, testing, listing, certifying, warning, instructing, marketing, selling, advertising, packaging or labeling of any product." N.C. Gen. Stat., Section 99B-1(3).

North Carolina's Product Liability Act provides that a manufacturer is not liable in a product liability action if alteration or modification of the product is a proximate cause of the injury or damage:

- (a) No manufacturer or seller of a product shall be held liable in any product liability action where a proximate cause of the personal injury, death or damage to property was either

⁵ A full discussion of the North Carolina Products Liability Statute is beyond the scope of this paper. A discussion of the more common defenses is included (Section 99B-3-Alteration or Modification of Product, and Section 99-B-4-Knowledge or Reasonable Care).

an alteration or modification of the product by a party other than the manufacturer or seller, which alteration or modification occurred after the product left the control of such manufacturer . . .

- (b) For the purposes of this section, alteration or modification includes changes in design, formula, function, or use of the product form that originally designed, tested or intended by the manufacturer . . .

N.C. Gen. Stat. § 99B-3 (1999); Rich v. Shaw, 98 N.C. App. 489, 391 S.E.2d 220 (1990). In Rich, the trial court held that the manufacturer of a trenching machine was not liable for plaintiffs' injuries where a safety guard had been removed after the machine left the manufacturer's control. The Court of Appeals affirmed.

When, as here, the forecast of evidence demonstrates that a proximate cause of Plaintiffs' injury was the modification or alteration of the machine by a party other than the manufacturer after it left the control of the manufacturer; and that the alteration of the machine was contrary to the instructions of the manufacturer and done without its express consent, then G.S., Section 99B-3 bars recovery from the manufacturer.

Id. at 492, 391 S.E.2d 223. Rich suggests that a product manufacturer is not liable when the manufacturer's products were not installed in accordance with the manufacturer's instructions or were impermissibly modified from the original design. See Id.

Section 99B-3(a) also provides that the modifications and alterations that are the subject of the 99B defenses must be a proximate cause of damage. See Rich, supra. In Rich, the court found, that had the missing belt guard still been in place, plaintiff would not have injured himself. The court reasoned that the removal of the belt guard was a proximate cause of plaintiffs' injuries; hence the manufacturer of the product could not be held liable. Rich, 98 N.C. App. at 492, 98 S.E.2d 222-23.

Thus, manufacturers will carefully seek to establish that the general contractor and subcontractor did not follow the applicable installation specifications of the manufacturer and that any deviations caused the problems with the product.

In a similar vein, N.C. Gen. Stat. § 99B-4(1) provides that the manufacturer of a product is not liable if (a) the product was used contrary to express and adequate instructions or warnings delivered with, appearing on, or attached to the product, and (b) the user should have known of the instructions in the exercise of reasonable care. Manufacturers will also seek to establish that the general contractor and subcontractors violated this provision of the statute as well.

APPLICATION OF THE ECONOMIC LOSS RULE IN CONSTRUCTION DEFECT CASES

In its simplest application, the “economic loss rule” precludes the parties to a construction project from recovering purely economic losses - typically contract damages - from other parties with whom they have no “privity of contract” (direct contractual relationship). Stated another way, “purely economic losses are not ordinarily recoverable under tort law.” Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 432, 391 S.E.2d 211, 217 (1990). Thus, a plaintiff who asserts the bald allegation of negligence, or some other tort, against a contractor, subcontractor, or manufacturer over a defective building component faces dismissal by the Court pursuant to the economic loss rule. There is ample case law in North Carolina and other jurisdictions pertaining to the rule, its exceptions, and the seemingly endless variety of situations to which it might apply.⁶ However, this paper analyzes the situation where a building component on a project is defective and the owner seeks to sue the general contractor, subcontractor, and manufacturer of the failed component, under a negligence theory. Negligence claims are much preferred by plaintiffs from an evidentiary standpoint. Asserting claims with the broad elements of duty, breach, proximate cause and damages is preferable to the encumbrances associated with specific violations of contract provisions, specific warranties with limited durations, etc. Indeed, courts have stated that one of the primary reasons for the rule is to prevent contract law from “drowning in a sea of tort.” East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986).

This paper will address several issues, as follows:

- Origins of the rule
- Definition of economic loss
- Application of the rule
- Exceptions to the rule

A. Origins of the Rule in North Carolina:

The economic loss rule has its origin in product liability cases. Under the common law, lack of privity of contract was a bar to an action for negligence. See e.g., Feinman, Economic Negligence, Liability of Professionals and Businesses to Third Parties for Economic Loss § 2.2.1 (1995). The requirement of privity was eventually discarded, however, to allow recovery for personal injuries and property damage caused by the negligence of another. Macpherson v. Buick Motor Co., 111 N.E. 1050 (N.Y. 1916). To limit the potential liability for negligence, the courts created a new defense – the economic loss rule. The rationale for the rule was described as preserving “the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and

⁶For example, claims against design professionals – David & Jones, Inc. v. New Hanover County, 41 N.C. App. 661, 255 S.E.2d 580, disc. rev. denied, 298 N.C. 295, 259, S.E.2d 911 (1979); Shoffner Industries, Inc. v. W.B. Lloyd Const. Co., 42 N.C. App. 259, 257 S.E.2d 50, disc. rev. denied, 298 N.C. 296, 259 S.E.2d 301 (1979).

thereby encourages citizens to avoid causing physical harm to others. Seeley v. White Motor Co., 403 P.2d 145 (Cal. 1965).

Two product liability cases decided in 1965 reflect opposing views toward the recovery of economic loss in tort actions. In the first case, the Supreme Court of New Jersey permitted a consumer to bring an action seeking solely economic losses directly against the manufacturer of a defective product, despite a lack of privity. Santor v. A&M Karagheusian, Inc., 207 A.2d 305 (N.J. 1965). The consumer sued the manufacturer for breach of an implied warranty of reasonable fitness for defective carpet that the consumer had purchased from a third-party seller. The New Jersey court acknowledged that tort liability applied principally to personal injury or property damage, but held that the manufacturer's responsibility should be no different where the damage was to the product itself.

In the second case, the Supreme Court of California rejected the New Jersey court's rationale and stated that economic losses could not be recovered in a tort action. Seeley, supra. In this case, the purchaser of a defective truck sued the manufacturer for breach of express warranty and strict tort liability, seeking repair damages, the purchase price, and lost profits. Although the court affirmed the contract claim, it rejected the tort claim. The California court distinguished between the types of damages that are recoverable for breach of contract. If the only breach is a breach of a duty assumed solely by contract, the economic loss rule will bar recovery of purely economic losses in a tort action.

The U.S. Supreme Court has approved the application of the economic loss rule in product liability cases. The Court referred to the California case as the majority view and noted that contract law should preclude tort liability if a defective product causes purely economic loss; otherwise, "contract law would drown in a sea of tort." East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986). The Court also acknowledged, however, that the line of cases following the New Jersey court's decision raised legitimate questions about restricting liability in all economic loss cases.

North Carolina adopted the economic loss rule in Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 432, 391 S.E.2d 211, 217 (1990). However, Chicopee was not a construction defect case, but instead, dealt with defective textile equipment that had exploded and caused damage. Although the words economic loss are never mentioned, the North Carolina Supreme Court dealt with the concept in a construction context, in North Carolina State Ports Auth. v. Roofing Co., 294 N.C. 73, 81, 240 S.E.2d 345, 350 (1978).

In the Ports Authority case, the State Ports Authority sued its roofing contractor, Dickerson, and Dickerson's roofing subcontractor, Scott, alleging that the defendants negligently installed a roof on a warehouse which the Ports Authority had contracted with Dickerson to build. Plaintiff claimed as damages not only the "non-economic" expense of repairing the roof but also the purely "economic" losses associated with moving goods to another location while the roof was being repaired. Plaintiff's complaint was dismissed, however, for failure to state a claim upon which relief could be granted.

The North Carolina Supreme Court agreed and found that the Ports Authority was not entitled to proceed against Dickerson in tort:

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. at 83, 240 S.E.2d at 351.

The North Carolina Supreme Court identified four exceptions to the prohibition against tort recovery based upon a breach of contract:

- (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 willful 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.
- (3) The injury, proximately caused by the promisor's negligent, or willful 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.
- (4) The injury so caused was a willful injury to or a conversion of the property of the promisee, which was the subject of the contract, by the promisor.

Id. at 82, 240 S.E.2d at 350 (citations omitted).

B. Definition of Economic Loss:

Economic losses are damages that are purely pecuniary losses without any personal injury or physical damage to other property. Economic losses have been defined as “damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits – without any claim of personal injury or damage to other property . . . as well as the diminution in the value of the product because it is inferior in quality and does not work for the general purposes for which it was manufactured and sold.” Moorman Mfg. Co. v. National Tank Co., 435 N.E.2d 443 (Ill. 1982). Economic losses are generally considered contract-type damages – they amount to disappointed economic expectations (the loss of the benefit of the bargain of the contract) and not harm from personal injury or property damage. Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 374 S.E.2d 55 (Va. 1988). In construction, economic losses may be delay damages, See Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1, 881 P.2d 986 (Wash. 1994), the cost to repair faulty work, See Stuart v. Coldwell Banker Commercial Group, Inc., 745 P.2d 1284 (Wash. 1987), the cost of extra work necessitated by defective design, lost profits, or other financial expenses.

C. Application of the Rule in North Carolina:⁷

Since the Ports Authority case, supra in 1978, a number of construction-related cases have been considered by the North Carolina Appellate Courts dealing with the economic loss rule.

In Oates v. JAG, Inc., 314 N.C. 276, 277, 333 S.E.2d 222, 223-224 (1985), plaintiff purchased a home originally built by defendant for the seller. After moving into the house, plaintiff discovered numerous defects in the construction of the home. Accordingly, plaintiff brought suit against the defendant alleging negligent construction. Defendant/builder moved to dismiss on the grounds that no contractual relationship existed between it and plaintiff. Not unexpectedly, the trial court granted defendant’s motion. The North Carolina Supreme Court reversed, however, and allowed plaintiff’s complaint to proceed against the builder, in tort, even though plaintiff’s losses were purely economic. As the Oates case noted:

Existence of a contract may uncontrovertibly establish that the parties owed a duty to each other to use reasonable care in the performance of the contract, but it is not an exclusive test to the existence of that duty. Whether a defendant’s duty to use reasonable care extends to a plaintiff not a party to the contract is determined by whether that plaintiff and defendant are in a relationship in which the defendant has a duty imposed by law to avoid harm to the plaintiff.

⁷ Some of the cases discussed do not deal with construction disputes *per se*, but the legal discussion is applicable to construction defect disputes.

Id. at 279, 333 S.E.2d at 225 (quoting Navajo Circle, Inc. v. Development Concepts Corp., 373 So. 2d 689, 691 (Fla. 2nd Dist. Ct. App. 1979)).

Several years later, in Warfield v. Hicks, 91 N.C. App. 1, 370 S.E.2d 689 (1988), the plaintiffs sued their contractor in contract and in tort arising out of the contractor's use of beetle-infested interior beams in the construction of their home. The Court of Appeals affirmed dismissal of the negligence claim finding that it did not fit any of the "exceptions in which a promisor might be held liable in tort for damages proximately caused by a negligent or willful act or omission in the course of performance of his contract." Id. at 10, 370 S.E.2d at 694.

The Warfield case distinguished the Oates decision as follows:

[i]n 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 the 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 the improper construction but who, because not in privity with the builder, have no basis for recovery in contract or warranty.

Id.

In Spillman v. American Homes of Mocksville, Inc., 108 N.C. App. 63, 422 S.E.2d 740 (1992), the North Carolina Court of Appeals was faced with plaintiffs who claimed tort damages resulting from the defendant's allegedly negligent construction and installation of a mobile home. After finding that the negligence claim was "premised upon the allegation that defendant's failure to properly perform the terms of the contract between the parties resulted in damage to the mobile home which is the subject matter of the contract," id. at 65, 422 S.E.2d at 741, the court held that the tort claim was deficient as a matter of law:

[A] tort action does not lie against a party to a contract who simply fails to properly perform the terms of the contract, even if that failure to properly perform was due to the negligent or intentional conduct of that party, when the injury resulting from the breach is damage to the subject matter of the contract. It is the law of contract and not the law of negligence which defines the obligations and remedies of the parties in such a situation.

Id. at 65, 422 S.E.2d at 741-42 (citations omitted). Similarly, that same court found that a plaintiff who had entered into a contract for the construction of a pool was not entitled to assert a negligence claim for the allegedly improper construction of the pool. Mason v. Yontz, 102 N.C. App. 817, 403 S.E.2d 536, 537-38 (1991). On remand for a new trial, the court explained that

North Carolina State Ports Authority limited the plaintiff to seeking recovery based upon breach of contract or warranty. Id. 818-19, 403 S.E.2d at 538.

In Gregory v. Atrium Door and Window Co., 106 N.C. App. 142, 415 S.E.2d 574, 575 (1992), the plaintiffs contracted with Defendant James Burriss to build a residence.⁸ Plaintiffs purchased doors manufactured by Defendant Atrium Door and Window Company. These doors did not function properly and were deteriorating, i.e., causing injury to themselves. On appeal, the issue was whether plaintiffs could assert a claim against the manufacturer of the doors for breach of an implied warranty involving only economic loss to the doors, despite the lack of privity. The Court of Appeals determined that such a claim was not available since the damage alleged was purely economic loss.

In Reece v. Homette Corp., 110 N.C. App. 462, 429 S.E.2d 768 (1993), the plaintiffs purchased a mobile home manufactured by the defendant.⁹ Four years after the defendant delivered the mobile home to the plaintiffs, the plaintiffs filed a complaint seeking relief for damage to their mobile home, alleging *inter alia* that the defendants negligently designed, manufactured, and misrepresented the mobile home. Because the entire home was the product sold by the defendants, the Court determined that these tort claims would be barred by the economic loss rule, since the plaintiffs sought recovery only for damage to the product sold by the defendant:

Here, plaintiffs' claims seek recovery only for damage to the mobile home, the very product manufactured by defendant. This claim is substantially different from a factual situation where the manufactured product causes physical injury to a person or to property other than the manufactured product itself.

Id. at 466, 429 S.E.2d at 770.

In Moore v. Coachman Industries, Inc., 129 N.C. App. 389, 499 S.E.3d 772, (1998), defendant Coachman Industries manufactured the recreational vehicle sold to the plaintiffs which incorporated an electrical power converter manufactured by Defendant Magne Tek. The recreational vehicle and all of its contents were destroyed by a fire caused by the defective power converter. The Court of Appeals found that the economic loss rule applied, because the "defect in the product damag[ed] the actual product." Id. at 402, 499 S.E.3d at 780. Accordingly, the Moore plaintiffs could not even bring a claim in tort for personal property contained in the vehicle and destroyed by the fire.

⁸ See section on manufacturer's defenses to a claim for negligence for further discussion of this case.

⁹ See section on manufacturer's defenses to a claim for negligence for further discussion of this case.

D. Exceptions to the Rule:

The exception to the economic loss rule is best illustrated by an analysis of Judge Britt's decision in Terry's Floor Fashions v. Georgia-Pacific Corp., 1998 WL 1107771, 36 UCC Rep. Serv. 2d 680 (E.D.N.C. 1998). As discussed earlier in this paper, plaintiff was a seller and installer of vinyl flooring. The plaintiff sued the manufacturer, *inter alia*, of a plywood underlayment for negligence. The plaintiff alleged that because the underlayment was defective, it caused the discoloration of rolls of vinyl flooring stored in plaintiff's warehouse. The Court dismissed the negligence claim pursuant to the economic loss rule. However, the analysis is instructive:

The nature of plaintiff's loss in this case is central to the viability of plaintiff's negligence claim. Defendant claims that plaintiff has suffered only economic loss. Plaintiff claims that the plywood underlayment that it purchased from defendant and installed for various clients caused the discoloration of the vinyl flooring it manufactured, marketed, sold and installed. To the extent plaintiff's negligence claim pertains to the negligent design, manufacture, inspection, and assembly of the plywood underlayment it purchased from defendant, and to the resulting defective nature and/or damage to that product, plaintiff's negligence claim is precluded by the application of the economic loss rule.

Plaintiff also seeks to recover in tort or damages to the vinyl flooring it installed above the underlayment, however. The vinyl flooring sold by plaintiff is property, and according to plaintiff, it was damaged and discolored as a direct result of installation above defendant's product. Plaintiff states that vinyl flooring is an expensive product and that it had to be replaced for several of plaintiff's customers as a result of the defect in the product supplied by defendant. Plaintiff argues that the vinyl flooring constitutes "other property" for purposes of the economic loss rule, and that, consequently, plaintiff should be permitted to proceed with its negligence action....

While this court accepts plaintiff's assertion that vinyl flooring is property separate and distinct from the plywood underlayment that formed the basis of the contract between the parties, [FN2] it appears from the plaintiff's complaint that the damaged vinyl flooring *is not plaintiff's property* but rather, the property of plaintiff's customers. Pursuant to the exception to the economic loss rule set out in Ports Authority and Mason, a plaintiff may seek damages in a negligence action only if the damage was to "property of the promisee other than the property that was the subject of the contract." Ports Authority, 294 N.C. at 81 (emphasis added).

Because plaintiff has not made factual allegations that bring its claim within the scope of the Ports Authority exception, its negligence claim is surplussage and will be dismissed pursuant to the economic loss rule. See Warfield v. Hicks, 91 N.C. App. 1, 9-10, 370 S.E.2d 689, 694, review denied, 323 N.C. 629, 374 S.E.2d 602 (1988).

Id. at *4-5.

Thus, for plaintiffs in any construction defect case, it is critical to allege and establish that the defective component also damages other property. The examples of other damaged property is endless. For example, if defective windows allow wood around the windows to rot, this exception should be satisfied. It is important to note that a few jurisdictions, such as Virginia, are not in accord with the foregoing analysis. See, Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 374 S.E.2d 55 (Va. 1988) (Court held that defective component became part of the house and thus damage to other parts of the house was not other property for purposes of this exception). The Fourth Circuit, on the other hand, has pointed to South Carolina's rule of protecting homeowners with claims against manufacturers of components on their homes in rejecting application of the rule in that context. 2000 Watermark Association, Inc. v. Celotex Corporation, 784 F.2d 1143 (4th Cir. 1986).

In summary, hopefully the foregoing discussion reveals that the economic loss rule is a viable and applicable legal concept in construction defect cases in North Carolina.

APPLICABLE STATUTES OF REPOSE AND LIMITATIONS IN CONSTRUCTION DEFECTS CASES

Claims asserted in construction defects cases are not only governed by several differing statutes of limitations, but also by the applicable statutes of repose. Each of these will be discussed below, in the context of the typical claims asserted by the plaintiffs in construction defect cases.

1. Statutes of Limitations

A. Plaintiffs' Claims for Breach of Contract, Non-UCC Implied Warranties, Express Warranties and Negligence:

Sections 1-52(1), (5), and (16) and 1-50 of the North Carolina General Statutes govern the statute of limitations applicable for claims of breach of contract, breach of non-UCC implied warranties, express warranties, and negligence in a typical construction defects case. Section 1-52(16) encompasses all of these claims and states:

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. Provided that no cause of action shall accrue more than 10 years from the last act or omission of the defendant giving rise to the cause of action.

N.C. Gen. Stat. § 1-52(16) (1999). Section 1-50(f) modifies § 1-52, and states as follows:

This subdivision prescribes an outside limitation of six years from the later of the specific last act or omission or substantial completion, within which the limitations prescribed by G.S. 1-52 and 1-53 continue to run. For purposes of the three-year limitation described 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. However, as provided in this subdivision, no action may be brought more than six years from the later of the specific last act or omission or substantial completion.

N.C. Gen. Stat. § 1-50(a)(5)(f) (1999). The Supreme Court has recognized, with specific reference to § 1-52, that “these statutes modify the sometimes harsh common law rule by protecting a potential plaintiff in the case of a latent injury by providing that a cause of action does not accrue until the injured party becomes aware or should reasonably have become aware of the existence of the injury.” Pembee Mfg. Corp. v. Cape Fear Constr. Co., Inc., 313 N.C. 488, 493, 329 S.E.2d 350, 354 (1985). In Pembee the court held that the statute of limitations began to run when the plaintiff first knew of the existence of leaks in the roof, even though the plaintiff was not aware of the extent of the damage.

The Court of Appeals reached a similar in conclusion in Bonestell v. North Topsail Shores Condominiums, Inc., 103 N.C. App. 219, 405 S.E.2d 222 (1991) (plaintiffs complained of leaks early in the ownership of the property, their subsequent claims were directly related to those leaks, and the resulting moisture intrusion, and the Court found that the plaintiffs’ claims accrued when they became aware of the alleged moisture problems), and in Haywood St. Redevelopment Corp., Inc. v. Harry S. Peterson Co., Inc., 120 N.C. App. 832, 463 S.E.2d 564 (1995), review denied, 342 N.C. 655, 467 S.E.2d 712 (1996) (plaintiff knew water was leaking into the building when water proofing was applied to concrete in 1987, but did not file claim until 1992, and was thus barred by the statute of limitations). The courts have also held, however, that the mere suspicion of a problem will not start the statute of limitations under N.C.G.S. § 1-52(16). In both Wilson v. McLeod Oil Co., Inc., 327 N.C. 491, 398 S.E.2d 586 (1990) and Crawford v. Boyette, 121 N.C. App. 67, 464 S.E.2d 301 (1995), the courts concluded that even though the plaintiffs, respectively, could smell gasoline and benzene in their water, and in Crawford even stopped using the water for cooking and drinking upon the advice of the Wake County Health Department, the statute of limitations did not begin to run until the date the plaintiffs received official notification of the contamination of their water. Obviously, the facts

of each given case need to be carefully analyzed to determine whether the defect or damage is latent or patent, the extent of what the plaintiffs know about the defect or damage to the structure, and when they knew that information.

B. Plaintiffs' Claims of Negligent Misrepresentation and Fraud:

N.C.G.S. § 1-52(9) specifies the applicable statute of limitations for claims arising from negligent misrepresentation and fraud. The statute states that “the cause of action should not be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud or [misrepresentation].” N.C. Gen. Stat. § 1-52(9) (1999). A claim for negligent misrepresentation does not accrue until two events occur: (1) the claimant discovers (or had a reasonable opportunity to discover) the misrepresentation, and (2) the claimant suffers harm because of that misrepresentation. See Barger v. McCoy, Hillard and Parks, 346 N.C. 650, 488 S.E.2d 215 (1997). Similarly, a cause of action for fraud accrues at the time the fraud is discovered or should have been discovered with reasonable diligence. Nash v. Motorola Communications and Elec., Inc., 96 N.C. App. 329, 385 S.E.2d 537 (1989), aff'd, 328 N.C. 267, 400 S.E.2d 36 (1991).

Because claims for negligent misrepresentation and fraud, as with claims for breach of contract, breach of warranty and negligence, begin to accrue upon the “discovery” of the negligent misrepresentation or fraud, the statute of limitations for negligent misrepresentation or fraud may accrue at the same time as the claims for breach of contract, warranties, and negligence, but it depends upon the facts constituting the misrepresentation or fraud. It is possible for the plaintiff to have knowledge of the damage that is occurring to the property such that the statute of limitations clock begins to run as to the breach of contract, negligence and breach of warranty claims, but until there is an actual factual determination, such as by an expert, as to the problems causing the damage or defect to the property, the facts that reveal the misrepresentation or the fraud may not become apparent until a significant period of time after the actual knowledge of the damage that is occurring to the property. Therefore, it arguably is possible for there to be distinctly different accrual dates for claims for negligent misrepresentation and fraud, which extend the date by which such claims must be filed, beyond the date that a claim must be filed for breach of contract, breach of warranties, or negligence.

C. Plaintiffs' Claims for Breach of UCC Implied Warranties:

If the plaintiff has asserted specific breaches of the implied warranties that arise under the Uniform Commercial Code as a matter of law, such claims are governed by the statute of limitations set forth in N.C. Gen. Stat. § 25-2-725 (1999), which states:

- (1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.
- (2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A

breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

Id.

D. Plaintiffs' Claim for Unfair and Deceptive Trade Practices:

The statute of limitations governing a claim for unfair and deceptive trade practices is set forth in N.C. Gen. Stat. § 75-16.2 (1999), which states that “any civil action brought under this Chapter to enforce the provisions thereof shall be barred unless commenced within four years after the cause of action accrues.” Id. The determination of when the statute of limitations begins to accrue for a Chapter 75-1.1 claim has been held to depend upon the nature of the 75-1.1 claim. In Hand v. Ace Hardware Corp., No. 4:92CV00454 (M.D.N.C. July 7, 1995), the court stated:

[i]f an action for unfair and fraudulent trade practices is based on fraud, the action does not accrue until discovery of the fraud. Nash v. Motorola Communications and Elec., Inc., 96 N.C. App. 329, 331, 385 S.E.2d 537, 538 (1989), aff'd, 328 N.C. 267, 400 S.E.2d 36 (1991). In contrast, if an action under §75-1.1 more closely resembles an action for breach of contract, the statute of limitations begins to run on the date of the termination of the contract. See Ring Drug Co. v. Carolina Medicorp Enter., Inc., 96 N.C. App. 277, 281, 385 S.E.2d 801, 804 (1989).

Id. at 10-11. In Hand, the court noted that the claim for unfair and deceptive trade practices arose from the same “factual scenario” as the fraudulent misrepresentation, and therefore the court determined that the discovery rule with regard to claims for fraud was to be utilized for determining the date of accrual of the 75-1.1 claim. Id. at 11. See also, Liner v. DiCresce, 905 F. Supp. 280 (M.D.N.C. 1994). Therefore, the facts of each given case will determine when the claim for unfair and deceptive trade practices begins to accrue. Because most construction defects claims are governed by the statute of limitations that sets forth that the claim accrues upon discovery of the damage or defect, presumably the statute of limitations with regard to the claim for unfair and deceptive trade practices for a construction defects claim would also arise from the date of discovery of the defect or damage. Similarly, if the unfair and deceptive claim is based upon misrepresentations or fraud, presumably the statute of limitations will begin to run upon the date of discovery of the misrepresentation or fraud. Obviously, such determination will have to be made on a case by case basis.

B. Statutes of Repose

Section 1-50 of the North Carolina General Statutes sets forth the applicable statutes of repose that govern the outside date upon which claims can be asserted in construction defects cases. The two applicable statutes of repose set forth in § 1-50 are commonly referred to as the

real property statute of repose, contained in § 1-50(a)(5)(a), and the product liability statute of repose, contained in § 1-50(a)(6). Because these two statutes of repose can both arise in a construction defects case, they will be discussed together in this paper.

N.C.G.S. § 1-50(a)(5)(a) provides as follows:

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.

N.C. Gen. Stat. § 1-50(a)(5)(a) (1999). “Substantial completion” is defined in the statute as:

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.

N.C. Gen. Stat. § 1-50(a)(5)(c) (1999).

The Court of Appeals defined “substantial completion” in Nolan v. Paramount Homes, Inc., 135 N.C. App. 73, 518 S.E.2d 789 (1999), holding that the date of substantial completion was the date the Certificate of Occupancy was issued for the structure. Id. at 76, 518 S.E.2d at 791.

With regard to the “specific last act or omission of the defendant giving rise to the cause of action” trigger set forth in § 1-50(a)(5)(a), the Nolan court stated that for the statute of repose clock to begin running from this trigger, the “plaintiff must establish a direct connection between the harm alleged and that last specific act or omission.” Id. at 77, 518 S.E.2d at 792. The court in Nolan noted that “punchlist” work performed by the builder after the issuance of the Certificate of Occupancy could constitute a last act or omission if it related to the harm complained of in the Complaint. Id. at 79, 518 S.E.2d at 793. However, in Monson v. Paramount Homes, Inc., 133 N.C. App. 235, 515 S.E.2d 445 (1999), the Court of Appeals held that repair work performed by a party four years after the house was completed did not constitute a last act giving rise to the cause of action because it was not required in the improvement contract between the parties. Id. at 241, 515 S.E.2d at 450.

It needs to be noted that subsections (d) and (e) of § 1-50(a)(5) provide limitations upon when the real property statute of repose can be asserted, with the subsections stating the following:

d. 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.

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.

N.C. Gen. Stat. §§ 1-50(a)(5)(d) and (e) (1999).

The product liability statute of repose contained in § 1-50(a)(6) reads as follows:

No action for the recovery of damages for personal injury, death or damage to property based upon or arising out of any alleged defect or any failure in relation to a product shall be brought more than six years after the date of initial purchase for use or consumption.

N.C. Gen. Stat. § 1-50(a)(6) (1999). In the context of a construction defects action, in which the plaintiff may make a claim against a manufacturer of a defective product that was installed in the structure, the interplay between the applicability of the real property statute of repose and the product liability statute of repose has been addressed by the courts in a case between Forsyth Memorial Hospital and Armstrong World Industries. In Forsyth Memorial Hospital v. Armstrong World Industries, Inc., 336 N.C. 438, 444 S.E.2d 423 (1994), the Supreme Court held that because the Complaint alleged that Armstrong was guilty of willful and wanton conduct in furnishing asbestos-containing flooring to the hospital, the real property statute of repose, contained in § 1-50(a)(5)(a), and not the product liability statute of repose, contained in § 1-50(a)(6), would govern the plaintiff's claims, if it could be shown that the defendant acted as a materialman on the defendant's hospital project. The court, in discussing the language contained in § 1-50(a)(5)(b)(9), which quantifies who can be sued in accordance with the statute, stated that "the phrase, 'any person furnishing materials,' refers to a materialman who furnished materials to the jobsite either directly to the owner of the premises or to a contractor or subcontractor on the job." Id. at 443, 444 S.E.2d at 426. The court further stated that if one was merely "a remote manufacturer, whose materials found their way to plaintiffs' jobsite indirectly through the commerce stream, then defendant would not be a materialman and would not have furnished materials on the jobsite within the meaning of [subsection (5)(b)(9),]" and, therefore, the products liability statute of repose would apply rather than the real property statute of repose, even if the products became fixtures on the property. Id. at 445, 444 S.E.2d at 427. Upon

remand, the Court of Appeals, in Forsyth Memorial Hospital, Inc. v. Armstrong World Industries, Inc., 122 N.C. App. 413, 470 S.E.2d 826 (1996), determined, after a thorough analysis, that defendant Armstrong World Industries was, for the purposes of that case, not a materialman, and thus the product liability statute of repose governed the claim against Armstrong World Industries.