IN THE

SUPREME COURT OF VIRGINIA

Record No. 091546

PHILLIP ABI-NAJM, et al.

Appellants,

v.

CONCORD CONDOMINIUM, LLC

Appellee.

BRIEF OF APPELLEE

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Statement of the Case

The Appellant homeowners ("Owners") filed their Complaint in the Arlington County Circuit Court on February 19, 2009. The Complaint sets forth allegations against Appellee, Concord Condominium, LLC ("Concord") regarding the purchase of certain real property at the West Village of Shirlington Condominium project in Arlington, Virginia ("Condominiums"). The Complaint contains five counts: Count I - Breach of Contract-Flooring; Count II - Breach of Contract-Parking Spaces; Count III - Virginia Consumer Protection Act; Count IV - Common Law Fraud; and Count V - Trespass. On April 3, 2009, Concord filed a Demurrer to the Complaint. On May 1, 2009, the Circuit Court heard oral argument on the Demurrer, and the Honorable Benjamin Kendrick sustained Concord's Demurrer and dismissed Counts I, III and IV of the Complaint with prejudice. The Owners appealed the May 1, 2009 Orders of the Circuit Court, and this court granted the Owners' Petition for Appeal on January 14, 2010.

Statement of Facts

In their brief, the Owners improperly state allegations as facts. Moreover, some of the allegations in their statement of facts are not allegations set forth in their Complaints. These allegations made by the Owners are not facts established in the trial court, but are simply contested allegations. The facts of the case are as follows:

The Owners allege that they entered into certain West Village of Shirlington Condominium Purchase Agreements with Concord for the purchase of the Condominiums ("Purchase Agreements"). Included in the Purchase Agreements was a Schedule of Standard Finishes ("Schedule A"). Copies of the Purchase Agreements were attached to the Complaint, and under Rule 1:4(i) of the Rules of the Supreme Court of Virginia, the Purchase Agreements are made a part of the Complaint.

Under the terms of the Purchase Agreements, the Owners were given walk-thru inspections of the Condominiums prior to closing (Purchase Agreement section 7 - Appendix p. 37), and they were given warranties on the Condominiums and components (Purchase Agreement section 17 - Appendix p. 39). Pursuant to the Purchase Agreements, the Owners closed on the purchase of the Condominiums in 2007.

In their Complaints, the Owners allege that the Purchase Agreements required that the flooring in the Condominiums be Bruce Oak hardwood 3/4 inch, but that the flooring installed in the Condominiums was 3/8 inch prefabricated engineered hardwood (Appendix p. 28). The Owners allege that the installation of different flooring is a breach of the Purchase Agreements and an act of fraud by Concord.

In fact, Schedule A of the Purchase Agreements does list "Bruce Oak hardwood 3/4" as a standard finish (Appendix p. 43). However, the very beginning of this Schedule A expressly states that the Declarant [Concord] "may substitute substantially equivalent materials and finishes for those specified herein." (Appendix p. 43). Section 6 of the Purchase Agreements further states that Concord shall install items as set forth in Schedule A, but that Concord shall have the right to "substitute substantially equivalent materials for any of the same set forth in any sales or other documents..." (Appendix p. 37).

It is an undisputed fact that section 22(a) of the Purchase Agreements expressly states:

> Notwithstanding anything to the contrary herein, acceptance of the deed at settlement shall constitute Purchaser's acknowledgement of full compliance by Declarant with the terms of this Agreement. The terms hereof shall be merged into and extinguished by delivery of the deed at settlement except for Sections 4(b), 5, 17, 18, 21, 22 and 23 which shall survive delivery of the deed and shall not be merged therein. (Appendix p. 40).

While certain terms of the Purchase Agreements, such as the warranty provision, are expressly excluded from this merger provision, Schedule A and section 6 are not excluded from this merger provision.

It is also undisputed that the Owners' claims against Concord are solely to seek to recover alleged economic losses.

In its Demurrer, Concord asserted that the Owners' breach of contract claim regarding the flooring is barred by the express terms of the Purchase Agreements and Schedule A permitting the substitution of substantially equivalent materials, and such claim is barred by the merger provision contained in the Purchase Agreements. Concord's Demurrer further asserts that the Virginia Consumer Protection Act and common law fraud claims are barred by the economic loss rule (Appendix pp. 50-52).

On May 1, 2009, the Circuit Court heard oral argument on the Demurrer, and the Honorable Benjamin Kendrick sustained Concord's Demurrer and dismissed the breach of contract, Virginia Consumer

Protection Act and common law fraud claims with prejudice (Appendix p. 82). Judge Kendrick found that it was clear that the merger clause in the Purchase Agreements applies, and therefore there is no breach of contract (Appendix p. 111). In holding that the economic loss rule applies to the Virginia Consumer Protection Act and common law fraud claims, Judge Kendrick concluded that the Owners were seeking to create a separate tort that does not exist in this case (Appendix p. 111).

Argument

1. The Breach of Contract Claim is Barred by Merger:

   A. Under section 22 of the Purchase Agreements, the parties agreed on the contract terms to be merged into and extinguished by delivery of the deed and those terms which survive, and the terms related to the flooring in the Condominiums are expressly merged into and extinguished by delivery of the deed.

The Owners rely on Schedule A and section 6 of the Purchase Agreements as the basis for their breach of contract claim. They contend that the flooring in the Condominiums is not a substantially equivalent material and finish to that which is listed in Schedule A of the Purchase Agreements, and Concord contends that such flooring is a substantially equivalent material and finish. By the terms of the Purchase Agreements, any such dispute must have been resolved prior to delivery of the deed at settlement, as section 22 of the Purchase Agreements states that "acceptance of the deed at settlement shall constitute Purchaser's acknowledgement of full compliance by Declarant with the terms of this Agreement." (Appendix p. 40).

Prior to delivery of the deed at settlement, the Owners made no such claims regarding the flooring, and they have no right to raise such breach of contract claim now.

The Owners expressly agreed that certain terms set forth in the Purchase Agreements shall be merged into and extinguished by delivery of the deed. Such terms include Schedule A and section 6 of the Purchase Agreements, as these terms are not included in those specifically listed as surviving delivery of the deed at settlement.

On the face of the pleadings and the documents made a part of the pleadings, the breach of contract claim set forth by the Owners is barred by merger, and the Circuit Court did not err in dismissing such claim.

B. The Circuit Court correctly ruled that merger is applicable under the facts of this case, and the cases cited by the Owners in opposition to merger are distinguishable from this case.

With respect to the sale of real estate, the merger doctrine generally provides that the deed represents the final agreement of the parties and all prior agreements are merged into the deed. See Empire Management & Development Co. v. Greenville Associates, 255 Va. 49, 496 S.E.2d 440 (1998). In the present case, the issue of merger was specifically addressed by the parties in the Purchase Agreements. After reviewing the merger clause in the Purchase Agreements, the Circuit Court correctly ruled that the clause is clear and the breach of contract claim is barred by merger.

In their appeal, the Owners ignore the express language of the merger clause in the Purchase Agreements and instead ask this Court to go beyond the parties' agreement and re-write their merger clause so that the terms addressing the flooring survive delivery of the deed and are not extinguished. The Owners cite a number of cases in which courts have declined to find merger of certain contract matters. However, reliance on such cases is misplaced, where, as here, the parties have already determined by agreement which contract matters are extinguished by delivery of the deed and which matters survive.

In Empire, this Court reversed a trial court's ruling that a closing statement may operate like a deed and extinguish contract terms previously agreed-to by the parties. The Owners contend that Empire stands for the proposition that no matter collateral to the passage of title can be merged into and extinguished by delivery of the deed at settlement. However, this is not the ruling of Empire, as Empire dealt with a specific separate writing (closing statement), and the opinion in Empire even alluded to the fact that the parties themselves could have determined merger by agreement. The Court noted that the closing statement "did not state that those previously executed agreements upon which the

recapitulations were based were extinguished or superseded." Empire at 53, 442. In the present case, the Owners and Concord have determined merger by agreement, and the Purchase Agreements expressly state which matters will survive and which will be extinguished by delivery of the deed.

The Owners' reliance on Tribby and Meurer v. Tribby, 241 B.R. 380 (E.D. Va., 1999) is also misplaced. In this case in which a party to a real estate sales contract sued for damages for failure to settle by a date certain, the U.S. District Court ruled that merger was inapplicable for a number of reasons, including "and perhaps most significant" the real estate sales contract contained an express survival provision which meant that the time of performance clause survived delivery of the deed at settlement. Tribby, at 385. Again, as in the present case, the parties have expressly agreed which matters will survive and which will be extinguished by delivery of the deed.

The Owners cite Woodson v. Smith, 128 Va. 652, 104 S.E. 794 (1920) for the proposition that merger only applies when there is an express conflict between the language in a sales contract and that in the deed. In fact, this was not the principal ruling in Woodson. It is true that under Woodson the doctrine of merger would certainly resolve any

express conflict in favor of the language in the deed. But even where no express conflict exits, merger would still apply where the parties have expressly agreed on the sales contract terms to be merged into the deed and those terms that survive delivery of the deed.

None of the cases cited by the Owners address merger with respect to a specific fixture item in the residence where the parties have an express merger clause determining which items will be merged into the deed and which shall survive settlement. Beck v. Smith, 260 Va. 452, 538 S.E.2d 312 (2000) involved a utility easement on the land and not a fixture in the home which the purchasers observed and inspected prior to settlement. Miller v. Reynolds, 216 Va. 852, 223 S.E. 2d 883 (1976) did not involve an express merger provision in the real estate sales contract, and in Miller the court ruled that the septic system defect claimed by the purchasers arose as a result of a mutual mistake and therefore justified rescission of the real estate sales contract. Davis v. Tazewell, 254 Va. 257, 492 S.E.2d 162 (1997) did not involve an express merger provision in the real estate sales contract. The issue was whether the home warranty merged with the deed. In the present case, the home warranty given to the Owners is not merged

into and extinguished by delivery of the deed as it is specifically listed as an item which survives delivery of the deed. In fact, such warranty is a remedy available to the Owners in this matter.

Despite their walk-thru and inspection of the flooring in the Condominiums prior to settlement, the Owners now ask this Court to ignore the express terms of the Purchase Agreements which include Schedule A and section 6 in the merger clause, so that they can now pursue a claim they were obligated to raise prior to settlement. There is no legal authority supporting such drastic court action, and for good reason. If the law were to permit a real estate purchaser to pursue a lawsuit for claimed defective fixture items after inspection and settlement and in spite of agreed express contract merger language, the courts would be faced with a never-ending barrage of claims involving every conceivable property issue, and such claims would continue for years after settlement and long after the seller has any reasonable opportunity to determine and remedy any claimed unsatisfactory item.

The Circuit Court correctly ruled that the Owners' breach of contract claim is barred by merger, and the Circuit Court did not err in dismissing this claim.

2. The Virginia Consumer Protection Act and Common Law Fraud Claims are Barred by the Economic Loss Rule:

A. The fraud claims made by the Owners arise from their contractual relationship with Concord and such fraud claims are barred since the claims seek to recover only alleged economic losses.

The Circuit Court was correct in ruling that the Owners may not maintain their Virginia Consumer Protection Act and common law fraud claims in this case in which they have only a contractual relationship with Concord and they seek only economic losses arising from an alleged breach of such contract.

As set forth by this Court in Sensenbrenner v. Rust, Orling & Neale, 236 Va. 419, 374 S.E.2d 55 (1988) and Filak v. George, 267 Va. 612, 594 S.E.2d 610 (2004), where a plaintiff seeks to recover economic losses arising from a defendant's failure to perform a contractual obligation, the law of contracts, not torts, provides the exclusive remedy.

Whether alleged under the Virginia Consumer Protection Act or under the common law, the fraud claims alleged by the Owners have no basis independent of the Purchase Agreements. In order to recover for fraud, the duty alleged to have been tortiously breached must be a separate common

law duty and not a duty arising solely by virtue of a contract. See Augusta Mutual Insurance Co. v. Mason, 274 Va. 199, 645 S.E.2d 290 (2007). This principal was most recently reiterated by this Court in Dunn Construction Company, Inc. v. Cloney, 278 Va. 260, 682 S.E.2d 943 (2009).

Despite this Court's succession of recent opinions affirming the economic loss rule, the Owners nevertheless contend that their Virginia Consumer Protection Act claim is not subject to the economic loss rule because the claim alleges a statutory duty owed beyond the parties' contractual duties. Even assuming for the sake of argument that the Virginia Consumer Protection Act applies to the sale of a condominium which is already governed by the Virginia Condominium Act (Virginia Code §55-79.39, et seq.), the regulations set forth in the Virginia Consumer Protection Act are not statutory duties which are independent of the parties' contractual relationship in this case.

The United States District Court for the Eastern District of Virginia addressed the issue of the economic loss rule as it pertains to an alleged independent statutory duty. In Ju v. Mark, 2006 U.S. Dist. LEXIS 42263 (E.D. Va., 2006), homeowners filed suit against their bank and the

settlement agent who conducted a mortgage refinance transaction in which these homeowners were allegedly defrauded. The homeowners sued for breach of contract, negligence and fraud. The homeowners based their negligence claim on alleged violations of the Virginia Consumer Real Estate Settlement Protection Act ("CRESPA"). The defendants in the case moved to dismiss the negligence claim as barred by the economic loss rule, since the alleged CRESPA violations arise from the same underlying conduct as the breach of contract claim. The homeowners sought to overcome the bar of the economic loss rule, arguing that since their negligence claim alleges the breach of statutory duties, the economic loss rule is inapplicable. In granting the motion to dismiss the negligence claim, the federal court ruled that the statutory duties under CRESPA are not the type of tort law duties which are independent of the duties owed pursuant to the contract between the parties. Citing Filak, the court held that the economic loss rule bars the homeowner's negligence claim, and the court stated that the CRESPA duties alleged "are not statutory duties involving the safety of persons and property, which are imposed to protect the broad interests of society, as contemplated by the Filak court." Ju at 10.

The federal court pointed out that these statutory duties under CRESPA are obligations that arise solely due to the contractual agreement of the parties. Id.

The Virginia Consumer Protection Act claim made by the Owners is no different from the CRESPA claims in Ju. The duties alleged under the Virginia Consumer Protection Act are not statutory duties involving the safety of persons and property, and these statutory duties, if applicable, are duties that arise solely by virtue of the Purchase Agreements entered into between the Owners and Concord. Contrary to the assertion by the Owners, the claimed violation of the Virginia Consumer Protection Act is not an entirely independent tort claim simply because statutory duties are alleged. The claim falls within and is barred by the economic loss rule.

There is no question that the common law fraud claim against Concord has no basis independent of the contractual relationship of the parties, as Concord owes no distinct common law duty to the Owners in this transaction. In their appeal, the Owners cite Prospect Development Co., Inc. v. Bershader, 258 Va. 75, 515 S.E.2d 291 (1999), Boykin v. Hermitage Realty, 234 Va. 26, 360 S.E.2d 177 (1987) and Lloyd v. Smith, 150 Va. 132, 142 S.E. 363 (1928) for the proposition that a purchaser can

maintain a separate fraud claim against a seller in a real estate sales transaction. However, these cases cited by the Owners are not economic loss rule cases, and the cases pre-date this Court's decisions in the Filak, Augusta Mutual and Dunn Construction Company cases.

In their appeal, the Owners' now characterize their fraud claims as claims of fraud in the inducement. The Owners cite Barnette v. Brook Road, Inc., 429 F. Supp 2d 741 (E.D. Va., 2006) in support of their argument that both a breach of contract and a fraud claim may be maintained in a single sales transaction, where the fraud claim is one for intentional fraud in the inducement.

It must first be noted that the Barnette case also pre-dates this Court's economic loss rule decisions in the Augusta Mutual and Dunn Construction Company cases.

More importantly, there is no authority for the proposition that the economic loss rule can be overcome by a claim of fraud in the inducement when the alleged fraud is not a material element of the contract. The Purchase Agreements at issue in this case relate to the sale of an entire completed home. The Owners suggest that the difference in the

hardwood flooring in the Condominiums is a material element of the Purchase Agreements such that it is central to the contract and a breach of this one element would defeat the very purpose of the contract. Essentially, the Owners suggest they would not have entered into the Purchase Agreements had they known of the different hardwood flooring. Such a suggestion is of questionable credibility, and taken to its logical conclusion, this means that a real estate purchaser could claim fraud in the inducement as to any item or fixture in or on real property, no matter how big or small. Under this theory advanced by the Owners, a real estate purchaser could avoid the bar of the economic loss rule and sue for damages for breach of the sales contract and for fraud long after purchasing a property, simply by alleging that the quality or type of a given fixture item is not as was anticipated prior to purchase. This would be a particularly troubling result, especially where, as here, most real estate sales contracts provide the purchaser the opportunity for inspection prior to purchase.

Assuming for the sake of argument that a claim of fraud in the inducement may provide an independent tort which can overcome the bar of the economic loss rule in this kind of breach of contract case, the subject

of the alleged fraud must be a material element of the contract. In the present case, the subject of the alleged fraud cannot be considered a material element of the contract between the parties. The Court need look no further than the Purchase Agreements to reach such conclusion. Schedule A expressly states that Concord] "may substitute substantially equivalent materials and finishes for those specified herein." (Appendix p. 43), and Section 6 further states that Concord shall have the right to "substitute substantially equivalent materials for any of the same set forth in any sales or other documents..." (Appendix p. 37). A material element in a contract is not one where the parties bargain for terms which allow the material element to be unilaterally substituted.

B. The Owners simply seek to create tort claims against Concord where none exist, and this practice is contrary to Virginia law.

It has become an unfortunate reality that many plaintiffs filing civil suits for breach of contract now add fraud claims to their complaints. The Owners are no different. But for their contractual relationship with Concord, the Owners would not and could not state any cause of action against Concord. Nevertheless, the Owners plead "on information and belief", and

they allege intentional fraud and demand punitive damages all arising from the sale of specific real estate which the Owners inspected prior to purchase.

The Owners essentially ask this Court to make an exception to the economic loss rule for home buyers. This same plea was made by home buyers in Casa Clara Condominium Association, Inc. v. Charley Toppino & Sons, Inc., 620 So. 2d 1244 (Fla. 1993). Citing Sensenbrenner, the Florida Supreme Court refused to make an exception to the economic loss rule for home buyers. The Florida Supreme Court recognized that home buyers may be appealing and sympathetic plaintiffs, but when the condition of the house causes economic disappointment, the home buyers' claim is one of failure to receive the benefit of the bargain, and that is a matter of contract, not tort law. Casa Clara Condominium Association, Inc. at 1247.

This practice of alleging a fraud claim in any simple breach of contract action has led this Court to affirm its commitment to "safeguard against turning every breach of contract into an actionable claim for fraud" Augusta Mutual Insurance Co at 208, 295, citing Richmond Metropolitan Authority v. McDevitt Street Bovis, Inc., 256 Va. 553, 507 S.E.2d 344

(1998); see also Dunn Construction Company at 267, 946. This Court should continue such commitment in this case and affirm the decision of the Circuit Court dismissing the Owners' claims. To reverse the Circuit Court and permit the Owners to pursue their Virginia Consumer Protection Act and common law fraud claims in this case would effectively eliminate the economic loss rule from Virginia jurisprudence. The end result of such precedent would be a fraud and violation of Virginia Consumer Protection Act claim included in virtually every consumer breach of contract action in Virginia.

The Circuit Court correctly ruled that the economic loss rule does apply in this case. The Circuit Court therefore dismissed the Virginia Consumer Protection Act and common law fraud claims. There was no error in the Circuit Court's ruling, as this result is supported by the law in Virginia.

Conclusion

The Circuit Court did not err in ruling that the Owners' breach of contract claim is barred by merger and their Virginia Consumer Protection Act and common law fraud claims are barred by the economic loss rule, and the decision of the Circuit Court should be affirmed.

RESPECTFULLY SUBMITTED,
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CERTIFICATE

Pursuant to Rule 5:26(d) of the Rules of the Supreme Court of Virginia, I hereby certify that on March 18, 2010, an original and fifteen copies of this Brief of Appellee have been filed with the Clerk of the Supreme Court of Virginia; one copy was sent by electronic mail to the Clerk of the Supreme Court of Virginia at scvbriefs@courts.state.va.us; and three copies were mailed by first class U.S. mail to counsel for Appellants:

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