IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

No. 30579

JAMES and AMBER MAY,

Plaintiffs/Appellants,

vs.

FIRST RATE EXCAVATE, INC.,

Defendant/Appellee.

Appeal from the Circuit Court
Second Judicial Circuit
Lincoln County, South Dakota

The Honorable Douglas E. Hoffman, Presiding Judge

BRIEF OF APPELLANTS

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Notice of Appeal filed December 28, 2023

ORAL ARGUMENT REQUESTED

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JURISDICTIONAL STATEMENT

Plaintiffs James and Amber May ("Mays") appeal from a December 1, 2023, Memorandum Decision and Judgment granting Defendant First Rate Excavate, Inc.'s ("First Rate") motion to dismiss. R. 42. Notice of Entry of the Order was given on December 5, 2023. R. 51. Mays filed their Notice of Appeal on December 28, 2023. R. 62.

STATEMENT OF THE ISSUES

Did the Trial Court err when it granted First Rate's motion to dismiss on the ground that the economic loss doctrine, raised *sua sponte* by the Trial Court, applied?

The Trial Court ruled the economic loss doctrine applied.

STATEMENT OF THE CASE

The Mays appeal the dismissal of their Complaint against First Rate and the Trial Court's determination that the economic loss doctrine applied to their claim.

This case stems from a lawsuit filed by the Mays against First Rate, because of First Rate's work on the Mays' new home. The Mays' one-count Complaint for negligence alleges that First Rate breached the duty it owed to the Mays to perform its work in a workmanlike manner and to ensure its employees could perform and actually performed their work competently. R. 3.

First Rate filed a motion to dismiss the Mays' claim based upon (1) the alleged insufficiency of the Complaint to support the claim of negligence because the parties were not in privity of contract and (2) that this action was purportedly not initiated within the time prescribed by South Dakota law. R. 9.

After the parties had briefed the issues raised by First Rate, the Circuit Court, requested supplemental briefing on the applicability of the economic loss doctrine, despite First Rate never raising the issue. Indeed, the Trial Court raised the issue *sua sponte* via email to the parties a week prior to the scheduled hearing. R. 29.

After the supplemental briefing and hearing, the Circuit Court, Hon. Douglas E. Hoffman presiding, issued a written decision granting First Rate's motion to dismiss on the basis that the economic loss doctrine applied. R. 42. The Mays appeal, raising the sole question above.

STATEMENT OF FACTS

The Mays hired RES Construction, LLC ("RES"), to construct a residential property in Sioux Falls, Lincoln County, South Dakota. R. 4. RES began construction of the home in 2015. (*Id.*) RES engaged First Rate to perform dirt work needed for the construction of the home, including digging and placing the foundation and placing the home's septic system according to the original engineer's renderings. (*Id.*) The Mays moved into the home in August 2016. (*Id.*)

On September 6, 2016, rain fell in Sioux Falls, and Plaintiffs noticed a creek running through their back yard. (*Id.*) First Rate had already completed the final grade of Plaintiffs' yard. (*Id.*) On May 8, 2017, water infiltrated the basement of the home. (*Id.*) Water infiltrated the basement again in early April 2018. (*Id.*)

The septic system First Rate installed was also under water and stopped functioning. (*Id.*) First Rate attempted to repair the septic system, including placing a second septic system in the yard. (*Id.*) First Rate did not perform a perc test for the second septic system it attempted to install, and neither septic system has ever worked

properly. R. 5. Now, a lagoon exists in the Mays' yard and drains onto their neighbors' property, causing significant issues. (*Id.*)

The problems with the home—including the repeated water intrusion, septic infiltration, and septic failure—are directly related to the digging and placement of the foundation for the home, which First Rate placed multiple feet lower than the original plans intended. (*Id.*) Because First Rate placed the foundation much lower than the original plans intended, it has attempted to regrade the yard and replace the septic system as described above. (*Id.*) None of the repairs First Rate has undertaken have ameliorated the problems associated with the home's foundation, and the problems persist. (*Id.*)

Because the foundation is much too low, the concrete around the house heaves and has sustained significant cracking. (*Id.*) The front of the house has moved and cracked around the front entryway. (*Id.*) Due to the deficient work performed by First Rate, the Mays' home will continue to suffer these defects unless it is correctly repaired. (*Id.*)

Because the home was built multiple feet too low, the only way to fix it is to lift the home, move it, and put in a new foundation that is where the original foundation was intended to be, and lower the home onto the new foundation. (*Id.*)

Accordingly, on September 22, 2022, the Mays initiated this action alleging negligence and claiming damages stemming from First Rate's breach of its duty to do its work in a competent and workmanlike manner. R. 6. Rather than answering these allegations, First Rate filed a Motion to Dismiss asserting the Mays' claim was barred by contract principles and the statute of limitations. R. 9.

ARGUMENT

Introduction

This case presents only one issue: whether the Trial Court erred when it granted First Rate's motion to dismiss on the ground that the economic loss doctrine applied, despite First Rate never raising the issue and the Trial Court raising the issue *sua sponte*.

"Whether a complaint fail[s] to state a claim upon which relief could be granted is a question of law [this Court] review[s] de novo." *Paul v. Bathurst*, 2023 S.D. 56, ¶ 10, 997 N.W.2d 644, 650 (citations omitted). Indeed, this Court's standard of review gives no deference to the trial court's conclusions of law. *Guthmiller v. Deloitte & Touche, LLP*, 2005 S.D. 77, ¶ 4, 699 N.W.2d 493, 496. "A motion to dismiss under SDCL 15-6-12(b) tests the legal sufficiency of the pleading, not the facts that support it." *N. Am. Truck & Trailer, Inc. v. M.C.I.*, 2008 S.D. 45, ¶ 6, 751 N.W.2d 710, 712 (quoting *Nygaard v. Sioux Valley Hosp. & Health Sys.*, 2007 S.D. 34, ¶ 9, 731 N.W.2d 184, 190). "The court accepts the pleader's description of what happened along with any conclusions reasonably drawn therefrom." *Thompson v. Summers*, 1997 S.D. 103, ¶ 5, 567 N.W.2d 387, 390. "[A] complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Id.*

The Trial Court Erred When it Granted First Rate's Motion to Dismiss on the Ground that the Economic Loss Doctrine Applied After Raising the Issue Sua Sponte.

The Trial Court raised the issue of the economic loss doctrine *sua sponte* after the parties had briefed the issues raised by First Rate. This Court very recently admonished this very same lower court for raising issues *sua sponte* and acting as a pseudo-advocate for one side. As this Court noted in *Ally v. Young*,

> Except in rare instances, the court is a neutral party that adjudicates only those issues raised by the parties. By raising issues *sua sponte* and participating as a pseudo-advocate . . . the circuit court abandoned its post of neutrality, threatening the integrity of the very process it was tasked with protecting.

2023 S.D. 65, ¶ 49, n. 14, 999 N.W.2d 237, 253. The exact same thing occurred in this case. Indeed, "[t]his Court has emphasized the 'well-established rule' that courts shall not raise an issue not first raised by the parties, except in the exceptional case in which a constitutional violation is *apparent*." *Id.* at ¶ 50, 999 N.W.2d at 254. (emphasis in original) (citation omitted). Not only did the Trial Court raise the economic loss doctrine *sua sponte*, it misapplied that doctrine. The Trial Court should be reversed.

I. The Economic Loss Doctrine Does Not Apply Between Non-Contracting Parties.

"The economic loss doctrine provides that 'purely economic interests are not entitled to protection against mere negligence.'" *Kreisers Inc. v. First Dakota Title Ltd. P'ship*, 2014 S.D. 56, ¶ 29, 852 N.W.2d 413, 421 (quoting *Diamond Surface, Inc. v. State Cement Plant Comm'n*, 1998 S.D. 97, ¶ 22, 583 N.W.2d 155, 160). The doctrine limits a contracting party's remedies to those specified in the contract; that is, it precludes a contracting party's ability to seek tort remedies. *See id.*, 2014 S.D. 56, ¶ 29, 852 N.W.2d at 421 (quotation omitted) ("The significance of the doctrine is that is precludes parties under certain circumstances from eschewing the more limited contract remedies and seeking tort remedies.")

However, the economic loss doctrine applies only to parties to a mutual contract and, in the absence of a contract between the Mays and First Rate, the doctrine does not preclude the Mays' ability to seek tort remedies for First Rate's negligence. "The prohibition against tort action to recover solely economic damages for those *in*

contractual privity is designed to prevent *parties to a contract* from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort." *Id.*, 2014 S.D. 56, ¶ 29, 852 N.W.2d at 421 (quotation omitted) (emphasis added). "The economic loss doctrine, therefore, sets forth that regardless of whether a tort duty may exist *between contracting parties*, the actual duty one party owes to another for purely economic loss should be based exclusively on the contract *to which they agreed* and assigned their various risks." *Id.* (quotation omitted) (emphasis added).

Where, as here, the parties are not in privity of contract and have no contractual remedies available, the economic loss doctrine does not apply. *See Sullivan v. Pulte Home Corp.*, 306 P.3d 1, 2–3 (Ariz. 2013) (declining "to extend economic loss doctrine to non-contracting parties"). The Arizona Supreme Court's *Sullivan* decision is analogous to this case. In *Sullivan*, the defendant constructed a house then sold it to its initial purchaser, who in turn sold it to the plaintiffs. *Id.* at 2. Because of the intermediary purchase and sale, the plaintiffs never had a contract with the defendant. *Id.* After the plaintiffs noticed irregularities in a retaining wall, they engaged an engineer to assess the damage. *Id.* The engineer determined that the home had been built in a defective and dangerous manner, and the plaintiffs sued the builder under theories of negligence to recover the cost of repair. *Id.*

The homebuilder raised the economic loss doctrine as a defense. *Id.* The Arizona Supreme Court found that the economic loss doctrine "bars only the recovery of pecuniary or commercial damage, including any decreased value or repair costs for a product or property that is itself the subject of a contract between the plaintiff and defendant, and consequential damages such as lost profits." *Id.* at 3 (quotation omitted).

The court declined to extend the doctrine to non-contracting parties, identifying support in the Restatement (Third) of Torts. *Id.*; Restatement (Third) of Torts: Liab. for Econ. Harm § 3 (2020) (noting the majority of courts apply the economic loss rule only to parties who have contracts). As the Arizona Supreme Court stated, "[t]he doctrine protects the expectations of contracting parties, but, in the absence of a contract, it does not pose a barrier to tort claims that are otherwise permitted by substantive law." *Id.* (citing Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 Wash. & Lee L. Rev. 523, 555 (2009)).

The same outcome is required here. The digging and foundation work performed by First Rate was defective and performed negligently, causing significant damage to the Mays' home and the surrounding land. As in *Sullivan*, the economic loss doctrine should not preclude tort remedies because the Mays and First Rate were never parties to a mutual contract. The Restatement further supports this conclusion, noting that the economic loss doctrine "does not foreclose claims between plaintiffs and defendants who are only indirectly linked by contract," that is, those who "had no contract with each other [but] both had contracts with the same third party." Restatement (Third) of Torts: Liab. for Econ. Harm § 3 cmt. f (2020).

Here, the Mays and First Rate both contracted with RES and were therefore indirectly linked by contract. In accord with the majority position identified by the Restatement, the economic loss doctrine does not apply to these non-contracting parties, and the Mays should not be barred from seeking tort remedies—and left with no remedy for First Rate's negligent performance—based on an irrelevant rule.

The Trial Court, on the other hand, rejected the majority rule, instead deciding to apply the minority rule from the Texas Supreme Court's holding in *LAN/STV v. Martin K. Eby Const. Co. Inc.*, 435 S.W.3d 234, 243, 247–48 (Tex. 2014). Applying the economic loss doctrine to non-contracting parties would put South Dakota in the minority, typified by that decision. Under that formulation, tort remedies would be unavailable for any economic damage, regardless of whether a plaintiff would be left wholly without a remedy. South Dakota courts have never read the economic loss doctrine so expansively, and the Mays urge the court to reject the Trial Court's decision here and reverse.

II. The Economic Loss Doctrine Does Not Apply to Transactions Outside the UCC.

Further, because this dispute does not concern damages incurred in the operation of a contract for the sale of goods, the economic loss rule does not limit the Mays' recovery to tort remedies. In *City of Lennox v. Mitek Indus., Inc.*, 519 N.W.2d 330, 333 (S.D. 1994), the South Dakota Supreme Court affirmed summary judgment against the City of Lennox, which had sued the supplier of roofing trusses for a municipal building. *Id.* at 331. The trusses failed, and the City brought claims for breach of contract, breach of implied warranties, and negligence. *Id.* The South Dakota Supreme Court first addressed whether the transaction was a commercial transaction, which would bring it within the ambit of the UCC. *Id.* at 332. If the UCC applied to the transaction, the Court reasoned, the City was limited to commercial theories of recovery identified by the UCC. *Id.* at 333. The Court found the truss transaction was for the sale of goods as defined by SDCL 57A-2-105(1) and concluded that the UCC applied. *Id.* Because the UCC applied, the court reasoned that "[r]ecovery of economic losses is limited to the remedies of the [UCC]." *Id.*

Here, neither the UCC nor the economic loss doctrine derived therefrom apply. First Rate's participation in the homebuilding was predominantly the provision of a service, not the provision of a good; First Rate's role in building the home was the service of digging and placing the foundation and septic system, not merely the provision of cement. *Compare Ins. Co. of N. Am. v. Cease Elec., Inc.*, 688 N.W.2d. 462, 472 (Wis. 2004) ("[W]e determine that the economic loss doctrine is inapplicable to claims for the negligent provision of services.") *with Diamond Surface, Inc. v. State Cement Plant Comm'n*, 1998 S.D. 97, ¶ 24, 583 N.W.2d 155, 161 (finding transaction to supply cement was for a "good" under the UCC and applying the economic loss rule). At least one court has found the UCC inapplicable to the construction of a foundation and installation of a septic system because those are services, not goods. *Stephenson v. Frazier*, 399 N.E.2d 794, 797 (Ind. Ct. App. 1980). Therefore, the economic loss doctrine does not apply to this non-commercial relationship.

This Court has declined to expand the economic loss doctrine beyond commercial transactions. *See Kreisers Inc.*, 2014 S.D. 56, ¶ 32, 852 N.W.2d at 422; *In re Syngenta AG MIR 162 Corn Litig.*, 131 F. Supp. 3d 1177, 1202 (D. Kan. 2015) (noting "there is no basis to predict that South Dakota courts would apply the [economic loss doctrine] in another context outside the realm of the UCC"). While the Trial Court cited to a decision by Judge Schreier from 2008 to conclude that the Supreme Court would expand the doctrine outside the UCC, it is inapposite as a result of the Supreme Court's later ruling in *Kreisers*. Because the parties' non-contractual relationship concerns the performance of a service, the economic loss doctrine does not apply, and the Mays should be permitted to pursue their tort claim against First Rate.

III. Even if the Economic Loss Doctrine Applies, Plaintiffs Have Alleged Damage to Other Property.

"The economic loss doctrine prohibits certain tort actions seeking 'pecuniary damage[s] not arising from injury to the plaintiff's person or from physical harm to property.'" *Sullivan*, 306 P.3d at 2 (quoting Restatement (Third) of Torts: Liability for Economic Harm § 2 (Tentative Draft No. 1, 2012).) The South Dakota Supreme Court has recognized an exception to the economic loss doctrine when a plaintiff's injury stems from "other property" collateral to the contracted-for product. *See City of Lennox*, 519 N.W.2d 330, 333 (S.D. 1994) (citing *Signal Oil and Gas Co. v. Universal Oil Prods.*, 572 S.W.2d 320 (Tex. 1978) (noting economic loss rule did not bar recovery in tort for property damage caused by a defective heater); *Jorgensen Farms, Inc. v. Country Pride Corp., Inc.*, 2012 S.D. 78, ¶ 26, 824 N.W.2d 410, 418–19.

Here, Plaintiffs have alleged that First Rate's negligence in digging and placing the foundation and septic system has not only caused extensive damage to their home; Plaintiffs have alleged damage to the surrounding land and their neighbor's property. Therefore, even if the economic loss doctrine applies to this non-UCC transaction between two non-contracting parties, Plaintiffs have alleged collateral damage to other property that takes this case outside of the economic loss doctrine.

CONCLUSION

The Trial Court violated the long-standing, well-established rule that courts should avoid raising an issue not first raised by the parties, except in the exceptional case in which a constitutional violation is apparent. Clearly, that is not the case here. The Trial Court not only violated this long-standing, well-established rule, it misapplied the economic loss doctrine to the facts of the case. The Trial Court should be reversed.

Dated at Sioux Falls, South Dakota, this 21st day of February, 2024.

DAVENPORT, EVANS, HURWITZ & SMITH, L.L.P.

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REQUEST FOR ORAL ARGUMENT

Appellants respectfully request oral argument.

Dated at Sioux Falls, South Dakota, this 21st day of February, 2024.

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CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that this Brief of Appellants complies with the type volume limitations set forth in SDCL § 15-26A-66. Based on the information provided by Microsoft Word 365, this Brief contains 2,867 words, excluding the table of contents, table of authorities, jurisdictional statement, statement of legal issues, any addendum materials, and any certificates of counsel. This Brief is typeset in Times New Roman (12 point) and was prepared using Microsoft Word 365.

Dated at Sioux Falls, South Dakota, this 21st day of February, 2024.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing "Brief of Appellants" was filed electronically with the South Dakota Supreme Court and that the original of the same was filed by mailing the same to 500 East Capital Avenue, Pierre, South Dakota, 57501-5070, on the 21st day of February, 2024.

The undersigned further certifies that an electronic copy of "Brief of Appellants" was emailed to the attorneys set forth below, on the 21st day of February, 2024:

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APPENDIX

STATE OF SOUTH DAKOTA	)	IN CIRCUIT COURT
	: SS	
COUNTY OF LINCOLN	)	SECOND JUDICIAL CIRCUIT

* *

JAMES and AMBER MAY,	*	41CIV22-000503
Plaintiffs,	*	
vs.	*	MEMORANDUM DECISION AND JUDGMENT OF DISMISSAL
FIRST RATE EXCAVATE, INC.	*	
Defendant.	*	

* *

ATTYS: Plaintiffs – Justin T. Clarke (Davenport Evans)
Defendant – Rene Charles Lapierre and Ryland Deinert (Klass Law Firm)

HEARING: Friday, December 9th, 2022 @ 9:30 a.m.

FACTUAL AND PROCEDURAL BACKGROUND

James and Amber May ("Plaintiffs") own a home located at 47152 Kings Circle in Lincoln County. First Rate Excavate, Inc. ("Defendant" or "FRE") is a South Dakota corporation with its principal place of business in Minnehaha County.

In 2015, Plaintiffs retained RES Construction, LLC ("RES") to construct the home. RES began construction in 2015. In-turn, RES hired FRE to perform dirt and masonry work to build a foundation and basement, and to install a septic system for the home. Defendant was specifically subcontracted to do these things in accordance with the construction engineer's renderings on file in Lincoln County. The home was eventually completed in August of 2016.

On September 6, 2016, within a few days of moving into the home, heavy rain fell in Sioux Falls. At that time, Plaintiffs noticed "a creek running through their backyard" which was formed "after the final grade had been completed by Defendant." Complaint ¶ 12. Water infiltrated the basement of the home on May 8, 2017 and in early April of 2018. *Id.* at ¶13-14. The septic system was subsequently determined to be submerged. *Id.* at ¶15. Eventually, the septic system quit working altogether due to groundwater issues. *Id.*

After these issues arose, Defendant attempted to repair and replace the septic system. *Id.* at ¶16. Defendant has also attempted to rectify the water issues by regrading the yard. *Id.* at ¶20. However, none of the attempted repairs have improved the issues with the home. *Id.* at ¶21. The result was a lagoon in Plaintiffs' yard draining onto their neighbor's property.*Id.* at ¶17. Additionally, the concrete work around the home has been damaged and cracked due to moisture sitting against the home and failing to drain away. *Id.* at ¶22, 23. The front of the home has also moved and cracked around the front entry way. *Id.* at ¶24.

Plaintiffs assert that the issues with the home, including the water infiltration, foundation cracks and movement, and septic failure, are all directly related to the digging and placement of the home's foundation, which is several feet lower than called for by the original plans. *Id.* at ¶19. According to Plaintiffs, the home will continue to suffer unless and until the home is correctly repaired. *Id.* at ¶25. Plaintiffs contend that the only way to fix the home is to pick up the home, move it, and put it on a new foundation that is multiple feet higher. *Id.* at ¶26.

According to Defendant's briefing, Plaintiffs asserted a claim against RES and settled with it out of court. Plaintiff's Reply Brief at 3. Plaintiff did not contradict this in its Reply or at oral argument. In any event, on September 22, 2022, Plaintiffs filed a Complaint against Defendant alone, alleging negligent construction. Defendant subsequently filed a Motion to Dismiss on October 17, 2022. Defendant alleged that Plaintiffs fail to state a claim upon which relief can be granted, because: (1) Plaintiffs lack privity of contract to sue Defendant, and (2) Plaintiffs failed to comply with the six-year statute of limitations under SDCL § 15-2-13. The Court raised the issue of the applicability of the Economic Loss Doctrine to the pleaded set of facts by email and solicited

supplemental briefs which were filed prior to hearing. Following oral argument, the matter was taken under advisement.

LAW AND ANALYSIS

Procedure

A motion to dismiss pursuant to Rule 12(b)(5) tests "only the legal sufficiency and not the facts of the pleading." *Fenske Media Corp. v. Banta Corp.*, 2004 S.D. 23, ¶ 7, 676 N.W.2d 390, 393 (citing *Stumes v. Bloomberg*, 1996 S.D. 93, ¶ 6, 551 N.W.2d 590, 593). These motions "are viewed with disfavor and seldom prevail." *Id.* (citing *Thompson v. Summers*, 1997 S.D. 103, ¶ 5, 567 N.W.2d 387, 390). Rather, the rules of civil procedure "favor the resolution of cases upon the merits by trial or summary judgment rather than on failed or inartful accusations." *Thompson*, 1997 S.D. 103, ¶ 6, 567 N.W.2d at 390 (quoting *Janklow v. Viking Press*, 378 N.W.2d 875, 877 (S.D. 1985)). "At the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice, for on a motion to dismiss [the court] presume[s] that general allegations embrace those specific facts which are necessary to support the claim." *Cable v. Union County Bd. of County Com'rs*, 2009 S.D. 59, ¶ 22, 769 N.W.2d 817, 826 (quoting *Lujan v. National Wildlife Federation*, 497 U.S. 871, 889 (1990) (*Lujan I*)).

In evaluating the sufficiency of the complaint, the court "must accept the material allegations as true and construe them in a light most favorable to the pleader and determine whether the allegations allow relief on 'any possible theory.'" *Fenske*, 2004 S.D. 23, ¶ 7, 676 N.W.2d at 392-93 (quoting *Schlosser v. Norwest Bank South Dakota, N.A.*, 506 N.W.2d 416, 418 (S.D. 1993)). However, the court may "ignore legal conclusions, unsupported conclusions, unwarranted inferences[,] and sweeping legal conclusions cast in the form of factual allegations." *Mordhorst v. Dakota Truck Underwriters and Risk Admin Serv's*, 2016 S.D. 70, ¶ 8, 886 N.W.2d 322, 324 (citation omitted). Finally, "[w]here the allegations show on the face of the complaint there is some insuperable bar to relief, dismissal under Rule 12(b)([5]) is appropriate." *Sisney v. State*, 2008 S.D. 71, ¶ 8, 754 N.W.2d 639, 643 (quoting *Benton v. Merrill Lynch & Co. Inc.*, 524 F.3d 866, 870 (8th Cir. 2008)). That is the situation at hand.

History of Negligence as a Cause of Action

Negligence emerged as a cause of action in tort in the early 1800's. W. Prosser, *Handbook on the Law of Torts* (1941) at 170. It is fundamental that "negligence" is "conduct falling below the standard established by law for the protection of others against unreasonable risk of harm." *Id.* at 175. For liability to be imposed, that risk of harm must be to those who are foreseeably within the danger zone of the risk posed by the challenged conduct. *Id.* at 178-88. *See also, Palsgraf v. Long Island Railroad*, 248 N.Y. 339, 162 NE 99, 59 ALR 1253 (1928). The duty to avoid creating foreseeable harm is imposed by the law upon the actor only toward those who are foreseeable victims, rather than others being more remote and thus outside the contemplation of the reasonable person. *Id.*

In contrast to contract obligations, which are created by the manifest consent of the parties, to protect the interest of the parties in having promises performed, tort duties are imposed by law, primarily based upon social policy, to protect the interests of all persons in being free from foreseeable harm. *Id.* at 201. It has been recognized since early on, however, that in certain situations these duties may coincide. *Id.* In other words, "[a]n action in tort may lie, although the relation between the parties which gives rise to it is the result of a contract." *Id.* at 202.

South Dakota Law

Under South Dakota law, "a duty may arise out of a relationship between the parties or through the foreseeability of injury to an unrelated person." *Taco John's of Huron, Inc. v. Bix Produce Company, LLC*, 2008 WL 11450655, at *2 (D.S.D. 2008). "For the law to impose a duty, a sufficient relationship must exist between the parties. Foreseeability may also create a duty." *Braun v. New Hope Twp.*, 646 N.W.2d 737, 740 (S.D. 2002). In short, the law of negligence imposes a duty to prevent foreseeable harm to others. *Id.*; *Janis v. Nash Finch Co.*, 2010 S.D. 27, ¶ 15.

"Those who undertake an activity pursuant to a contract have both a self-imposed contractual duty and a 'social' duty imposed by the law to act without negligence, and this social duty extends to persons who, although strangers to the contract, are within the foreseeable orbit

of risk of harm." 57A Am. Jur.2d, Negligence § 112. Thus, "[a] defendant who has committed only a breach of contract is liable only to those with whom the defendant has contracted, but a defendant who has tortiously committed a breach of duty apart from the contract is not protected by setting up a contract in respect of the same matter with another person." *Id.*

Despite these general strictures, Defendant asserts that *Amert. Const. Co. v. Spielman*, 331 N.W.2d 307 (S.D. 1983) stands for the proposition that in South Dakota, privity of contract is required for a property owner to sue a subcontractor. *See Amert. Const. Co. v Spielman*, In *Spielman*, the South Dakota Supreme Court held that a subcontractor does not have a personal claim against a property owner for payment for goods and services provided, when there is no privity of contract between them; rather, the subcontractor was hired by the general contractor that was hired by the property owner. *Id.* at 310. But that case is the converse of the situation at hand, and is, in this Court's view, inapposite.

Plaintiffs rely on *Mid-Western Elec., Inc. v. DeWild Grant Reckert & Assoc. Co.*, 500 N.W.2d 250, 254 (S.D. 1993), where the Court recognized a cause of action sounding in negligence "for economic damage for professional negligence *beyond the strictures of privity of contract.*" (Emphasis added). There, the Court allowed an electrical subcontractor that was not in privity with the Project Engineers on a large government construction job to sue the engineers for negligence in giving them faulty specifications and advice relating to the performance of their subcontract. *Id.* at 252-54. Because the specs and advice were wrong, the subcontractor had to redo work and substitute products at great financial loss. *Id.* Despite some broad wording in the opinion, the specific issue in the case was whether to "allow a cause of action against an architect or an engineer for economic damages if a party was foreseeably harmed by the professional's negligence." *Id.* at 253. All the authorities cited by the *Mid-Western* Court in its analysis of this issue were cases involving suits brought against construction architects and engineers under similar circumstances. *Id.* at 253-54.

"'Professional negligence" is a field of law that does not include excavators. *See generally*, 65 C.J.S Negligence §159. A "profession" as a legal term means

> [a] vocation or occupation requiring special, usually advanced, education and skill; *e.g.*, law or medical professions.... The labor and skill involved in a profession is predominantly mental or intellectual, rather than physical or manual. ... The term originally contemplated only theology, law and medicine, but as application of science and learning are extended to other departments of affairs, other vocations also receive the name, which implies professed attainments in special knowledge as distinguished from mere skill.

Black's Law Dictionary (5th ed.) 1979 at 1089-90. Clearly, the *Mid-Western* case is dealing with professional negligence as so defined and is not extending that concept to the realm of skilled labor such as excavation and masonry work. Therefore, the *Mid-Western* case, like *Spielman*, is inapposite to the matter at bar. *Limpert v. Bail*, 447 N.W.2d 48, 50 (S.D. 1989), where the Supreme Court found that the purchaser of cattle could sue a veterinarian for economic damages although it was the seller of the cattle who engaged and paid the veterinarian, fails to control here for the same reason.

Economic Loss Doctrine

In *Kreisers, Inc. v. First Dakota Title Ltd. Partnership*, 852 N.W.2d 413 (S.D. 2014) the South Dakota Supreme Court stated that "[t]he economic loss doctrine provides that 'purely economic interests are not entitled to protection against mere negligence.' *Diamond Surface, Inc. v. State Cement Plant Comm'n*, 1998 S.D. 97, ¶ 22, 583 N.W.2d 155, 160 (internal citation omitted). The significance of the doctrine is that it 'precludes parties under certain circumstances from eschewing the more limited contract remedies and seeking tort remedies.' *Ins. Co. of N. Am. v. Cease Elec. Inc.*, 276 Wis.2d 361, 688 N.W.2d 462, 467 (2004)." *Id.* at 421.

> The "doctrine draws a legal line between contract and tort liability that forbids tort compensation for 'certain types of foreseeable, negligently caused, financial injury.'" *Terracon Consultants Western, Inc. v. Mandalay Resort Grp.*, 125 Nev. 66, 206 P.3d 81, 87 (2009) (quoting *Barber Lines A/S v. M/V Donau Maru*, 764 F.2d 50, 52 (1st Cir.1985)). The economic loss doctrine, therefore, sets forth that regardless of whether a tort duty may exist between contracting parties, the actual duty one party owes to another for purely economic loss should be based exclusively on the contract to which they agreed and assigned their various risks. *See Indianapolis–Marion Cnty. Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722, 729–30 (Ind.2010).

Id.

"Economic loss 'is defined as that loss resulting from the failure of the product to perform to the level expected by the buyer and the consequential losses resulting from the buyer's inability to make use of the ineffective product, such as lost profits.'" *Taco John's of*

Huron, Inc. v. Bix Produce Company, LLC, 2008 WL 1140655 *4 (D.S.D. 2008). The economic loss doctrine is most commonly applied to the sale of goods under the UCC, but many courts, including the U.S. District Court for the District of South Dakota, applying South Dakota law, have applied it to commercial transactions outside of the UCC. *See, Taco Johns* at 2008 WL 1140655 at ** 4-6. There are three generally acknowledged exceptions to the application of the economic loss doctrine in commercial cases- (1) where there is a personal injury; (2) where there is damage to property other than the property that was the subject of the contract; or (3) where there is professional negligence as outlined above. Id. at *4. *See also, Jorgensen Farms, Inc. v. Country Pride Corp., Inc.* 824 N.W.2d 410, 418 (S.D. 2012).

Here, while First Rate did not contract with the Mays, Defendant contends that the economic loss doctrine is nevertheless applicable because First Rate is being sued due to allegations that the foundation and septic systems it sold to RES were nonconforming to that contract, and there is a chain of privity connecting the three parties in the common transaction of building the Mays' home. There is no personal injury, and, as the South Dakota Supreme Court held in *City of Lennox v. Mitek Industries, Inc.*, 519 N.W.2d 330 (S.D. 1994), where a defect in trusses forced the City of Lennox to remove insulation, sheet metal, and other parts of a building in the remediation process, the same were not deemed "other property" as excepted by the economic loss doctrine. The claimed losses in this case are to the home that was the subject of the construction contracts at issue and in no way may be construed as damage to "other property" as that term in to be understood in this context.

Chief U.S. District Judge Schreier, in the *Taco Johns* case, applied the economic loss doctrine where the Plaintiff was suing the defendant for lost profits under a negligence theory in a commercial setting, even though the defendant and plaintiff in that case were not in privity of contract, which is the Mays' primary defense to the application of that doctrine to defeat their claims herein. *See Taco Johns* at *6. Further, Chief Judge Schreier forcefully rejected that assertion that South Dakota law only recognizes the economic loss rule in UCC cases, because "many courts applying the economic loss doctrine have stated the rule without any hint that it only applies if the UCC governs the transaction," and "to do so would lead to perverse results." Id. at *5. For a powerful articulation for the historical context and social utility of the economic

loss rule, applied to a construction case outside the UCC sphere and to parties without direct privity, see *LAN/STV v. Martin K. Eby Const. Co. Inc.*, 435 S.W.3d 234, 243, 247–48 (Tex. 2014) ("The [economic loss rule] serves to provide a more definite limitation on liability than foreseeability can and reflects a preference for allocating some economic risks by contract rather than by law.... Construction projects operate by [vertical] agreements among the participants [owner, general contractor, subcontractors]. We think it is beyond argument that one participant... cannot recover from another... for economic loss caused by negligence.")

Plaintiffs assert that it is unfair to them to disallow a tort remedy in their favor against the negligent excavator because to do so leaves them with no contractual remedy against the excavator. But, the digging and foundation work performed by FRE was a contract obligation owed by the general contractor to the Plaintiffs, and they had a direct contractual remedy against the general contractor for any breach of that contract and were entitled to be made whole therefrom. *See generally*, 17A Am Jur2d, Contracts §702. Because of this, Plaintiffs are in no way left without a remedy to address their damages. To the contrary, it is stated that plaintiffs have already pursued and obtained that remedy. In any event, there is no injustice in legal policy that confines parties to construction contracts to the exercise of contract remedies for purely economic damages due to breach within the chain of privity, rather than allowing that chain to be leveraged with piecemeal litigation alleging disparate but overlapping theories of liability against multiple parties. Indeed, with the general contractor having a potential breach of contract cause of action against its subcontractor for its own liability to the owners, Plaintiffs' strategies here could result in a double recovery for themselves while leaving Defendant at risk of duplicate liabilities for a single injury, which is a dubious policy, indeed. Thus, Plaintiffs' reliance upon the Restatement (Third) of Torts: Liab. for Econ. Harm § 3 cmt. f (2023) and *Sullivan v. Pulte Home Corp.*, 306 P3d 1 (AZ 2013) is unsound under the pleaded facts of this case.

It is the more prudent and just policy to allow commercial actors in construction projects to define the boundaries of their risk allocation within the traditional rubric of contract law in order to adjust potential breach of promise or warranty claims resulting from nonconforming work. "If there is a convincing rationale for the economic loss rule, it is that the

rule performs a critical boundary-line function, separating the law of torts from the law of contracts. More specifically, '[t]he underlying purpose of the economic loss rule is to preserve the distinction between contract and tort theories in circumstances where both theories could apply.'" V. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 Wash & Lee LRev 523, 546 (2009).

ORDER AND JUDGMENT

Accepting the material allegations as true and construing them in a light most favorable to the Plaintiffs, the allegations do not state a cognizable claim for relief on a negligence theory. Now, therefore, it is hereby ADJUDGED, ORDERED AND DECREED that the Motion to Dismiss is GRANTED, and this matter is hereby dismissed upon the merits and with prejudice.

Dated this 1 day of December, 2023.

BY THE COURT:

Honorable Douglas E. Hoffman
Circuit Court Judge

ATTEST:
BRITTAN ANDERSON, Clerk of Courts

By: JM Baker
Deputy

IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

No. 30579

JAMES and AMBER MAY,

Plaintiffs/Appellants

vs.

FIRST RATE EXCAVATE, INC.,

Defendant/Appellee.

Appeal from the Circuit Court
Second Judicial Circuit
Lincoln County, South Dakota

The Honorable Douglas E. Hoffman, Presiding Judge

BRIEF OF APPELLEE

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Notice of Appeal filed December 28, 2023

ORAL ARGUMENT REQUESTED

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JURISDICTIONAL STATEMENT

Plaintiffs James and Amber May ("Mays") have appealed the Circuit Court's December 1, 2023, Memorandum Decision and Judgment granting Defendant First Rate Excavate, Inc.'s ("First Rate") Motion to Dismiss. R. 42. The Notice of Entry of the Order was filed on December 5, 2023. R. 51. The May's Notice of Appeal was filed on December 28, 2023. R. 62.

STATEMENT OF THE ISSUES

Did the Trial Court err when it granted First Rate's Motion to Dismiss?

The Circuit Court correctly ruled that the economic loss doctrine required dismissal of the May's Complaint.

STATEMENT OF THE CASE

The Mays appeal the Circuit Court's dismissal of their Complaint against First Rate holding that the economic loss doctrine required the dismissal.

The Mays' lawsuit against First Rate arose after the Mays reached a settlement with the general contractor, RES Construction, LLC ("RES"), for work on their house in Lincoln County. The Mays served and filed a Complaint alleging First Rate was negligent in the work it did on the Mays' house. R. 3.

First Rate filed a pre-Answer Motion to Dismiss, pursuant to SDCL § 15-26-12(b), the Mays' Complaint based upon (1) a lack of privity of contract between First Rate and the Mays; and (2) the Mays failed to comply with the appropriate statute of limitations to bring their claim. R. 9.

The Circuit Court, *sua sponte*, requested briefing, and provided sufficient time to do so, before the hearing on the issue of whether the economic loss doctrine applied to this matter. R. 29.

The Honorable Douglas E. Hoffman issued a written decision granting First Rate's Motion to Dismiss holding that the economic loss doctrine applied. R. 42. The Mays now appeal to this Court.

STATEMENT OF FACTS

The Mays hired RES to construct their house in Lincoln County. R. 4. RES was the general contractor of the house. R. 4 & App. 1. RES began construction of the home in 2015. (*Id.*) RES contracted with First Rate to perform dirt work needed for the construction of the house. (*Id.*) First Rate's work involved the foundation and placement of the septic system for the house. (*Id.*) First Rate and the Mays did not directly contract with each other; First Rate contracted with RES. App. 1-2 & R. 42-43. The Mays moved into the house in August 2016. R. 4.

There was a rainstorm in Sioux Falls on September 6, 2016. (*Id.*) The Mays alleged in their Complaint that they observed a creek running through their back yard. (*Id.*) By this time, the final grade for the house had been completed. (*Id.*) Water is alleged to have infiltrated the Mays' home on May 8, 2017, into the basement. (*Id.*) Water again is alleged to have infiltrated the basement in early April 2018. (*Id.*)

It is alleged that the septic system First Rate installed was also under water and stopped functioning. (*Id.*) First Rate attempted to repair the septic system and placed a second septic system in the Mays' yard. (*Id.*) It is claimed that First Rate did not perform

a perc test for the second septic system it attempted to install. R. 5. It is also alleged that neither septic system has ever worked properly. (*Id.*) The May alleged in their Complaint that a lagoon exists in their yard. (*Id.*)

The Mays allege that the problems with their house are related to the digging and placement of the foundation for the home by First Rate. (*Id.*) It is alleged that First Rate placed the foundation lower than the original plans intended, and that the regrade of the home and placement of the second septic system was incorrect. (*Id.*) The Mays aver that none of the repairs First Rate did have fixed the problems. (*Id.*)

Prior to the Mays filing their negligence lawsuit against First Rate on September 22, 2022, the Mays mediated this claim and reached a settlement with RES, the general contractor, for the problems they alleged with the house. App. 2 & R. 43. The Mays and RES reached a settlement and executed a release regarding the same. (*Id.*) This makes sense as RES is the party with whom the Mays contracted with; not First Rate. (*Id.*)

The Mays then filed suit against First Rate arguing it breached its duty to do its work competently and in a workmanlike manner under a negligence count. R. 1 & 3. The Circuit Court granted First Rate's Rule 12(b) Motion to Dismiss. R. 42.

ARGUMENT

"Whether a complaint fail[s] to state a claim upon which relief could be granted is a question of law [this Court] review[s] de novo." *Paul v. Bathurst*, 2023 S.D. 56, ¶ 10, 997 N.W.2d 644, 650 (citations omitted "A motion to dismiss under SDCL 15-6-12(b) tests the legal sufficiency of the pleading, not the facts that support it." *N. Am. Truck & Trailer, Inc. v. M.C.I.*, 2008 S.D. 45, ¶ 6, 751 N.W.2d 710, 712 (quoting *Nygaard v.*

Sioux Valley Hosp. & Health Sys., 2007 S.D. 34, ¶ 9, 731 N.W.2d 184, 190). "The court accepts the pleader's description of what happened along with any conclusions reasonably drawn therefrom." *Thompson v. Summers*, 1997 S.D. 103, ¶ 5, 567 N.W.2d 387, 390.

The Circuit Court Was Correct in Finding That The Economic Loss Doctrine Applied and In Its Dismissal of the Mays' Complaint.

To begin, First Rate agrees that the Circuit Court first raised the issue of the economic loss doctrine *sua sponte,* but First Rate also asserts that the Circuit Court provided the parties with sufficient opportunity to address the issue in both written and oral argument. The Mays cite to this Court's recent ruling in *Ally v. Young,* 2023 S.D. 65, ¶ 49, n.1. in criticizing the Circuit Court for bringing the issue before the parties. The *Ally* case, however, is inapposite of the issues in this case as it was a *habeas corpus* matter. Here, this matter involves a 12(b) motion to dismiss, which is similar to a motion for summary judgment although it is a pre-Answer motion. In that regard,

> [t]his Court has recognized the importance of providing a non-moving party with notice and an opportunity to present evidence and arguments in opposition to a motion for summary judgment in other contexts. For example, we have held that "[w]here the court elects to treat a motion to dismiss as a motion for summary judgment, it must notify the parties of its intent and give them an opportunity to present matters pertinent to summary judgment." *Herr v. Dakotah, Inc.*, 2000 S.D. 90, ¶ 18, 613 N.W.2d 549, 553 (citation omitted); *see* SDCL 15–6–12(b). In addition, "[s]ua sponte orders of summary judgment will be upheld only when the party against whom judgment will be entered was given sufficient notice and an adequate opportunity to demonstrate why summary judgment should not be granted." *Brown v. Hanson*, 2007 S.D. 134, ¶ 19, 743 N.W.2d 677, 682 (quoting *Myers v. Tursso Co., Inc.*, 496 F.Supp.2d 986, 993 (N.D.Iowa 2007)) (internal quotation marks omitted).

Leonhardt v. Leonhardt, 2012 S.D. 71, f.n. 3.

The Circuit Court, while not converting First Rate's motion to dismiss into a summary judgment motion, provided more than sufficient notice and opportunity to address the issue of the economic loss doctrine. No one was surprised Moreover, even if error, it is harmless as this Court, if it grants the relief requested by the Mays, would send this matter back to the Circuit Court, at which time First Rate would file a motion for summary judgment seeking a judgment of dismissal based upon the economic loss doctrine.

I. The Economic Loss Doctrine Precludes the Mays' Claim Against First Rate.

This Court has stated that, "[t]he economic loss doctrine provides that 'purely economic interests are not entitled to protection against mere negligence.'" *Kreisers Inc. v. First Dakota Title Ltd. P'ship*, 2014 S.D. 56, ¶ 29, 852 N.W.2d 413, 421 (quoting *Diamond Surface, Inc. v. State Cement Plant Comm'n*, 1998 S.D. 97, ¶ 22, 583 N.W.2d 155, 160). "The significance of the doctrine is that it ''precludes parties under certain circumstances from eschewing the more limited contract remedies and seeking tort remedies.' *Ins. Co. of N. Am. V. Cease Elec. Inc,* 276 Wis.2d 361, 688 N.W.2d 462, 467 (2004)." *Kreiser's* at ¶ 29.

As the United States District Court for the District of South Dakota pointed out, the,

> Economic loss 'is defined as that loss resulting from the failure of the product to perform to the level expected buy the buyer and the consequential losses resulting from the buyers'inability to make use of the ineffective product, such as lost profits.'

Taco John's of Huron, Inc. v. Bix Produce Company, LLC, 2008 WL 1140655, *4 (D.S.D. 2008). The economic loss doctrine is partly intended to prevent the death of the contract or the "tortification of contract law." *Annett Holdings, Inc. v. Kum & Go, L.C.,*

801 N.W.2d 499, 503 (Iowa 2011). "When two parties have a contractual relationship, the economic loss rule prevents one party from bringing a negligence action against the other over the first party's defeated expectations – a subject matter the parties can be presumed to have allocated between themselves in their contract." *Id.* (other citations omitted.) However,

> the doctrine is by no means limited to the situation where the plaintiff and the defendant are in direct contractual privity. For example, in *Nebraska Innkeepers,* plaintiffs sought recovery from a bridge contractor for purely economic loss that occurred when the bridge had to be closed because of the contractor's negligence. 345 N.W.2d 12 1280-29. This is an example of what is sometimes called 'the stranger economic loss rule.' *See,* Dobbs, 48 Ariz. L.Rev. at 715. This aspect of the economic loss rule has several underlying justifications. In a complex society such as ours, economic reverberations travel quickly and widely, resulting in potentially limitless liability. As Professor Dobbs puts it, 'Stand-alone economic loss often spreads without limit.' *Id.* Also, the rule encourages parties to enter into contracts. *Id.* at 716-17.

Annett's at 504. The *Taco John's* case in the United States District Court for the District of South Dakota also applied the economic loss doctrine where the plaintiff was suing the defendant under a negligence theory in a commercial setting even though there was no direct privity of contract. *Taco John's* at * 6. The economic loss doctrine applies in situations where like here the parties are not in direct privity of contract. Although the Mays and First Rate didn't directly contract with each other, the economic loss doctrine is still applicable and provides that this Court should uphold the Circuit Court's dismissal of the Complaint. Although there is not a direct contract between the Mays and First Rate, there was a contract between RES and First rate for the work First Rate did at the Mays' house.

The economic loss doctrine has three generally recognized exceptions to its application in commercial cases. The first is in a personal injury case. *Id.* at **4-6. The

second is where there is damage beyond the property subject of the contract. *Id.* And the third is where there is professional negligence such as legal and medical malpractice cases. *Id.*

A. None of the Generally Recognized Exceptions Are Applicable.

None of the three exceptions to the economic loss doctrine are applicable to this matter.

First, this is not a personal injury claim. As such, the first exception is inapplicable to this matter.

Second, the damage to the property is the subject of the contract, in that it is damage to the products of First Rate and RES. This Court, in *City of Lennox v. Mitek Industries, Inc.*, 519 N.W.2d 330 (S.D. 1994), held that in a case involving alleged defective trusses, which forced the City of Lennox to remove insulation, sheet metal, and other materials in a building in the remediation process, that all of these items were not deemed "other property." It should be noted that the Mays argue in their brief that they have alleged "damage to the surrounding land and their neighbor's property." (Appellants' Brief, pg. 10.) However, a look at the Complaint shows this is not true as the damages alleged include:

- Concrete work around the house has been damaged due to moisture sitting against the house and failing to drain; (R. 5, ¶ 22)
- Concrete heaves and sustained significant cracking; (R. 5, ¶ 23)
- The front of the house has moved and cracked around the front entry way; (R. 5, ¶ 24)
- The home will continue to suffer the effects for years to come unless the home is correctly repaired; (R, 5, ¶ 25)

- Breaches have resulting in damages to parts of the home on which Defendant did not work; (R. 6, ¶ 32)

- Damages include cost of repairing the home. (R. 6, ¶ 33.)

While the Mays state that water drains into the neighbor's property, they are not suing for those damages. The damages the Mays are suing for are related to the work product of First Rate and RES.

Third, this is clearly not a claim of professional negligence.

None of the generally recognized exceptions to the economic loss rule are applicable in this matter.

II. The Economic Loss Doctrine Applies to Transactions Outside the UCC.

The United States District Court for the District of South Dakota in *Taco John's* clearly rejected any claim that South Dakota law only recognizes that the economic loss doctrine applies in UCC cases because "many courts applying the economic loss doctrine have stated the rule without any hint that it only applies if the UCC governs the transaction" and doing so "would lead to perverse results." *Taco John's* at * 5.

Because this dispute does not concern damages incurred in the operation of a contract for the sale of goods, the economic loss rule does not permit the Mays' recovery to tort remedies. In *City of Lennox v. Mitek Indus., Inc.*, 519 N.W.2d 330, 333 (S.D. 1994), this Court affirmed summary judgment against the City of Lennox, which had sued the supplier of roofing trusses for a municipal building. *Id.* at 331. The trusses failed, and the City brought claims for breach of contract, breach of implied warranties, and negligence. *Id.* This Court first addressed whether the transaction was a commercial transaction, which would bring it within the ambit of the UCC. *Id.* at 332. If the UCC

applied to the transaction, the Court reasoned, the City was limited to commercial theories of recovery identified by the UCC. *Id.* at 333. The Court found the truss transaction was for the sale of goods as defined by SDCL 57A-2-105(1) and concluded that the UCC applied. *Id.* Because the UCC applied, the court reasoned that "[r]ecovery of economic losses is limited to the remedies of the [UCC]." *Id.*

Here, the work of First Rate for RES was outside of the UCC and the economic loss doctrine applies precluding the Mays' claims.

III. The Mays Had Their Opportunity To Seek Recovery for the Damages Claimed in this Case.

One thing the Mays fail to consider in arguing this case is that they had an opportunity to seek compensation for the damages being claimed in this case. That was through RES, which they mediated and settled the claims with already. The Mays made the decision to settle with their general contractor, RES, who they had the direct contractual relationship with to perform the excavation work including constructing the foundation and installing the septic tanks. The Mays had the right to seek recovery against RES for these damages that they now seek to recover but they made the conscious decision to settle with RES on a limited basis for a full/final release, and then now come after First Rate who did the work for RES.

CONCLUSION

The Circuit Court was correct in granting First Rate's Motion to Dismiss because the economic loss doctrine is applicable to this case and precludes recovery under tort. Additionally, the Circuit Court was well within its authority to bring up the economic

loss doctrine *sua sponte* and there was no prejudice to the Mays because they had the opportunity to research, brief, and argue it. Moreover, even if error, it is harmless as First Rate will only proceed with filing a motion for summary judgment should this Court send this case back to the Circuit Court by overruling the dismissal. The Circuit Court's Order dismissing this case should be affirmed.

Dated at Sioux City, Iowa, this 22nd day of March, 2024.

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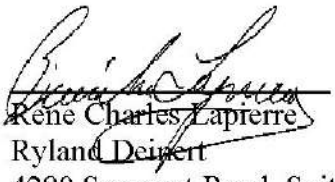
CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that this Brief of Appellee complies with the type volume limitations set forth in SDCL § 15-26A-66. Based on the information provided by Microsoft Word 365, this Brief contains 3403 words, excluding the table of contents, table of authorities, jurisdictional statement, statement of legal issues, any addendum materials, and any certificates of counsel. This Brief is typeset in Times New Roman (12 point) and was prepared using Microsoft Word 365.

Dated at Sioux City, Iowa, this 22nd day of March, 2024.

KLASS LAW FIRM, LLP



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing "Brief of Appellee" was filed electronically with the South Dakota Supreme Court and that the original of the same was filed by mailing the same to 500 East Capital Avenue, Pierre, South Dakota, 57501-5070, on the 22nd day of March, 2024.

The undersigned further certifies that an electronic copy of "Brief of Appellee" was emailed to the attorney set forth below, on the 22nd day of March, 2024:

Justin Clarke
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on this 22nd day of March, 2024.

/s/ Rene Charles Lapierre
Rene Charles Lapierre

APPENDIX

Tab	Document	Pages
A.	Memorandum Decision & Judgment of Dismissal	1 - 9

History of Negligence as a Cause of Action

Negligence emerged as a cause of action in tort in the early 1800's. W. Prosser, *Handbook on the Law of Torts* (1941) at 170. It is fundamental that "negligence" is "conduct falling below the standard established by law for the protection of others against unreasonable risk of harm." *Id.* at 175. For liability to be imposed, that risk of harm must be to those who are foreseeably within the danger zone of the risk posed by the challenged conduct. *Id.* at 178-88. *See also, Palsgraf v. Long Island Railroad*, 248 N.Y. 339, 162 NE 99, 59 ALR 1253 (1928). The duty to avoid creating foreseeable harm is imposed by the law upon the actor only toward those who are foreseeable victims, rather than others being more remote and thus outside the contemplation of the reasonable person. *Id.*

In contrast to contract obligations, which are created by the manifest consent of the parties, to protect the interest of the parties in having promises performed, tort duties are imposed by law, primarily based upon social policy, to protect the interests of all persons in being free from foreseeable harm. *Id.* at 201. It has been recognized since early on, however, that in certain situations these duties may coincide. *Id.* In other words, "[a]n action in tort may lie, although the relation between the parties which gives rise to it is the result of a contract." *Id.* at 202.

South Dakota Law

Under South Dakota law, "a duty may arise out of a relationship between the parties or through the foreseeability of injury to an unrelated person." *Taco John's of Huron, Inc. v. Bix Produce Company, LLC*, 2008 WL 11450655, at *2 (D.S.D. 2008). "For the law to impose a duty, a sufficient relationship must exist between the parties. Foreseeability may also create a duty." *Braun v. New Hope Twp.*, 646 N.W.2d 737, 740 (S.D. 2002). In short, the law of negligence imposes a duty to prevent foreseeable harm to others. *Id.*; *Janis v. Nash Finch Co.*, 2010 S.D. 27, ¶ 15.

"Those who undertake an activity pursuant to a contract have both a self-imposed contractual duty and a 'social' duty imposed by the law to act without negligence, and this social duty extends to persons who, although strangers to the contract, are within the foreseeable orbit

of risk of harm." 57A Am. Jur.2d, Negligence § 112. Thus, "[a] defendant who has committed only a breach of contract is liable only to those with whom the defendant has contracted, but a defendant who has tortiously committed a breach of duty apart from the contract is not protected by setting up a contract in respect of the same matter with another person." *Id.*

Despite these general strictures, Defendant asserts that *Amert. Const. Co. v. Spielman*, 331 N.W.2d 307 (S.D. 1983) stands for the proposition that in South Dakota, privity of contract is required for a property owner to sue a subcontractor. *See Amert. Const. Co. v Spielman*, In *Spielman*, the South Dakota Supreme Court held that a subcontractor does not have a personal claim against a property owner for payment for goods and services provided, when there is no privity of contract between them; rather, the subcontractor was hired by the general contractor that was hired by the property owner. *Id.* at 310. But that case is the converse of the situation at hand, and is, in this Court's view, inapposite.

Plaintiffs rely on *Mid-Western Elec., Inc. v. DeWild Grant Reckert & Assoc. Co.*, 500 N.W.2d 250, 254 (S.D. 1993), where the Court recognized a cause of action sounding in negligence "for economic damage for professional negligence *beyond the strictures of privity of contract.*" (Emphasis added). There, the Court allowed an electrical subcontractor that was not in privity with the Project Engineers on a large government construction job to sue the engineers for negligence in giving them faulty specifications and advice relating to the performance of their subcontract. *Id.* at 252-54. Because the specs and advice were wrong, the subcontractor had to redo work and substitute products at great financial loss. *Id.* Despite some broad wording in the opinion, the specific issue in the case was whether to "allow a cause of action against an architect or an engineer for economic damages if a party was foreseeably harmed by the professional's negligence." *Id.* at 253. All the authorities cited by the *Mid-Western* Court in its analysis of this issue were cases involving suits brought against construction architects and engineers under similar circumstances. *Id.* at 253-54.

"'Professional negligence" is a field of law that does not include excavators. *See generally*, 65 C.J.S Negligence §159. A "profession" as a legal term means

> [a] vocation or occupation requiring special, usually advanced, education and skill; *e.g.*, law or medical professions.... The labor and skill involved in a profession is predominantly mental or intellectual, rather than physical or manual. ... The term originally contemplated only theology, law and medicine, but as application of science and learning are extended to other departments of affairs, other vocations also receive the name, which implies professed attainments in special knowledge as distinguished from mere skill.

Black's Law Dictionary (5th ed.) 1979 at 1089-90. Clearly, the *Mid-Western* case is dealing with professional negligence as so defined and is not extending that concept to the realm of skilled labor such as excavation and masonry work. Therefore, the *Mid-Western* case, like *Spielman*, is inapposite to the matter at bar. *Limpert v. Bail*, 447 N.W.2d 48, 50 (S.D. 1989), where the Supreme Court found that the purchaser of cattle could sue a veterinarian for economic damages although it was the seller of the cattle who engaged and paid the veterinarian, fails to control here for the same reason.

Economic Loss Doctrine

In *Kreisers, Inc. v. First Dakota Title Ltd. Partnership*, 852 N.W.2d 413 (S.D. 2014) the South Dakota Supreme Court stated that "[t]he economic loss doctrine provides that 'purely economic interests are not entitled to protection against mere negligence.' *Diamond Surface, Inc. v. State Cement Plant Comm'n*, 1998 S.D. 97, ¶ 22, 583 N.W.2d 155, 160 (internal citation omitted). The significance of the doctrine is that it 'precludes parties under certain circumstances from eschewing the more limited contract remedies and seeking tort remedies.' *Ins. Co. of N. Am. v. Cease Elec. Inc.*, 276 Wis.2d 361, 688 N.W.2d 462, 467 (2004)." *Id.* at 421.

> The "doctrine draws a legal line between contract and tort liability that forbids tort compensation for 'certain types of foreseeable, negligently caused, financial injury.'" *Terracon Consultants Western, Inc. v. Mandalay Resort Grp.*, 125 Nev. 66, 206 P.3d 81, 87 (2009) (quoting *Barber Lines A/S v. M/V Donau Maru*, 764 F.2d 50, 52 (1st Cir.1985)). The economic loss doctrine, therefore, sets forth that regardless of whether a tort duty may exist between contracting parties, the actual duty one party owes to another for purely economic loss should be based exclusively on the contract to which they agreed and assigned their various risks. *See Indianapolis–Marion Cnty. Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722, 729–30 (Ind.2010).

Id.

"Economic loss 'is defined as that loss resulting from the failure of the product to perform to the level expected by the buyer and the consequential losses resulting from the buyer's inability to make use of the ineffective product, such as lost profits.'" *Taco John's of*

Huron, Inc. v. Bix Produce Company, LLC, 2008 WL 1140655 *4 (D.S.D. 2008). The economic loss doctrine is most commonly applied to the sale of goods under the UCC, but many courts, including the U.S. District Court for the District of South Dakota, applying South Dakota law, have applied it to commercial transactions outside of the UCC. *See, Taco Johns* at 2008 WL 1140655 at ** 4-6. There are three generally acknowledged exceptions to the application of the economic loss doctrine in commercial cases- (1) where there is a personal injury; (2) where there is damage to property other than the property that was the subject of the contract; or (3) where there is professional negligence as outlined above. Id. at *4. *See also, Jorgensen Farms, Inc. v. Country Pride Corp., Inc.* 824 N.W.2d 410, 418 (S.D. 2012).

Here, while First Rate did not contract with the Mays, Defendant contends that the economic loss doctrine is nevertheless applicable because First Rate is being sued due to allegations that the foundation and septic systems it sold to RES were nonconforming to that contract, and there is a chain of privity connecting the three parties in the common transaction of building the Mays' home. There is no personal injury, and, as the South Dakota Supreme Court held in *City of Lennox v. Mitek Industries, Inc.*, 519 N.W.2d 330 (S.D. 1994), where a defect in trusses forced the City of Lennox to remove insulation, sheet metal, and other parts of a building in the remediation process, the same were not deemed "other property" as excepted by the economic loss doctrine. The claimed losses in this case are to the home that was the subject of the construction contracts at issue and in no way may be construed as damage to "other property" as that term in to be understood in this context.

Chief U.S. District Judge Schreier, in the *Taco Johns* case, applied the economic loss doctrine where the Plaintiff was suing the defendant for lost profits under a negligence theory in a commercial setting, even though the defendant and plaintiff in that case were not in privity of contract, which is the Mays' primary defense to the application of that doctrine to defeat their claims herein. *See Taco Johns* at *6. Further, Chief Judge Schreier forcefully rejected that assertion that South Dakota law only recognizes the economic loss rule in UCC cases, because "many courts applying the economic loss doctrine have stated the rule without any hint that it only applies if the UCC governs the transaction," and "to do so would lead to perverse results." Id. at *5. For a powerful articulation for the historical context and social utility of the economic

loss rule, applied to a construction case outside the UCC sphere and to parties without direct privity, see *LAN/STV v. Martin K. Eby Const. Co. Inc.*, 435 S.W.3d 234, 243, 247–48 (Tex. 2014) ("The [economic loss rule] serves to provide a more definite limitation on liability than foreseeability can and reflects a preference for allocating some economic risks by contract rather than by law.... Construction projects operate by [vertical] agreements among the participants [owner, general contractor, subcontractors]. We think it is beyond argument that one participant... cannot recover from another... for economic loss caused by negligence.")

Plaintiffs assert that it is unfair to them to disallow a tort remedy in their favor against the negligent excavator because to do so leaves them with no contractual remedy against the excavator. But, the digging and foundation work performed by FRE was a contract obligation owed by the general contractor to the Plaintiffs, and they had a direct contractual remedy against the general contractor for any breach of that contract and were entitled to be made whole therefrom. *See generally*, 17A Am Jur2d, Contracts §702. Because of this, Plaintiffs are in no way left without a remedy to address their damages. To the contrary, it is stated that plaintiffs have already pursued and obtained that remedy. In any event, there is no injustice in legal policy that confines parties to construction contracts to the exercise of contract remedies for purely economic damages due to breach within the chain of privity, rather than allowing that chain to be leveraged with piecemeal litigation alleging disparate but overlapping theories of liability against multiple parties. Indeed, with the general contractor having a potential breach of contract cause of action against its subcontractor for its own liability to the owners, Plaintiffs' strategies here could result in a double recovery for themselves while leaving Defendant at risk of duplicate liabilities for a single injury, which is a dubious policy, indeed. Thus, Plaintiffs' reliance upon the Restatement (Third) of Torts: Liab. for Econ. Harm § 3 cmt. f (2023) and *Sullivan v. Pulte Home Corp.*, 306 P3d 1 (AZ 2013) is unsound under the pleaded facts of this case.

It is the more prudent and just policy to allow commercial actors in construction projects to define the boundaries of their risk allocation within the traditional rubric of contract law in order to adjust potential breach of promise or warranty claims resulting from nonconforming work. "If there is a convincing rationale for the economic loss rule, it is that the

rule performs a critical boundary-line function, separating the law of torts from the law of contracts. More specifically, '[t]he underlying purpose of the economic loss rule is to preserve the distinction between contract and tort theories in circumstances where both theories could apply.'" V. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 Wash & Lee LRev 523, 546 (2009).

ORDER AND JUDGMENT

Accepting the material allegations as true and construing them in a light most favorable to the Plaintiffs, the allegations do not state a cognizable claim for relief on a negligence theory. Now, therefore, it is hereby ADJUDGED, ORDERED AND DECREED that the Motion to Dismiss is GRANTED, and this matter is hereby dismissed upon the merits and with prejudice.

Dated this 1 day of December, 2023.

BY THE COURT:

Honorable Douglas L. Hoffman
Circuit Court Judge

ATTEST:
BRITTAN ANDERSON, Clerk of Courts

By: JM Baker
Deputy

IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

No. 30579

JAMES and AMBER MAY,

Plaintiffs/Appellants,

vs.

FIRST RATE EXCAVATE, INC.,

Defendant/Appellee.

Appeal from the Circuit Court
Second Judicial Circuit
Lincoln County, South Dakota

The Honorable Douglas E. Hoffman, Presiding Judge

REPLY BRIEF OF APPELLANTS

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Notice of Appeal filed December 28, 2023

ORAL ARGUMENT REQUESTED

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ARGUMENT

I. The Trial Court Erred in Raising the Economic Loss Doctrine Sua Sponte and Dismissing the Mays' Complaint On Such Grounds.

The Trial Court erred when it raised the economic loss doctrine *sua sponte* and dismissed James and Amber Mays' ("Mays") Complaint on such grounds. First Rate Excavate, Inc. ("First Rate") agrees the issue of economic loss doctrine was raised by the Trial Court *sua sponte*, but argues the Trial Court's action was harmless because the parties were provided an opportunity to address the application of the doctrine. In support of this position, First Rate argues this Court's recent ruling in *Ally v. Young* is not applicable to this matter because *Ally* was a *habeas corpus* proceeding. (Brief of Appellee at 4-5 (citing 2023 S.D. 65, ¶ 49, n. 14, 999 N.W.2d 237, 253-54).)

Respectfully, as set forth in *Ally*, courts are bound to follow the "well-established rule" that "courts *shall not raise an issue not first raised by the parties*, except in the *exceptional* case in which a constitution violation is apparent." *Ally*, 2023 S.D. 65 at ¶ 50, 999 N.W.2d at 254 (citing *Ibrahim v. Dep't of Pub. Safety*, 2021 S.D. 17, ¶ 22, 956 N.W.2d 799, 804-05) (emphasis added). Thus, if there is not an apparent constitutional violation, "courts *shall not* raise issues not first raised by the parties" *sua sponte*, regardless the posture or subject matter of a case. *Id.* (emphasis added). Said another way, the inquiry does not concern the type of case a court improperly interjects within. Whether the matter is that of a criminal or civil proceeding makes no difference. Instead, the inquiry is whether the matter before the lower court was the type of "exceptional case requiring the court's *sua sponte* intervention" in which a "constitutional violation is apparent." *Id.*

Here, no constitutional violation was in dispute requiring the Trial Court's intervention. As set forth in the Mays' Statement of the Facts, this case concerns First Rate's faulty work related to the digging and placement of the foundation of a home. (Brief of Appellants at 3.) Surely, there is no constitutional violation at issue that require the Trial Court's pseudo-advocacy. As such, First Rate has failed to show its Motion to Dismiss was an exceptional case in which a constitutional violation was apparent, requiring the Trial Court's *sua sponte* involvement. Absent such showing, First Rate fails to demonstrate the Trial Corut's intervention was necessary.

Moreover, as this Court recently made clear concerning the very same Trial Court, a court shall not interject itself and raises issues for a party. *See Ally*, 999 N.W.2d 237, ¶ 49, n. 14, 999 N.W.2d at 253. Indeed, the United States Supreme Court has also recently made clear it is up to the "parties to frame the issue for decision and assign the courts the role of neutral arbiter of matters the parties present." *United States v. Sineneng-Smith*, 590 U.S. 371, 375-76 (2020). This is because "courts are essentially passive instruments of government" which "should not, sally forth each day looking for wrongs to right. They wait for cases to come to them, and when cases arise, courts normally decide *only* questions presented by the parties." *Id.* (internal quotations and citations omitted) (emphasis added).

Here, the Trial Court failed to be a "neutral party that adjudicates only those issued raised by the parties." *Ally*, 999 N.W.2d 237, ¶ 49, n. 14, 999 N.W.2d at 253. The Trial Court did not simply adjudicate the issues raised by First Rate in its Motion to Dismiss and supporting pleadings. Instead, the Trial Court raised the economic loss doctrine *sua sponte* and participated "as a pseudo-advocate" for First Rate, "abandon[ing]

its post of neutrality." *Id.* Because the economic loss doctrine was not raised by First Rate, the Court failed to decide First Rate's Motion to Dismiss only on issues raised by the parties. *Id.*

The Trial Court granted First Rate's Motion to Dismiss on an issue that was not raised by any party but instead was raised *sua sponte* by the Trial Court. The issue raised by the Trial Court was not an exceptional constitutional violation issue which required court intervention. Such action by the Trial Court is reversible error.

II. South Dakota Supreme Court Controlling Precedent Makes Clear That the Economic Loss Doctrine Does Not Apply to Transactions Outside the UCC

First Rate next argues the economic loss doctrine precludes the Mays' claims against First Rate. Relying on *Taco John's of Huron, Inc. v. Bix Produce Co., LLC*, First Rate suggests the economic loss doctrine applies to transactions outside the Uniform Commercial Code ("UCC"). (Brief of Appellee at 5-6 (citing 2008 WL 11450655, at *4 (D.S.D. 2008).) However, that is not the law. Instead, under South Dakota Supreme Court precedent, the economic loss doctrine does not apply to the Mays' claims. The Trial Court erred when it applied the economic loss doctrine to a matter outside the UCC.

First, First Rate's reliance on *Taco John's of Huron, Inc.* is misplaced. *Taco Johns of Huron, Inc.* was decided in 2008. *See* 2008 WL 11450655 (D.S.D. 2008). Years later, however, in 2012, this Court made clear that "[i]n UCC cases, this Court has adopted the economic loss doctrine" such that a plaintiff is "limited to the commercial theories found in the UCC." *Jorgensen Farms, Inc. v. Country Pride Corp.*, 2012 S.D. 78, ¶ 24, 824 N.W.2d 410, 418. Again, two years later, this Court once more confirmed it had not yet "extended the [economic loss] doctrine" beyond "commercial transactions under the Uniform Commercial Code." *Kreisers Inc. v. First Dakota Title Ltd. P'ship*,

2014 S.D. 56, ¶ 30, 852 N.W.2d 413, 421. And, just last year the United States District Court for the District of South Dakota noted that the South Dakota Supreme Court has not yet "signal[ed]" a change or extension of the general rule. *Zoss v. Protsch*, 2023 WL 114369, at *5 (D.S.D. Jan. 5, 2023) (noting, in the context of an attorney malpractice action, that the South Dakota Supreme Court has not yet adopted a rule expanding the economic loss doctrine); *see also In re Syngenta AG MIR 162 Corn Litig.*, 131 F. Supp. 3d 117, 1202 (D. Kan. 2015) (stating "there is no basis to predict that South Dakota courts would apply the [economic loss doctrine] in another context outside the realm of the UCC.") . Accordingly, this Court's precedent—not *Taco John's of Huron, Inc.*—controls.

Indeed, "[i]n formulating [South Dakota's] economic loss rule, [this Court] cited Minnesota law, which has declined to extend the economic loss doctrine beyond commercial transactions." *Id.* (internal citations omitted). This is because, as the United State Supreme Court has stated, the economic loss doctrine applies "when a defective product purchased in *a commercial transaction* malfunctions, injuring only the product itself and causing purely economic loss." *East River S.S. Corp. v. Transamerica*, 476 U.S. 858, 859 (1986) (emphasis added). Thus, this Court has not applied the economic loss doctrine outside of UCC cases.

As set forth in the Mays' opening Brief, this matter is outside the UCC. (Brief of Appellants at 8-10.) This matter does not concern damages incurred in the operation of a contract for the sale of goods under the UCC. *See, e.g., City of Lennox v. Mitek Indus., Inc.*, 519 N.W.2d 330, 332 (S.D. 1994) (UCC governs "sale of goods" because "goods are defined as all things which are movable at the time of identification to the contract for

sale."). Instead, the Mays' Complaint against First Rate concerns the performance of a service and labor and the negligent rendering of such services. *See Id.* Accordingly, because this matter is outside the UCC, the economic loss doctrine does not apply.

This Court has declined to expand the economic loss doctrine beyond commercial transactions. And, for the reasons set forth above, the parties' relationship concerned the performance of a service, not the sale of goods. Because the Complaint alleges causes of action outside the UCC, the economic loss doctrine does not apply. Thus, the Trial Court erred when it dismissed the Mays' Complaint.

III. The Economic Loss Doctrine Does Not Preclude the Mays' Complaint Because the Doctrine Does Not Apply Between Non-Contracting Parties.

Next, even if the economic loss doctrine applies to transactions outside the UCC (which it does not), the economic loss doctrine does not preclude the Mays' claims.

First, the economic loss doctrine does not apply to non-contracting parties who have no contractual remedies available. Indeed, as set forth in the Mays' opening Brief, courts have declined to extend the economic loss doctrine to cases where, as here, the parties are not in privity of contract and have no contractual remedies available. (*See* Brief of Appellants at 5-8 (citing *Kreisers Inc.*, 2014 S.D. 56, ¶ 29, 852 N.W.2d at 421; *Sullivan v. Pulte Home Corp.*, 306 P.3d 1, 2-3 (Ariz. 2013); Restatement (Third) of Torts: Liab. for Econ. Harm § 3 (2020) (noting the majority of courts apply the economic loss rule only to parties who have contracts)).)

First Rate again relies on *Taco John's of Huron, Inc.* in arguing the United States District Court for the District of South Dakota applied the economic loss doctrine where there was no direct privity of contract between the parties. (Brief of Appellee at 6 (citing *Taco John's of Huron, Inc.*, 2008 WL 11450655, at *4 (D.S.D. 2008).) But, for the

reasons previously explained, the District Court erroneously applied the economic loss doctrine to a transaction outside the UCC. Instead, years after the *Taco John's of Huron, Inc.* opinion, this Court made clear that the economic loss doctrine is a "prohibition against tort action to recover solely economic damages for those *in contractual privity*" as it "is designed to prevent *parties to a contract* from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort." *Kreisers Inc.*, 2014 S.D. 56, ¶ 29, 852 N.W.2d at 421 (quotation omitted) (emphasis added).

Here, there is no allocation of losses set forth in a contract between the Mays and First Rate. Applying the economic loss doctrine in such a transaction is nonsensical because neither party has contractual damages and expectations to rely on. This is precisely why the economic loss doctrine "does not foreclose claims between plaintiffs and defendants who are only indirectly linked by contract," that is, those who "had no contract with each other [but] both had contracts with the same third party." Restatement (Third) of Torts: Liab. for Econ. Harm § 3 cmt. f (2020). If the economic loss doctrine applied, the Mays would have no recourse against First Rate.

For these reasons, the South Dakota Supreme Court has made clear: the economic loss doctrine applies to those in contractual privity. *Kreisers Inc.*, 2014 S.D. 56, ¶ 29, 852 N.W.2d at 421. Because the Mays and First Rate are not contracting parties, the economic loss doctrine is inapplicable. The Trial Court erred when it dismissed the Mays' Complaint under such doctrine.

IV. Even if the Economic Loss Doctrine Applied, Plaintiffs Damages Concern Damage to "Other Property."

Moreover, even if the economic loss doctrine applied outside the UCC (which it does not), and if it applied to non-contracting parties (again, which it does not), the

economic loss doctrine still would not bar the Mays' Complaint. The South Dakota Supreme Court has recognized an exception to the economic loss doctrine when a plaintiff's injury stems from "other property" collateral to the contracted-for product. *See City of Lennox*, 519 N.W.2d 330, 333 (S.D. 1994); *Jorgensen Farms, Inc.*, 2012 S.D. 78, ¶ 26, 824 N.W.2d at 418–19.

First Rate Argues the Mays have failed to allege damage to "other property" to fall within such recognized exception. (Brief of Appellee at 8.) But here, the Mays' Complaint alleges damage to the Mays' home itself. (*See* R. 5, ¶ 19.) The Mays' asserted damage is not simply to the concrete work completed by First Rate. (*Id.*) Thus, the damage sustained and alleged by the Mays is more than just to the "specific goods that were part of the transaction." *Jorgensen Farms, Inc.*, 2012 S.D. 78, ¶ 25, 824 N.W.2d at 418. The Mays allege damage to their home including water infiltration, septic infiltration, and septic failure, all of which are "other property" apart from the cement and foundation poured by First Rate. (*See* R. 5, ¶ 19.)

Likewise, the Mays have further alleged First Rate's negligence caused damaged to the surrounding land, the Mays' yard, and their neighbor's property. (*See* R. 5, ¶ 17 (noting a lagoon exists in Plaintiffs' yard and drains into their neighbors' property, causing significant issues).) Once more, such damages are not merely damage to the defective product and the underlying subject of the parties' transaction, but instead are allegations of damage to "other property."

Thus, even if the economic loss doctrine applied to this non-UCC transaction between two non-contracting parties, the Mays have alleged damage to "other property" such that their claims fall outside the economic loss doctrine. *Jorgensen Farms, Inc.*,

2012 S.D. 78, ¶ 27, 824 N.W.2d at 419. The Trial Court erred when it dismissed the Mays' Complaint under such doctrine.

V. The Mays May Proceed Against First Rate After Releasing RES

Finally, First Rate argues the Mays cannot proceed against First Rate after releasing the general contractor, RES Construction, LLC ("RES") on a "limited basis for a full/final release." (Brief of Appellee at 9.) However, First Rate's position is unfounded in fact and contrary to the law.

Instead, the Mays properly entered into a release wherein the terms of the agreement make clear the Mays reserved the right to pursue claims against any other persons or entities for damages to their home. Such release (and the explicit reservation of the Mays' rights) is a common, permissible and accepted release under the law. *See, e.g.*, 76 C.J.S. Release § 60 (noting written release does not release all other liable parties when release expressly reserve the right to sue other individuals); *Krause v. Reyelts*, 2002 S.D. 64, ¶¶ 19-22, 646 N.W.2d 732, 735–36 (release of claims against one subcontractor did not prevent suit against general contractor for its own deficient work); *Lansing v. Concrete Design Specialties, Inc.*, 2006 WL 1229638, at *1 (Minn. Ct. App. May 9, 2006) (settlement agreement between homeowners and their general contractor, which did not list subcontractor as a party released from liability in list of enumerated parties, did not release subcontractor from liability). Thus, the Mays may proceed against First Rate.

Moreover, whether the Mays properly reserved their rights against First Rate in the release was not raised by First Rate in the underlying matter and thus, was not the basis for the Trial Court's dismissal of the Mays' Complaint. Accordingly, the issue is not dispositive before this Court. *See State v. Hays*, 1999 S.D. 89, ¶ 16, 598 N.W.2d 200,

203 (noting "an issue not raised before the trial court will not be reviewed at the appellate level."); *Hall v. State ex rel. S. Dakota Dep't of Transp.*, 2006 S.D. 24, ¶ 12, 712 N.W.2d 22, 26 ("We have repeatedly stated that we will not address for the first time on appeal issues not raised below."). Because the release was not raised before the Trial Court, the argument should not be considered here.

CONCLUSION

First Rate's argument on appeal is that the multitude of legal errors in the Trial Court's decision are harmless, particularly the Trial Court's error of raising an issue itself *sua sponte*. *Mendenhall v. Swanson*, 2017 S.D. 2, ¶ 13, 889 N.W.2d 416, 421. Error, however, is not harmless when such error has substantial influence on the result. By raising the economic loss doctrine *sua sponte* and then misapplying the doctrine to the facts of the case, the Trial Court committed an error that must be reversed. For the reasons set forth above, the economic loss doctrine does not apply to this non-UCC transaction between two non-contracting parties. Thus, the Trial Court's dismissal must be reversed.

Dated at Sioux Falls, South Dakota, this 5th day of April, 2024.

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CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that this Reply Brief of Appellants complies with the type volume limitations set forth in SDCL § 15-26A-66. Based on the information provided by Microsoft Word 365, this Brief contains 2,664 words, excluding the table of contents, table of authorities, jurisdictional statement, statement of legal issues, any addendum materials, and any certificates of counsel. This Brief is typeset in Times New Roman (12 point) and was prepared using Microsoft Word 365.

Dated at Sioux Falls, South Dakota, this 5th day of April, 2024.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing "Reply Brief of Appellants" was filed electronically with the South Dakota Supreme Court and that the original of the same was filed by mailing the same to 500 East Capital Avenue, Pierre, South Dakota, 57501-5070, on the 5th day of April, 2024.

The undersigned further certifies that an electronic copy of "Reply Brief of Appellants" was emailed to the attorneys set forth below, on the 5th day of April, 2024:

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