The Supreme Court of Tennessee held that the economic loss doctrine applies specifically to fraud claims that are designed to recover solely economic losses between sophisticated commercial parties and when the only misrepresentations or nondisclosures relate to the quality of goods to which the parties contracted. However, the Court declined to entirely rule out a fraudulent inducement exception to the economic loss doctrine and reserves the question to a future case. *Milan Supply Chain Solutions, Inc.. v. Navistar, Inc.*, 627 S.W. 3d 125 (Tenn. 2021).

Nicole Roth

In this case, the Supreme Court of Tennessee addressed whether the economic loss doctrine—often precluding recovery of purely economic losses in tort actions—applies to fraudulent inducement claims.[1] Previously, Tennessee's application of the economic loss doctrine when a defective product damages itself was influenced by the United States Supreme Court's decision in *East River* as well as the Restatement of (Third) of Torts and economic losses from the damage were barred in favor of contractual remedies.[2] Notwithstanding this general rule, the Court considers whether a fraud exception is warranted considering the balance in Tennessee of the freedom to contract with the abhorrence of fraud.[3] Here, the Court determines that in fraud claims the economic loss doctrine still bars recovery when the misrepresentations between sophisticated parties are related to the matter for which the parties are contracting.

In 2011, Milan Supply Chain Solutions, Inc. ("Milan") began looking to purchase new trucks due to maintenance costs of their old fleet.[4] Since the 2010 EPA standards were in effect, all manufacturers had come in compliance with the standards—resulting in a majority employing a selective catalytic reduction ("SCR") which initially required more technology and infrastructure.[5] Navistar, Inc. ("Navistar) chose instead to use the exhaust gas recirculation ("EGR") method that was already in use and attempt to reduce emissions to meet the standards, though Navistar's competitors had concerns that such technology combined with the reduction in emissions required by the EPA standards would reduce

[1] Milan Supply Chain Solutions, Inc.. v. Navistar, Inc., 627 S.W. 3d 125, 129 (Tenn. 2021).
[2] *See id.* at 152 (quoting Lincoln General Ins. v. Detroit Diesel Corp., 293 S.W. 3d 487 (Tenn. 2009) (citing East River Steamship Corp. v. Transamerica Delaval, Inc., 106 S.Ct. 2295 (1986))).
[3] *Navistar, Inc.*, 627 S.W. 3d at 153-54.
[4] *Id.* at 132.
[5] *Id.* at 130, 132.

engine reliability due to excess heat and soot in the engine.[6] Though Milan was considering continuing their business relationship with Volunteer International, Inc ("Volunteer")—Volunteer exclusively sold Navistar trucks and equipment.[7] When considering the purchase, Milan reached out to competitors and was informed that due to the EGR method produced engines that would not be reliable and the heat in the engine would cause damage to the major components.[8]

In April 2011 as part of an effort to gain Milan's business, Volunteer loaned Milan, at no cost, two trucks with MaxxForce engines that utilized the EGR technology.[9] Before purchasing, Milan requested to hear from Navistar regarding the trucks, the MaxxForce engine, and the EGR technology.[10] Milan stated that Navistar described the "rigorous extensive testing, [with] millions of miles over the last several years" including "that the testing had proven the engine's reliability, that 'all feedback [on the trucks] was positive,' and that the 'major components' of the engine, including EGR coolers and EGR valves, would last a million miles."[11] After this information Milan proceeded to purchase the Navistar trucks from Volunteer.[12] In three separate purchases over 2011 and 2012, Milan bought 243 trucks with the MaxxForce engines—for a total cost of approximately thirty million dollars—with financing and purchase agreements on the delivery.[13] The agreements also included limited warranties "which covered non-engine vehicle components for twelve months or 100,000 miles, and engine components for two years. Milan also purchased an 'Optional Service Contract,' which extended the warranty coverage on certain components for up to seventy-two months."[14] The warranties required Navistar "to repair or replace covered truck components that proved defective in material and/or workmanship in normal use and service" and specifically excluded "coverage for '[l]oss of time or use of the vehicle, loss of profits, inconvenience, or other consequential or incidental damages or expenses.'"[15] Milan began

[6] *Id.* at 130.
[7] *Id.* at 129, 132.
[8] *Id.* at 132.
[9] *Id.*
[10] *Id.*
[11] *Id.* 132-33.
[12] *Id.* at 133.
[13] *Id.*
[14] *Id.*
[15] *Id.*

receiving the first order of trucks in 2011 with the majority by the end of 2011 and the second order began delivery in 2012.[16] Also in 2012, the some of the truck began requiring repairs—all of which Navistar repaired in accordance with the warranties.[17] Even after discussing the reliability issues in late 2012, Milan ordered the third round of trucks.[18] Milan's own analysis in 2013 found that failures on the trucks were continuing and even increasing.[19]

On November 13, 2014, Milan filed suit.[20] The trial court only permitted Milan's fraud claim and a claim under the TCPA to proceed to trial.[21] The jury found for Milan on both claims and awarded benefit-of-the bargain damages, lost profit damages, and eventually for punitive damages.[22] Notwithstanding Navistar's post-trial motions, the trial court entered judgement on the jury's verdicts and Navistar appealed.[23] The Court of Appeals ruled against Milan by holding that the "economic loss doctrine bars Milan's fraud claim, that the trucks do not qualify as "goods" for purposes of the TCPA." The Supreme Court granted Milan's application for permission to appeal.[24]

On appeal, the Supreme Court noted the historical development of the economic loss doctrine and the different applications. Specifically, while Tennessee applies the economic loss doctrine to products liability, the application to fraud claims is less clear.[25] The Court considers three approaches to the fraud exception that have developed outside of Tennessee.[26]

The first approach, the strict approach bars states that the economic loss doctrine bars all recovery of fraud claims based on the rationale that "the need to provide a plaintiff with tort remedies is 'diminished greatly when (1) the plaintiff can be made whole under contract law, and (2) allowing additional tort remedies will impose

16 *Id.* at 134.
17 *Id.*
18 *Id.*
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.* at 141.
23 *Id.*
24 *Id.*
25 *Id.* at 153.
26 *Id.* at 146.

additional costs on society.'"[27] The Supreme Court declines to adopt this approach, and notes especially that the strict approach's application has been called into question in other jurisdictions.[28]

The second approach, the "broad fraud approach" recognizes that parties to a contract create their own expectations and commitments, however, proponents cannot accurately allocate the risks appropriately when fraud is involved.[29] Further, fraud is socially undesirable and as such aligns with the tort goals to punish and deter such conduct.[30]

Finally, there is the narrow fraud exception, which allows a limited exception to the economic loss doctrine for fraud in the inducement of the contract.[31] Utah has adopted a formulation of the narrow fraud exception by declining to provide an exception to the economic loss rule when the torts actions are regarding the subject matter of the contract.[32] Tennessee, like Utah, declines to create a broad rule on the application of the economic loss doctrine to fraud claims.[33] Rather, between sophisticated commercial business entities in cases of "a fraudulent inducement claim seeking recovery of economic losses only, the economic loss doctrine applies if "the only misrepresentation[s] by the dishonest party concern[ ] the quality or character of the goods sold."[34] The parties still have the ability to negotiate warranties and other terms, upholding one crucial point of Tennessee law—the freedom to contract.[35] But still, a fraud exception is a possibility—which aligns with Tennessee's "dim view of fraud."[36]

In light of this decision, transactional attorneys in Tennessee should be aware that between sophisticated parties the economic loss doctrine will still apply when the only misrepresentation[s] by the dishonest party concern[ ] the quality or character of the goods sold."[37] Thereby, limiting potentially limitless liability the doctrine protects

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[27] *Id.* (quoting Werwinski v. Ford Motor Co., 286 F.3d 661, 680 (3d Cir. 2002)).
[28] *Navistar, Inc.*, 627 S.W. 3d at 146.
[29] *Id.* at 147.
[30] *Id.* at 148.
[31] *Id.* 149-50.
[32] *Id.* at 150.
[33] *Id.* at 153.
[34] *Id.* at 154.
[35] *Id.*
[36] *Id.*
[37] *Id.* at 154.

defendants from.[38] However, the Court has specifically reserved the right to consider the fraudulent inducement exception in the future.[39]

[38] *See id.* at 144.
[39] *Id.* at 155.