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Tort Trial & Insurance Practice Law Journal
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CONTENTS

RECENT DEVELOPMENTS IN BUSINESS LITIGATION

Lisa L. Pittman, Daniel Wilson, and Van Cates

This past year has seen notable developments in business litigation, with particularly significant decisions in civil RICO, contracts, and remedies. Developments in cannabis law, arbitration clause interpretation, and the economic loss doctrine show that numerous facets of business litigation are changing rapidly.

I. CIVIL RICO

A. *Introduction*

Around 2015, people enraged by the growing legal cannabis industry—now authorized for medical use in thirty-three states and recreational or adult use in ten states and Washington, D.C.—conspired to devise a

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strategy to attempt to dismantle a state's entire regulated cannabis regime and, thus, the industry itself.[1] Instead of alleging odor or nuisance claims against their neighbors, these people crafted detailed private civil RICO allegations against not only the unwanted cannabis business neighbor, but also against every person who had ever done business with the cannabis business, including the banks, insurance companies, land owners, construction companies, and contractors, in an effort to cause these defendants to sever ties with the cannabis business. Even the governors and the state and local officials in charge of the regulatory programs that issue licenses to cannabis businesses were sued with the purpose of taking down the entire state's regulatory system governing state legal cannabis, permitted under the Tenth Amendment, by alleging that the governing officials were all part of an ongoing conspiratory criminal enterprise that encouraged drug trafficking in contravention of the United States Controlled Substances Act (CSA), which places cannabis on Schedule 1 alongside LSD and heroin. A Schedule 1 designation means a substance has no possible accepted medical use and a high potential for abuse. Cocaine is Schedule 2. These plaintiffs relied on the Supremacy Clause of the U.S. Constitution to assert that states allowing cannabis businesses were thereby enriching themselves by the enormous tax revenues and license fees that they were deriving from the cannabis program, which was federally illegal, and the plaintiffs requested that the state be enjoined from continuing the state cannabis program.

The first such lawsuit was filed in Pueblo, Colorado, and after the district court dismissed the plaintiffs' claims in their entirety, the Tenth Circuit Court of Appeals held that the plaintiffs had met the basic elements of their civil RICO claim and thus could proceed. Emboldened by the Tenth Circuit's opinion, similar lawsuits were brought in Massachusetts, California, Oregon, and Washington, sometimes naming up to 200 defendants (sometimes not even served), no matter how tangential their relationship to the target cannabis business defendant may have been.

B. *Civil RICO*

Courts have held that "RICO is to be read broadly."[2] RICO "created a new civil cause of action for '[a]ny person injured in his business or property by reason of a violation of [its] prohibitions.'"[3] That is, RICO vests a private

1. "Marihuana" is the term used to define the plant Cannabis sativa L. under the CSA, and the terms cannabis and marijuana may be used interchangeably throughout this article. 21 U.S.C. § 812 (c)(c)(10).

2. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497 (1985).

3. RJR Nabisco, Inc. v. European Cmty., 136 S. Ct. 2090, 2096 (2016) (alteration in original) (quoting 18 U.S.C. § 1964(c)).

citizen with substantive rights to avoid "injur[ies]" to "his business or property" caused by a pattern of racketeering activity, and it explicitly creates a federal cause of action to vindicate those federal rights.[4] To maintain a cause of action under § 1964(c), a plaintiff must plead and ultimately prove: (1) that the defendant violated § 1962; (2) that the plaintiff's business or property was injured; and (3) that the defendant's violation is the cause of that injury.[5]

Thus, RICO creates a private right of action for "any person injured in his business or property by reason of a violation of 18 U.S.C. § 1962."[6] Under 18 U.S.C. § 1962(c), it is "unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity."[7] An "enterprise" for purposes of RICO "includes any . . . partnership, corporation, association, or other legal entity."[8]

"RICO is founded on the concept of racketeering activity. The statute defines 'racketeering activity' to encompass dozens of state and federal offenses, known in RICO parlance as predicates. These predicates include any act 'indictable' under specified federal statutes," and among them is "drug-related activity that is 'punishable' under federal law."[9] As relevant here, "racketeering activity" includes "dealing in a controlled substance or listed chemical as defined in" the CSA.[10] Racketeering activity also includes "any offense involving . . . the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in a controlled substance or listed chemical," as defined in the CSA, that is "punishable under any law of the United States."[11]

In these lawsuits, the plaintiffs allege that the cannabis businesses are "RICO enterprises," and that those who participate with them in any manner to fulfill their purpose of selling cannabis to the public form an association-in-fact for the purposes of the RICO statute. Further, according to these plaintiffs, all those who understood that the business was selling cannabis and assisted the RICO enterprise all formed an ongoing pattern of criminal racketeering activity.

4. 18 U.S.C. § 1964(c).
5. *Id.*; *see RJR*, 136 S. Ct. at 2096–97.
6. 18 U.S.C. § 1964(c).
7. *Id.* at § 1962.
8. *Id.* at § 1961(4).
9. *RJR*, 136 S. Ct. at 2096 (quoting 18 U.S.C. § 1961(1)(D)).
10. 18 U.S.C. § 1961(1)(A).
11. *Id.* § 1961(1)(D).

C. *Colorado*

The civil RICO tactic began in Colorado in 2015 with *Safe Streets Alliance v. Alternative Holistic Healing, LLC.*[12] Safe Streets Alliance is alleged to be a nonprofit organization devoted to reducing crime and illegal drug dealing. But, the Reillys are the only members of this organization. In their second amended complaint, the plaintiffs named the governor of Colorado, John Hickenlooper, the executive directors of both the state and local cannabis licensing agencies, the Board of Commissioners of Pueblo County where the cannabis businesses' manufacturing facilities are located, the Pueblo County Liquor & Marijuana Licensing Board, all of the holding companies related to Alternative Holistic Healing LLC (AHH) as well as its owners individually, the development corporation serving as AHH's landlord, the bank that issued AHH a surety bond, and even a John Doe contractor who must have known his work on the manufacturing facility had to do with cannabis.[13]

The plaintiffs proclaim outright that they filed this suit "to vindicate the federal laws prohibiting the cultivation and sale of recreational marijuana and their rights under RICO. Plaintiffs also seek an injunction under RICO directing the marijuana operations affecting their land to stop violating the federal drug laws. In addition to their RICO claims, plaintiffs are also suing the state and local officials who are facilitating and encouraging Colorado's recreational marijuana trade, including the racketeering activity that is injuring their property, through a licensing regime that purports to authorize federal drug crimes."[14] Shortly thereafter, much like former Attorney General Jeff Sessions declared, "good people don't smoke marijuana," the plaintiffs state in their second amended complaint that "[m]arijuana businesses make bad neighbors."[15] The plaintiffs requested that AHH be forced to cease its operations, that all of the alleged conspiring racketeering defendants be held liable for treble damages and fees to plaintiffs, and that the state officials be enjoined from engaging in or permitting the cannabis programs to continue in the State.

The plaintiffs asserted a RICO claim was justified because of the CSA. To capture all the named defendants' involvement as conspirators to racketeering activity, they pleaded:

> In addition to its prohibitions on cultivation, sale, and possession of marijuana, the CSA also forbids a wide range of other activities connected with the

12. Plaintiffs' Second Amended Complaint, Safe Streets Alliance v. Alternative Holistic Healing, LLC, No. 1:15-CV-00349-REB-SKC (D. Col. Feb. 1, 2016), ECF No. 126 [hereinafter Plaintiff's Second Amended Complaint].

13. *Id.*

14. *Id.* at 1.

15. *Id.* at 2.

> operations of a marijuana business. Thus, it is a crime to possess "any equipment, chemical, product, or material" with the intention of using it to manufacture marijuana, *id.* § 843(a)(6), or to distribute any such material with the knowledge that it will be used to manufacture marijuana, *id.* § 843(a)(7). The CSA bars the use of a telephone, email, mail, or any other "communication facility" in furtherance of the manufacture or sale of marijuana, *id.* § 843(b), and it is a federal crime to use the Internet to advertise the sale of marijuana, *id.* § 843(c)(2)(A). Reinvesting the proceeds from marijuana operations is also a crime, *id.* § 854(a), as is knowingly facilitating a financial transaction involving funds derived from manufacturing and selling marijuana, 18 U.S.C. §§ 1956, 1957,1960. It is also a crime to knowingly lease, rent, maintain, manage, or control a place where marijuana is manufactured or sold. 21 U.S.C. § 856. Leading a group of five or more people who commit a continuing series of federal marijuana crimes is an especially serious offense. *Id.* § 848. And attempting or conspiring to commit most of those crimes is also a criminal offense. *See id.* § 846; 18 U.S.C. §§ 1956(a)(1),1956(h), 1957(a).[16]

The plaintiffs noted that, in 2012, voters approved Amendment 64 to the Colorado Constitution, allowing both personal use and cultivation and commercial retail adult use of cannabis under a robust regulatory regime.[17] In 2017, Colorado sold about $1.5 billion dollars in medical and recreational cannabis, translating to $247,368,473 in tax revenue used primarily for schools and roads.[18] Colorado has already outpaced these numbers in 2018, and as of October 31, 2018, the Colorado Department of Revenue collected $223,300,334 in revenue from $801.2 million in sales—a 12% increase from the prior year.[19]

The plaintiffs went on to assert that Colorado's adoption of a Retail Marijuana Code to regulate the growth, distribution, and sale of cannabis impermissibly violates the CSA. The plaintiffs further asserted that the Code facilitates and promotes the sale of retail marijuana and that Colorado and the local licensing entities are all enriching themselves from the proceeds of drug money by the licensing fees charged and the taxes derived from the sale of cannabis to the public. The state officials are thereby alleged to be profiting from and conspiring in racketeering activity to justify their inclusion in the lawsuit. The plaintiffs even claim that Colorado's public service announcements to tourists as to the dangers and dosing of

16. *Id.* at 10.

17. *Id.* (citing Colo. Const. art. XVIII § 16(3)).

18. *Marijuana Tax Data*, Colo. Dep't Rev. (2018), https://www.colorado.gov/pacific/revenue/colorado-marijuana-tax-data.

19. *Id.*; *see also* Eli McVey, *Chart: Colorado on Pace for Record Setting Billion-Dollar Year of Recreational Cannabis Sales*, Marijuana Bus. Daily (Nov. 12, 2018), https://mjbizdaily.com/colorado-another-record-setting-year-of-adult-use-cannabis-sales; Joe Rubino, *Colorado Cracks a Billion in Annual Marijuana Sales in Record Time, Generating $200M in Tax Revenue*, Denver Post (Oct. 18, 2018, updated Oct. 19, 2018), https://www.denverpost.com/2018/10/18/colorado-cracks-billion-marijuana-sales-record.

cannabis constitute "marketing efforts [which] are a transparent attempt to promote the commercial recreational marijuana industry."[20] The plaintiffs likewise characterized Pueblo County as having "a policy . . . to promote and profit from federal drug crimes."[21]

For context, the Reillys owned 105 acres of land in rural Pueblo, Colorado on which they did not live, but used for horseback riding and containing two agriculture buildings.[22] One of AHH's owners bought a forty acre tract next door and built a cannabis cultivation and manufacturing facility with extensive HVAC and odor control systems to prevent odors from escaping the facility. AHH sold the cannabis at a dispensary in Black Hawk, Colorado. No members of the public could visit or access the Pueblo grow facility.[23] The plaintiffs allege that all the individuals and entities involved in deciding to purchase this property to grow cannabis conspired in racketeering activity to commit a federal crime.[24] The plaintiffs alleged that their John Doe defendant who worked on construction of the facility was "clearly aware of the purpose of this building" due to "the many specialized features that are necessary to make a building suitable for growing marijuana."[25] Moreover, the plaintiffs alleged the "telephone, email or other communications" were used by defendants "to take steps in furtherance of their efforts to unlawfully lease . . . and develop" the cannabis business facility," further bolstering their RICO claim.[26]

The plaintiffs complained that the state and local officials granted AHH a cannabis license "to openly violate the federal drug laws through large-scale cultivation and storefront sale of recreational marijuana."[27] Thus, the plaintiffs extrapolated:

> By authorizing, supporting, and facilitating the Individual Defendants' drug crimes in exchange for licensing fees and in expectation that those crimes will generate economic development and tax revenues, the Pueblo Defendants conspired with the Individual Defendants to violate the federal drug laws. This constitutes conspiracy under 21 U.S.C. § 846, which is racketeering activity under 18 U.S.C. § 1961(1)(D).[28]

and similarly, that these defendants' use of the telephone to obtain the licenses facilitated commissions of felonies under the CSA.[29]

20. *See* Plaintiffs' Second Amended Complaint, *supra* note 15, at 16.
21. *Id.* at 20.
22. *Id.* at 5.
23. *Id.* at 21.
24. *Id.*
25. *Id.*
26. *Id.* at 23.
27. *Id.* at 24.
28. *Id.* at 25.
29. *Id.* at 26.

And, for the nail in the coffin, the plaintiffs alleged:

> All of the Individual Defendants and Pueblo Defendants have contractual and other relationships with each other and are collaborating together to contribute to the association-in-fact enterprise's efforts to cultivate recreational marijuana at 6480 Pickney Road and thereby engage in an ongoing pattern of racketeering activity. Alternative Holistic Healing, Joseph Licata, Jason Licata, 6480 Pickney, Walton, and Camp Feel Good all participated in the agreement as part of which Alternative Holistic Healing leased the 6480 Pickney Road property for cultivating marijuana.[30]

Despite expert testimony at trial later demonstrating the cannabis facility did not vent to the outdoors, the Reillys claimed that the cannabis cultivation facility emitted noxious odors, interfered with their vista of the mountains, and caused the value of their property to decline due to the cannabis cultivation facility next door.[31] The Reillys' property is in a high acreage master planned community of sorts, but the cannabis facility next door was outside of that community's boundaries. Nonetheless, the Reillys also complained that AHH's activities broke the covenants of their community.[32] The Reillys also asserted an increased risk of crime in the area because of the cannabis facility, even though the cannabis is only grown there but sold in Black Hawk, Colorado.[33] These are the issues the Tenth Circuit remanded for trial for a jury to determine.

1. The Tenth Circuit Decision

The Tenth Circuit considered three appeals arising out of the plaintiffs' lawsuit, which was dismissed in its entirety and with numerous defendants having settled before appeal. Because of the nature of the activity that violates federal drug laws, the Tenth Circuit quickly concluded that the plaintiffs had met the bare minimum standard of pleading the elements of their RICO claim.

The Tenth Circuit went on to analyze and conclude that the plaintiffs had plausibly argued an association-in-fact among the numerous defendants named in the lawsuit. Turning to the alleged affiliates of the facility at issue here, "RICO broadly defines 'enterprise' as 'any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity.'"[34] Among other theories, the Reillys relied on "the latter part of this definition, alleging

30. *Id.* at 28.
31. *Id.* at 33.
32. *Id.*
33. *Id.*
34. George v. Urban Settlement Servs., 833 F.3d 1242, 1248 (10th Cir. 2016) (quoting 18 U.S.C. § 1961(4)).

that" the Marijuana Growers[35] "formed an association-in-fact enterprise."[36] An "association-in-fact enterprise is 'a group of persons associated together for a common purpose of engaging in a course of conduct.'"[37] Such an entity "need not have a hierarchical structure or a 'chain of command.'"[38] For it to exist requires only "a purpose, relationships among those associated with the enterprise, and longevity sufficient to permit these associates to pursue the enterprise's purpose."[39]

Here, the Reillys alleged that for over a year the Marijuana Growers formed "an association-in-fact enterprise for the purpose of cultivating marijuana at 6480 Pickney Road and selling it at Alternative Holistic Healing's Black Hawk store, among other places." To advance their aims, the Marijuana Growers purportedly "pooled their resources, knowledge, skills, and labor to achieve through th[at] enterprise efficiencies in the cultivation and distribution of marijuana that none of them could have achieved individually."[40] Id. The Reillys' allegations of purpose, relationship, and longevity are sufficient for them to proceed on the basis that the Marijuana Growers together created an association-in-fact enterprise.

The Marijuana Growers appear to suggest that these allegations are insufficient because the Reillys also alleged that the corporate defendants were separate, smaller RICO enterprises. So far as it goes, they are correct that RICO "requires that the 'person' conducting the enterprise's affairs be distinct from the 'enterprise.'"[41] That is, "a single person cannot be both the RICO enterprise and the RICO defendant."[42] But that is irrelevant in this instance. Specifically, the Reillys' alternative enterprise theories do not undermine their well-supported allegations that the Marijuana Growers are each participating in a distinct, larger, association-in-fact enterprise.[43] The Marijuana Growers allegedly have long worked in concert to achieve market efficiencies toward their common aim of cultivating, distributing, and selling marijuana, which undisputedly affects interstate commerce.[44]

35. The Tenth Circuit referred to the cannabis entity and individual defendants as the "Marijuana Growers."

36. Safe Streets Alliance v. Hickenlooper, 859 F.3d 865, 882–83 (10th Cir. 2017).

37. Boyle v. United States, 556 U.S. 938, 946–47 (2009) (explaining that "evidence used to prove" the elements of a RICO claim may "coalesce").

38. *Id.* at 948.

39. *Id.* at 946.

40. *Id.*

41. George v. Urban Settlement Servs., 833 F.3d 1242, 1249 (10th Cir. 2016) (citing Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158, 160 (2001)).

42. RJR Nabisco, Inc. v. European Cmty., 136 S. Ct. 2090, 2104 (2016) (citing *Cedric*, 533 U.S. at 162).

43. *See* Boyle v. United States, 556 U.S. 938, 946 (2009); *George*, 833 F.3d at 1250.

44. *See RJR*, 136 S. Ct. at 2106 (explaining that the enterprise must affect interstate commerce).

The Reillys have adequately alleged that the Marijuana Growers formed an association-in-fact enterprise.[45]

The Tenth Circuit then went on to consider the conduct of the enterprise's affairs element of the plaintiffs' RICO claim, concluding the plaintiffs plausibly alleged this element. To maintain a § 1964(c) claim against any particular defendant, the Reillys need only to have alleged facts plausibly demonstrating that the defendant "conduct[ed] or participate[d], directly or indirectly, in the conduct of [the] enterprise's affairs."[46] "This, in turn, requires a showing that the defendant 'participate[d] in the operation or management of the enterprise itself.'"[47] "Under *Reves*' operation or management test, the defendant must have 'some part in directing' the enterprise's affairs."[48] However, to be liable under RICO, "the defendant need not have 'primary responsibility for the enterprise's affairs,' 'a formal position in the enterprise,' or 'significant control over or within [the] enterprise.'" The defendant's actions also need not have advanced an "economic motive."[49] "Nevertheless, a defendant must do more than simply provide, through its regular course of business, goods and services that ultimately benefit the enterprise."[50] For example, the Reillys at one time alleged that a contractor violated § 1962 by delivering water to the Marijuana Growers' operation. Without more, that would be insufficient to establish that the contractor was part of the enterprise.[51] But "a plaintiff can easily satisfy *Reves*' operation and management test by showing that an enterprise member played some part—even a bit part—in conducting the enterprise's affairs."[52] The Marijuana Growers admit that they all "agreed to grow marijuana for sale" at the facility adjacent to the Reillys' property, a facility at which they allegedly have been doing just that. This plausibly alleges that the Marijuana Growers each conducted the enterprise's affairs.[53]

The Tenth Circuit then declined to determine whether the defendants' operations and activities constituted a "pattern" under RICO, but nevertheless held that the plaintiffs had sufficiently alleged violations of the CSA sufficient to establish a RICO claim against the defendants. However, the Tenth Circuit noted that while it felt the plaintiffs' pleadings were adequate to plausibly allege property damages (whereas the district court held the plaintiffs alleged mere speculative emotional or personal injuries rather than concrete property damage injuries), the court remanded the element

45. Safe Streets Alliance v. Hickenlooper, 859 F.3d 865, 882–83 (10th Cir. 2017).
46. 18 U.S.C. § 1962(c).
47. *George*, 833 F.3d at 1251 (quoting Reves v. Ernst & Young, 507 U.S. 170, 185 (1993)).
48. *Id.* (quoting *Reves*, 507 U.S. at 179).
49. Nat'l Org. for Women, Inc. v. Scheidler, 510 U.S. 249, 252 (1994).
50. *George*, 833 F.3d at 1251 (citation omitted).
51. *See id.*
52. *Id.* at 1252.
53. Safe Streets Alliance v. Hickenlooper, 859 F.3d 865, 883–84 (10th Cir. 2017).

of the plaintiffs' alleged damages back to district court. In so holding, the court discussed Colorado's law of nuisance.[54] "[T]he Reillys plausibly pled an injury to their property rights caused by the stench that the enterprise's operations allegedly produce." "Congress meant to incorporate common-law principles when it adopted RICO."[55] In Colorado, "a property owner whose land is diminished in value by the acquisition and use of adjoining land by a private party" has a cause of action "in the law of nuisance."[56] But Colorado also has long recognized that invasion of one's property by noxious odors itself gives rise to a nuisance claim and is a direct injury to property.[57] Under Colorado law, "the elements of a claim of nuisance are an intentional, negligent, or unreasonably dangerous activity resulting in the unreasonable and substantial interference with a plaintiff's use and enjoyment of her property."[58] Thus, "a plaintiff must establish that the defendant has unreasonably interfered with the use and enjoyment of her property," which is "an issue of fact" determined by "weigh[ing] the gravity of the harm and the utility of the conduct causing that harm."[59] "Generally, to be unreasonable, an interference must be significant enough that a normal person in the community would find it offensive, annoying, or inconvenient."[60]

Finally, the Tenth Circuit determined whether the plaintiffs had sufficiently alleged direct injuries proximately caused by the RICO defendants. The court concluded that the plaintiffs had sufficiently pleaded these elements but that they were inherently fact-based determinations a jury must decide.[61] The court then reversed the dismissal of the RICO claims against the defendants and ordered remand on the plaintiffs' allegations of injuries and granted them permission to prove their RICO claims.[62] The court held that its holding was narrow and fact based, holding only that the plaintiffs had successfully pleaded the basic elements of their claims, and that it was not suggesting anyone could allege a RICO claim against an unwanted cannabis business neighbor. But, as seen *infra*, that is what has happened

54. *Id.* at 886.
55. Beck v. Prupis, 529 U.S. 494 (2000).
56. Pub. Serv. Co. of Colo. v. Van Wyk, 27 P.3d 377, 388 (Colo. 2001) (citation omitted).
57. *See* Hobbs v. Smith, 493 P.2d 1352, 1353–54 (Colo. 1972) (explaining that where the facts evidenced "noxious odors" wafting onto the plaintiffs' adjoining property, they had "suffered a substantial interference with the use and enjoyment of their property"); Webster v. Boone, 992 P.2d 1183, 1185–86 (Colo. App. 1999) (holding that "damages may be recovered" for "nuisance and trespass" to property, which "generally refers to distress arising out of physical discomfort, irritation, [and] inconvenience caused by *odors*, pests, noise, and the like" (emphasis added)).
58. *Van Wyk*, 27 P.3d at 391.
59. *Id.* (citations omitted).
60. *Id.* (citations omitted).
61. Safe Streets Alliance v. Hickenlooper, 859 F.3d 865, 887–91 (10th Cir. 2017).
62. *Id.* at 891.

in other states. Finally, the court held that the plaintiffs had no substantive federal rights violated by the CSA and therefore that the state and local officials were improperly named in the lawsuit, that the plaintiffs were not entitled to injunctive relief of any kind, including a halt to Colorado's cannabis program, and that their preemption claims failed as a matter of law.[63]

2. The Colorado Jury's Verdict

Interestingly, the plaintiffs were not required to prove any elements of their RICO claims, merely their alleged damages. The jury's verdict was rendered on October 31, 2018, after a half-day deliberation as to the remaining parties in the remanded litigation, all plaintiffs and operational cannabis business defendants 6480 Pickney, LLC, Parker Walton, and Camp Feel Good, LLC.[64] In the first question, jurors were asked to answer whether the plaintiffs proved all three elements of their claims of injuries to their real property caused by the defendants. The jury answered, "No."[65]

The next question was repetitive of the first one, except asking if the defendants' actions "in conjunction with other persons" caused the plaintiff's alleged real property injuries. The jury answered, "No."[66]

Finally, the jury was asked to assess an amount of damages, if any, to certain categories of damages alleged by the plaintiffs:

- Loss of use and enjoyment due to noxious odors, noise, and/or obstruction of view;
- Diminution in value of property due to noxious odors; and
- Diminution in value of property due to operation of marijuana cultivation facility adjacent to the plaintiffs' property.[67]

The jury awarded no damages to any of those categories of damages.[68] Apart from the defendants, who said their business would have been bankrupted by an adverse ruling, the effects of this ruling have been celebrated as a victory in the cannabis community, after having had to deal with the effects of the Tenth Circuit's *Safe Streets* ruling that RICO claims could be pursued by private citizens against cannabis businesses due to the inherently illegal nature of the businesses under federal law, even though they were legal and compliant under state law.

63. *Id.* at 904–05.
64. Verdict Form, Safe Streets Alliance v. Alternative Holistic Healing, LLC, No. 1:15-cv-00349-REB-SKC (D. Col. Oct. 31, 2018), ECF No. 254.
65. *Id.* at *1.
66. *Id.* at *2.
67. *Id.* at *3.
68. *Id.*

D. *Massachusetts*

Cambridge neighbors of the medical cannabis dispensary Healthy Pharms sued the dispensary, its top officials, a real estate company, advisers and insurers, as well as the state, the city of Cambridge and the town of Georgetown, which licensed Healthy Pharm, in federal court.[69] The neighbors, led by Crimson Galeria, argued that federal law, under which cannabis is illegal, should pre-empt state law, which allows it. The plaintiffs used the RICO statute, a law intended to address mob-related racketeering, to argue that Healthy Pharms and the businesses that support it are involved in illegal cannabis crimes, which are lowering neighborhood property values.[70] The neighbors alleged that their properties will lose $29 million in value due to Healthy Pharms' operations.[71]

The Massachusetts lawsuit even originally listed the consulting firm 4Front Advisors and its president, Kris Krane, as defendants for allegedly providing services to Healthy Pharms.[72] But the judge in the case recently indicated the conspiracy claims against 4Front and several other defendants were insufficient.[73]

According to Brian Barnes, a partner at Cooper and Kirk in Washington, D.C, consulting with Crimson Galeria, said that the advantage to the plaintiffs of using RICO is that it lets someone sue a business owner personally, not only the corporation.[74] It also allows for treble damages and attorneys' fees and can lead to settlements from someone eager to avoid legal risk.[75] The potential for a RICO suit could also scare off other businesses—such as insurers or banks—from getting involved with cannabis.[76]

Former Massachusetts Supreme Judicial Court Justice Robert Cordy, now at McDermott, Will and Emery, represents Century Bank in the case. Century Bank was sued because it provides banking services to Healthy Pharms. "A lot of banks are watching this case," Cordy said.[77] Banks do not want the liability of a potential federal cannabis lawsuit, Cordy said, but

69. Complaint, Crimson Galeria LP v. Healthy Pharms, Inc., No. 1:17-cv-11696-ADB (D. Miss. Sept. 7, 2017), ECF No. 1.

70. First Amended Complaint at 8, Crimson Galeria LP v. Healthy Pharms, Inc., No. 1:17-cv-11696-ADB (D. Miss. Oct. 5, 2018), ECF No. 82.

71. *Id.* at *4.

72. Complaint at 14, Crimson Galeria LP v. Healthy Pharms, Inc., No. 1:17-cv-11696-ADB (D. Miss. Sept. 7, 2017), ECF No. 1.

73. Memorandum and Order on Motions to Dismiss at 31, Crimson Galeria LP v. Healthy Pharms, Inc., No. 1:17-cv-11696-ADB (D. Miss. Aug. 21, 2018), ECF No. 78.

74. Shira Schoenberg, *Neighborhood Dispute over Cambridge Dispensary Could Upend Massachusetts' Marijuana Industry*, Masslive (Apr. 19, 2018), https://www.masslive.com/politics/index.ssf/2018/04/neighborhood_dispute_over_camb.html.

75. *Id.*

76. *Id.*

77. *Id.*

banking services are needed for the cannabis industry.[78] Thus, disruption to the cannabis industry is an intended side-effect to these lawsuits.

E. *Oregon*

Laura Underwood joined forces with Rachel McCart, a lawyer from Beavercreek, Oregon, who once specialized in equine law but now has gained notoriety suing legal cannabis businesses for racketeering.[79] In their lawsuit, Underwood and McCart sued more than 200 businesses—every company that had ever done business with the cannabis business neighbor of Underwood: Oregon Candy Farm.[80] The suit, filed in U.S. District Court for the District of Oregon, alleges that every grower and dispensary that ever did business with her neighbor conspired to commit crimes that damaged the value of Underwood's Sandy home.[81]

Similar to the plaintiffs in Safe Streets Alliance, Underwood worked with a group called Unwanted Pot Grows, which is based in Clackamas County and rallies around efforts to combat the expanding legal marijuana market. Its complaints mostly center on disputes between cannabis companies and their angry neighbors.[82] Underwood's suit says the cannabis businesses "directly and proximately injured Plaintiff's Property by interfering with Plaintiff's use and enjoyment of Plaintiff's Property, burdening it with noxious odors, diminishing its market value and making it more difficult to sell."[83]

F. *California*

Nine neighbors of Sonoma area Green Earth Coffee sued it, its proprietor Carlos Zambrano, property owner Flying Rooster, and deed of trust holder Exchange Bank for alleged violations of racketeering and state and local laws in the U.S. District Court for the Northern District of California, seeking treble damages on the racketeering claims as well as punitive damages, an order stopping the grow, attorney fees and legal costs.[84]

Zambrano, operator of the Green Earth Coffee cultivation site near Petaluma, argued in a motion to dismiss that the nine neighbors suing him have not stated a valid claim under RICO:

78. *Id.*

79. Complaint, Underwood v. 1450 SE Orient, LLC, No. 3:18-cv-01366 (D. Or. July 20, 2018).

80. *Id.*

81. *Id.*

82. Katie Shepherd, *A Racketeering Lawsuit Brought by an Oregon Equine Lawyer Is Part of a National Strategy to Upend Legal Weed*, Willamette Week (Aug. 22, 2018), https://www.wweek.com/news/courts/2018/08/22/a-racketeering-lawsuit-brought-by-an-oregon-equine-lawyer-is-part-of-a-national-strategy-to-upend-legal-weed.

83. Complaint at 172, Underwood v. 1450 SE Orient, LLC, No. 3:18-cv-01366 (D. Or. July 20, 2018), ECF No. 1-5.

84. Verified Complaint, Bokaie v. Green Earth Coffee, LLC (N.D. Cal. Aug. 27, 2018).

> Plaintiffs' allegations of personal injuries and annoyances from the smells and sounds coming from the cannabis farm, as well as speculative reduction in their property value from living next to a cannabis business, are decidedly not actionable under RICO because they do not constitute concrete (i.e. 'out of pocket' monetary) damage to 'business or property.[85]

The plaintiffs living near Green Earth Coffee, however, alleged the site generates a:

> Skunk-like stench of cannabis [that] now pervades plaintiffs' homes, inside and out, making it impossible for plaintiffs to enjoy their yards or let fresh air into their homes by opening the windows. Plaintiff Bokaies' teenage son has stopped playing basketball in his driveway because of the sickening cannabis odor. Inside, the acrid smell permeates draperies, furniture, carpeting and clothing. When the odor is particularly strong, plaintiffs cannot enjoy being in their homes, even with the windows shut. . . . Defendants' commercial cannabis grow is also loud. Defendants continuously operate a generator near to the Adobe Road Site, approximately 300 feet from the Bokaie home, presumably to power lights and other equipment. The generator is loud, can easily be heard on plaintiffs' property, and has run all day and all night since the end of June 2018, interfering with plaintiffs' sleep and depriving them of the sense of serenity they previously felt at home. . . . Defendants' operation of the Cannabis Enterprise through repeated acts of racketeering has directly and proximately injured plaintiffs' property. The Cannabis Enterprise emits loud noises and foul odors that envelop and permeate plaintiffs' property, thereby interfering with plaintiffs' use and enjoyment of their homes and diminishing the homes' present market value by making them less attractive to potential buyers. The open and ongoing commission of federal crimes near plaintiffs' homes further diminishes their market value by causing potential buyers to fear associated criminal activity or by otherwise making the homes less attractive to potential buyers.[86]

Under terms of a settlement agreement with the county due to a separate violation by Green Earth Coffee, a copy of which was included with the October 15, 2018, motion to dismiss, Green Earth Coffee agreed to stop all marijuana operations at the site by November 15, 2018.[87] The company also agreed to pay the county $415,000 for costs, current and back taxes and penalties.[88] The agreement also requires the property owner, Flying

85. Notice and Motion to Dismiss and Memorandum of Points and Authorities in Support of Defendant Cultivators' Motion to Dismiss at 8, Bokaie v. Green Earth Coffee, LLC (N.D. Cal. Oct. 15, 2018), ECF No. 17.

86. Verified Complaint at 7–8, 12, Bokaie v. Green Earth Coffee, LLC (N.D. Cal. Aug. 27, 2018).

87. Declaration of Kenneth Stratton at 3, Bokaie v. Green Earth Coffee, LLC (N.D. Cal. Oct. 15, 2018), ECF No. 17-1.

88. *Id.* at 6.

Rooster, to record a covenant "permanently prohibiting" commercial cannabis operations at the site.[89]

On December 27, 2018, the trial court dismissed the RICO claim.[90] Civil RICO requires an injury to business or property and excludes personal injuries.[91] Interference with the use and enjoyment is a personal injury that cannot form the basis of a civil RICO claim.[92] And, under California law, a plaintiff cannot recover diminution in value damages for an ongoing nuisance because the plaintiff could obtain an improper double recovery by winning diminution in value damages and have the nuisance removed.[93] With no cognizable injury to property pleaded, the court dismissed the RICO claim.[94] The unfair competition claim remained.[95]

II. BREACH OF CONTRACT AND BREACH OF FIDUCIARY

In 2018, the trend of courts compelling the determination of the arbitrability of a dispute to arbitration continued. When parties agree to "arbitrate arbitrability," the so-called "delegation clauses" can require a court to send a case to arbitration after finding little more than a contract exist. When two parties have a contract with a delegation clause, court have held that a motion to compel arbitration should be granted in "almost all cases."[96]

In *Archer & White Sales, Inc. v. Henry Schein, Inc.*, the Fifth Circuit considered the "arbitrability of the arbitrability" of a dispute between a manufacturer and seller/distributor.[97] There, Archer, the seller, accused Henry Schein, the manufacturer, of numerous antitrust violations in connection with dental equipment sales and sought tens of millions of dollars in damages.[98] Because Archer had signed an agreement with a predecessor to Henry Schein that contained an arbitration clause and a delegation clause, a magistrate judge compelled the case to arbitration.[99] The District Court for the Eastern District of Texas then vacated the order, holding that the court could decide the question of arbitrability, and further holding that the suit fell under an express exclusion to arbitration because it involved requests for injunctive relief.[100]

89. *Id.*
90. Bokaie v. Green Earth Coffee LLC, No. 18-cv-05244-JST, 2018 WL 6813212, *6 (N.D. Cal. Dec. 27, 2018).
91. *Id.* at *5.
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. Kubala v. Supreme Prod. Servs., Inc., 830 F.3d 199, 201 (5th Cir. 2016).
97. Archer & White Sales, Inc. v. Henry Schein, Inc., 878 F.3d 488 (5th Cir. 2017).
98. *Id.* at 491.
99. *Id.*
100. *Id.*

On appeal, the Fifth Circuit upheld the District Court's order that denied the motion to compel arbitration.[101] To do so, the Fifth Circuit had to determine the question "who should have the primary power to decide whether the claim is arbitrable."[102] The Fifth Circuit applied the two-step *Douglas* test.[103] The first step requires a showing of a clear and unmistakable intent to arbitrate.[104] The second step, also known as the "wholly groundless" exception, requires a determination that there is a "plausible argument" that the arbitration clause covers the dispute, or else the argument that the dispute falls within the agreement to arbitrate is "wholly groundless."[105] The Fifth Circuit found that the first step was satisfied because the parties' agreement to arbitrate under the American Arbitration Association (AAA) rules has been held to function as a delegation clause.[106] Archer argued that the lawsuit was an action seeking injunctive relief.[107] Henry Schein argued in response that the second prong of the *Douglas* test defeated the entire point of a delegation clause requiring an arbitrator to determine the arbitrability of the dispute.[108]

The Fifth Circuit, while acknowledging that the "wholly groundless" exception is a "narrow one" whose contours are "not yet fully developed," held that the "wholly groundless" exception must apply where an arbitration clause excludes certain types of disputes.[109] In this case, the agreement to arbitrate excluded "an action seeking injunctive relief."[110] Relying on the plain language of the agreement, the Fifth Circuit determined that no plausible argument existed that the parties agreed to arbitrate because the action included a request for an injunction.[111]

In June of 2018, the Supreme Court granted certiorari, and, on October 29, 2018, the Supreme Court heard oral arguments. Based on the questions posed during oral arguments, the Supreme Court may invalidate lower courts' "wholly groundless" exception altogether.[112] In such an event, the

101. *Id.* at 497–98.
102. *Id.* at 492.
103. *Id.* (citing Douglas v. Regions Bank, 757 F.3d 460, 464 (5th Cir. 2014)).
104. *Id.*
105. *Id.* (citing *Douglas*, 757 F.3d at 464).
106. Archer & White Sales, 878 F.3d at 492 (citing Petrofac, Inc. v. DynMcDermott Petroleum Operations Co., 687 F.3d 671, 675 (5th Cir. 2012)) (citing Rule 7 of the American Arbitration Association Commercial Rules).
107. *Id.* at 493–95.
108. *Id.* at 493–96.
109. *Id.* at 494, 497.
110. *Id.* at 497.
111. *Id.*
112. *See* Ronald Mann, *Argument Analysis: Justices Signal Opposition to Vague Exceptions That Would Limit Enforceability of Arbitration Agreements*, SCOTUSblog (Oct. 30, 2018, 3:05 PM), http://www.scotusblog.com/2018/10/argument-analysis-justices-signal-opposition-to-vague-exceptions-that-would-limit-enforceability-of-arbitration-agreements.

popularity of delegation clauses in all sorts of alternative dispute resolution agreements is likely to explode, and the courts will be helpless to stem the tide of cases that never see a jury.

The Federal Arbitration Act (FAA) has historically exempted certain contracts for employment in the transportation industry.[113] As employers continue to shift employees—legitimately and illegitimately—to independent contractor relationships, and as employers follow the trend of inserting delegation clauses in the contracts, the FAA's exemption will remain one of the few areas unaffected by the continuing explosion of arbitration. The facts in *New Prime v. Oliveira*, a case that was recently granted certiorari by the Supreme Court, represent the culmination of the conflict between the FAA employment contract exemption and the spread of arbitration-containing independent contractor agreements.

In *New Prime v. Oliveira*, a long-haul truck driver, Oliveira, sued New Prime, for whom he was ostensibly an independent contractor—albeit earning less than minimum wage.[114] When a dispute between Oliveira and New Prime arose, New Prime sought to force Oliveira to arbitrate as agreed in his operator agreement and further argued that the parties' agreement required an arbitrator, not the district court, to determine whether Oliveira's claims are arbitrable.[115] When the district court held that the court, not the arbitrator, could determine arbitrability and ordered discovery, New Prime appealed.[116]

On appeal, the First Circuit held that Oliveira was, in fact, a transportation worker within the meaning of the FAA and that his operator agreement governing his independent contractor relationship was a "contract for employment" under the Federal Arbitration Association.[117] Siding with previous authority from the Ninth Circuit, the First Circuit also held that a federal court, not an arbitrator, must determine whether or not an independent contractor's agreement is a "contract for employment" under 9 U.S.C. § 1 because the determination of the court's power is an "antecedent determination."[118] Simply put, the First Circuit determined that if the district court had no power to compel arbitration, it had no power to compel the determination of arbitrability to arbitration.[119]

In February 2018, the Supreme Court granted certiorari, and commentators have speculated from the oral arguments that the Supreme Court is

113. 9 U.S.C. § 1.
114. Oliveira v. New Prime, Inc., 857 F.3d 7, 11 (1st Cir. 2017).
115. *Id.* at 11–12.
116. *Id.*
117. *Id.* at 21–22.
118. *Id.* at 14.
119. *Id.*

likely to side with the First Circuit, holding that independent contractors' agreements can nevertheless function as "contracts for employment" under the FAA.[120] If these predictions hold true, then independent contractors are likely to become much more willing to pursue and enforce their rights in the courts where they previously were required to arbitrate.

Like other states, Minnesota enacted a law that automatically revokes all life insurance designations listing a former spouse as a beneficiary upon divorce.[121] In *Sveen v. Melin*, the constitutionality of that statute was challenged when a would-be beneficiary claimed that a court's denial of the life insurance proceeds under the Minnesota statute violated the contracts clause.[122] There, an ex-wife argued that her deceased ex-husband's beneficiary designation was still valid, and the man's children argued the Minnesota law required that they receive the proceeds.[123]

The Eighth Circuit Court of Appeals held that the ex-wife should receive the money under the contracts clause that prohibits "impairing the obligations of contracts."[124] Because the policy was created before the Minnesota law was enacted, the Eighth Circuit held that the law changed the outcome of the beneficiary designation and impaired the contract.[125]

In an 8-1 split, the Supreme Court disagreed. Writing for the court, Justice Kagan wrote that the Minnesota law did not "cross the constitutional line" for three reasons: (1) the law did not impair the relationship created by the contract because the statute honors the wishes of the decedent; (2) divorce courts have wide discretion to divide property, including life insurance proceeds, and (3) if a beneficiary designation should remain after divorce, a policyholder may notify his or her insurance company.[126] By holding that the contracts clause's prohibition on contract impairment is not "absolute," *Sveen v. Melin* has arguably broadened states' abilities to alter the contractual outcomes and parties' ability to contract, and will remain a primary citation for any case implicating the contracts clause for a long time.

Under the rules of bankruptcy, a trademark-owning debtor can cancel an executory contract, including a trademark license. 11 U.S.C. § 365(g). More than thirty years ago, however, the infamous *Lubrizol* opinion held that a debtor's cancellation of a license terminated all of the licensee's

120. *See* Ronald Mann, *Argument Analysis: Justices Signal Opposition to Vague Exceptions That Would Limit Enforceability of Arbitration Agreements*, SCOTUSblog (Oct. 30, 2018, 3:05 PM), http://www.scotusblog.com/2018/10/argument-analysis-justices-signal-opposition-to-vague-exceptions-that-would-limit-enforceability-of-arbitration-agreements.

121. Minn. Stat. § 524.2–804, subd. 1.

122. Sveen v. Melin, 138 S. Ct. 1815, 1817–19 (2018).

123. *Id.*

124. *Id.* at 1821 (citing U.S. Const. art. I, § 10, cl. 1).

125. *Id.*

126. *Id.* at 1817–21.

rights previously granted under the license.[127] In response, Congress overruled many of *Lubrizol*'s holdings by statute, enacting 11 U.S.C. § 365(n).[128] Following the procedure established by Congress, creditor Mission Product Holdings (Mission) elected to retain its intellectual property licensing rights following a bankruptcy by debtor Tempnology, LLC n/k/a/ Old Cold LLC. However, in addition to trademark licensing rights, Mission's licensing agreement gave Mission other rights, including distribution and sales rights, to Tempnology's products.[129] A bankruptcy court held that Mission's "other rights" did not survive through Mission's election and held that those rights ended when Tempnology rejected them in bankruptcy.[130] On appeal, a Bankruptcy Appellate Panel, citing the Seventh Circuit, held that because § 365(g) deems the effect of rejection to be a breach of contract, and a Tempnology's breach of a trademark agreement outside the bankruptcy context does not necessarily terminate the Mission's rights, rejection under § 365(g) likewise does not necessarily eliminate those rights.[131] On appeal, the First Circuit disagreed with the Bankruptcy Appellate Panel and the Seventh Circuit and held that the trademark licensing and the other rights were not preserved by Mission's election, citing a strict construction of § 365(g).[132]

Following the First Circuit's January 2018 opinion, the Supreme Court granted certiorari on the issue of whether a debtor's rejection of a trademark license terminates the licensee's rights that would survive the licensor's breach under non-bankruptcy law.[133] If the Supreme Court sides with the First Circuit, reading § 365(g) to explicitly exclude trademark licenses, trademark holders may be forced to assign, rather than license, their trademarks—the exact rationale behind Congress's statutory overthrow of *Lubrizol*. If not, the Seventh Circuit's rationale is likely to become the predictable standard for an intellectual property licensor in bankruptcy.

As the rate of filing of shareholder suits continues to climb, corporations continue to argue for heightened loss causation standards in fraud suits.[134] The Ninth Circuit may have expanded shareholders' ability to show loss causation resulting from public omissions and misrepresentations recently,

127. Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985).

128. 11 U.S.C. § 365(n).

129. In re Tempnology, LLC, 879 F.3d 389 (1st Cir. 2018).

130. *Id.* at 394.

131. In re Tempnology LLC, 559 B.R. 809 (B.A.P. 1st Cir. 2016) (citing Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC, 686 F.3d 372 (7th Cir. 2012)).

132. In re Tempnology, LLC, 879 F.3d 389, 404–05 (1st Cir. 2018).

133. Supreme Court of the United States Granted & Noted List October Term 2018 Cases for Argument, https://www.supremecourt.gov/orders/18grantednotedlist.pdf.

134. *See* Cornerstone Research, Securities Class Action Filings: 2018 Midyear Assessment, https://www.cornerstone.com/Publications/Reports/Securities-Securities-Class-Action-Filings—2018-Midyear-Assessment (last visited Jan. 23, 2019).

and that opinion has prompted forceful feedback from industry.[135] In *First Solar, Inc. v. Mineworkers' Pension Scheme*, a group of investors brought fraud claims against First Solar for allegedly concealing and falsifying information regarding the functionality of its electricity-generating products.[136] Importantly, however, First Solar's alleged fraud was not revealed until after the class period and after significant losses to First Solar's stock price.[137] Apparently, First Solar began disclosing adverse financial figures without adequately disclosing the impact of heat degradation on solar components that would be covered by First Solar's warranties, requiring additional accruals set aside for warranty coverage.[138]

Relying heavily on case law from the Ninth Circuit that mirrors case law from the Third Circuit (but not necessarily other circuits), the district court and the Ninth Circuit found that the plaintiffs had established proximate causation connecting the losses to the alleged misrepresentations, even though the eventual disclosure of the underlying alleged misrepresentations occurred after the class period, when the precipitous drop of the stock prices occurred.[139] Specifically, the Ninth Circuit held that plaintiffs need only show a "causal connection" between the fraud and the loss, and that disclosure may be shown "even where the alleged fraud is not necessarily revealed prior to the economic loss."[140] The Ninth Circuit's holdings arguably conflict with prior law from the Fourth Circuit, which held that gradually revealed information must ultimately expose "to the market in some sense the fraudulent nature of the practices about which the plaintiff complains."[141] Likewise, the Tenth Circuit has previously held that the "plaintiff bears the burden of showing that his losses were attributable to the revelation of the fraud and not the myriad other factors that affect a company's stock price."[142]

Given the arguable conflict among the circuits, it is no surprise that First Solar has already petitioned for certiorari before the Supreme Court and has already been joined by an amici curiae. With the loss causation at stake, *First Solar* will be a petition to watch for developments in fraud and fiduciary duty litigation.

135. Mineworkers' Pension Scheme v. First Solar Inc., 881 F.3d 750, 753 (9th Cir. 2018).
136. *Id.* at 752.
137. *Id.*
138. *Id.* at 753.
139. *Id.* at 753–54.
140. *Id.* at 753.
141. Katyle v. Penn Nat'l Gaming, Inc., 637 F.3d 462, 473 (4th Cir. 2011).
142. In re Williams Securities Litigation—WCG Subclass, 558 F.3d 1130, 1143 (10th Cir. 2009).

III. REMEDIES

The last year has seen the continued expansion and contraction in various states of the economic loss rule, which was created by the California Supreme Court in *Seely v. White Motor Co.*,[143] and adopted by the United States Supreme Court in *East River Steamship Corp. v. Transamerica Delaval, Inc.*[144]

The economic loss rule is a judicially created doctrine that seeks "(1) to maintain the fundamental distinction between tort law and contract law; (2) to protect commercial parties' freedom to allocate economic risk by contract; and (3) to encourage the party best situated to assess the risk [of] economic loss, the commercial purchaser, to assume, allocate, or insure against that risk."[145] The economic loss rule generally provides that a contracting party who suffers purely economic losses must seek his remedy in contract and not in tort.[146]

Recent Supreme Court decisions in the states of California, Idaho, and Kentucky, along with a recent Seventh Circuit U.S. Court of Appeals decision interpreting Illinois and Missouri law, which involve the application of the economic loss rule and were decided in the past year, show the differences among the states regarding the application of the economic loss rule.

In the case of *McMillin Albany LLC v. Superior Court*,[147] the California Supreme Court held that the California Right to Repair Act[148] supplanted California common law with respect to construction defect claims for both economic loss and property damage, which made the Act the "virtually exclusive remedy not just for economic loss but also for property damage arising from construction defects" and, in so doing, excluded claims for pure economic loss under the Act from the application of the economic loss rule.[149] While the court acknowledged that it had earlier held in *Aas v. Superior Court*[150] that the economic loss rule bars homeowners from suing in negligence for construction defects for pure economic damages where there is no showing of actual property damage or personal injury,[151] the court emphasized in *Aas* that the legislature was free to alter these limits on recovery and to add whatever additional homeowner protections it deemed

143. 403 P.2d 145 (Cal. 1965).
144. 476 U.S. 858 (1986).
145. Van Lare v. Vogt, Inc., 683 N.W.2d 46, 51 (Wis. 2004).
146. Gen. Elec. Co. v. Lowe's Home Centers, 608 S.E.2d 636, 637 (Ga. 2005).
147. 408 P.3d 797 (Cal. 2018).
148. Cal. Civ. Code § 895.
149. *McMillin*, 408 P.3d at 799.
150. 12 P.3d 1125 (Cal. 2000).
151. *McMillin*, 408 P.3d at 799.

appropriate,[152] and the court recognized that the Act was in fact promulgated two years after *Aas* to respond to the *Aas* holding.[153] In part, the Act created a new statutory cause of action for pure economic loss damages arising from construction defects where there was an absence of property damage or personal injury.[154] While the specific holding in *McMillin* is that the homeowners in the case alleging common law construction defect claims for both economic loss and property damage are subject to the Act's pre-litigation notice and cure procedures since the Act supplanted California law and constitutes the exclusive remedy for construction defects covered by the Act, the case also effectively holds that common law claims by homeowners for pure economic loss from construction defects in California will be covered and controlled by the Act, including the pre-litigation notice and cure procedures, and will be excluded from the application of the economic loss rule.[155]

In the case of *Taylor v. Taylor*,[156] the Idaho Supreme Court, among other things, reversed and remanded the district court's dismissal of the shareholder's fraud claim that the district court determined was barred by the economic loss rule since fraud is an intentional tort that is excluded from the application of the economic loss rule in Idaho.[157] In so holding, the court affirmed its earlier decision in *Path to Health, LLP v. Long*[158] that "[t]he economic loss rule is a judicially created doctrine that applies to negligence cases," and "[u]nless an exception applies, the economic loss rule prohibits recovery of purely economic losses in a negligence action because there is no duty to prevent economic loss to another."[159] The two exceptions to the economic loss rule are (1) where a special relationship exists between the parties, or (2) where unique circumstances require a reallocation of the risk.[160] In *Taylor*, the plaintiff claimed that the defendants committed fraud, which is an intentional tort.[161] The court held the economic loss rule did not bar the plaintiff's fraud claim because it was not a negligence cause of action.[162] The court noted that "a claim for fraud will nearly always involve claims for economic loss, and if the economic loss rule operated to bar fraud claims, it would vitiate fraud causes of action."[163]

152. *Id.*
153. *Id.* at 799.
154. *Id.* at 799, 800–01.
155. *Id.* at 799.
156. 422 P.3d 1116 (Idaho 2018).
157. *Id.* at 1125.
158. 383 P.3d 1220, 1226 (Idaho 2016).
159. *Id.* at 1125; Brian & Christie, Inc. v. Leishman Elec., Inc., 244 P.3d 166, 172 (Idaho 2010); Blahd v. Richard B. Smith, Inc., 108 P.3d 996, 1000 (Idaho 2005).
160. 383 P.3d at 1125; Aardema v. U.S. Dairy Sys., Inc., 215 P.3d 505, 512 (Idaho 2009).
161. 383 P.3d at 1125.
162. *Id.* at 1125.
163. *Id.*

The court, therefore, reversed and remanded the fraud claim back to the district court since it was not barred by the economic loss rule.[164]

In the case of *Petrus Family Trust Dated May 1, 1991 v. Kirk*,[165] the Idaho Supreme Court again dealt with the economic loss rule in the connection with claims by a secondary purchaser of home that filed an action against the home builder, the home vendor, and other defendants, asserting various claims against the defendants, including specifically breach of the implied warranty of habitability, arising from damage to the home caused by water infiltration allegedly caused by construction defects that cost the plaintiff over $60,000 to remedy extensive rot and mold from water intrusion.[166] The economic loss rule issue came up when the district court granted summary judgment to the builder defendant (Kirk) on the plaintiff's breach of the implied warranty of habitability claim because it arose in contract and was therefore untimely under Idaho Code § 5-241(b), and the plaintiff argued in the alternative that the implied warranty of habitability claim arose in tort, to which the district responded that the tort claim was barred by the economic loss rule.[167] While the court's holding did not reach the economic loss rule issue because the court held that the plaintiff's claim for warranty of habitability arose in contract and was untimely, the court nevertheless spent numerous pages of the opinion discussing the juxtaposition of the implied warranty of habitability between contract law and tort law, which included the following observation by the court:

> [T]his Court's precedent instructs that privity of contract is required to recover economic loss flowing from a breach of implied warranty "unless the application of this rule would have the effect of unfairly prejudicing the plaintiff." One instance illustrating unfair prejudice is where a breach of the implied warranty of habitability is alleged, and the economic loss rule bars the plaintiff from tort recovery; in that instance, the plaintiff cannot recover in tort, but can recover in contract, even absent privity of contract.[168]

The court continued:

> We conclude the district court is correct that a breach of the implied warranty of habitability arises in contract, making Petrus's claim untimely. *This conclusion, however, is not to say that a home buyer is left without a tort remedy when a builder negligently constructs a home and causes tort damages. In that scenario, an appropriate tort claim may be asserted, and our ruling today does not foreclose that claim*."[169]

164. *Id.* at 1128.
165. 415 P.3d 358 (Idaho 2018).
166. *Id.* at 361.
167. *Id.*
168. *Id.* at 367 (internal citations omitted).
169. *Id.* at 369.

If your case involves a claim for breach of the implied warranty of habitability in Idaho, it is strongly recommended that you read this opinion for the Court's detailed history and nuances of the claim in Idaho.

In the case of *Nami Resources Co., L.L.C. v. Asher Land & Mineral, Ltd.*,[170] the Kentucky Supreme Court dealt with the case of an oil and gas lessor (Asher) who brought an action against the lessee developer (Nami) for breach of oil and gas lease and underpayment of royalties by intentionally overstating post-production costs, understating quantity of gas extracted, and understating market price of gas sold, and demanded forfeiture or termination of leases.[171] At the district court, the jury verdict was rendered against Nami and in favor of Ash for $1,308,403.60 in compensatory damages and $2,686,000.00 in punitive damages,[172] which was subsequently affirmed by the appellate court.[173] On appeal, the Kentucky Supreme Court reversed the appellate court's affirmation of the punitive damages award in part based on the long-standing common law[174] and statutory[175] prohibitions on the award of punitive damages for a breach of contract claims and in part based on support from the economic loss doctrine which the Court stated was succinctly described in *Foster Poultry Farms v. Alkar-Rapidpak-MP Equipment, Inc.*:

> [T]he economic loss doctrine "requires a purchaser to recover in contract for purely economic loss due to disappointed expectations, unless he can demonstrate harm above and beyond a broken contractual promise." *To that end, the economic loss rule prohibits the recovery of tort damages in a breach of contract case*. "Quite simply, the economic loss rule 'prevents the law of contract and the law of tort from dissolving one into the other.'" *Courts have applied the economic loss rule to bar fraud claims where "the damages plaintiffs seek are the same economic losses arising from the alleged breach of contract." In such cases, permitting a fraud claim to proceed "would 'open the door to tort claims in virtually every case in which a party promised to make payments under a contract but failed to do so.'"*[176]

The court, therefore, reiterated the rule in Kentucky that when a plaintiff is able to obtain complete relief for contractual losses by means of

170. 554 S.W.3d 323 (2018).
171. *Id.* at 329.
172. *Id.* at 328.
173. *Id.*
174. Hardaway Mgmt. Co. v. Southerland, 977 S.W.2d 910, 917 (Ky. 1998) (holding "fraudulent concealment is actionable only if the concealment itself caused damages independent of those flowing from the wrongful act attempted to be concealed"); Deaton v. Allstate Ins. Co., 548 S.W.2d 162, 164 (Ky. App. 1977); Gen. Accident Fire & Life Assurance Corp. v. Judd, 400 S.W.2d 685, 688 (Ky. 1966); Cumberland Tel. & Tel. Co. v. Cartwright Creek Tel. Co., 108 S.W. 875, 878 (Ky. 1908).
175. Ky. Rev. Stat. § 411.184(4) provides, "In no case shall punitive damages be awarded for breach of contract."
176. 868 F. Supp. 2d 983, 991–92 (E.D. Cal. 2012) (emphasis added) (internal citations omitted).

compensatory damages under a breach of contract claim, even when the breach is motivated by malice and accomplished through fraud, the plaintiff may not simultaneously recover punitive damages after being made whole on his contractual damages.[177]

In the case of *Community Bank of Trenton v. Schnuck Markets, Inc.*,[178] the Seventh Circuit used the economic loss rules in the states of Illinois and Missouri to affirm the district court's dismissal of negligence and other claims brought by four banks against a large Midwestern grocery store that had its payment processing system attacked by hackers that stole an estimated 2.4 million credit- and debit-card numbers from seventy-nine grocery stores in Illinois, Indiana, Missouri, and Wisconsin.[179] The four banks were required by federal law to indemnify their card-holding customers for losses from fraudulent activity, which required the banks to bear the costs of reissuing cards and indemnifying their customers for damages caused by the hackers' fraud.[180] In analyzing the case, the court summarized its ruling and analysis as follows:

> The principal issues in this case present fairly new variations on the economic loss rule in tort law. The central issue is whether Illinois or Missouri tort law offers a remedy to card-holders' banks against a retail merchant who suffered a data breach, above and beyond the remedies provided by the network of contracts that link merchants, card-processors, banks, and card brands to enable electronic card payments. The plaintiff banks assert claims under the common law as well as Illinois consumer protection statutes. Our role as a federal court applying state law is to predict how the states' supreme courts would likely resolve these issues. We predict that both states would reject the plaintiff banks' search for a remedy beyond those established under the applicable networks of contracts. Accordingly, we affirm the district court's dismissal of the banks' complaint.[181]

The court includes a very detailed description of the interconnected series of contracts between merchants, card-processors, banks, and card brands that allocate risk among the parties,[182] a detailed analysis of the development of the economic loss rule in the United States over the last fifty years,[183] and a detailed analysis of negligence claims and the application of the economic loss rule in Illinois and Missouri,[184] which constitute

177. Nami Resources Co., L.L.C. v. Asher Land & Mineral, Ltd., 554 S.W.3d 323, 336 (2018).
178. 887 F.3d 803 (7th Cir. 2018).
179. *Id.* at 807.
180. *Id.*; *see* 15 U.S.C. § 1643(a) (limiting credit-card-holder liability for unauthorized use); 12 C.F.R. § 205.6 (limiting debit-card-holder liability for unauthorized use).
181. *Id.* at 813.
182. *Id.* at 808–09.
183. *Id.* at 812–16.
184. *Id.* at 816–18.

a very good primer on the economic loss rule in the United States and the two states. Ultimately, as stated previously, the court decided that Illinois and Missouri would bar the banks' claims for pure economic losses from Schnuck based on the economic loss rules in the states and the existence of a network of contracts between the parties to the payment processing system that allocate risks and responsibilities between the parties.[185]

185. *Id.* at 815.