

## Fourth Circuit Holds Consequential Damages Exclusion Bars \$19 Million Fire Loss Claim

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Sunday, January 10, 2016

### Case Background

Poyner Spruill represented the defendant pesticide applicator, Industrial Fumigant Company (IFC), in *Severn Peanut Co., Inc. v. Industrial Fumigant Co.*, 2015 U.S. App. LEXIS (4th Cir. Dec. 2, 2015). IFC was sued in the aftermath of a massive fire and explosion which occurred a few days after it performed a commercial fumigation with a flammable phosphine-based pesticide. The fire occurred at an agricultural storage warehouse in which 21 million pounds of farmer stock peanuts were stored prior to milling.

IFC entered into a two-page contract with Severn Peanut Company (“Severn Peanut”) to fumigate the warehouse with phosphine tablets, a highly regulated, restricted-use pesticide. In return for IFC’s services, Severn Peanut agreed to pay IFC \$8,604.00. The contract expressly provided that this sum was not “sufficient to warrant IFC assuming any risk of incidental or consequential damages” to Severn Peanut’s “property, product, equipment, downtime, or loss of business.”

Application of phosphine is regulated by federal and North Carolina pesticide laws, both of which require application to be in conformity with the product label. In this case, the product label required applicators to avoid piling the tablets upon each other due to the propensity of piled tablets to ignite and cause a fire. Severn Peanut and its subrogated insurance carrier, Travelers, alleged in their complaint that IFC’s applicators violated the label – and state and federal law – by piling the tablets, which they alleged caused the fire.

The fire destroyed all 21 million pounds of peanuts, the state-of-the art warehouse in which they were stored, and also resulted in millions of dollars in business-related losses. Travelers paid Severn Peanut in excess of \$19 million for its property and business losses. Both Travelers and Severn Peanut then sued IFC for breach of contract, negligence, and negligence per se for violating state and federal pesticide laws. After extensive discovery, the district court entered summary judgment in favor of IFC.

### Significance of Consequential Damages Exclusions to American System of Commerce

The Fourth Circuit affirmed. Writing for a unanimous panel, Judge Harvie Wilkinson waxed poetic about the significance of consequential damages exclusions to the American system of commerce. He observed that “enforcement of explicit consequential damages provisions allocating the risk of consequential damages to one party or another further maximizes parties’ freedom of contract and allows them to better achieve predictability in their business relations.” Courts, in his view, should “avoid the indulgence of paternalism and respect individuals’ entitle[ment] to contract on their own terms.”

Though a bargain excluding consequential damages may look like a “raw deal” in hindsight, “[p]arties assuming risks often receive benefits in the form of lower prices in exchange. Without the ability of contracting parties to protect against the imposition of consequential damages, some consumers might not be able to access needed goods and services at all.” These benefits explain why consequential damages exclusions are “widespread and widely enforced” and represent “tools of doing business . . . throughout North Carolina and many other states.”



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Judge Wilkinson's opinion noted that companies have choices when bargaining over consequential damages exclusions: "First, they may purchase outside insurance to cover the consequential risks of a contractual breach, and second, they may attempt to bargain for greater protection against breach from their contractual partner." Severn actually did purchase insurance, which is why it recovered over \$19 million from Travelers. "But it did not take the latter one, and there is no inequity in our declining to rewrite its contractual bargain now."

### **Court Rejects Plaintiffs' Unconscionability and Public Policy Arguments**

The Fourth Circuit squarely rejected the plaintiffs' contention that enforcement of IFC's consequential damages exclusion would be unconscionable and would contravene public policy. Such limitation clauses are fully enforceable as against experienced businesses like Severn Peanut. "If courts are too quick to free harmed parties from the results of their bargains, an erosion of the law's respect for consequential damages limitations would shortly ensue."

The court concluded that the mere fact that IFC was engaging in a highly regulated activity - allegedly in violation of state and federal pesticide laws - did not preclude enforcement of the consequential damages exclusion. Judge Wilkinson noted that those laws have their own regulatory framework, which provides for criminal and civil penalties for their violation. Those laws, therefore, do not in any way affect the bargain parties to a private contract make which establish their respective rights and obligations. Public policy comes into play, the court held, only when individual consumers are involved or there is an inequality of bargaining power. "We are not presently considering the plight of a valuable member of the public adrift among the variegated hazards of a complex commercial world. Instead, we are considering a rather typical agreement among two commercial entities, and we may hold them to the contract's terms."

### **Court Rejects Plaintiffs' Attempt to Evade Contractual Bargain by Finding Refuge in Tort**

The Fourth Circuit accepted IFC's argument that the plaintiffs' negligence claims were barred by the economic loss doctrine. That doctrine prohibits recovery for purely economic loss in tort when a contract operates to allocate the risk. The court recognized that the plaintiffs' negligence claims attempted to undo Severn Peanut's commercial bargain "through the vehicle of tort law." Because IFC's contract was for the "treatment of commodities and/or space," both the peanuts and the storage warehouse were property appropriately considered the "subject matter of the contract." Therefore, the "other property" exception to the economic loss doctrine did not apply. Rather, the "doctrine counsels that the contract's allocation of risk in the event of economic and commercial adversity should be respected."

### **Effect of Severn Peanut on Commercial Litigation**

Severn Peanut should result in North Carolina courts reliably enforcing limitation clauses contained in commercial agreements, thereby holding commercial parties to their bargains - no matter how raw a deal they may have received in hindsight. If the Fourth Circuit did not hesitate to do so in a case in which one contracting party suffered over \$19 million in losses, it is hard to conceive of a case in which a contractual limitation between commercial parties would be deemed unenforceable.

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