

Negligence, Economic Loss, and the U.C.C.

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INTRODUCTION

The traditional distinction between tort and contract has been that tort deals with obligations imposed by law for the general benefit of society while contract deals with obligations voluntarily assumed by the parties.¹ This distinction has become blurred in a variety of areas with the result that the law in those areas is often confusing and inconsistent.² The field of products liability provides an excellent example of such an area,³ and, within the field of products liability, no issue has been more subject to confusion as a result of the doctrinal overlap of tort and contract than the problem of economic loss resulting from defective products.⁴

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1. "The law of torts enforces a set of obligations imposed by society for the common good and which operate irrespective of individual consent. The law of contracts, on the other hand, enforces the expectations created by bargained for promises that are voluntarily made." *Tort Theories in Computer Litigation*, 38 REC. A.B. CITY N.Y. 426, 437 (1983); see W. KEETON, D. DOBBS, R. KEETON & D. OWEN, *PROSSER AND KEETON ON THE LAW OF TORTS* 655, 656 (5th ed. 1984) [hereinafter cited as PROSSER]; see also J. DOOLEY, *MODERN TORT LAW* § 2.06, at 13-14 (1977); G. GILMORE, *THE DEATH OF CONTRACT* 87-90 (1974); S. SPEISER, C. KRAUSE & A. GANS, *THE AMERICAN LAW OF TORTS* § 1.20 (1983); Bertschy, *Negligent Performance of Service Contracts and the Economic Loss Doctrine*, 17 J. MAR. L. REV. 249 (1984).

2. See PROSSER, *supra* note 1, at 655 (availability of both kinds of liability for the same kind of loss has resulted in confusion and unnecessary complexity); see also G. GILMORE, *supra* note 1, at 87-95; W. PROSSER, *The Borderland of Tort and Contract*, in *SELECTED TOPICS ON THE LAW OF TORTS* 380 (1953); Bertschy, *supra* note 1, at 252-53 (in the area of service contracts outside of professional malpractice cases, "the law is tangled and ambiguous with respect to tort responsibilities engendered by a contractual relationship"); Fridman, *The Interaction of Tort and Contract*, 93 L.Q.R. 422, 436-37 (1977).

3. Dean Prosser, in describing the modern action for breach of warranty in the sale of goods, spoke of the "peculiar and uncertain nature and character of warranty, a freak hybrid born of the illicit intercourse of tort and contract." Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1126 (1960); see also G. GILMORE, *supra* note 1, at 92-93; Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective Product Cases*, 18 STAN. L. REV. 974 (1966); Fridman, *supra* note 2, at 436-37; Wade, *Is Section 401A of the Second Restatement of Torts Preempted by the UCC and Therefore Unconstitutional?*, 42 TENN. L. REV. 123, 126-29 (1974); Wade, *Tort Liability for Products Causing Physical Injury and Article 2 of the U.C.C.*, 48 MO. L. REV. 1, 24-26 (1983).

4. See *infra* note 15.

Most jurisdictions now recognize strict tort liability in products liability cases.⁵ The majority of those jurisdictions, however, limit strict liability to personal injury and physical property damage and do not impose strict liability for purely economic losses.⁶ Similarly, most courts refuse to recognize a cause of action in negligence for purely economic losses in products liability cases.⁷ Deprived of these tort remedies, a purchaser of a defective product

5. The first case to announce a general theory of strict tort liability in products cases was *Greenman v. Yuba Power Prods., Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963). The following year the American Law Institute adopted the doctrine in section 402A of the *Restatement (Second) of Torts*. As of June 1984, 36 states and the District of Columbia had adopted § 402A and an additional nine states had adopted some variation of the doctrine. I PROD. LIAB. REP. (CCH) ¶¶ 4018-4025 (1984); see also *West v. Caterpillar Tractor Co.*, 336 So. 2d 80, 87 n.1 (Fla. 1976); 1 R. HURSH & H. BAILEY, *AMERICA LAW OF PRODUCTS LIABILITY* § 4.41 (2d ed. 1974); PROSSER, *supra* note 1, at 694.

6. See, e.g., *Purvis v. Consolidated Energy Prods. Co.*, 674 F.2d 217 (4th Cir. 1982) (South Carolina law); *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.2d 1165 (3d Cir. 1981) (Pennsylvania law); *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*, 626 F.2d 280 (3d Cir. 1980) (Illinois law); *City of Clayton v. Grumman Emergency Prods.*, 576 F. Supp. 1122 (E.D. Mo. 1983) (Missouri law); *Copiers Typewriters Calculators, Inc. v. Toshiba Corp.*, 576 F. Supp. 312 (D. Md. 1983) (Maryland law); *Sioux City Community School Dist. v. International Tel. & Tel. Corp.*, 461 F. Supp. 662 (N.D. Iowa 1978) (Iowa law); *Morrow v. New Moon Homes*, 548 P.2d 279 (Alaska 1976); *Rocky Mountain Fire & Casualty Co. v. Biddulph Oldsmobile*, 131 Ariz. 289, 640 P.2d 851 (1982); *Seely v. White Motors Co.*, 63 Cal. 2d 9, 402 P.2d 145, 45 Cal. Rptr. 17 (1965); *Hügel v. General Motors Corp.*, 190 Colo. 57, 544 P.2d 983 (1975); *Cedars of Lebanon Hosp. Corp. v. European X-ray Distribs. of Am., Inc.*, 444 So. 2d 1068 (Fla. Dist. Ct. App. 1984); *Henderson v. General Motors Corp.*, 152 Ga. App. 63, 262 S.E.2d 238 (1979); *Chrysler Corp. v. Taylor*, 141 Ga. App. 671, 234 S.E.2d 123 (1977); *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159 (Minn. 1981); *Forrest v. Chrysler Corp.*, 632 S.W.2d 29 (Mo. Ct. App. 1982); *Clevenger & Wright Co. v. A.O. Smith Harvester Prods., Inc.*, 625 S.W.2d 906 (Mo. Ct. App. 1981); *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 332 N.W.2d 39 (1983); *Local Joint Executive Bd. v. Steru*, 98 Nev. 409, 651 P.2d 637 (1982); *Schiavone Constr. Co. v. Elgood Mayo Corp.*, 56 N.Y.2d 667, 436 N.E.2d 1322, 451 N.Y.S.2d 720 (1982); *Mid-Hudson Mack, Inc. v. Dutchess Quarry & Supply Co.*, 99 A.D.2d 751, 471 N.Y.S.2d 664 (1984); *Price v. Gatlin*, 241 Or. 315, 405 P.2d 502 (1965); *Nobility Homes, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977); *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854 (W. Va. 1982). *But see* *Mead Corp. v. Allendale Mut. Ins. Co.*, 465 F. Supp. 355 (N.D. Ohio 1979) (Ohio law); *Cova v. Harley Davidson Motor Co.*, 26 Mich. App. 602, 182 N.W.2d 800 (1970); *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965); *Iacono v. Anderson Concrete Corp.*, 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975); *Berg v. General Motors Corp.*, 87 Wash. 2d 584, 555 P.2d 818 (1976); *City of La Crosse v. Schubert, Schroeder & Assocs.*, 72 Wis. 2d 38, 240 N.W.2d 124 (1976).

7. See, e.g., *R.W. Murray Co. v. Shatterproof Glass Corp.*, 697 F.2d 818 (8th Cir. 1983) (Missouri law); *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.2d 1165 (3d Cir. 1981) (Pennsylvania law); *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*, 626 F.2d 280 (3d Cir. 1980) (Illinois law); *S.M. Wilson & Co. v. Smith Int'l Inc.*, 587 F.2d 1363 (8th Cir. 1978) (California law); *Copiers Typewriters Calculators, Inc. v. Toshiba Corp.*, 576 F. Supp. 312 (D. Md. 1983) (Maryland law); *Consolidated Edison Co. v. Westinghouse Elec. Corp.*, 567 F. Supp. 358 (S.D.N.Y. 1983); *County of Westchester v. General Motors Corp.*, 555 F. Supp. 290 (S.D.N.Y. 1983); *Kaiser Alum. & Chem. Corp. v. Ingersoll-Rand Co.*, 519 F. Supp. 60 (S.D. Ga. 1981); *Tribble Trucking Corp. v. General Motors Corp.*, 144 U.C.C. REP. SERV. (CALLAGHAN) 63 (N.D. Ga. 1973); *Karl's Shoe Stores, Ltd. v. United Shoe*

who has suffered economic injury but no personal injury or property damage⁸ may recover only if he can establish fraud, misrepresentation,⁹ or a breach

Mach. Corp., 145 F. Supp. 376 (D. Mass. 1956); *Donovan Constr. Co. v. General Elec. Co.*, 133 F. Supp. 870 (D. Minn. 1955); *Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc.*, 666 P.2d 544 (Ariz. Ct. App. 1983); *Anthony v. Kelsey-Hayes Co.*, 25 Cal. App. 3d 442, 102 Cal. Rptr. 113 (1972); *Wyatt v. Cadillac Motor Car Div.*, 145 Cal. App. 2d 423, 302 P.2d 665 (1956); *Crowell Corp. v. Topkis Constr. Co.*, 280 A.2d 730 (Del. Super. Ct. 1971); *GAF Corp. v. Zack Co.*, 445 So. 2d 350 (Fla. Dist. Ct. App. 1984); *Chrysler Corp. v. Taylor*, 141 Ga. App. 671, 234 S.E.2d 123 (1977); *Long v. Jim Letts Oldsmobile, Inc.*, 135 Ga. App. 293, 217 S.E.2d 602 (1975); *Clark v. International Harvester Co.*, 99 Idaho 326, 581 P.2d 784 (1978); *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982); *Marcil v. John Deere Indus. Equip Co.*, 9 Mass. App. 625, 403 N.E.2d 430 (1980); *A.C. Hoyle Co. v. Sperry Rand Corp.*, 128 Mich. App. 557, 340 N.W.2d 326 (1983); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159 (Minn. 1981); *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 322 N.W.2d 39 (1983); *Mid-Hudson Mack, Inc. v. Dutchess Quarry & Supply Co.*, 99 A.D.2d 751, 471 N.Y.S.2d 664 (1984); *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 95 A.D.2d 225, 465 N.Y.S.2d 606 (1983); *Amodeo v. Autocraft Hudson, Inc.*, 195 N.Y.S.2d 711 (Sup. Ct. 1959), *aff'd*, 12 A.D. 2d 499, 207 N.Y.S.2d 101 (1960); *Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, 1 Misc. 2d 477, 148 N.Y.S.2d 284 (1955); *Inglis v. American Motors Corp.*, 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965). *But see* *Moorman Mfg. Co. v. National Tank Co.*, 92 Ill. App. 3d 136, 414 N.E.2d 1302 (1980), *rev'd on this point*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982); *Omni Flying Club, Inc. v. Cessna Aircraft Co.*, 366 Mass. 154, 315 N.E.2d 885 (1974); *Groppel Co. v. United States Gypsum Co.*, 616 S.W.2d 49 (Mo. Ct. App. 1981); *State ex rel. Western Seed Prod. Corp. v. Campbell*, 250 Or. 262, 442 P.2d 215 (1968), *cert. denied*, 393 U.S. 1093 (1969); *Nobility Homes Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977); *Berg v. General Motors Corp.*, 87 Wash. 2d 584, 555 P.2d 818 (1976).

8. The distinction between "property damage" and "economic loss" is not always a clear one. Although there is little difficulty when a product causes physical damage to other property (property damage) or when the only damage is loss of use of the product itself or other consequential economic losses (economic loss), substantial difficulties arise when there is "damage" to the product itself. The most common approach is to treat damage to the product itself as "property damage" when it results from a sudden calamitous occurrence or accident which could endanger people or other property, but to treat such damage as "economic loss" when it does not result from such an accident. *See, e.g., Flintkote Co. v. Dravo Corp.*, 678 F.2d 942 (11th Cir. 1982) (applying Georgia law); *Northern Power & Eng'g Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324 (Alaska 1981); *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 322 N.W.2d 39 (1983); *Russell v. Ford Motor Co.*, 281 Or. 587, 575 P.2d 1383 (1978); *Industrial Uniform Rental Co. v. International Harvester Co.*, 317 Pa. Super. 65, 463 A.2d 1085 (1983); *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854 (W. Va. 1982). For a discussion of the distinction between "property damage" and "economic loss," see PROSSER, *supra* note 1, at 707-09; Franklin, *supra* note 3, at 979-90; Ribstein, *Guidelines for Deciding Product Economic Loss Cases*, 29 MERCER L. REV. 493, 496-501 (1978); Note, *Products Liability: Expanding the Property Damage Exception in Pure Economic Loss Cases*, 54 CHI.-KENT L. REV. 963, 968-72 (1978).

The problem of distinguishing economic loss from property damage is beyond the scope of this article. Rather than focusing on the difficulties involved in that distinction, this article deals with the question of under what circumstances, if any, economic losses should be recoverable under a negligence theory in products cases.

9. Purely economic losses may be recovered in actions for fraud or intentional misrepresentation in products cases. *See, e.g., Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658 (9th Cir. 1982) (purchaser of defective computer system awarded over \$250,000 in consequential damages and over \$2,000,000 in punitive damages for intentional misrepresentation); *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604 F.2d 737 (2d Cir. 1979), *after remand and second appeal*, 651 F.2d 132 (2d Cir. 1981) (buyer of computer system recovered \$35,000 in damages for fraud in the inducement of the contract). *See generally* PROSSER, *supra* note 1, at 725-70.

of warranty. If the contract of sale sufficiently limits express warranties¹⁰ and disclaims implied warranties¹¹ the damaged purchaser may have no remedy at all even if his damage is demonstrably a result of the defendant's carelessness. In cases where the plaintiff did not purchase the defective product directly from the defendant the obstacles to recovery are even greater.¹² Although a large majority of courts clearly subscribe to this approach, there continue to be occasional courts,¹³ and dissenting judges,¹⁴ who would permit recovery in tort. It may be that these courts and judges never sufficiently learned the old maxim that "hard cases make bad law," but often an accumulation of "hard cases" is symptomatic of a doctrinal deficiency.

There has been much discussion concerning the applicability or non-applicability of strict tort liability to economic loss resulting from defective products.¹⁵ There has been much less discussion, however, concerning re-

10. See generally U.C.C. §§ 2-313, 2-316 (1978).

11. See generally *id.* §§ 2-314 to 2-316.

12. Many courts still require privity of contract in actions seeking to recover purely economic loss on the basis of breach of implied warranties. See, e.g., *Curtis v. Murphy Elevator Co.*, 407 F. Supp. 940 (E.D. Tenn. 1976); *Flory v. Silvercrest Indus.*, 129 Ariz. 514, 633 P.2d 383 (1981); *Hole v. General Motors Corp.*, 83 A.D.2d 715, 442 N.Y.S.2d 638 (1981); *City of La Crosse v. Schubert, Schroeder & Assocs.*, 72 Wis. 2d 38, 240 N.W.2d 124 (1976). But see, e.g., *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); *Hiles Co. v. Johnston Pump Co.*, 93 Nev. 73, 560 P.2d 154 (1977); *Old Albany Estates, Ltd. v. Highland Carpet Mills, Inc.*, 604 P.2d 849 (Okla. 1979); *Western Equip. Co. v. Sheridan Iron Works, Inc.*, 605 P.2d 806 (Wyo. 1980). See generally J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* 399-411 (2d ed. 1979).

13. See, e.g., *Mead Corp. v. Allendale Mut. Ins. Co.*, 465 F. Supp. 355 (N.D. Ohio 1979) (recovery allowed under strict liability); *Omni Flying Club, Inc. v. Cessna Aircraft Co.*, 366 Mass. 154, 315 N.E.2d 885 (1974) (recovery allowed under negligence); *Cova v. Harley Davidson Motor Co.*, 26 Mich. App. 602, 182 N.W.2d 800 (1970) (recovery allowed under tort theory without proving negligence); *Groppel Co. v. United States Gypsum Co.*, 616 S.W.2d 49 (Mo. Ct. App. 1981) (recovery allowed under negligence); *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965) (recovery allowed under strict liability); *Iacono v. Anderson Concrete Corp.*, 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975) (recovery allowed under strict liability); *State ex rel. Western Seed Prod. Corp. v. Campbell*, 250 Or. 262, 442 P.2d 215 (1968), *cert. denied*, 393 U.S. 1093 (1969) (recovery allowed under negligence); *Nobility Homes, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977) (recovery allowed under negligence); *Berg v. General Motors Corp.*, 87 Wash. 2d 584, 555 P.2d 818 (1976) (recovery allowed under negligence); *City of La Crosse v. Schubert, Schroeder & Assocs.*, 72 Wis. 2d 38, 240 N.W.2d 124 (1976) (recovery allowed under strict liability). But see *Moorman Mfg. Co. v. National Tank Co.*, 92 Ill. App. 3d 136, 414 N.E.2d 1302 (1980), *rev'd on this point*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982) (no recovery for economic loss under either negligence or strict tort liability).

14. See, e.g., *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965) (Peters, J., concurring and dissenting); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159 (Minn. 1981) (Yetka, J., concurring in part and dissenting in part); *Price v. Gatlin*, 241 Or. 315, 405 P.2d 502 (1965) (O'Connell, J., dissenting, joined by Sloan & Denecke, JJ.); see also *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976) (Erwin, J., concurring).

15. See, e.g., *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*, 626 F.2d 280 (3d Cir. 1980); *Scely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982); *Santor v. A.*

covery of such losses in negligence.¹⁶ In part this may be due to the existence of a broader notion that, as a general matter, negligent injury to purely economic interests of any sort is simply not actionable.¹⁷ Often courts simply allude to this general notion as the basis for denying the cause of action in products liability cases.¹⁸ Frequently, too, courts discuss the arguments against

& M. Karagheusian, Inc., 44 N.J. 52, 206 A.2d 305 (1965); see also cited *supra* note 6.

The commentary has been extensive on the matter of strict products liability and economic loss. See Franklin, *supra* note 3; Golker & Yesavich, *Recovery of Economic Loss Based Upon Strict Products Liability*, 54 N.Y. ST. B.J. 519 (1982); Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791 (1966); Ribstein, *supra* note 8; Sales & Perdue, *Strict Liability in Texas*, 14 HOUS. L. REV. 1 (1977); Speidel, *Products Liability, Economic Loss and the UCC*, 40 TENN. L. REV. 309 (1973); Note, *Products Liability—Manufacturer Not Liable for Economic Losses of Consumer Under Theory of Strict Liability*, 15 BUFFALO L. REV. 758 (1966); Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917 (1966); Comment, *Strict Liability: Recovery of "Economic" Loss*, 13 IDAHO L. REV. 29 (1976); Note, *Economic Losses and Strict Products Liability: A Record of Judicial Confusion Between Contract and Tort*, 54 NOTRE DAME LAW. 118 (1978); Note, *Manufacturer's Strict Tort Liability to Consumers for Economic Loss*, 41 ST. JOHN'S L. REV. 401 (1967); Comment, *The Vexing Problem of the Purely Economic Loss in Products Liability: An Injury in Search of a Remedy*, 4 SETON HALL 145 (1972); Comment, *Strict Liability—Will It be Expanded to Allow Recovery for Commercial Loss?*, 16 S. TEX. L.J. 341 (1975).

16. There has, however, been some discussion of the issue. See, e.g., Clark v. International Harvester Co., 99 Idaho 326, 335-36, 581 P.2d 784, 793-94 (1978) (court discussed but rejected negligence recovery for economic loss); Moorman Mfg. Co. v. National Tank Co., 92 Ill. App. 3d 136, 414 N.E.2d 1302 (1980) (recovery for economic loss allowed under negligence and strict tort liability theories), *rev'd on this point*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982) (plaintiffs cannot recover for pure economic loss under tort theories of strict tort liability, negligence and innocent misrepresentation); Superwood Corp. v. Siempelkamp Corp., 311 N.W.2d 159, 162-63 (Minn. 1981) (Yetka, J., concurring in majority's conclusion that strict tort liability cannot be used by a commercial plaintiff to recover pure economic loss, but dissenting on the grounds that commercial plaintiffs should be able to assert negligence theories against a manufacturer to recover economic loss); State *ex rel.* Western Seed Prod. Corp. v. Campbell, 250 Or. 262, 269, 442 P.2d 215, 218 (1968) (to allow strict tort liability would conflict with the U.C.C. scheme of nonfault recovery under warranty; recovery for negligence, however, since it is fault based, "falls within the traditional tort rules and presents no serious conflict with the statutory system of nonfault recovery under the Uniform Commercial Code"); W.R.H., Inc. v. Economy Builders Supply, 633 P.2d 42 (Utah 1981) (court recognized and discussed the "valid distinctions" between negligence and strict liability, citing *Campbell*, 250 Or. 262, 442 P.2d 215, with approval); *Tort Theories in Computer Litigation*, 38 REC. A.B. CITY N.Y. 426, 429-31 (1983); see also cases cited *supra* note 7 (many of which, however, do not discuss negligence and strict liability separately).

17. PROSSER, *supra* note 1, at 657: "Generally speaking, there is no general duty to exercise reasonable care to avoid intangible economic loss or losses to others that do not arise from tangible physical harm to persons and tangible things." See also F. HARPER & F. JAMES, *THE LAW OF TORTS* § 6.11, at 513 (1956); RESTATEMENT (SECOND) OF TORTS § 766(c) (Tent. Draft No. 23, 1977); Harvey, *Economic Losses and Negligence*, 50 CAN. B. REV. 580 (1972); Note, *Negligent Interference with Economic Expectancy: The Case for Recovery*, 16 STAN. L. REV. 664 (1964).

18. See, e.g., GAF Corp. v. Zack Co., 445 So. 2d 350 (Fla. Dist. Ct. App. 1984); Vulcan Materials Co. v. Driltech, 251 Ga. 383, 306 S.E.2d 253 (1983); Chrysler Corp. v. Taylor, 141 Ga. App. 671, 234 S.E.2d 123 (1977); Long v. Jim Letts Oldsmobile, Inc., 135 Ga. App. 293, 217 S.E.2d 602 (1975); Alfred N. Koplin & Co. v. Chrysler Corp., 49 Ill. App. 3d 194,

extending strict liability to economic loss and, without any separate discussion of negligence, conclude with a broad statement that there is no tort remedy for purely economic losses in products cases.¹⁹ Indeed, courts occasionally cite the nonexistence of a cause of action in negligence as a reason for denying a cause of action in strict liability, noting that it would be anomalous to impose strict liability where there was no liability even for negligence.²⁰

This article will examine the general rule denying a cause of action in negligence in products cases where the damages are purely economic. The article accepts as a premise that this rule, frequently referred to as the economic loss rule, is consistent with the reasonable expectations of the parties and, therefore, appropriate in most instances. However, it will argue that in some circumstances the rule may frustrate rather than implement the parties' legitimate expectations. Such frustration is most likely to occur in cases involving custom-manufactured goods which require the seller/manufacturer to render sophisticated design and engineering services as part of the overall transaction. Courts often treat such transactions as sales rather than service transactions. As a result, the negligence liability that would otherwise exist for economic loss resulting from failure to exercise due care in the performance of such services is eliminated by the economic loss rule—often to the surprise of the “buyer.” Because courts, in justifying the economic loss rule in products cases, sometimes rely on the general notion that economic interests are not protected against negligence, this article will begin with an overview of that broader proposition. This overview will suggest that the policies underlying that general notion do not provide a persuasive basis for a blanket rule in products cases. Next the article will explore the policy justifications for the economic loss rule in the products cases specifically, and will suggest that the principal justification involves effectuating the parties' expectations. The article will examine separately the policy concerns underlying the economic loss rule as they apply to strict liability and to negligence. It will argue that, while refusal to extend strict liability to economic loss may be consistent with the parties' expectations, refusal to recognize a cause of action in negligence may interfere with the parties' expectations, at least in some cases involving services as well as

364 N.E.2d 100 (1977); *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 332 N.W.2d 39 (1983); *Inglis v. American Motors Corp.*, 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965); *W.R.H., Inc. v. Economy Builders Supply*, 633 P.2d 42 (Utah 1981).

19. See, e.g., *Copiers Typewriters Calculators, Inc. v. Toshiba Corp.*, 576 F. Supp. 312, 324-26 (D. Md. 1983); *Alfred N. Koplín & Co. v. Chrysler Corp.*, 49 Ill. App. 3d 194, 364 N.E.2d 100 (1977); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159 (Minn. 1981); *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 332 N.W.2d 39 (1983).

20. See, e.g., *Fireman's Fund v. Burns Elec. Sec.*, 93 Ill. App. 3d 298, 417 N.E.2d 131 (1981): “In Illinois, economic losses are not recoverable in tort. [Citations omitted] Although [previous cases have] proceeded on negligence theories, if economic loss resulting from negligence is not recoverable in tort, we see no reason for permitting recovery for loss of the same character in tort without fault.”

goods. The article thus advocates a narrow exception to the economic loss rule to permit an action for negligent performance of services where sophisticated design or engineering services are rendered as a part of a contract for custom-designed and manufactured goods. Finally, it should be noted that the proposed liability for failure to exercise due care in the services portion of such transactions would not be inconsistent with generally accepted principles of contract law, but that to the contrary such liability, because it would be based upon the reasonable expectations of the parties, could be imposed as a matter of contract law without any reference to tort law whatsoever.

I. NEGLIGENCE AND ECONOMIC LOSS

Perhaps the most basic principle in the law of negligence is that one is liable for negligent conduct which causes foreseeable injury to the person or property of another.²¹ It is perhaps surprising, therefore, that courts have shown great reluctance to impose similar liability for negligent conduct which causes foreseeable injury to the economic interests of another,²² at least in cases in which the injury is limited to economic interests.²³

Courts have applied general rules denying recovery for negligent infringement of contract and other economic interests in a wide variety of factual circumstances. A common scenario involves a negligent injury to the person or property of one party which in turn causes economic loss to a third party. Courts have denied recovery where a personal injury to an initial victim results in economic loss to the victim's employer through loss of the victim's services,²⁴ or to one who had a contractual obligation to provide medical

21. See PROSSER, *supra* note 1, at 359; see also RESTATEMENT (SECOND) OF TORTS § 328A(d) (1979).

22. See PROSSER, *supra* note 1, at 997-1002 and 1008-09. RESTATEMENT (SECOND) OF TORTS § 766C (1979), entitled *Negligent Interference with Contract or Prospective Contractual Relation*, provides:

- One is not liable to another for pecuniary harm not deriving from physical harm to the other, if that harm results from the actor's negligently
- (a) causing a third person not to perform a contract with the other,
 - (b) interfering with the other's performance of his contract or making the performance more expensive or burdensome, or
 - (c) interfering with the other's acquiring a contractual relation with a third person.

See also F. HARPER & F. JAMES, *supra* note 17, at 501-13 (1956); Harvey, *supra* note 17; James, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 44 (1972); Comment, *Negligent Interference with Economic Expectancy: The Case for Recovery*, 16 STAN. L. REV. 664 (1964).

23. See PROSSER, *supra* note 1, at 997; see also *infra* notes 35, 36.

24. See, e.g., *Baughman Surgical Assocs. v. Aetna Casualty & Sur. Co.*, 302 So. 2d 316 (La. Ct. App. 1974) (defendant insurer held not liable to plaintiff professional medical corporation for loss of working time when one of its employees was injured as a result of accident

care to the victim,²⁵ or to an insurance company that insured the victim's life or health.²⁶ In other cases courts have denied recovery where the destruction of property belonging to a third party resulted in some economic injury to the plaintiff. In one case the court denied recovery for losses sustained by the plaintiff as a result of the defendant's negligent destruction of the only bridge to the island where the plaintiff's business was located.²⁷

with the insured); *Ferguson v. Green Island Contracting Corp.*, 36 N.Y.2d 742, 328 N.E.2d 792, 368 N.Y.S.2d 163 (1975) (employer denied recovery of economic loss sustained as a result of negligent injury to employee responsible for product design and development who was very difficult to replace); *Snow v. West*, 250 Or. 114, 440 P.2d 864 (1968) (employer had no cause of action for lost profits due to loss of employee's services resulting from defendant's alleged negligence in causing their deaths); *Hartridge v. State Farm Mut. Auto Ins. Co.*, 86 Wis. 2d 1, 271 N.W.2d 598 (1978) (medical clinic had no claim for relief for loss of income due to injury to employee caused by defendant's negligence); *see also United States v. Standard Oil Co.*, 332 U.S. 301 (1947) (federal government could not recover for loss of services of a soldier negligently injured by the defendant).

A traditional common law exception to the rule of non-recovery was recognized in favor of a master for negligent injury to his servant. At present, however, this exception has little if any vitality. *See PROSSER, supra* note 1, at 998; *see also infra* note 63.

Recovery has also been denied for damages to an employer other than loss of an injured employee's services per se. For example, where the employer is contractually obligated to continue paying the injured employee's wages or his medical expenses, or where the employer has had to pay worker's compensation benefits or has suffered an increase in premiums for worker's compensation insurance, the employer has not been permitted to recover these payments from the tortfeasor. *See, e.g., Crab Orchard Improvement Co. v. Chesapeake & Ohio Ry.*, 115 F.2d 277 (4th Cir. 1940), *cert. denied*, 312 U.S. 702 (1941); *The Federal No. 2*, 21 F.2d 313 (2d Cir. 1927); *Chelsea Moving & Trucking Co. v. Ross Towboat Co.*, 280 Mass. 282, 182 N.E. 477 (1932); *Northern States Contracting Co. v. Oakes*, 191 Minn. 88, 253 N.W. 371 (1934); *Interstate Tel. & Tel. Co. v. Public Serv. Elec. Co.*, 86 N.J.L. 26, 90 A. 1062 (1914); *Decker Constr. Co. v. Mathis*, 122 N.E.2d 38 (Ohio C.P. 1953); *Ore-Ida Foods, Inc. v. Indian Head Cattle Co.*, 290 Or. 909, 627 P.2d 469 (1981). *But see Jones v. Waterman Steamship Corp.*, 155 F.2d 992 (3d Cir. 1936); *Midvale Coal Co. v. Cardox Corp.*, 152 Ohio St. 437, 89 N.E.2d 673 (1949), *second appeal*, 157 Ohio St. 526, 106 N.E.2d 556 (1952).

25. *Fifield Manor v. Finston*, 54 Cal. 2d 632, 354 P.2d 1073, 7 Cal. Rptr. 377 (1960) (denying recovery to a nonprofit organization retirement home which was obligated under a life-care contract to provide medical care to party negligently injured by defendant).

26. *See, e.g., Conn. Mut. Life Ins. Co. v. New York & N.H. R.R.*, 25 Conn. 265 (1856) (insurance company paid on life insurance policy; held payment from tortfeasor in absence of subrogation not recoverable); *Peoria Marine & Fire Ins. Co. v. Frost*, 37 Ill. 333 (1865) (fire insurance policy); *Economy Auto Ins. Co. v. Brown*, 334 Ill. App. 579, 79 N.E.2d 854 (1948); *see generally PROSSER, supra* note 1, at 999. In certain instances, however, the insurer is allowed to stand in the shoes of the insured and enforce any claims the insured might have against the tortfeasor, by way of subrogation. *See supra* notes 67, 68.

27. *Rickards v. Sun Oil Co.*, 23 N.J. Misc. 89, 41 A.2d 267 (1945). The plaintiffs in *Rickards* proceeded on the theory that the negligent conduct of the defendant which resulted in the destruction of the bridge amounted to a public nuisance, which the plaintiffs were entitled to enforce because they had suffered "special" damages. Ordinarily, a private individual cannot complain of a public nuisance either by way of a tort action for damages or by an abatement action. *PROSSER, supra* note 1, at 646-52. It is only when the private individual suffers some particular harm not shared in common by the public that the courts have allowed private enforcement of a public nuisance. *Id.* In *Rickards*, however, the court never reached the issue of special damages because it held that the defendant's negligent conduct was not the proximate cause of the plaintiff's economic injury, a threshold requirement in private enforcement of

In another, plaintiffs who lost their jobs after the defendant negligently destroyed the factory where they worked could not recover for their loss of employment.²⁸ Likewise, courts have denied recovery in numerous cases where the defendant negligently cut a utility company's power cable or gas line thereby depriving plaintiff of gas or electricity.²⁹

Courts have also refused to impose tort liability in cases in which the defendant negligently failed to perform some obligation (usually contract) owed to one party and this failure in turn caused economic injury to the plaintiff. For example, a contractor who negligently fails to complete a construction project in a timely manner is not normally liable in tort to third parties economically damaged by the delay.³⁰ Similarly, an accountant who negligently prepares an erroneous financial statement, or an attorney who negligently gives incorrect legal advice, is not liable for losses suffered by third parties who rely upon that information or advice except in carefully limited circumstances.³¹

public nuisance cases.

For a good discussion and summary of the cases involving negligent damage or destruction of public bridges where plaintiffs have been denied recovery for economic loss, see *Nebraska Innkeepers v. Pittsburgh-Des Moines Corp.*, 345 N.W.2d 124 (Iowa 1984) (plaintiffs could not maintain action for negligence, breach of warranty and public nuisance to recover economic loss caused by closure of bridge). See also *Leadfree Enters. v. United States Steel Corp.*, 711 F.2d 805 (7th Cir. 1983); *In re Kinsman Transit Co.*, 388 F.2d 821 (2d Cir. 1968); *In re Marine Navig. Sulphur Carriers, Inc.*, 507 F. Supp. 205 (E.D. Va. 1980), *aff'd*, 638 F.2d 700 (4th Cir. 1981); *General Foods Corp. v. United States*, 448 F. Supp. 111 (D. Md. 1978); *Forcum-James Co. v. Duke Transp. Co.*, 231 La. 953, 93 So. 2d 228 (1957).

28. *Adams v. Southern Pac. Transp. Co.*, 50 Cal. App. 3d 37, 123 Cal. Rptr. 216 (1975); *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200 (Ohio Ct. App. 1946). To the extent that *Adams* holds that there can be no recovery for negligent interference with prospective economic advantage, it was later disapproved by the California Supreme Court in *J'Aire Corp. v. Gregory*, 24 Cal. 3d 799, 807, 598 P.2d 60, 65, 157 Cal. Rptr. 407, 412 (1979).

29. See, e.g., *Cargill v. Offshore Logistics*, 615 F.2d 212 (5th Cir. 1980); *Kaiser Aluminum v. Marshland*, 455 F.2d 957 (5th Cir. 1972); *Byrd v. English*, 117 Ga. 191, 43 S.E. 419 (1903); *PPG Indus. v. Bean Dredging Co.*, 447 So. 2d 1058 (La. 1984). But see *Dunlop Tire & Rubber Corp. v. FMC Corp.*, 53 A.D.2d 150, 385 N.Y.S.2d 971 (1976).

30. *Just's, Inc. v. Arrington Constr. Co.*, 99 Idaho 462, 583 P.2d 997 (1978) (plaintiff denied recovery in tort, but court allowed recovery in contract under a third party beneficiary theory); *Mandal v. Hoffman Constr. Co.*, 270 Or. 248, 527 P.2d 387 (1974) (defendant not liable in tort for negligent performance of contract which resulted in economic loss to plaintiff); see also *Alvord & Swift v. S.M. Muller Constr. Co.*, 46 N.Y.2d 276, 385 N.E.2d 1238, 413 N.Y.S.2d 309 (1978); *Keel v. Titan Constr. Corp.*, 639 P.2d 1228 (Okla. 1981). But see *J'Aire Corp. v. Gregory*, 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979) (plaintiff lessee could maintain a negligence action against defendant contractor who allegedly was negligent in performing his contract with plaintiff's lessor, resulting in economic loss to plaintiff); *Hawthorne v. Koher Constr. Co.*, 196 Mont. 519, 640 P.2d 467 (1982) (independent workers in a common project—defendant supplier negligently failed to meet contractual obligations to general contractor, held liable to subcontractor for economic loss sustained as a result).

31. See, e.g., *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931) (auditor's duty is owed only to those with whom he is in privity or to those who are known beneficiaries at the time of the auditor's undertaking—those for whose "primary benefit" the statements were intended); RESTATEMENT (SECOND) OF TORTS § 552 comment a (1979) (liability extends only

Perhaps the most common situation in which courts deny recovery in tort for purely economic loss, however, arises in products liability cases. When a purchaser or user of a defective product suffers economic loss as a result of the product's failure to function properly the overwhelming majority of courts refuse to permit recovery from the manufacturer on a negligence theory.³² Frequently the injured party has not acquired the defective product directly from the defendant and courts often cite lack of privity as a reason for denying recovery.³³ However, courts have been equally reluctant to permit recovery in cases in which the plaintiff and defendant were in privity.³⁴

Despite the broad scope of the general rule restricting liability for the economic consequences of negligence, there are circumstances in which courts do impose such liability. The most common circumstance in which courts permit recovery of economic loss is where there is also some physical injury.³⁵ Indeed, a common statement of the general rule is that there can be no recovery for economic loss in the absence of some physical injury.³⁶

to known and intended class of beneficiaries); PROSSER, *supra* note 1, at 746-48; *see also infra* note 48. *But see* H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 461 A.2d 138 (1983); Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 335 N.W.2d 361 (1983).

32. PROSSER, *supra* note 1, at 708: "Historically . . . the only tort action available to a disappointed purchaser suffering intangible commercial loss has been the tort action of deceit for fraud. . . . [T]his remains the generally accepted view." *See supra* note 7 and accompanying text.

33. *E.g.*, Wyatt v. Cadillac Motor Car Div., 145 Cal. App. 2d 423, 426, 302 P.2d 665, 667 (1956); Crowell Corp. v. Topkis Constr. Co., 280 A.2d 730, 732 (Del. Super. Ct. 1971); Tolar Constr. Co. v. GAF Corp., 154 Ga. App. 127, 127, 267 S.E.2d 635, 638 (1980); Local Joint Exec. Bd. v. Stern, 98 Nev. 409, 410, 651 P.2d 637, 638 (1982); Trans World Airlines v. Curtiss-Wright Corp., 1 Misc. 2d 477, 479, 148 N.Y.S.2d 284, 290 (1955); Inglis v. American Motors Corp., 3 Ohio St. 2d 132, 132, 209 N.E.2d 583, 583 (1965).

34.

We believe that the issue of privity merely diverts attention from the fundamental issue presented: whether a negligence action can be maintained by any plaintiff who claims only damages such as those alleged in this case [pure economic loss]. In reaching our decision, we do not rely on the presence or absence of privity between the plaintiff and the defendants.

Marcil v. John Deere Indus. Equip. Co., 403 N.E.2d 430, 434 n.5 (Mass. App. Ct. 1980); *see also* Consolidated Edison Co. v. Westinghouse Elec. Corp., 567 F. Supp. 358 (S.D.N.Y. 1983); County of Westchester v. General Motors Corp., 555 F. Supp. 290 (S.D.N.Y. 1983); Moorman Mfg. Co. v. National Tank Co., 91 Ill. 2d 69, 435 N.E.2d 443 (1982); A.C. Hoyle Co. v. Sperry Rand Corp., 128 Mich. App. 557, 340 N.W.2d 326 (1983); McGhee v. General Motors Corp., 98 Mich. App. 495, 296 N.W.2d 286 (1980); National Crane Corp. v. Ohio Steel Tube Co., 213 Neb. 782, 332 N.W.2d 39 (1983).

35. *See, e.g.*, LeSueur Creamery, Inc. v. Haskon, Inc., 660 F.2d 342 (8th Cir. 1981), *cert. denied*, 455 U.S. 1019 (1982); Newlin v. New England Tel. & Tel. Co., 316 Mass. 234, 54 N.E.2d 929 (1944); Duchene v. Wolstan, 258 N.W.2d 601 (Minn. 1977); Dunlop Tire & Rubber Corp. v. FMC Corp., 53 A.D.2d 150, 385 N.Y.S.2d 971 (1976); Turner v. Reynolds, 271 A.D. 413, 66 N.Y.S.2d 339 (1946).

36. *See, e.g.*, State of La. *ex rel.* Guste v. M/V Testbank, 752 F.2d 1019, 1021 (5th Cir. 1985); Just's, Inc. v. Arrington Constr. Co., 99 Idaho 462, 468 & n.1, 583 P.2d 997, 1003 & n.1 (1978); *see also* RESTATEMENT (SECOND) OF TORTS § 766C comment b (1979).

The difference in treatment between pure economic loss on the one hand and economic loss

Even where the plaintiff suffers exclusively economic loss, courts permit recovery in negligence where there is some special relationship between the

accompanied by some physical injury on the other has been criticized as being arbitrary and as leading to anomalous results. For example, in *Moorman Mfg. Co. v. National Tank Co.*, 92 Ill. App. 3d 136, 414 N.E.2d 1302 (1980), *rev'd*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982), the court stated:

In products liability actions in which the plaintiff has suffered either personal injury or property damage, courts have generally also allowed recovery for economic losses. . . . To deny recovery for economic loss under strict liability in tort when there is no accompanying personal injury or property damage is an arbitrary distinction leading to opposite results in cases that are virtually indistinguishable. In the instant case, had the plaintiff alleged that a mere bushel of corn had been destroyed by rain water leaking into the tank through the crack, then it would have suffered property damage sufficient to allow recovery of economic loss. Likewise, if an individual had cut his finger while inspecting the crack in the tank, he would have suffered a personal injury allowing recovery for all types of harm.

Id. at 141, 414 N.E.2d at 1307. Similarly, Justice Peters' concurring and dissenting opinion in *Seely v. White Motor Co.*, 63 Cal. 2d 9, 25, 403 P.2d 145, 155-56, 45 Cal. Rptr. 17, 27-28 (1965) (emphasis in original), stated:

Suppose, for example, defective house paint is sold to two home owners. One suffers temporary illness from noxious fumes, while the other's house is destroyed by rot because the paint proved ineffective (a loss generally uninsured). Although the latter buyer may clearly suffer the greater misfortune, the majority would not let him recover under a strict liability doctrine because *his* loss is solely "economic," while letting the first buyer recover the minimal costs and lost earnings caused by his illness.

The majority opinion in *Seely* was written by Chief Justice Traynor:

The distinction . . . between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. A manufacturer can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the consumer's demands.

Id. at 18, 403 P.2d at 151, 45 Cal. Rptr. at 23.

In some instances, courts appear to have stretched the property damage concept to its limits to find the accompanying physical injury necessary to permit recovery of economic loss. In *LeSueur Creamery, Inc. v. Haskon, Inc.*, 660 F.2d 342 (8th Cir. 1981), *cert. denied*, 455 U.S. 1019 (1982), for example, the Court of Appeals for the Eighth Circuit held that a cheesemaker could recover in negligence for lost profits resulting from a loss of cheese yield caused by excessive heat from a pasteurizer installed by the defendant, on the basis that there had been property damage in addition to the economic loss. In describing the property damage the court stated: "The excessive heat denatured the whey proteins in the milk and reduced the solubility of the ionic calcium in the milk and this damage decreased LeSueur's yield." 660 F.2d at 349. In another case, one court held that damage to a piece of paper (a football pool coupon) was sufficient to allow recovery for the lost prize of \$20,000. *Bart v. British West Indian Airways*, [1967] 1 Lloyd's List L.R. 239, 267 (Guyana Ct. App.). See also Note, *Products Liability: Expanding the Property Damage Exception in Pure Economic Loss Cases*, 54 CHI.-KENT L. REV. 963 (1978).

For an explanation of the difference in treatment between pure economic loss and economic loss accompanied by some physical injury, see *supra* notes 92, 93.

parties.³⁷ A sufficient relationship is found most easily where the defendant stands in a fiduciary or professional relationship to the plaintiff.³⁸ Thus a trustee may be liable if in fulfilling his trust he negligently injures the economic interests of a beneficiary.³⁹ Similarly an accountant,⁴⁰ attorney,⁴¹ architect,⁴² engineer⁴³ or other professional⁴⁴ may be liable to his client for malpractice even though the damages are purely economic.⁴⁵ Moreover,

37. "There are, however, a few situations in which recovery [in a negligence action] has been permitted, all of them apparently to be justified upon the basis of some special relation between the parties." PROSSER, *supra* note 1, at 1008.

38. See *infra* notes 39-44.

39. See RESTATEMENT (SECOND) OF TRUSTS §§ 174, 201 (1979); see also *id.* § 205 illustrations 1-7.

40. See, e.g., *Dantzer Lumber & Export Co. v. Columbia Casualty Co.*, 115 Fla. 541, 156 So. 116 (1934); *National Surety Corp. v. Lybrand*, 256 A.D. 226, 9 N.Y.S.2d 554 (1939) (accountant held liable for failure to discover embezzlements by employee of accountant's client, resulting in economic loss to client); *Smith v. London Assur. Corp.*, 109 A.D. 882, 96 N.Y.S. 820 (1905).

41. See, e.g., *Smiley v. Manchester Ins. & Indem. Co.*, 71 Ill. 2d 306, 375 N.E.2d 118 (1978) (defendant attorney held liable in negligence for failing to settle a case, resulting in economic loss to plaintiff); *Practical Offset, Inc. v. Davis*, 83 Ill. App. 3d 566, 404 N.E.2d 516 (1980) (attorney held liable for failing to file a financing statement to perfect a security interest of plaintiff, resulting in economic loss); *House v. Maddox*, 46 Ill. App. 3d 68, 360 N.E.2d 580 (1977) (attorney held liable in negligence for allowing a statute of limitations to run without instituting suit in his client's behalf, thus depriving his client of any compensation).

42. See, e.g., *Bayshore Dev. Co. v. Bonfoey*, 75 Fla. 455, 78 So. 507 (1918); *Housing Authority v. Ayers*, 211 Ga. 728, 88 S.E.2d 368 (1955) (additional expenses to correct building defects held recoverable on a negligence theory against architect for failing to provide sufficient footing for foundations in his drawings and specifications); *Sears, Roebuck & Co. v. Enco Assocs., Inc.*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977); *Paver & Wildfoerster v. Catholic High School Ass'n*, 38 N.Y.2d 669, 345 N.E.2d 565, 382 N.Y.S.2d 22 (1976); *Hubert v. Aitken*, 2 N.Y.S. 711, 25 N.E. 954 (C.P. 1888), *reargued*, 5 N.Y.S. 839 (1889) (plaintiff can recover cost to repair defect in house from architect under a negligence theory); *Surf Realty Corp. v. Standing*, 195 Va. 431, 78 S.E.2d 901 (1953) (plaintiffs allowed to maintain a negligence action against architect for failure to discover defect and negligent supervision of roof construction which resulted in loss of plaintiff's contractual expectation and in the junking and salvaging of the roof structure).

43. See, e.g., *Mauldin v. Sheffer*, 113 Ga. App. 874, 150 S.E.2d 150 (1966) (plaintiff architect's complaint against mechanical engineer seeking to recover economic losses allegedly resulting from defendant engineer's negligence in drawing up faulty designs, plans and specifications for the plaintiff held to have stated a cause of action *ex delicto*); *Audlane Lumber & Builders Supply, Inc. v. D.E. Britt Assocs.*, 168 So. 2d 333 (Fla. Dist. Ct. App. 1964), *cert. denied*, 173 So. 2d 146 (Fla. 1965).

44. See, e.g., *Ajax Hardware Mfg. Corp. v. Industrial Plants Corp.*, 569 F.2d 181, 185 (2d Cir. 1977) (machinery appraisers); *Remeikis v. Boss & Phelps, Inc.*, 419 A.2d 986, 991 (D.C. 1980) (real estate agent); *McAlvain v. General Ins. Co.*, 97 Idaho 777, 554 P.2d 955 (1976) (insurance agent); *Essex v. Ryan*, 446 N.E.2d 368 (Ind. Ct. App. 1983) (surveyor); *Commissioner of Highways v. Beebe*, 55 Mich. 137, 20 N.W. 826 (1884) (surveyor); *Morin v. Divide County Abstract Co.*, 183 N.W. 1006 (N.D. 1921) (abstractor).

45. RESTATEMENT (SECOND) OF TORTS § 552(1) (1979), entitled *Information Negligently Supplied for the Guidance of Others*, provides:

One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for

liability for economic loss caused by negligent performance of services is not limited to professional malpractice actions but rather may extend to other service transactions as well.⁴⁶

Occasionally courts have imposed liability for purely economic loss even in the absence of any contractual relationship between the parties. Although the traditional rule was to the contrary,⁴⁷ a number of courts have now held that an accountant who negligently prepares an erroneous financial statement for a client may be liable not only for losses suffered by the client, but also for economic loss suffered by a third party who relies upon the erroneous statement.⁴⁸ Some courts have imposed similar liability upon

pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

While § 552 speaks in terms of negligent communication of information, the principle of liability it embodies seems to be broader than that, for courts have imposed liability for economic loss in numerous instances which cannot comfortably be described in terms of negligent misrepresentation. *See, e.g.*, *Smiley v. Manchester Ins. & Indem. Co.*, 71 Ill. 2d 306, 375 N.E.2d 118 (1978) (attorney liable in negligence for failing to settle a claim); *Practical Offset, Inc. v. Davis*, 83 Ill. App. 3d 566, 404 N.E.2d 516 (1980) (failure to file a financing statement in order to perfect a security interest); *House v. Maddox*, 46 Ill. App. 3d 68, 360 N.E.2d 580 (1977) (failure to file suit before the statute of limitations ran out).

46. *See infra* note 203. For example, courts have imposed liability in negligence for economic loss upon a test hole driller, *Gagne v. Bertran*, 34 Cal. 2d 481, 275 P.2d 15 (1954), a telephone company, *Bunch v. South Central Bell Tel. Co.*, 356 So. 2d 104 (La. Ct. App. 1978), and a burglar alarm company, *DCR Inc. v. Peak Alarm Co.*, 663 P.2d 433 (Utah 1983).

47. *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931), holding that a public accountant who negligently made an audit report could not be liable in negligence to third parties who justifiably relied on it, represented the position of most American courts until recently, and it is still followed in several jurisdictions. *See Investors Tax Sheltered Real Estate Ltd. v. Laventhold, Krekstein, Horwath & Horwath*, 370 So. 2d 815 (Fla. Dist. Ct. App. 1979); *MacNerland v. Barnes*, 129 Ga. App. 367, 199 S.E.2d 564 (1973); *Dworman v. Lee*, 83 A.D.2d 507, 441 N.Y.S.2d 90 (1981) (mem.), *aff'd without opinion*, 56 N.Y.2d 816, 438 N.E.2d 103, 452 N.Y.S.2d 570 (1982).

48. *E.g.*, *Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs*, 455 F.2d 847 (4th Cir. 1972) (accountants liable to third parties who are actually foreseen and who belong to a limited class of persons) (applying Rhode Island law); *Briggs v. Sterner*, 529 F. Supp. 1155 (S.D. Iowa 1981) (accountant liable in negligence to third parties for whose benefit and guidance the accountant knows the information is intended); *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85 (D.R.I. 1968) (accountant who knew that the statements were to be used by his client for the purpose of obtaining credit from a third party, but who did not know of the specific relying third party, held liable in negligence to that third party); *Brumley v. Touche, Ross & Co.*, 123 Ill. App. 3d 636, 463 N.E.2d 195 (1984) (where accountant acts at the direction of or on behalf of his client to benefit or influence a third party, he may be held liable in negligence to that third party); *H. Rosenblum, Inc. v. Adler*, 93 N.J. 324, 461 A.2d 138 (1983) (accountants owe duty in negligence to third parties who are reasonably foreseeable recipients of the statements, who receive the statements for proper business purposes and who justifiably rely on them); *Haddon View Inv. Co. v. Coopers & Lybrand*, 70 Ohio St. 2d 154, 436 N.E.2d 212 (1982) (accountant may be held liable to third party for negligence when that third party is a member of a limited class whose reliance is specifically foreseen); *Shatterproof Glass Corp. v. James*, 466 S.W.2d 873 (Tex. Civ. App. 1971) (accountant liable for negligence in certification of audit reports to corporations knowing that these reports would be used by creditors in making loans to corporations); *Citizens State Bank v. Timm, Schmidt*

attorneys,⁴⁹ surveyors,⁵⁰ abstractors,⁵¹ and others⁵² who provide information for the guidance of others. In most of these cases, however, the defendants furnished the information for the specific purpose of inducing reliance by the plaintiffs, or at least with the knowledge that the information would be used for that purpose.⁵³

As with liability to one's own client,⁵⁴ liability to third parties is not limited to cases of negligent misrepresentation, but may extend to negligent performance of other services so long as there is a sufficient relationship between

& Co., 113 Wis. 2d 376, 386, 335 N.W.2d 361, 366 (1983) ("[l]iability will be imposed on . . . accountants for the foreseeable injuries resulting from their negligent acts unless, as a matter of policy to be decided by the Court, recovery is denied on grounds of public policy"); see also PROSSER, *supra* note 1, at 746-48; Keeton, *Professional Malpractice*, 17 WASHBURN L.J. 445 (1978); Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231 (1966); Comment, *Adjusting Accountants' Liability for Negligence*, 13 BALTIMORE L. REV. 301 (1984); Note, *TORT LAW—The Enlarging Scope of Auditor's Liability to Relying Third Parties*, 59 NOTRE DAME LAW. 281 (1983); Note, *Accountant's Liability to Third Parties*, 52 NOTRE DAME LAW. 281 (1977); Annot., 46 A.L.R.3d 979 (1972).

49. See, e.g., *Heyer v. Flaig*, 70 Cal.2d 223, 449 P.2d 161, 74 Cal. Rptr. 225 (1969); *Lucas v. Hamm*, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), *cert. denied*, 368 U.S. 987 (1962); *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (1976); *Licata v. Spector*, 26 Conn. Super. Ct. 378, 225 A.2d 28 (1966); *United Leasing Corp. v. Miller*, 45 N.C. App. 400, 263 S.E.2d 313 (1980); *Guy v. Liederbach*, 279 P. Super. 543, 421 A.2d 333 (1980); *Auric v. Continental Gas. Co.*, 111 Wis. 2d 507, 331 N.W.2d 325 (1983).

50. See, e.g., *Rozny v. Marzul*, 83 Ill. 2d 110, 250 N.E.2d 656 (1969) (surveyor liable in negligence to plaintiffs for his preparation of an inaccurate survey which he had done several years before for a different party, and which plaintiffs subsequently obtained and relied on, causing them economic loss); *Tarter v. Palumbo*, 224 Tenn. 262, 453 S.W.2d 780 (1970) (allegations that defendant surveyor negligently prepared a survey and plot for buyer of property, and that plaintiff sellers of the property sustained damage when required to move the house because of inaccurate survey and plot, held to state a cause of action for negligent misrepresentation despite absence of privity between plaintiff and defendant).

51. *William v. Polger*, 391 Mich. 6, 215 N.W.2d 149 (1974) (abstractor's liability for negligent misrepresentation arising out of his contractual duties extends to those an abstractor could reasonably foresee as relying on the accuracy of the abstract that is put into circulation); *Kovaleski v. Tallahassee Title Co.*, 363 So. 2d 1156 (Fla. Dist. Ct. App. 1978) (abstractor's liability for economic loss proximately caused by negligent performance of his contractual duty extends to any reasonably foreseeable plaintiff even if not in privity with the abstractor).

52. *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922) (public weigher who certified an incorrect weight of beans held liable under a negligent misrepresentation theory to a purchaser of a quantity of the beans); *United States v. Rogers & Rogers*, 161 F. Supp. 132 (S.D. Cal. 1958) (applying California law) (architect); *Hardy v. Carnichael*, 207 Cal. App. 2d 218, 24 Cal. Rptr. 475 (1962) (termite inspector); see also RESTATEMENT (SECOND) OF TORTS § 552 (1979) (discussed *supra* note 45).

53. See cases cited *supra* note 48. With respect to these cases Prosser notes that [t]he obligation arising out of the implied promise to render the service with reasonable care extends to the promisee and third party beneficiaries, and it is extremely doubtful if courts have carried liability any further than could have been carried through the reasonable application of third party beneficiary ideas. The main point to be made is that liability that has been imposed could have been imposed on a contractual basis.

PROSSER, *supra* note 1, at 746.

54. See *supra* note 44.

the parties.⁵⁵ Indeed it has been suggested that misperformance of a contract by anyone in a public calling may be actionable by a party on whose behalf the contract was made.⁵⁶ In addition, some courts have held subcontractors or suppliers who negligently delay a construction project liable to other subcontractors who suffer economic loss due to the delay.⁵⁷ And, in one case a bank which provided construction financing for a housing development was held liable to the purchasers of defective homes for its negligent failure to insist on adequate inspections during construction.⁵⁸

Courts have also imposed liability for negligent injury to economic interests in cases in which there is a special relationship (usually a family relationship), not between the plaintiff and the defendant, but rather between the plaintiff and the initial victim of the defendant's negligence.⁵⁹ Thus, a spouse can

55. See *Biakanja v. Irving*, 49 Cal. 2d 647, 320 P.2d 16 (1958) (notary public; will not properly attested). In *Biakanja* the court stated:

The determination of whether, in a specific case, the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.

Id. at 650, 320 P.2d at 19; see also *Connor v. Great Western Savings & Loan Ass'n*, 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968); *Lucas v. Hamm*, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961) (attorney's negligent drafting of will), *cert. denied*, 368 U.S. 987 (1962); *Ross v. Caunters*, [1979] 3 All E.R. 580. *Accord* *McAbee v. Edwards*, 340 So. 2d 1167 (Fla. Dist. Ct. App. 1976) (failure to advise change in will necessary upon remarriage); *Ward v. Arnold*, 52 Wash. 2d 581, 328 P.2d 164 (1958) (negligent advice of attorney that no will was necessary).

56. PROSSER, *supra* note 1, at 1000-01:

It seems likely that any negligent misperformance of a contract by a public utility or by one in a public calling, such as a lawyer, may be actionable by the person in whose behalf the contract was made. . . . But if these are cases for liability, the exception is a quite narrow one, turning on a special relationship or an assumption of responsibility by the negligent promissor, and equally on the presence of a narrow and particular class of potential plaintiffs.

57. See, e.g., *Chameleon Eng'g Corp. v. Air Dynamics, Inc.*, 101 Cal. App. 3d 418, 161 Cal. Rptr. 463 (1980); *Hawthorne v. Kober Constr. Co.*, 196 Mont. 519, 640 P.2d 467 (1982); *Keel v. Titan Constr. Co.*, 639 P.2d 1228 (Okla. 1982); *c.f.* *Green Constr. Co. v. Williams Form Eng'g Corp.*, 506 F. Supp. 173 (W.D. Mich. 1980); *J'Aire Corp. v. Gregory*, 24 Cal. App. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979).

58. *Connor v. Great Western Savings & Loan Ass'n*, 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968).

59. Courts very early permitted recovery by the master for loss of services when his servant was negligently injured. See *infra* note 63. Later courts permitted recovery by a husband for loss of consortium (including loss of services) for injury to his wife. The emphasis in such actions, however, has shifted away from loss of services toward a recognition of the more intangible aspects of the relationships involved, such as companionship and affection. See PROSSER, *supra* note 1, at 916, 931.

While these actions do involve recovery of economic losses in the absence of any physical injury to the plaintiff, they are not really examples of recovery of pure economic loss because they also involve injury to protected non-economic aspects of a relationship. Accordingly,

recover damages for loss of consortium resulting from an injury to the other spouse,⁶⁰ and a parent can recover for the loss of services resulting from injury to a child.⁶¹ In some cases family members of the victim have also recovered costs incurred in caring for the victim.⁶² Likewise, courts, at one time, permitted a master to recover damages for loss of services due to injury to a servant.⁶³

Another group of cases in which courts occasionally impose liability for negligent injury to economic interests involves recovery by a private party for damages resulting from a public nuisance.⁶⁴ A private party normally

recovery of economic loss in these cases might be explained on the basis that the defendant has committed an independent tort for which the plaintiff may recover all damages proximately caused including economic loss. See *infra* note 93. Still, the history of the action—which began with recovery for loss of services and only later began to focus on the non-economic aspects of these relationships—suggests that this kind of explanation is not the whole story.

60. An action in favor of the husband for loss of consortium resulting from injury to his wife was recognized quite early. A similar action in favor of the wife was recognized only much later. See generally PROSSER, *supra* note 1, at 931-34.

61. See generally PROSSER, *supra* note 1, at 934-35. Traditionally there was no reciprocal action in favor of the child when a parent was injured. Recently, however, several courts have rejected the traditional rule. *Id.* at 935, 936. See also *Estate of Davis v. Hazen*, 582 F. Supp. 938 (C.D. Ill. 1983); *Weitl v. Moes*, 311 N.W.2d 259 (Iowa 1981), *rev'd*, *Audubon-Exira Ready Mix, Inc. v. Illinois Central Gulf R.R. Co.*, 335 N.W.2d 148 (Iowa 1983); *Ferriter v. Daniel O'Connell's Sons, Inc.*, 381 Mass. 507, 413 N.E.2d 690 (1980); *Berger v. Weber*, 411 Mich. 1, 303 N.W.2d 424 (1981). *But see Clark v. Romeo*, 561 F. Supp. 1209 (D. Conn. 1983); *Block v. Pielet Bros. Scrap & Metal*, 119 Ill. App. 3d 983, 457 N.E.2d 509 (1983); *Mueller v. Hellrung Constr. Co.*, 107 Ill. App. 3d 337, 437 N.E.2d 789 (1982); *Fayden v. Guerrero*, 420 So. 2d 656 (Fla. Dist. Ct. App. 1982), *petition denied*, 430 So. 2d 450 (Fla. 1983); *Salin v. Kloempken*, 322 N.W.2d 736 (Minn. 1982); *Norwest v. Presbyterian Intercommunity Hosp.*, 293 Or. 543, 652 P.2d 318 (1982).

62. See PROSSER, *supra* note 1, at 933-34.

63. This action was apparently based on the historically close relationship between master and servant analogous in many ways to relationships among family members, and it has been suggested that the disappearance of many of the special attributes of the master-servant relationship accounts for the general disappearance of the action as well. See, e.g., *Myurgia Perfumes, Inc. v. American Airlines, Inc.*, 68 Misc. 2d 712, 327 N.Y.S.2d 861 (N.Y. Civ. Ct. 1971); *Hartridge v. State Farm Mut. Auto. Ins. Co.*, 86 Wis. 2d 1, 271 N.W.2d 598 (1978); see also *Dobbs, Tortious Interference with Contractual Relationships*, 34 ARK. L. REV. 335, 337-44 (1980); *Perlman, Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 CHI. L. REV. 61, 73 (1982); *Seavey, Liability to Master for Negligent Harm to Servant*, 1956 WASH. U.L.Q. 309. See generally PROSSER, *supra* note 1, at 998-99.

64. PROSSER, *supra* note 1, at 997, suggests that recovery of economic damages in these cases is not because the interference with the economic expectancy is actionable but rather because the interference is simply an item of damages resulting from some other tort—here, the commission of a public nuisance. The idea is the same as economic loss which is recovered as parasitic damages where the plaintiff also suffers a physical injury. See *infra* note 93. There is a difference, however, because where the plaintiff has also suffered a physical injury the plaintiff has a cause of action and can recover something even if he does not recover the economic loss. In the case of a public nuisance, on the other hand, the whole question is whether the plaintiff will be entitled to recover anything at all. If the plaintiff is not permitted to recover the economic loss, there is no other damage to the individual plaintiff that can be recovered in these cases.

cannot maintain an action for a public nuisance unless he suffers some particular damage as distinguished from that suffered by the public in general.⁶⁵ However, pecuniary damage has been deemed sufficient in a number of cases where, for example, the plaintiff has been disadvantaged in the performance of a particular contract by the defendant's blockage of a public highway or bridge.⁶⁶

Finally, even in cases in which courts will not permit recovery of economic losses on a negligence theory, recovery may still be available on some other theory. In particular the doctrines of subrogation and third party beneficiaries often permit recovery of economic loss in cases where such recovery would be unavailable in negligence. For example, a defendant who negligently destroys property is normally liable in negligence only to the owner of the property and not to an insurance company which insures the property.⁶⁷ Nevertheless, the insurance company in such cases may be subrogated to the insured's claim against the defendant and would thus be able to recover.⁶⁸

65. See generally PROSSER, *supra* note 1, at 646-52; Prosser, *Private Action for Public Nuisance*, 52 VA. L. REV. 997 (1966).

66. See *Holcomb Constr. Co. v. Armstrong*, 590 F.2d 811 (9th Cir. 1979); *Burgess v. M/V Tamano*, 370 F. Supp. 247 (D. Me. 1973); *Brewer v. Missouri Pac. Ry. Co.*, 161 Ark. 525, 257 S.W.2d 53 (1923); *Stop & Shop Co. v. Fisher*, 387 Mass. 889, 444 N.E.2d 368 (1983); see also RESTATEMENT (SECOND) OF TORTS § 821C comment h, illustration 1 (1979).

67. *Insurance Co. v. Brame*, 95 U.S. 754, 758 (1877) ("The relation between the insurance company and McLemore, the deceased, was created by a contract between them, to which Brame [the person who killed the deceased] was not a party. The injury inflicted by him [Brame] was upon McLemore, against his personal rights; that it happened to injure the plaintiff [insurance company] was an incidental circumstance, a remote and indirect result, not necessarily or legitimately resulting from the act of killing."); *Connecticut Mut. Life Ins. Co. v. New York & N.H. Ry.*, 25 Conn. 265 (1856) (insurance company has no direct right of action against negligent tortfeasor who injures the insured because its damages were too remote and indirect); *Peoria Marine and Fire Ins. Co. v. Frost*, 37 Ill. 333 (1865) (insurance company cannot maintain an action in its own name against tortfeasor who has damaged insured property in order to recover for what it has paid the insurer); *Economy Auto. Ins. Co. v. Brown*, 334 Ill. App. 579, 79 N.E.2d 854 (1948) (plaintiff insurance company has no right of action under the Dram Shop Act to recover against a tortfeasor who injured its insured because plaintiff's injuries [property loss] were not proximately caused by the defendant's conduct).

In certain situations the insurance company may by subrogation have a claim against the tortfeasor. See *infra* note 68. But in those circumstances the insurance company has an indirect right of action which it acquires through the rights which the injured (insured) party had against the wrongdoer. See J. DOBBYN, *INSURANCE LAW IN A NUTSHELL* 227-36, 243-45 (1981); 2 F. HARPER & F. JAMES, *THE LAW OF TORTS* § 6.10 (1956); R. KEETON, *INSURANCE LAW BASIC TEXT* 151-52 (1971); J. MAY, *MAY ON INSURANCE* § 454 (4th ed. 1900); 4 G. PALMER, *LAW OF RESTITUTION* 464 n.22 (1978); W. VANCE, *INSURANCE* 679 (2d ed. 1930).

68. Subrogation is an equitable principle which allows an insurer to step into the shoes of the insured party and to enforce the insured party's rights and remedies against the person causing the loss. It is of two types: conventional, pertaining to an express subrogation as where the insurer and insured provide for subrogation in the insurance contract; and legal, which is effected or implied by operation of law. BLACK'S LAW DICTIONARY 807, 1279 (5th ed. 1979).

Thus, where an insurance company pays its insured for property losses caused by a negligent tortfeasor, it may succeed by subrogation to its insured's right of action against that tortfeasor. The availability of legal subrogation in a given case depends largely upon the type of insurance

Rules permitting third party beneficiaries to enforce contracts can also provide a means for a party to recover for negligently inflicted economic losses. In one case⁶⁹ the defendant contracted with a city to renovate a portion of the city's downtown area. This contract between the defendant and the city required the defendant to take certain precautions to minimize disruption to businesses in the renovation area. The plaintiff brought an action against the defendant alleging that the defendant negligently failed to take the precautions required in the contract resulting in a loss of business to the plaintiff. The court specifically held that the plaintiff could not recover in negligence because the damages were purely economic.⁷⁰ However, the court also held that the plaintiff was a third party beneficiary of the contract between the defendant and the city, and that as such could bring an action directly against the defendant for breach of contract.⁷¹

Although economic loss may sometimes be recovered under one of the exceptions to the rule or on some theory other than negligence, courts are generally much less willing to impose liability for the economic consequences of negligent acts than for the physical consequences of such acts. One explanation sometimes offered for this difference in treatment between economic loss and physical injury is that the integrity of the body and tangible property is more important than the integrity of intangible economic interests and that economic interests are simply not worthy of protection, at least against mere negligence.⁷² One difficulty with this explanation is that courts do in fact protect economic interests against negligence in a number of circumstances. Moreover, even assuming that interests in physical security are of a higher order than interests in economic security, it does not necessarily follow that economic interests are unworthy of protection. If economic injury is not worthy of redress, there must be some explanation. Nevertheless, the only explanation offered by many courts is that there is no general duty to avoid negligent injury to the economic interests of others,⁷³

involved. Subrogation rights are generally recognized in property and liability insurance cases, and are generally not recognized in life or accident insurance. Between these two extremes, jurisdictions vary when it comes to medical-related insurance and workman's compensation insurance. R. KEETON, *supra* note 67, at 147-53. See generally D. DOBBS, *REMEDIES* 250-52 (1973); J. DOBBYN, *supra* note 67, at 227-36, 243-45; R. KEETON, *supra* note 67, § 3.10; G. PALMER, *supra* note 67, at 345-76.

Professor Keeton points out that in some instances the insurer may be able to recover against the policy holder but not against the third party tortfeasor.

69. *Just's, Inc. v. Arrington Constr. Co.*, 99 Idaho 462, 583 P.2d 997 (1978).

70. *Id.* at 1005-06.

71. *Id.* at 1002.

72. See, e.g., *James*, *supra* note 22, at 54 n.45: "A number of participants in the London workshop also felt that the integrity of the body and . . . of tangible property are entitled to a higher priority in the scale of man's proper value than the integrity of intangible wealth."

73. See, e.g., *Union Oil Co. v. Oppen*, 501 F.2d 558, 563 (9th Cir. 1974); *The Federal No. 2*, 21 F.2d 313 (2d Cir. 1927); *Byrd v. English*, 117 Ga. 191, 43 S.E. 419 (1903); *Chelsea*

or that the damages were not proximately caused⁷⁴ or that they were too remote.⁷⁵ Such explanations, of course, do little more than beg the question.

The notion that economic interests are not worthy of protection may reflect a rather different idea—not that economic injuries are not of sufficient concern to merit redress, but rather that some conduct should be protected despite the fact that it causes economic harm. For example, if *A* opens a business and competes with *B*, this may have a detrimental impact on *B*'s business prospects, but *A*'s conduct is not actionable.⁷⁶ It is not that the damage to *B* is not important, but that the social utility of *A*'s activity is deemed to outweigh the impact on *B*. Consequently, even conduct which intentionally⁷⁷ interferes with the economic interests of others is actionable only when "improper."⁷⁸ This concern may not have much applicability to negligent infliction of economic harm, however, because negligent conduct, almost by definition, lacks the social utility to merit protection.

Perhaps the most satisfactory explanation for the reluctance to permit recovery for negligent infliction of economic harm is what Professor James has called the pragmatic objection to liability.⁷⁹ Professor James noted that as a practical matter the physical consequences of negligence are usually

Moving & Trucking Co. v. Ross Towboat Co., 280 Mass. 282, 182 N.E. 477 (1932); Brink v. Wabash R.R., 160 Mo. 87, 60 S.W. 1058 (1901); Mandal v. Hoffman Constr. Co., 527 P.2d 387 (Or. 1974).

74. See, e.g., Union Oil Co. v. Oppen, 501 F.2d 558, 563 (9th Cir. 1974); The Federal No. 2, 21 F.2d 313 (2d Cir. 1927); Byrd v. English, 117 Ga. 191, 43 S.E. 419 (1903); Chelsea Moving & Trucking Co. v. Ross Towboat Co., 280 Mass. 282, 182 N.E. 144 (1932); Rickards v. Sun Oil Co., 23 N.J. Misc. 89, 41 A.2d 267 (1945); La Societe Anonyme de Remorquage a Helice v. Bennets [1911] 1 K.B. 243 (1910).

75. See, e.g., Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303 (1927); Union Oil Co. v. Oppen, 501 F.2d 558, 563 (9th Cir. 1974); Sinram v. Penn. Ry., 61 F.2d 767 (2d Cir. 1932); Cain v. Vollmer, 19 Idaho 163, 112 P. 686 (1910); Anthony v. Slaid, 52 Mass. (11 Met.) 290 (1846); Northern States Contracting Co. v. Oakes, 191 Minn. 88, 253 N.W. 371 (1934); Brink v. Wabash R.R., 160 Mo. 87, 60 S.W. 1058 (1901); Dunlop Tire & Rubber Corp. v. FMC Corp., 53 A.D.2d 1250, 385 N.Y.S.2d 971 (1976).

76. See RESTATEMENT (SECOND) OF TORTS § 768 illustration 1 (1979).

77. In the example just given, *A*'s conduct might be said to be intentional, not in the sense that *A*'s primary purpose was to interfere with *B*'s business prospects, but rather in the sense that, although the interference was incidental to *A*'s primary purpose, it was known by *A* to be a necessary consequence of his actions. See *id.* § 766 comment j.

78. See *id.* §§ 766, 767. See generally PROSSER, *supra* note 1, at 982-89. Two recent articles have suggested that the tort of interference with contract or other economic relations be even more narrowly restricted to cases in which the defendant's acts are independently unlawful. Dobbs, *Tortious Interference with Contractual Relationships*, 34 ARK. L. REV. 335 (1980); Perlman, *Interference with Contracts and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 61 (1982). Professor Perlman notes particularly that current tort doctrine sometimes imposes liability for interference with contract on the basis that the intent or the result of a defendant's conduct was to disrupt a particular contractual relationship, even where the defendant's actions were otherwise lawful. Professor Perlman suggests that such liability is somewhat inconsistent with an economic system based on competition, and moreover, is inconsistent with the objective of efficiency which is promoted by the general scheme of contract remedies. *Id.* at 78-91.

79. James, *supra* note 22.

limited, but that "the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended."⁸⁰ The physical consequences of an automobile accident, for example, are necessarily restricted to persons and property within some limited physical proximity. However, no such inherent limitation exists with respect to the economic consequences. Instead, the physical injuries suffered by the initial victims could set off a chain reaction of economic repercussions extending to an unlimited number of parties. As a result, liability for the economic consequences of negligence raises the fear of "liability in an indeterminate amount for an indeterminate time to an indeterminate class."⁸¹

The pragmatic concern with such open-ended liability is, of course, that it could unduly inhibit useful activity.⁸² To the extent that such liability would inhibit negligent conduct, it would be desirable. However, the problem is that because the line between negligent and non-negligent conduct is not a clear one, there would be a substantial chilling effect on non-negligent conduct as well.⁸³

80. *Id.* at 45. The existence of inherent limitations to the extent of physical damages and the lack of any such inherent limitations with respect to the extent of economic damages has been noted by others. See Perlman, *supra* note 63, at 71-72; Comment, *Foreseeability of Third Party Economic Injuries—A Problem in Analysis*, 20 U. CHI. L. REV. 283 (1953).

81. *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931). The fear of unpredictable liability has been a constant theme in judicial decisions and commentary dealing with problems of economic loss. See, e.g., *Louisiana ex rel. Guste v. M/V Testbank*, 752 F.2d 1019, 1028-29 (5th Cir. 1985); *Isbrandtsun Co. v. Local 1291*, 204 F.2d 495, 498 (3d Cir. 1943); *Darmour Prods. Corp. v. Herbert M. Baruch Corp.*, 135 Cal. App. 351, 27 P.2d 664 (1933); *Connecticut Mut. Life Ins. Co. v. New York & N.H. Ry.*, 25 Conn. 265, 275 (1856); *Byrd v. English*, 117 Ga. 191, 43 S.E. 419 (1903); *Economy Auto Ins. Co. v. Brown*, 334 Ill. App. 579, 79 N.E.2d 854 (1948); *Weller & Co. v. Foot & Mouth Disease Research Inst.* [1966] 1 Q.B. 569, 577; *Cattle v. Stockton Waterworks Co.*, [1875] 10 L.R.-Q.B. 453, 457; see also *Union Oil Co. v. Oppen*, 501 F.2d 558, 563 (9th Cir. 1974).

For commentary that discusses this justification, see FLEMING, *THE LAW OF TORTS* 182-84 (1957); James, *supra* note 22, at 45; Comment, *Negligent Interference with Economic Expectancy: A Case for Recovery*, 16 STAN. L. REV. 664, 679 (1964); Comment, *Liability for Negligent Interference with Contract Relations*, 23 CAL. L. REV. 420, 427 (1935); Comment, *Foreseeability of Third-Party Economic Injuries—A Problem in Analysis*, 20 U. CHI. L. REV. 283, 286, 295 n.71, 298 (1953).

82. See, e.g., *Just's, Inc. v. Arrington Constr. Co.*, 99 Idaho 462, 470, 583 P.2d 997, 1005 (1978) ("the common underlying pragmatic consideration is that a contrary rule, which would allow compensation for losses of economic advantage caused by the defendant's negligence, would impose too heavy and unpredictable a burden on the defendant's conduct"); see also RESTATEMENT (SECOND) OF TORTS § 766C comment a (Tent. Draft No. 23, 1977) ("the fear of an undue burden upon the defendant's freedom of action" is one of the factors that have led courts to refuse protection against negligent interference with economic interests).

83. See Perlman, *supra* note 63, at 70-71. The author also makes the point that the chilling effect problem takes on an added significance where, as is often the case, the conduct causing economic loss consists of expression. *Id.* at 74; see also *New York Times v. Sullivan*, 376 U.S. 254, 279-80 (1964).

Courts have responded to these fears by formulating rules excluding liability in whole classes of cases involving economic loss,⁸⁴ thereby avoiding the case by case analysis applicable in cases of physical injury.⁸⁵ Formulation of these rules in terms of economic loss, however, appears merely to reflect the fact that the economic consequences of negligence are often more widespread than the physical consequences.⁸⁶ In circumstances where that generalization does not hold true, courts often react differently. In cases in which the physical consequences of negligence are more widespread, such as mass fire cases, courts have reacted as they have in the economic loss cases and employed restrictive rules of liability.⁸⁷ Conversely, in cases in

84. See *supra* note 22.

85. These rules also serve institutional needs of the courts. The potential for economic loss to occur in a chain reaction with more and more victims being brought into the fray makes it difficult for courts to articulate any sensible stopping point for liability. Courts want rules that can be applied consistently and articulated sensibly to guide future cases to avoid the appearance of arbitrariness. See Perlman, *supra* note 63, at 71.

The Court of Appeals for the Fifth Circuit in Louisiana *ex rel. Guste v. M/V Testbank*, 752 F.2d 1019, 1028-29 (5th Cir. 1985), in denying recovery for economic losses emphasized that:

Those who would delete the requirement of physical damage have no rule or principle to substitute. Their approach fails to recognize limits upon the adjudicating ability of courts. We do not mean just the ability to supply a judgment; prerequisite to this adjudicatory function are preexisting rules, whether the creature of courts or legislatures. Courts can decide cases without preexisting normative guidance but the result becomes less judicial and more the product of managerial, legislative or negotiated function. . . . The point is not that such a process cannot be administered but rather that its judgments would be much less the products of determinable rule of law. In this important sense, the resulting decisions would be judicial only in their draw upon judicial resources.

86. A similar observation is made by Judge Wisdom in his dissent in *Testbank*, 752 F.2d at 1044. See also James, *supra* note 22, at 50-51 where he says "all this suggests that the prevailing distinction between indirect economic loss and physical damage is probably a crude and unreliable one that may need reexamination if a limitation on liability for pragmatic reasons is to be retained."

87. See James, *supra* note 22, at 50. Some courts have imposed specialized rules to limit liability. In New York, for example, the rule in fire cases is that a negligent tortfeasor's liability extends only to the fire and damage of the structure nearest (adjacent) to the property where the fire first broke out. See PROSSER, *supra* note 1, at 282-83 & cases cited n.18. Prosser notes that the rule has been relaxed a little in recent cases, *id.* at n.18, but nevertheless New York still stands out as the only jurisdiction that employs a more specialized rule in fire cases to limit liability.

Another area where the courts have been quick to restrict liability are cases involving a water company which contracts with a city to supply water to the public, but fails to do so when it is needed, and a private citizen's house is destroyed by fire. In *H.R. Moch Co. v. Rensselaer Water Co.*, 247 N.Y. 160, 159 N.E. 896 (1928), Chief Justice Cardozo of the New York Court of Appeals observed that:

liability would be unduly and indeed indefinitely extended by this enlargement of the zone of duty. . . . Everyone making a promise having the quality of a contract will be under a duty to the promisee by virtue of the promise, but [will also be] under another duty, apart from contract, to an indefinite number of potential

which courts have been able to articulate manageable limits for liability, they have been willing to impose liability even for purely economic loss.⁸⁸

beneficiaries when performance has begun. The assumption of one relation will mean the involuntary assumption of a series of new relations, inescapably hooked together. Again we may say in the words of the Supreme Court of the United States, "The law does not spread its protection so far."

Id. at 168, 159 N.E. at 899 (quoting *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303, 309 (1927)).

According to Prosser, similar rules of nonliability have been applied in cases involving interruption of gas or electricity:

But the imposition of tort liability on those who must render continuous service of this kind . . . could be ruinous and the expense of litigating and settling claims over the issue of whether or not there was negligence could be a greater burden to the rate payer than can be socially justified. This is the more important question.

PROSSER, *supra* note 1, at 671.

Congress has also addressed the problem of indefinite and excessive liability through various legislation. The Price Anderson Act, 42 U.S.C. §§ 2210-22 (1982), for example, was enacted "to assure that funds are available to pay liability claims in the event of a catastrophic nuclear accident, and . . . to protect the nuclear industry against unlimited liability if such an event were to occur." S. REP. NO. 454, 94th Cong., 1st Sess. 1 (1975). The statutory provisions allow a plaintiff to recover under a strict liability theory only in the event of a statutorily defined "extraordinary nuclear occurrence." Other nuclear accidents, however, that do not rise to the level of an "extraordinary nuclear occurrence" require a suit under common law tort or other applicable state law in order to obtain recovery. As one commentator describes it, the Price Anderson Act

adopts a restrictive approach toward compensation. The mandatory waiver provisions only apply in the event of an 'extraordinary nuclear occurrence.' In the absence of such an event plaintiffs are forced to sue under the common law. The difficulties attendant in maintaining such actions have been widely noted. Among these difficulties are requirements related to showing cause in fact, proximate cause, compensable injuries and timeliness of suit.

Trauberman, *Compensating Victims of Toxic Substances*, 5 HARV. ENVTL. L. REV. 1, 14 (1981).

Another commentator on a related problem, exposure to low level radiation, has argued that the courts ought to employ a more rigid test of proximate cause (and/or a higher standard of care) in order to limit liability for low level radiation injuries, liability which in his view might spread too far under current judicial standards. Keys & Howarth, *Approaches to Liability for Remote Causes: The Low Level Radiation Example*, 56 IOWA L. REV. 531, 547-48 (1971). The Limitation of Liability Act, 46 U.S.C. §§ 181-89 (1982) limits the liability of the owner of any vessel to "the amount or value of the interest of [the] owner in [the] vessel, and her freight then pending," if the damage is incurred "without the privity or knowledge of [the] owner or owners." *Id.* § 183(a). As one commentator remarked,

The Limitation Act extends to tort claims for damages to shorebased property, and applies even where the tort is non-maritime in nature. While the statute is neutral on its face, it is now well established by judicial interpretation that the value of the vessel is determined after the loss rather than at the commencement of the voyage. Moreover, insurance proceeds carried by the owner are not recoverable by the claimant. Thus, when a tanker carrying millions of gallons of oil runs aground or collides with another vessel, discharges its cargo into the ocean, and then sinks, the value of the ship is reduced to zero, and under the Limitation Act plaintiffs will be unable to obtain any monetary recovery.

Comment, *Private Action for Damages Resulting from Offshore Oil Pollution*, 2 COLUM. J. ENVTL. LAW 140, 148 (1975).

88. This observation has been made by others. See James, *supra* note 22, at 50, where he

Indeed, each of the groups of cases discussed above, in which courts do impose liability for negligent infliction of economic harm, is defined in such a way to confine liability within manageable limits by limiting the class of potential plaintiffs. One exception operates in favor only of plaintiffs having a special relationship to the defendant,⁸⁹ another in favor only of plaintiffs having a special relationship to the initial victim of the defendant's negligence.⁹⁰ Another restricts liability for public nuisance to those plaintiffs who suffer particular damage as opposed to that suffered by the community in general.⁹¹ Still another exception operates in favor only of plaintiffs who suffer physical damage as well as economic loss, thus tying recovery of economic loss to the usually less open-ended chain of physical causation.⁹² These limitations all serve to diminish or eliminate the problem of open-ended liability and thus provide functional substitutes for the limitations inherent in physical damage cases.⁹³

states: "On the other hand, there are some situations in which economic loss—or at least a given type of economic loss—indirectly caused by negligence is not only foreseeable, but also just as limited as the physical consequences would be. To a certain extent the present law accommodates these facts." (citations omitted); see also Perlman, *supra* note 63, at 73-75; Comment, *Negligent Interference with Economic Expectancy: The Case for Recovery*, 16 STAN. L. REV. 664, 691 (1964).

89. See *supra* notes 37-58 and accompanying text. The special relationship cases tend to limit liability to only those plaintiffs with whom the defendant was in privity of contract, or who could recover anyway on a third party beneficiary theory, or who were specifically foreseen rather than merely foreseeable.

90. See *supra* notes 59-63 and accompanying text. These cases tend to be limited to recovery by family members of the initial victims. See Perlman, *supra* note 63, at 73.

91. See *supra* notes 64-66 and accompanying text. The number of parties suffering similar damage (i.e.—the number of potential plaintiffs) is sometimes an explicit consideration in deciding whether a particular party can recover. See, e.g., *Stop & Shop Co. v. Fisher*, 387 Mass. 889, 897, 444 N.E.2d 368, 373 (1983):

The plaintiff must suffer special pecuniary harm from the loss of access. Severe pecuniary loss is usually a special type of harm, but if a whole community suffers such loss, then it becomes a public wrong and the plaintiff cannot recover. . . .

Thus, the question becomes whether so many businesses have suffered the same economic harm that the plaintiff's damages are no longer special.

Id. (citations omitted); see also RESTATEMENT (SECOND) OF TORTS § 821C comment h (1979); Prosser, *Private Action for Public Nuisance*, 52 VA. L. REV. 997, 1013-16 (1966).

92. See *supra* notes 35-36 and accompanying text; see also Comment, *supra* note 88, at 691.

93. Prosser notes that the exceptions for cases in which the plaintiff suffers some physical injury in addition to an economic loss and for cases in which a private plaintiff is permitted to recover for damages resulting from a public nuisance may be explained on the basis that the defendant has committed some independent tort. PROSSER, *supra* note 1, at 997. See *supra* note 64. In other words, although there is no general duty to avoid injury to economic interests, when such damage results from breach of some other duty it is recoverable. However, to some extent this explanation begs the question because it does not explain why, in view of the lack of any general duty to avoid economic injury to others, such injury should be a compensable item of damage when it happens to occur as a result of a breach of a duty to avoid injury to some other interest. Thus, the fact that limitation of recovery of economic loss to cases in which there is an independent tort limits the class of potential plaintiffs provides a more satisfactory explanation for the recoverability of economic loss as parasitic damages in such cases.

The doctrines of subrogation and third party beneficiaries, which sometimes serve to circumvent the rules restricting recovery of economic loss in tort,⁹⁴ also serve to restrict liability. Under the *Restatement (Second) of Contracts*, liability to third party beneficiaries is limited to "intended beneficiaries" and does not extend to "incidental beneficiaries."⁹⁵ In subrogation, the plaintiff is subrogated to the rights of another.⁹⁶ Such cases involve only one loss and the question is simply whether the plaintiff or the original victim should be the one to recover.⁹⁷ Thus, subrogation cases do not raise any potential for liability to an unlimited class of plaintiffs.

Although recovery of economic loss has generally been limited to circumstances in which the potential for open-ended liability can be avoided, there are a few recent cases that suggest a more relaxed judicial attitude toward the problem of indefinite liability, or at least a greater willingness to deal with it on a case by case basis. A number of courts, as already noted, have held accountants liable for losses suffered by third parties in reliance on negligently prepared financial statements.⁹⁸ For the most part, however, such liability has been extended only to third parties whose losses were not only foreseeable, but actually foreseen.⁹⁹ This restriction serves to avoid problems of indefinite liability. However, in two recent cases, *Rosenblum v. Adler*¹⁰⁰ and *Citizens State Bank v. Timm, Schmidt & Co.*,¹⁰¹ the New Jersey and Wisconsin Supreme Courts respectively refused to restrict liability to specifically foreseen plaintiffs, holding instead that liability should extend to virtually all foreseeable plaintiffs.¹⁰² The Wisconsin court stated specifically that liability of accountants for economic loss suffered by third parties should be governed by the general principles of Wisconsin negligence law according to which a tortfeasor is fully liable for all foreseeable consequences of his negligence, unless under the facts of a particular case liability is denied on grounds of public policy.¹⁰³ Among the factors mentioned by the court to be considered on a case by case basis as matters of public policy were whether the injury is wholly out of proportion to the culpability of the defendant; whether allowance of recovery would place too unreasonable a

94. See *supra* notes 67-71 and accompanying text.

95. RESTATEMENT (SECOND) OF CONTRACTS §§ 302, 304 (1981).

96. See *supra* notes 67, 68; PROSSER, *supra* note 1, at 999. See generally D. DOBBS, REMEDIES § 4.3, at 250-52 (1973); F. DOBbyn, INSURANCE LAW IN A NUTSHELL 227-45 (1981); R. KEETON, INSURANCE LAW BASIC TEXT 147-68 (1971); 4 G. PALMER, LAW OF RESTITUTION 345-76 (1978); I.M. TAYLOR, THE LAW OF INSURANCE 21-22 (1983).

97. PROSSER, *supra* note 1, at 999.

98. See *supra* note 48.

99. See *supra* note 53.

100. 93 N.J. 324, 461 A.2d 138 (1983).

101. 113 Wis. 2d 376, 335 N.W.2d 361 (1983).

102. *Rosenblum*, 93 N.J. at 348-53, 461 A.2d at 151-53; *Citizens State Bank*, 113 Wis. 2d at 386-87, 335 N.W.2d at 366.

103. *Citizens State Bank*, 113 Wis. 2d at 386-87, 335 N.W.2d at 366.

burden on the defendant; and whether allowance of recovery would enter a field that has no sensible or just stopping point.¹⁰⁴ Thus the problems associated with indeterminate liability are still to be considered, but on a case by case basis.

In an opinion of potentially broader applicability, the California Supreme Court indicated its willingness to deal with problems of indefinite liability on a case by case basis. In *J'Aire Corp. v. Gregory*¹⁰⁵ the defendant negligently failed to complete a construction project in a timely manner thereby forcing the plaintiff, a lessee who operated a restaurant in the premises involved, to remain closed longer than would otherwise have been the case. The trial court sustained a demurrer to plaintiff's claim for lost profits, but the California Supreme Court reversed and held that there was no absolute bar to recovery for negligent interference with prospective economic advantage.¹⁰⁶ The court acknowledged the problems associated with indeterminate liability, but concluded that a case by case consideration of such factors as the foreseeability of the injury and the nexus between the defendant's conduct and the plaintiff's injury, together with ordinary principles of tort law, are fully adequate to limit liability without resort to an absolute rule.¹⁰⁷

Several maritime decisions also point in the same direction. In *In re Kinsman Transit Company*¹⁰⁸ the court, in denying recovery for damages resulting from a blockage of the Buffalo River, rejected any absolute rule prohibiting recovery for negligent interference with contract. Instead, the court chose to apply normal tort principles and concluded that, on the facts of that case, the connection between the defendant's negligence and the plaintiffs' damages was too tenuous to permit recovery.

More recently, in *Union Oil Co. v. Oppen*,¹⁰⁹ the plaintiffs, commercial fishermen, suffered losses as a result of an oil spill which diminished the quantity of aquatic life in the Santa Barbara Channel. The court acknowledged the general rule that negligent interference with prospective economic advantage is not actionable, but nevertheless refused defendants' request for partial summary judgment. In effect the court held that the defendants'

104. *Id.*

105. 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979).

106. *Id.* at 808, 598 P.2d at 65-66, 157 Cal. Rptr. at 412-13. The Court said: "These factors [i.e., those enumerated in the *Biakanja* case, 49 Cal. 2d 647, 320 P.2d 16 (1958)] and ordinary principles of tort law such as proximate cause are fully adequate to limit recovery without the drastic consequences of an absolute rule which bars recovery in all such cases [where economic interests are harmed]. Following these principles, recovery for negligent interference with prospective economic advantage will be limited to instances where the risk of harm is foreseeable and is closely connected with the defendant's conduct, where damages are not wholly speculative and the injury is not part of the plaintiff's ordinary business risk." *Gregory*, 24 Cal. 3d at 808, 598 P.2d at 65-66, 157 Cal. Rptr. at 412-13 (citations omitted).

107. *Id.*

108. 388 F.2d 821 (2d Cir. 1968).

109. 501 F.2d 558 (9th Cir. 1974).

alleged negligent conduct was actionable because plaintiffs' alleged injury was a foreseeable consequence of that conduct, thus applying general principles of negligence law even though plaintiffs' injuries were purely economic.¹¹⁰

On the other hand, the court noted that plaintiffs as commercial fishermen made direct use of the sea in the ordinary course of their business, and carefully stated that it did not mean to open the door to claims by other parties who might have suffered economic losses as a result of the oil spill.¹¹¹ Thus, although the court spoke in terms of foreseeability, the opinion strongly suggests that the court would restrict liability short of the limits of foreseeability, perhaps to those who make direct uses of the sea.¹¹²

Another recent case involving similar facts forced the court to confront the problem of indefinite liability more directly. In *Pruitt v. Allied Chemical Corp.*,¹¹³ the defendants were allegedly responsible for chemical pollution of the James River and the Chesapeake Bay. Plaintiffs included commercial fishermen, seafood wholesalers, retailers, restaurateurs, marina operators, boat owners, tackle and bait shop owners, and others, all of whom claimed that the pollution in some way caused them economic loss. The defendant, relying on *Union Oil Co. v. Oppen*,¹¹⁴ urged the court to limit its liability to those who exploited the Bay directly. The court observed, however, that no sharp distinction existed between those who relied on the Bay directly and those who relied on the Bay only indirectly, but rather that the different groups of plaintiffs depended on the Bay in varying degrees of immediacy.¹¹⁵ Moreover, the court noted that, as one traced the stream of profits flowing

110. *Id.* at 569. "[W]e can not escape the conclusion that under California law the presence of a duty on the part of the defendants in this case would turn substantially on foreseeability. That being the crucial determinant, the question must be asked whether the defendants could reasonably have foreseen that negligently conducted drilling operations might diminish aquatic life and thus injure the business of commercial fishermen. We believe the answer is yes." *Id.* However, the court also hinted at two other possible explanations for its result. The court, citing *Carbone v. Ursich*, 209 F.2d 178 (9th Cir. 1953), noted that recovery for pure economic loss has been recognized in maritime settings. *Union Oil Co.*, 501 F.2d at 567. Also the court recognized that recovery might be proper on the theory that defendant's activities constituted a public nuisance and that plaintiffs had a sufficiently particular injury to be able to bring a private action for recovery. *Id.* at 570. As a result of these suggestions, the basis of the holding in *Union Oil* has been a subject of dispute. Compare the majority opinion in *Louisiana ex rel. Guste v. M/V Testbank*, 752 F.2d 1019 (5th Cir. 1985) which takes the position that the holding in *Union Oil* is based on the historical protection of fishermen's interests under maritime law, *id.* at 1026, with Judge Wisdom's dissent in the same case which points out that, although *Union Oil* extended protection only to commercial fishermen, the court's emphasis was on the factor of foreseeability. *Id.* at 1043 (Wisdom, J., dissenting).

111. 501 F.2d at 570-71.

112. This limitation has been criticized on the basis that the court did not satisfactorily explain any reason for permitting recovery by the plaintiffs and denying it to others. See Perlman, *supra* note 63, at 72 n.64.

113. 523 F. Supp. 975 (E.D. Va. 1981).

114. 501 F.2d 558 (9th Cir. 1974).

115. *Pruitt*, 523 F. Supp. at 978-79.

from the Bay's seafood, the set of potential plaintiffs became almost infinite. Accordingly, the court acknowledged a need to impose some limit upon the defendant's potential liability, but confessed that it had no articulable reason for excluding any particular group of plaintiffs.¹¹⁶ Ultimately the court held that the losses suffered by those who purchased and marketed seafood from commercial fishermen were not actionable, because they were insufficiently direct, but that the losses suffered by commercial fishermen and by boat, tackle and bait shop, and marina owners were actionable. The court described its resolution of the case as "an attempt to tailor justice to the facts of the instant case."¹¹⁷

These cases should not necessarily be taken to indicate a trend. Indeed, in another maritime case involving a chemical spill, the fifth circuit, sitting *en banc*, recently rejected the case by case approach and reaffirmed the rule that there could be no recovery for negligent infliction of economic loss without accompanying physical damage.¹¹⁸

Although the future of the traditional rules precluding liability for negligent infliction of solely economic loss is uncertain, courts have applied them with particular strictness in the products liability area.¹¹⁹ Yet, perhaps ironically, the most persuasive justifications for the general rule—the problems associated with indefinite liability—are conspicuously inapplicable to products cases. Even with respect to remote purchasers, the number of potential plaintiffs who could directly suffer economic losses as a result of a defective product is limited by the number of defective products sold. Thus the absence of any doctrine permitting recovery even by parties who purchase defective products directly from the manufacturer is striking. This is particularly so in view of the exceptions in other cases where the problems of indefinite liability are not present.¹²⁰ Moreover, at least with respect to parties in privity of contract, the rule in products cases contrasts sharply with the rule in cases involving service transactions where courts often impose liability on the basis of the relationship between parties.¹²¹ Although the rule in products cases is consistent in its result with the general rule denying recovery for negligent infliction of economic loss, the policy considerations which justify the general rule are not applicable in the products context, at least in cases

116. *Id.* at 980.

117. *Id.*

118. *Louisiana ex rel. Guste v. M/V Testbank*, 752 F.2d 1019 (5th Cir. 1985). The court, however, was divided. Five judges joined in a dissent authored by Judge Wisdom urging the court to adopt a case by case approach rather than a blanket rule.

119. *See supra* notes 32-34 and accompanying text; *see also infra* notes 122-45 and accompanying text.

120. *See supra* notes 88-93 and accompanying text.

121. *See supra* notes 37-46 and accompanying text; *see also infra* notes 191-204 and accompanying text.

where the parties are in privity of contract. Consequently, justification for the rule in products cases must be sought elsewhere.

II. THE GENERAL RULE—PRODUCTS CASES

The general rule that negligent injury to purely economic interests is not actionable operates to deny liability in products cases perhaps more frequently than in any other kind of case. When a product fails to work properly and causes economic damage to the buyer or user but does not cause any other damage, an overwhelming majority of courts have refused to permit recovery in tort.¹²²

Virtually every discussion of this subject begins with the case of *Seely v. White Motor Co.*¹²³ Ironically, however, *Seely* reaches this question only in dictum. In *Seely* the plaintiff purchased, through a dealer, a truck manufactured by the defendant. The truck proved to be defective in that it had a problem referred to as "galloping." The dealer made numerous attempts to correct the "galloping" but was unsuccessful. In addition, on one occasion, which the trial court found to be an unrelated incident, the brakes failed and the truck overturned.¹²⁴ Sometime after having had the accident damage repaired, the plaintiff refused to make further payments on the truck because the "galloping," problem had never been solved. Thereupon the dealer repossessed and resold the truck. The plaintiff then brought suit against both the dealer and White seeking return of the money he paid on the truck, lost profits resulting from his inability to use the truck during the dealer's unsuccessful attempts to eliminate the "galloping" and the cost of repairing the truck following the accident.¹²⁵

The trial court found that the "galloping" constituted a breach of an express warranty, and on that basis awarded damages to the plaintiff for the money he paid for the truck and for lost profits.¹²⁶ However, the court denied recovery for the costs of repairing the accident damage because the plaintiff failed to prove that the accident was caused by the "galloping."¹²⁷

On appeal, the California Supreme Court affirmed the trial court in a well-known opinion by Justice Traynor.¹²⁸ In the course of that opinion the court considered the applicability of strict tort liability to the case. The court held that the cost of repairing the truck following the accident, although a

122. *See supra* notes 7, 32.

123. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

124. The court found that the plaintiff had not proved that the accident was caused by the galloping. *Id.* at 13, 403 P.2d at 148, 45 Cal. Rptr. at 20.

125. *Id.* at 12-13, 403 P.2d at 147-48, 45 Cal. Rptr. at 19-20.

126. *Id.* at 13, 403 P.2d at 148, 45 Cal. Rptr. at 20.

127. *Id.*

128. *Id.* at 19, 403 P.2d at 152, 45 Cal. Rptr. at 20.

type of damage recoverable in strict tort liability generally,¹²⁹ could not be recovered in that case because there had been no showing that the accident was caused by the defect in the truck.¹³⁰ With respect to the other items of damage, the court held that they could not be recovered in strict tort liability because they were commercial losses rather than personal injury or physical damage to property.¹³¹ In support of this distinction between "tort recovery for physical injuries and warranty recovery for economic loss," the court asserted that "[e]ven in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone."¹³² In the twenty years since the *Seely* decision, this dictum has been cited so frequently to deny tort recovery of economic loss in products cases that it seems almost to be the foundation of the rule.

*Clark v. International Harvester Co.*¹³³ is typical of the recent cases following the *Seely* dictum. In *Clark* the plaintiff, a farmer, purchased through one of the defendant's dealers a tractor manufactured by the defendant. Subsequently, the plaintiff experienced numerous problems with the tractor costing the plaintiff in excess of \$2,000 in repair costs and over \$24,000 in lost profits due to plaintiff's inability to use the tractor.¹³⁴ Plaintiff then brought suit against defendant alleging both breach of warranty and negligent manufacture and design of the tractor. The trial court granted summary judgment dismissing the breach of warranty claim.¹³⁵ On the negligence count,

129. The court stated, "plaintiff contends that, even though the law of warranty governs the economic relations between the parties, the doctrine of strict liability in tort should be extended to govern physical injury to plaintiff's property, as well as personal injury. We agree with this contention. Physical injury to property is so akin to personal injury that there is no reason for distinguishing them." *Id.* at 19, 403 P.2d at 152, 45 Cal. Rptr. at 24 (citations omitted). This was an early statement of what has come to be the prevalent position with respect to strict tort liability. Where courts differ significantly however, is with respect to whether the property damage must be to other property or whether damage to the defective product itself is sufficient. Even where courts permit recovery for damage to the defective product itself, however, there is a further dispute as to whether that damage must occur as the result of a traumatic accident or whether slow deterioration would suffice. *See supra* note 8.

130. *Seely*, 63 Cal. 2d at 19, 403 P.2d at 152, 45 Cal. Rptr. at 24.

131. *Id.* at 18-19, 403 P.2d at 151-52, 45 Cal. Rptr. at 23-24.

132. *Id.* at 18, 403 P.2d at 151, 45 Cal. Rptr. at 23. It has been noted that the authority for this proposition was rather scant at the time Justice Traynor wrote the *Seely* opinion. In Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 STAN. L. REV. 974 (1966), the author states, "[b]ut even calling this [the rule against recovery and negligence for economic loss in products cases] a 'doctrine' overstates it, for the body of law is really found in a New York trial court opinion and in one intermediate California opinion—not the sort of authority Justice Traynor usually accepts without question." *Id.* at 1003. The two cases in question are *Wyatt v. Cadillac Motor Car Div.*, 145 Cal. App. 2d 423, 302 P.2d 665 (1956), *rev'd in part*, *Sabella v. Westler*, 59 Cal. 2d 21, 377 P.2d 899, 27 Cal. Rptr. 689 (1963), and *Trans World Airlines v. Curtiss-Wright Corp.*, 1 Misc. 2d 477, 148 N.Y.S.2d 284 (Sup. Ct. 1955).

133. 99 Idaho 326, 581 P.2d 784 (1978).

134. *Id.* at 331, 581 P.2d at 789.

135. *Id.* at 329, 581 P.2d at 787.

however, the trial court found that plaintiff's damages were "caused by design defect in the value train of the engine and negligent manufacture or assembly in the torque amplifier."¹³⁶ Accordingly, the trial court granted judgment for the plaintiff on the negligence count for more than \$26,000 in damages.¹³⁷

On appeal, the Supreme Court of Idaho reversed the trial court's judgment on both counts and remanded the case for trial on the warranty claim.¹³⁸ With respect to the negligence count, the court noted that plaintiff had not alleged any personal injury or property damage and held that the purchaser of a defective product who had suffered only economic losses could not recover those losses in a negligence action against the manufacturer.¹³⁹ The court observed that

[t]he law of negligence requires the defendant to exercise due care to build a tractor that does not harm person or property. If the defendant fails to exercise such due care it is of course liable for the resulting injury to person or property as well as other losses which naturally follow from that injury. However, the law of negligence does not impose on International Harvester a duty to build a tractor that plows fast enough and breaks down infrequently enough for Clark to make a profit in his custom farming business.¹⁴⁰

In sum, the court held that such losses could be recovered, if at all, only in an action for breach of warranty.

*Moorman Manufacturing Co. v. National Tank Company*¹⁴¹ provides another recent example of a state supreme court adopting a rule against recovery of purely economic loss in negligence in products cases. In *Moorman*, the plaintiff purchased a grain storage tank from the defendant. Approximately ten years after the plaintiff began using the tank it developed a crack.¹⁴² Sometime thereafter the plaintiff brought suit seeking to recover the costs of repairing the tank as well as damages for loss of its use. The plaintiff alleged four theories of recovery: strict tort liability, negligent design, innocent misrepresentation and breach of warranty.¹⁴³ Like the court in *Clark*, the Illinois Supreme Court in *Moorman* held that in the absence of personal injury or property damage, economic losses such as those suffered by *Moorman* could be recovered only under article 2 of the U.C.C. on a theory of breach of warranty.¹⁴⁴

136. *Id.* at 331, 581 P.2d at 789.

137. *Id.*

138. *Id.* at 348, 581 P.2d at 806.

139. *Id.* at 332-36, 348, 581 P.2d at 790-94, 806.

140. *Id.* at 336, 581 P.2d 794.

141. 91 Ill. 2d 69, 435 N.E.2d 443 (1982).

142. *Id.* at 73, 435 N.E.2d at 445.

143. *Id.*

144. *Id.* at 78-81, 88-92, 435 N.E.2d at 447-48, 452-53.

As these cases suggest, most courts, in denying tort recovery for economic loss in products cases, have not focused much attention on the distinction between the tort theories of strict liability and negligence. Instead, courts typically discuss recovery of economic loss in strict liability, and then, without any examination of whether the reasons for denying recovery in strict liability apply also to negligence, simply conclude that there can be no recovery in tort.¹⁴⁵ There are important differences, however, between the tort theories of strict liability and negligence—differences which require separate analyses of the recoverability of economic loss under each theory.

A. *Strict Tort Liability & Economic Loss*

In rejecting extension of strict tort liability to economic loss in *Seely*, Justice Traynor noted that strict liability theory had developed specifically as a response to the difficulties involved in applying warranty theory to physical injuries caused by defective products.¹⁴⁶ He suggested, however, that just as strict liability is better suited to the field of physical injuries, warranty theory is better suited to the field of economic losses.¹⁴⁷ He pointed out that extension of strict liability to economic losses would subject manufacturers and sellers to liability for a product's failure to perform as the buyer wished even when the manufacturer or seller had not agreed or promised that the product would so perform.¹⁴⁸ Moreover, this liability could not be disclaimed.¹⁴⁹ In addition, if a manufacturer of a mass produced defective product were liable for economic loss suffered by one ultimate purchaser, he could be similarly liable for losses suffered by many other purchasers, thus raising the specter of liability for "damages of unknown and unlimited scope."¹⁵⁰

145. See, e.g., *Copiers Typewriters Calculators, Inc. v. Toshiba Corp.*, 576 F. Supp. 312 (D. Md. 1983); *Arrow Leasing Corp. v. Cummins Ariz Diesel*, 136 Ariz. 444, 666 P.2d 544 (1983); *Alfred N. Koplín & Co. v. Chrysler Corp.*, 49 Ill. App. 3d 194, 364 N.E.2d 100 (1977); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159 (Minn. 1981); see also cases cited *supra* notes 6, 7.

146. *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 149, 45 Cal. Rptr. 17 (1965).

147. *Id.* at 16-17, 403 P.2d at 150-51, 45 Cal. Rptr. at 22-23.

148. *Id.* at 16, 403 P.2d at 151, 45 Cal. Rptr. at 23.

149. *Id.* Courts have been generally unreceptive to disclaimers of strict tort liability. See *infra* note 176.

150. *Seely*, 63 Cal. 2d at 16-17, 403 P.2d at 150-51, 45 Cal. Rptr. at 22-23. The court stated: [i]f under these circumstances defendant is strictly liable in tort for the commercial loss suffered by plaintiff, then it would be liable for business losses of other truckers caused by the failure of its trucks to meet the specific needs of their businesses, even though those needs were communicated only to the dealer.

In his dissent, Justice Peters took strong issue with this statement, stating:

[h]ere the majority seem to equate strict liability and the implied warranty of fitness for a particular purpose. . . . No authority is cited for this proposition, and I have found none. So far as I know, no proponent of the concept of

Justice Traynor ultimately concluded that, "[t]he distinction . . . between tort recovery for physical injuries and warranty recovery for economic loss"¹⁵¹ rests on an understanding of what responsibilities are appropriately imposed upon a manufacturer who distributes his products. According to Justice Traynor, and the overwhelming majority of courts which have followed *Seely*, it is appropriate to impose upon a manufacturer responsibility to produce products which are reasonably safe; but it is not appropriate to impose responsibility for the level of performance of a product in a purchaser's business absent agreement by the manufacturer.¹⁵² As subsequent decisions have noted, this distinction reflects the essential difference between tort and contract¹⁵³—that is, the difference between obligations that may appropriately be imposed by law and obligations that may appropriately be imposed only by consent of the party upon whom they are imposed.¹⁵⁴

The notion, that risks relating to parties' economic expectations should be allocated by private agreement rather than imposed as a matter of law, is inherent in two arguments often raised against extending strict liability to economic loss. The first of these arguments is that to permit a purchaser to recover economic damage in strict liability would undermine the bargain

manufacturers' strict liability has ever seriously argued that the manufacturer should be liable for the product's inability to serve specific needs which the buyer communicates only to the retailer, except insofar as those needs conform to what the product is ordinarily expected (by the manufacturer and the consuming public) to do.

Id. at 156 (Peters, J., dissenting).

151. *Id.* at 16, 403 P.2d at 151, 45 Cal. Rptr. at 23.

152. *Id.*

153. In *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854 (W. Va. 1982), the Supreme Court of West Virginia explained:

The difficulty in determining whether to apply strict liability for any type of economic loss results from the tension between the tort doctrine of strict liability and contract theory embodied in the Uniform Commercial Code.

. . . .

This delineation between damage resulting from physical injury and that resulting from purchase of unsatisfactory products is in line with the general boundaries of tort and contract theory. Tort law traditionally has been concerned with compensating for physical injury to person or property. Contract law has been concerned with the promises parties place upon themselves by mutual obligation. Physical harm to the defective products belongs with tort principles; reduction in value merely because of the product flaw falls into contract law.

Id. at 858-59; *see also* *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*, 626 F.2d 280, 284-85 (3d Cir. 1980) (applying Illinois law); *Northern Power & Engineering Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324, 328 (Alaska 1981); *Just's Inc. v. Arrington Constr. Co.*, 99 Idaho 462, 468, 583 P.2d 997, 1003 (1978); *Moorman Mfg. Co.*, 91 Ill. 2d 69, 86-87, 435 N.E.2d 443, 450-51 (1982); *Alfred N. Koplín & Co.*, 49 Ill. App. 3d 194, 198, 364 N.E.2d 100, 103 (1977).

154. *See supra* notes 1, 153. This concept is perhaps reflected in the Uniform Commercial Code itself. U.C.C. § 2-719(3) (1978) states that it is prima facie unconscionable to exclude liability for consequential damages consisting of personal injury but that it is not prima facie unconscionable to exclude liability for consequential damages where the loss is commercial.

of the parties.¹⁵⁵ Commercial losses are, of course, recoverable under a theory of breach of warranty where there is an applicable warranty.¹⁵⁶ If the buyer did not obtain warranty protection in the contract, however, allowing him to recover in tort gives the buyer rights which he gave up in the contract. In essence the argument is that to permit recovery of economic loss in strict liability when the contract could not allow for recovery of the same loss in warranty lets the buyer have his cake and eat it too.

The second argument is that to extend strict tort liability to economic loss is inconsistent with the scheme of article 2 of the U.C.C.¹⁵⁷ Article 2 gives

155. See, e.g., *Moorman Mfg. Co.*, 91 Ill. 2d at 78, 435 N.E.2d at 447; *Fireman's Fund Am. Ins. Cos. v. Burns Elec. Sec. Serv.*, 93 Ill. App. 3d 298, 300-01, 417 N.E.2d 131, 133-34 (1981); *Alfred N. Koplín & Co.*, 49 Ill. App. 3d at 203-04, 364 N.E.2d at 107; *Superwood Corp.*, 311 N.W.2d 159, 161-62 (Minn. 1981); *Mid Continent Aircraft Corp. v. Curry County Spraying Serv.*, 572 S.W.2d 308, 312 (Tex. 1978).

156. U.C.C. §§ 2-714, 2-715 (1978). The former deals with the measure of damages for breach of warranty, §§ 2-714(2), (3), and the latter deals with recovering incidental and consequential damages. See J. WHITE & R. SUMMERS, *supra* note 12, at 375-97.

157. In *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976), the Alaska Supreme Court observed:

Under the Uniform Commercial Code the manufacturer is given the right to avail himself of certain affirmative defenses which can minimize his liability for a purely economic loss. Specifically, the manufacturer has the opportunity . . . to disclaim liability and . . . limit the consumer's remedies. . . . In addition, the manufacturer is entitled to reasonably prompt notice from the consumer to the claimed breach of warranties

In our view, recognition of the doctrine of strict liability in tort for economic loss would seriously jeopardize the continued viability of these rights. The economically injured consumer would have a theory of redress not envisioned by our legislature when it enacted the U.C.C., since this strict liability remedy would be completely unrestrained by disclaimer, liability limitation and notice provisions. Further, manufacturers could no longer look to the Uniform Commercial Code provisions to provide a predictable definition of potential liability for direct economic loss.

Id. at 285-86; see also *Jones & Laughlin Steel Corp.*, 626 F.2d at 289; *Moorman Mfg. Co.*, 91 Ill. 2d at 78, 435 N.E.2d at 447; *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 787, 332 N.W.2d 39, 44 (1983); *Star Furniture Co.*, 297 S.E.2d 854, 859-60. The court in *Clark*, 99 Idaho at 335, 581 P.2d at 793, made a similar observation in a negligence action for recovery of pure economic loss.

Various commentators have said much the same thing. Professor Franklin, for example, in his article, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, *supra* note 132, at 989-90, vigorously criticized the lack of judicial awareness of the scope of sales law in defective-product cases:

It is striking that those who would use tort law to protect consumers in defective-product cases do so with only the most cursory explicit recognition that there may already be a body of law directed toward regulating the rights of buyers and sellers, and a statutory body at that. The courts are operating at the border of an area considered by draftsmen at great length and framed in legislation arguably irrelevant to the cases before the courts. Yet, these judges appear either unaware of the merging of the tort and sales lines or else unwilling to consider the possible limitations legislation may impose on traditional judicial primacy in tort law.

....

At best, we have judicial lack of awareness of the possible relevance of

detailed treatment to the subject of sellers' liability for economic loss stemming from a product's failure to work properly. Several sections deal with the creation of express and implied warranties.¹⁵⁸ Article 2, however, explicitly permits a seller to disclaim warranties.¹⁵⁹ Even where a seller does give a warranty, article 2 permits the seller to exclude liability for consequential damages¹⁶⁰ (other than personal injury) or limit the available remedies.¹⁶¹ The argument is that a rule which would automatically permit recovery of economic losses under a theory of strict tort liability would frustrate this carefully drafted scheme of article 2 which clearly envisions the possibility that a seller would not be liable for such losses where warranties are not given or where liability for consequential damages is excluded. Implicit in this argument is the notion that because article 2 is statutory, courts are not free to disregard or frustrate it by judicial adoption of other rules inconsistent with it.

In sum, three separate, but related, arguments against extending strict tort liability to economic loss can be identified. First is the notion that contract law rather than tort law should govern the economic expectations of the parties—that is, the risks that those expectations will not be met should be allocated by voluntary agreement rather than imposed upon one party as a matter of law. This is what courts are suggesting when they object that to permit recovery of economic losses in tort would “make the seller a guarantor of his products,”¹⁶² or that recovery in tort would “undermine the bargain of the parties,”¹⁶³ or that “contract, rather than tort, law provides the appropriate set of rules for recovery.”¹⁶⁴ The second objection is the argument that tort recovery would be inconsistent with article 2 of the U.C.C. Here the notion is that, in adopting article 2, the legislature has provided an

sales law. At worst, we have open judicial defiance of apparent statutory commands.

The Delaware Supreme Court has taken the extreme position that the adoption of the Uniform Commercial Code, Article 2 on Sales has entirely preempted any tort remedy in products cases even where there is physical damage or personal injury. *Cline v. Prowler Indus.*, 418 A.2d 968 (Del. 1980). This case is mentioned and discussed in Wade, *Tort Liability for Products Causing Physical Injury and Article 2 of the U.C.C.*, 48 Mo. L. Rev. 1, 3 (1983).

158. U.C.C. §§ 2-313, 2-314, 2-315 (1978).

159. *Id.* § 2-316.

160. *Id.* § 2-719.

161. *Id.* § 2-719(1).

162. See e.g., *Jones & Laughlin Steel Corp.*, 626 F.2d at 289 (“[t]he extension of strict liability to cover economic losses in effect would make a manufacturer the guarantor that all of its products would continue to perform satisfactorily throughout their reasonably productive life”); *Moorman Mfg. Co.*, 91 Ill. 2d at 91, 435 N.E.2d at 453.

163. See *supra* note 155.

164. E.g., *Moorman Mfg. Co.*, 91 Ill. 2d at 86-87, 435 N.E.2d at 451 (“[w]hen the defect is of a qualitative nature and the harm relates to the consumer's expectation that a product is of particular quality so that it is fit for ordinary use, contract, rather than tort, law provides the appropriate set of rules for recovery”); see also *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.2d 1165, 1169, 1172-73 (3d Cir. 1981).

extensive scheme to govern the obligations of the parties to a sales transaction, including the remedies available in the event of product failure, and that courts should not interfere with that scheme by recognizing conflicting remedies in tort. The third notion is that tort recovery for economic loss caused by defective products would subject manufacturers and sellers to unforeseeable and potentially unlimited liability. This article will not attempt to examine the merits of the arguments against extending strict liability to economic loss.¹⁶⁵ Instead, it will argue that, even assuming the validity of these arguments with respect to strict liability, they do not justify a blanket refusal to recognize a cause of action in negligence for economic loss in products cases.

B. *Economic Loss and Negligence in Product Cases*

Only a few cases discuss separately the questions of whether a cause of action for economic loss in products cases should be permitted in strict tort liability and whether such a cause of action should be permitted in negligence. Moreover, the cases that do treat these questions separately generally conclude quickly that the same concerns which lead them to reject strict liability for economic loss also apply to negligence. In *Clark v. International Harvester Co.*,¹⁶⁶ for example, the court dealt specifically with plaintiff's contention that the strict liability precedents were inapplicable to his negligence claim, but rejected the distinction on the basis that permitting a negligence action would be just as inconsistent with the scheme of article 2 as permitting an action in strict liability.¹⁶⁷ Similarly, in *Moorman Manufacturing Co.*,¹⁶⁸ the court noted that "[t]he policy considerations against allowing recovery for solely economic loss in strict liability cases apply to negligence actions as well."¹⁶⁹ Like the court in *Clark*, the *Moorman* court asserted that allowing negligence actions for solely economic losses would be an unwarranted infringement upon the scheme of article 2.¹⁷⁰ In addition, the *Moorman* court suggested that imposition of liability for negligence, like imposition of strict liability, would subject manufacturers to liability of unknown and unlimited scope.¹⁷¹

To the extent courts have considered the issue at all, the arguments raised against permitting a cause of action in negligence have been essentially the same as those raised against extending strict tort liability to economic loss:

165. The vast majority of courts and commentators who have considered the question have declined to apply strict tort liability to economic loss. See *supra* notes 6, 15.

166. 99 Idaho 326, 581 P.2d 784.

167. *Id.* at 336, 581 P.2d at 794.

168. 91 Ill. 2d 69, 435 N.E.2d 443.

169. *Id.* at 86-87, 435 N.E.2d at 451.

170. *Id.* at 90-91, 435 N.E.2d at 452-53.

171. *Id.* at 86-87, 435 N.E.2d at 451-52.

that it would undermine the bargain of the parties,¹⁷² frustrate the scheme of article 2,¹⁷³ and create the potential for indefinite liability.¹⁷⁴ In the context of negligence, however, at least in certain cases, these arguments are much less persuasive than they are in the context of strict liability.¹⁷⁵ This is due in large measure to two important differences between strict tort liability and negligence. First, strict tort liability generally cannot be disclaimed¹⁷⁶ whereas negligence liability can be disclaimed in most situations.¹⁷⁷ Second,

172. See *supra* note 155 and accompanying text.

173. See *supra* note 157 and accompanying text.

174. See, e.g., *Arrington*, 99 Idaho at 470, 583 P.2d at 1005; *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200, 201, 203-04 (Ohio Ct. App. 1946).

175. Nevertheless, the results in *Clark and Moorman Mfg.* may be correct. See *infra* note 211 and accompanying text.

176. Comment m to the RESTATEMENT (SECOND) OF TORTS § 402A (1981), the strict products liability section, states that the liability imposed by § 402A cannot be disclaimed. See also RESTATEMENT (SECOND) OF CONTRACTS § 195(3) (1981). Most courts follow comment m to § 402A, but some have permitted disclaimers of strict tort liability at least in commercial settings where the buyer and seller are large commercial entities who have negotiated their contract on relatively equal footing. See, e.g., *Tokio Marine & Fire Ins. Co. v. McDonnell Douglas Corp.*, 617 F.2d 936 (2d Cir. 1980) (applying California law); *Idaho Power Co. v. Westinghouse Elec. Corp.*, 596 F.2d 924 (9th Cir. 1979) (applying Idaho law); *Keystone Aeronautics Corp. v. R.J. Enstrom Corp.*, 499 F.2d 146 (3d Cir. 1974) (applying Pennsylvania law); *Ebasco Servs., Inc. v. Pennsylvania Power & Light Co.*, 460 F. Supp. 163 (E.D. Pa. 1978) (applying Pennsylvania law); *Salt River Project. Agr. v. Westinghouse Elec. Corp.*, 143 Ariz. 368, 694 P.2d 198 (1984); *K-Lines, Inc. v. Roberts Motor Co.*, 273 Or. 242, 541 P.2d 1378 (1975). See generally Comment, *Contractual Disclaimers of Strict Tort Liability in Oregon*, 18 WILLAMETTE L.J. 631 (1982).

Two California appellate courts and several federal courts applying California law have gone further and held that the doctrine of strict liability is simply inapplicable as between commercial entities who have bargained regarding the risk of loss from product defects. *Airlift Int'l, Inc. v. McDonnell Douglas Corp.*, 685 F.2d 267 (9th Cir. 1982); *S.A. Empresa, Etc. (Varig Airlines) v. Boeing Co.*, 641 F.2d 746 (9th Cir. 1981); *Scandinavian Airlines Sys. v. United Aircraft Corp.*, 601 F.2d 425 (9th Cir. 1979); *International Knights of Wine, Inc. v. Ball Corp.*, 110 Cal. App. 3d 1001, 168 Cal. Rptr. 301 (1980); *Kaiser Steel Corp. v. Westinghouse Elec. Corp.*, 55 Cal. App. 3d 737, 127 Cal. Rptr. 838 (1976); see also *Purvis v. Consolidated Energy Prods. Co.*, 674 F.2d 217 (4th Cir. 1982) (applying South Carolina law and following the approach of the cases already cited). Cf. *Henry Heide, Inc. v. WRH Prods. Co.*, 766 F.2d 105 (3d Cir. 1985) (applying New Jersey law); *Spring Motors Distribs., Inc. v. Ford Motor Co.*, 98 N.J. 555, 589 A.2d 660 (1985) (holding that the doctrine of strict liability is inapplicable as between commercial entities with respect to economic loss, thus limiting *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1964), to noncommercial settings).

177. PROSSER, *supra* note 1, at 482-84; RESTATEMENT (SECOND) OF CONTRACTS § 195 (1981); RESTATEMENT (SECOND) OF TORTS § 496B comments a, b (1981). Comment b to the RESTATEMENT (SECOND) OF TORTS § 496B states:

Likewise they (the plaintiff and defendant) may agree that the defendant shall not be liable for conduct which would otherwise be negligent. . . . Where such an agreement is freely and fairly made, between parties who are in an equal bargaining position, and there is no social interest with which they interfere, it will generally be upheld.

The courts have held with near-unanimity that negligence liability can be disclaimed except when contrary to public policy, as when one of the parties is at such an obvious disadvantage in bargaining power that the contract effectively puts him at the mercy of the other party. PROSSER, *supra* note 1, at 482; see, e.g., *Northwest Airlines, Inc. v. Alaska Airlines, Inc.*, 351 F.2d 253 (9th Cir. 1965); *Dessert Seed Co. v. Drew Farmers Supply, Inc.*, 248 Ark. 858, 454 S.W.2d

strict tort liability, although not absolute liability, is liability without fault.¹⁷⁸ Negligence liability, on the other hand, is fault based.¹⁷⁹

1. Tort v. Contract

One of the principle arguments raised against permitting tort recovery of economic loss in products cases has been that the allocation of risks relating to the parties' expectations should be governed by the rules of contract rather than tort law. To permit a cause of action in tort, it is often argued, would

307 (1970). Even in jurisdictions that have adopted the "general principle . . . that a party may not contract against his own negligence," *Housing Auth. v. Morris*, 244 Ala. 557, 563, 14 So. 2d 527, 531 (1947), exceptions have been made for "agreements that are essentially private covenants in which the public has no interest and the enforcement of which will in no way be injurious to the public." *Alabama Great S. Ry. v. Sumter Plywood*, 359 So. 2d 1140 (Ala. 1978).

Where the courts have not been uniform, however, is in deciding what language would be sufficient to constitute a valid disclaimer of negligence liability. Some courts require that the disclaimer use the word "negligence." *See, e.g., O'Connell v. Walt Disney*, 12 N.Y.2d 301, 189 N.E.2d 693, 239 N.Y.S.2d 337 (1963). Other courts require that the party's intention to contract away negligence liability be expressed in "clear and unequivocal terms." *E.g., Smith v. Seaboard Constr. Line R.R.*, 639 F.2d 1235, 1239 (5th Cir. 1981) (applying Georgia law); *Batson-Cook Co. v. Georgia Marble Setting Co.*, 112 Ga. App. 226, 229-30, 144 S.E.2d 547, 549-50 (1965). The Illinois courts require that it be "clear from the contract that the parties' intent was to shift the risk of loss," and that this would be determined by applying "the accepted rule of interpretation which requires that the agreement be given a fair and reasonable interpretation based upon a consideration of all of its language and provisions." *Rutter v. Arlington Park Jockey Club*, 510 F.2d 1065, 1067 (7th Cir. 1975) (citing *Tatar v. Maxon Constr. Co.*, 54 Ill. 2d 64, 67, 294 N.E.2d 272, 273-74 (1973)). In *Haugen v. Ford Motor Co.*, 219 N.W.2d 462 (N.D. 1974), the supreme court of North Dakota held that a disclaimer of negligence liability would be valid only if the particular alleged negligent conduct was "plainly and precisely" covered by the disclaimer.

178. *Newman v. Utility Trailer & Equip. Co.*, 278 Or. 395, 397-99, 564 P.2d 674, 675-76 (1977); *Berkebile v. Brantly Helicopter Corp.*, 462 Pa. 83, 337 A.2d 893, 902 (1975); *see also* RESTATEMENT (SECOND) OF TORTS § 402A(2)(a) comment a (1979). *But see* Powers, *The Persistence of Fault in Products Liability*, 61 TEX. L. REV. 777 (1983). Powers observes:

While negligence requires a conclusion that the defendant acted inappropriately, strict liability purports to impose liability even if the defendant has behaved appropriately under the circumstances. Although divergent liability theories may use different standards of fault, they remain fault-oriented insofar as they judge the propriety of the defendant's conduct. Strict liability purports to differ from negligence not in the standard by which it judges fault, but by eschewing an evaluation of the defendant's conduct altogether.

Nevertheless courts have never equated strict liability with absolute liability, in which a defendant would be liable merely for causing injury. The distinction between absolute liability and strict products liability is maintained by requiring a plaintiff to prove that the offending product was defective. Proponents of strict products liability have argued that the requirement of defectiveness does not transform it into a fault-based system as long as courts focus their evaluation on the condition of the product rather than on the propriety of the defendant's conduct.

Id. at 778 n.3 (citations omitted).

179. *See generally* PROSSER, *supra* note 1, at 168-73, 608-09; RESTATEMENT (SECOND) OF TORTS § 282 comment f (1979).

undermine the bargain of the parties.¹⁸⁰ There is merit in this argument. Extension of strict tort liability to economic loss caused by defective products would impose the risks of economic loss due to product failure on the manufacturer as a matter of law. To the extent that strict tort liability cannot be disclaimed, any agreement of the parties attempting to absolve the manufacturer of these risks would be unenforceable.¹⁸¹ Thus, imposition of strict tort liability for economic loss is fundamentally inconsistent with a policy committing allocation of the risks of such losses to the process of private agreement.

Recognition of a cause of action in negligence to recover economic losses caused by product failure, however, although a "tort" theory rather than a "contract" theory, would not prevent allocation of these risks through private agreement. It would not impose any risk on the manufacturer as a matter of law. Because negligence liability, unlike strict tort liability, can be disclaimed,¹⁸² recognition of a cause of action in negligence would impose risks upon the manufacturer only in the absence of a contrary agreement.¹⁸³

Whether recognition of a cause of action in negligence would undermine the bargain of the parties thus becomes an issue of contract interpretation. If a contract explicitly provided that the seller or manufacturer would not be liable for economic loss caused by its own negligence, the matter would be clear; imposition of liability would totally vitiate the parties' agreement. A more common and more difficult question arises, however, where the contract makes no reference to negligence but does contain a disclaimer of warranty.¹⁸⁴ In such cases a manufacturer or seller who has carefully bargained for the disclaimer might feel that to permit recovery of economic loss on a tort theory would be to give the buyer the precise advantage he had voluntarily given up in the contract.

Again it is important to distinguish between the tort theories of strict liability and negligence. Warranty liability is liability without fault.¹⁸⁵ In agreeing to forego warranty protection, the buyer has at least given up the

180. See *supra* note 155 and accompanying text.

181. However, some courts have held that strict tort liability may be disclaimed as between commercial entities and some other courts have held that strict liability is not even applicable as between commercial entities. See *supra* note 176.

182. See *supra* note 177.

183. Not only would recognition of a cause of action in negligence impose risks upon the manufacturer only in the absence of a contrary agreement, but also the liability that would be involved would be only liability for negligence as opposed to the liability without fault that would result from an extension of strict liability to cover economic loss.

184. Similar issues may arise if the contract includes other liability-limiting clauses such as an exclusion of consequential damages, limitation of remedy or a liquidated damages clause. See *infra* notes 216-20 and accompanying text.

185. B. CLARK & C. SMITH, *THE LAW OF PRODUCT WARRANTIES* § 12.03(1), (11), at 12-5-8, 12-27-31 (1984); PROSSER, *supra* note 1, at 678, 690; J. WHITE & R. SUMMERS, *supra* note 12, at 271, 286.

opportunity to hold the seller liable irrespective of fault for economic loss resulting from product defects. Because strict tort liability also involves liability without fault it would, if it were extended to economic loss, be a close substitute for warranty protection, and would thus, in effect, nullify the parties' agreement excluding warranty.¹⁸⁶

Allowance of a cause of action in negligence, however, would not necessarily thwart a contractual disclaimer of warranty. Indeed, a disclaimer of warranty would still be important to permit the manufacturer or seller to avoid liability without fault. A manufacturer or seller who gives a warranty can be held liable merely upon a showing that the product does not conform to the warranty.¹⁸⁷ Before a manufacturer or seller could be held liable in negligence, however, the buyer would have to show not only that the product was defective but also that the defect was caused by the manufacturer's or seller's negligence.¹⁸⁸

Thus a disclaimer of warranty is not inherently inconsistent with the existence of negligence liability. Nevertheless, a disclaimer might still be intended, or understood, by the parties as eliminating all liability for economic loss including liability for negligence. Whether a disclaimer should be so interpreted depends on the reasonable expectations of the parties.¹⁸⁹

186. Extension of strict liability to economic loss could present problems even in a jurisdiction which would permit strict tort liability to be disclaimed. *See supra* note 176. If the parties have contracted with respect to the extent of the seller's liability in warranty, that would seem to preempt the field of liability without fault for economic loss resulting from product failure. Accordingly, recognition of a cause of action in strict liability beyond the scope of warranty protection in any particular contract would appear to undermine the bargain of the parties. In other words, an agreement to exclude warranty liability is basically inconsistent with strict tort liability for economic loss.

187. *See* B. CLARK & C. SMITH, *supra* note 185, § 12.03(1), at 12-5-8; B. STONE, *THE UNIFORM COMMERCIAL CODE IN A NUTSHELL* 60-65 (1975); J. WHITE & R. SUMMERS, *supra* note 12, at 360-65.

188. *See* PROSSER, *supra* note 1, at 164-65 (describing the elements of a negligence cause of action).

189. The RESTATEMENT (SECOND) OF CONTRACTS § 201 (1981), entitled *Whose Meaning Prevails*, provides:

- (1) Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning.
- (2) Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made
 - (a) that party did not know of any different meaning attached by the other, and the other knew the meaning attached by the first party; or
 - (b) that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party.
- (3) Except as stated in this Section neither party is bound by the meaning attached by the other, even though the result may be failure of mutual assent.

See also J. CALAMARI & J. PERILO, *THE LAW OF CONTRACTS* 116-23 (2d ed. 1977); 3 A. CORBIN, *CORBIN ON CONTRACTS* § 538 (1960).

Where the seller bargains for a disclaimer of warranty, should the buyer understand that the seller seeks to avoid not only the absolute liability of warranty but also any liability for economic loss due to the seller's own negligence?

In considering this question, it is useful to compare sales transactions with service transactions. In sales cases, courts have generally refused to permit recovery of economic loss in negligence and have limited the buyer to an action for breach of warranty.¹⁹⁰ In service transactions, however, the reverse is often the case. That is, courts may deny recovery for breach of warranty but permit an action in negligence, even to recover purely economic losses.¹⁹¹ Courts have frequently suggested that the entire concept of warranty is foreign to at least some kinds of service contracts.¹⁹² Certainly warranty liability would be inconsistent with the reasonable expectations of the parties in some instances. In many service transactions the obtaining of a successful outcome is inherently uncertain because the ultimate result sought by the party purchasing the services depends on factors in addition to the proper performance of the service in question. A patient may die even though the physician properly performs an operation, or a client may be convicted even though the attorney properly and skillfully defended the case. In such cases it is highly unlikely that the party performing the service intends to, or would even be willing to, "guarantee" the outcome, and consequently it is unreasonable for the party purchasing the service to think that he is receiving a warranty of result.¹⁹³ Consequently, in the absence of an explicit agreement to the contrary, courts are very reluctant to find a warranty of result in many service transactions.

190. See *supra* notes 7, 32.

191. See *infra* note 196.

192. See, e.g., *Audlane Lumber & Builders Supply v. D.E. Britt Assocs.*, 168 So. 2d 333, 335 (Fla. Dist. Ct. App. 1964) ("An engineer, or any other so-called professional, does not 'warrant' his service or the tangible evidence of his skill to be 'merchantable' or 'fit for an intended use.' These are terms uniquely applicable to goods."); *Corceller v. Brooks*, 347 So. 2d 274, 277 (La. Ct. App. 1977) ("[w]arranty or guarantee by an attorney of a particular result of a litigious claim is foreign to the nature of the legal profession"); *Aegis Prod., Inc. v. Arriflex Corp. of Am.*, 25 A.D.2d 639, 639, 238 N.Y.S.2d 185, 187 (1966) ("Warranties are limited to sales of goods. No warranty attaches to the performance of a service.").

Warranties may be applicable, however, in mixed transactions involving goods as well as services. See B. CLARK & C. SMITH, *supra* note 185, § 2.04(2)(b)(iii), at 2-26-29.

193. In *Corceller v. Brooks*, 347 So. 2d 274, 277-78 (La. Ct. App. 1977), the court stated: This is not to say that we cannot conceive that an attorney may guarantee that he will follow a particular course of action or do a specific thing on the client's behalf. However, because the dispute between Corceller and Bonanza involved litigious rights, the attorney for Corceller could not have warranted or guaranteed a result favorable to [the] plaintiff.

The inherent uncertainty of result is not the only factor which might tend to suggest no warranty of result was intended. In addition, where the fee charged for services is unrelated to the importance of the result sought to be achieved and thus also unrelated to the extent of potential liability if a warranty were given, this also supports an inference of no warranty.

On the other hand, numerous cases impose liability in negligence holding that one performing services must do so in a "workmanlike manner" or that he must exercise the degree of care and skill that would be exercised by one who was "reasonably prudent, skilled and qualified" to perform the service.¹⁹⁴ Although warranty liability may be contrary to the reasonable expectations of the parties, negligence liability is often consistent with the parties' reasonable expectations. While it would be generally unreasonable for a patient to assume that a surgeon intended to guarantee that an operation would be a success, it seems perfectly reasonable for a patient to assume that the surgeon was undertaking to properly perform the surgery. The outcome of surgery is not entirely within the control of the surgeon, but it is within the surgeon's control to avoid carelessness in performing surgery, and it is reasonable to expect that the surgeon in agreeing to perform surgery undertakes to do what he can to contribute to a successful result.¹⁹⁵ Whenever one party agrees to perform services for another, a natural inference arises that in agreeing to perform the service one undertakes to perform it in a prudent and careful manner.

Liability for negligent failure to perform services in a "workmanlike manner" has not been confined to cases involving physical damage. To the contrary, courts have imposed such liability in a variety of contexts involving

194.

Those who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct. In other words, unless the parties have contractually bound themselves to a higher standard of performance, reasonable care and competence owed generally by practitioners in the particular trade or profession defines the limits of an injured party's justifiable demands.

Milau Assocs. v. North Ave. Dev. Corp., 42 N.Y.2d 482, 486, 398 N.Y.S.2d 882, 884, 368 N.E.2d 1247, 1250 (1977); see also Consolidated Edison Co. v. Westinghouse Elec. Corp., 567 F. Supp. 358 (S.D.N.Y. 1983) (holding that while the plaintiff utility company's claims of defective equipment and improper operating instructions did not state a cause of action in negligence, the plaintiff did have a negligence action under New York Law for negligent performance of contractual duties and for alleged concealment by defendant of data showing that problems had developed with the steam generator for the nuclear power plant); Gagne v. Bertran, 42 Cal. 2d 481, 489, 275 P.2d 15, 21 (1954) ("The services of experts are sought because of their special skill. They have a duty to exercise the ordinary skill and competence of members of their profession, and a failure to discharge the duty will subject them to liability for negligence."); Strong v. Retail Credit Co., 38 Colo. App. 125, 552 P.2d 1025 (1976) (preparation of a defective credit report by credit bureau should be governed by negligence principles and not the U.C.C.); D.E. Britts Assocs., 168 So.2d 333 (Fla. Dist. Ct. App. 1964) (a professional, such as an engineer or architect, owes a duty to exercise his skills reasonably and without neglect, and breach of this duty subjects him to negligence liability); Jones v. Clark, 36 N.C. App. 327, 244 S.E.2d 183 (1978) (testing laboratory that gave mobile home a seal of approval subject to negligence standard to measure the quality of its inspection services); PROSSER, *supra* note 1, at 185-86, 658-64.

195. See generally PROSSER, *supra* note 1, at 186-93. Professionals such as physicians are held to a "higher" standard of care in that they are required to perform in accordance with accepted medical practice. *Id.* at 187.

only economic loss.¹⁹⁶ The most common examples involve negligence on the part of accountants,¹⁹⁷ architects,¹⁹⁸ attorneys,¹⁹⁹ engineers²⁰⁰ and other professionals.²⁰¹ In addition, the *Restatement (Second) of Torts* § 552 imposes similar liability for economic loss resulting from negligent provision of erroneous information upon anyone who in the course of his business provides information for the guidance of others in their business affairs.²⁰² Courts have occasionally imposed liability for economic loss due to negligent performances of contractual duties in other circumstances as well.²⁰³ The point is that courts have long recognized, in the context of service transactions, that liability in negligence for economic loss is not necessarily inconsistent with the absence of warranty liability for the same loss.²⁰⁴

196. "Moreover, a suit for negligent performance of contractual duties is clearly available even where only economic injury is alleged." *Consolidated Edison Co.*, 567 F. Supp. 358, 364 (S.D.N.Y. 1983); see *infra* notes 197-203.

197. See *supra* note 40.

198. See *supra* note 42.

199. See *supra* note 41.

200. See *supra* note 43.

201. See *supra* note 44.

202. See *supra* note 45. Quite a number of courts have allowed even third parties not in privity with the person who negligently supplied information to recover for economic losses in negligence. See cases cited *supra* note 48.

203. For example, in *DCR, Inc. v. Peak Alarm Co.*, 663 P.2d 433 (Utah 1983), the plaintiff, a clothing store owner, contracted with defendant alarm company for the purchase, installation and maintenance of a burglar alarm system in plaintiff's store. The contract contained a clause limiting damages to \$50.00 in the event of breach. Some time later the store was burglarized and \$50,000.00 was taken. Plaintiff then discovered that the burglars had bypassed the alarm using a simple deactivating technique well-known to criminals, and that the defendant knew of the technique and of the inexpensive way to protect against it. The plaintiff sued on negligence, breach of contract, and product liability theories. The Utah Supreme Court characterized the transaction as a service transaction, and held that: (1) the negligence action existed independently of the contract claims, the alleged negligent conduct being a breach of the duty to warn; (2) since the alleged negligent conduct was an omission or nonfeasance, a special relationship must exist between the parties, and here it did by virtue of the service contract between plaintiff and defendant; and (3) the liquidated damages clause did not operate to limit noncontractual liability as it did not clearly and unequivocally express intent to do so. *Id.* at 434-38. Another case, *Bunch v. South Central Bell Tel. Co.*, 356 So. 2d 104 (La. Ct. App. 1978), involved a negligence action against a telephone company to recover lost profits and increased expenses allegedly resulting from defendant's negligence in incorrectly listing the telephone number of plaintiff's business competitor as the telephone number of plaintiff's business. There the court approved of the negligence action without discussion of the economic loss issue and held that the contractual disclaimer of liability between the parties (limiting damages to an abatement of charges) did not operate to disclaim negligence liability. See also *Consolidated Edison Co.*, 567 F. Supp. 358, 363-66 (S.D.N.Y. 1983) (plaintiff utility company's claims concerning alleged concealment by defendant of data showing problems with steam generators in nuclear power plant that defendant agreed to furnish and construct stated a cause of action in negligence, as did their separate claim for negligent performance of contractual services). However, contractual limitations on liability may apply to the tort action. See *infra* note 220.

204. There has been some recognition of this in products cases as well. "Limiting contractual language and limitless liability predicated upon negligence can coexist in situations such as this one, and this duality can only be forewarned by language which will bear no interpretation other

Of course a simple sales contract is very different from a contract for services. When a retail merchant sells an item over the counter to a purchaser the item is either defective or it is not. If the seller is to be liable in the event that the item is defective, his liability almost has to be liability without fault because there is virtually no conduct on the seller's part which could have anything to do with the item's being defective. Consequently, a disclaimer of warranty would seem to eliminate any reasonable expectation on the part of the buyer that the seller will be liable if the item is defective. Just as the concept of warranty is foreign to some service contracts, so the concept of negligence is foreign to a simple sales contract.

Many sales contracts, however, involve more than the simple over the counter retail sales. Specifically, many "sales" transactions involve services as well as goods. A beautician may not only sell but may also apply a beauty treatment.²⁰⁵ Similarly a contractor may install as well as sell a swimming pool.²⁰⁶ Courts commonly treat such "mixed transactions" as sales.²⁰⁷ The

than that the seller shall not be held responsible for his own negligent wrongdoing." *Jig the Third Corp. v. Puritan Marine Ins. Underwriters Corp.*, 519 F.2d 171, 178-79 (5th Cir. 1975), *cert. denied*, 424 U.S. 954 (1976) (quoted in *Miller Indus. v. Caterpillar Tractor Co.*, 733 F.2d 813, 817-18 (11th Cir. 1984)).

205. *E.g.*, *Newmark v. Gimbels, Inc.*, 54 N.J. 585, 258 A.2d 697 (1969). *But see* *Epstein v. Giannattasio*, 25 Conn. Supp. 109, 197 A.2d 342 (1963).

206. *See, e.g.*, *Riffe v. Black*, 548 S.W.2d 175 (Ky. 1977); *Hannon v. Original Gunite Aquatech Pools, Inc.*, 385 Mass. 813, 434 N.E.2d 611 (1982). *But see* *Gulash v. Stylarama, Inc.*, 33 Conn. Supp. 108, 364 A.2d 1221 (1975).

207. The courts have generally employed a "predominant element" or "essence of the transaction" test to determine whether the transaction is to be treated as a sale under the U.C.C. or as a service. If the predominant element or essence of the transaction is the sale of the goods rather than the rendition of services, the rules of article 2 are applied to the transaction. *Bonebrake v. Cox*, 499 F.2d 951 (8th Cir. 1974). The courts have not been uniform as to what factors are considered in applying this test, and the lack of guidelines has subjected the test to criticism from numerous commentators. This is a rather mechanical approach, but the courts favor it. Sometimes they are swayed by the wording of the contract, as when the plaintiff is denominated as 'owner' rather than as 'buyer,' and the defendant as 'contractor' rather than 'seller.' *See, e.g.*, *Nitrin, Inc. v. Bethlehem Steel Corp.*, 35 Ill. App. 3d 577, 342 N.E.2d 65 (1976). Sometimes the courts look at the price factor, attempting to analyze the billing, *see, e.g.*, *Arvida Corp. v. A.J. Indus., Inc.*, 370 So. 2d 809 (Fla. Dist. Ct. App. 1979) and *Aluminum Co. of Am. v. Electro Flo Corp.*, 451 F.2d 1115 (10th Cir. 1971), and sometimes the decision is based on nothing more than a judicial hunch as to which element predominates. *See, e.g.*, *Wells v. 10-X Mfg. Co.*, 609 F.2d 248 (6th Cir. 1979); *Manes Org., Inc. v. Standard Dyeing & Finishing Co.*, 472 F. Supp. 687 (S.D.N.Y. 1979); *see also* B. CLARK & C. SMITH, *supra* note 185, § 2.04(2)(a), at 2-19 to 2-20. For general commentary dealing with the goods-services issue, *see* *Farnsworth, Implied Warranties of Quality in Non-Sale Cases*, 57 COLUM. L. REV. 653 (1957); *Singal, Extending Implied Warranties Beyond Goods: Equal Protection for Consumers of Services*, 12 NEW ENGL. L. REV. 859 (1977); *Comment, Guidelines for Extending Implied Warranties to Service Markets*, 125 U. PA. L. REV. 365 (1976). For other leading cases applying the predominant element test, *see* *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604 F.2d 37 (2d Cir. 1979); *Gulash*, 33 Conn. Supp. 108, 364 A.2d 1221 (1975); *Meyers v. Henderson Constr. Co.*, 147 N.J. Super. 77, 370 A.2d 547 (1977).

Under this all-or-nothing approach, courts frequently treat mixed transactions as sales and, consequently, apply the U.C.C. rules to the entire transaction, including the service portion.

phenomenon of "mixed transactions" being treated as sales is not limited, however, to circumstances in which the services involve only routine applications or installations of products. Many transactions have been held to be sales rather than services even when they involve sophisticated engineering or design services.²⁰⁸ A good example involves contracts to supply computer systems with custom-designed or adapted software for the particular applications needed by the party acquiring the computer system.²⁰⁹

See infra notes 208, 209. As B. CLARK & C. SMITH, *supra* note 185, have observed, in most cases involving the purchase and installation of products that were identifiable goods before installation and that when installed constituted only a small part of a total building, courts have generally treated the transactions as sales under article 2. Some examples are the sale and installation of carpets, electrical equipment, steel lockers, overhead doors, furnaces, swimming pools, and air conditioning systems. *Id.* at § 2.04(2)(b), 2-26-27.

There is some authority in England for splitting mixed transactions where possible and applying warranty law at least to the goods portion of the transaction even if the transaction as a whole does not constitute a sale. This is discussed in Farnsworth, *supra* at 664.

208. This is perhaps most evident in transactions involving the sale of computer hardware and software packages specially adapted to the buyer's business needs. *See infra* note 209. The courts have also been quite willing to treat other mixed transactions involving sophisticated design or engineering services as sales of goods under the U.C.C. *See, e.g.*, Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572 (7th Cir. 1976) (undertaking to design and construct a one million gallon water tank and to fabricate the structural steel for it); *Electro Flo Corp.*, 451 F.2d 1115 (10th Cir. 1971) (undertaking to design, manufacture and deliver portable electrified flooring for amusement park rides); *Standard Structural Steel Co. v. Debron Corp.*, 515 F. Supp. 803 (D. Conn. 1980) (undertaking to "detail," fabricate and deliver structural steel); *see also Belmont Indus. v. Bechtel Corp.*, 425 F. Supp. 524, 528 (E.D. Pa. 1976), where the court said: "The fact that a specially designed product [i.e., the structural steel] . . . was required does not negate the characterization of the transaction as a sale of goods." *See generally* B. CLARK & C. SMITH, *supra* note 185, § 2.04(2)(a), at 2-19-22.

209. "The courts are, with virtual unanimity, sweeping both hardware and software transactions, into the scope of article 2 [of the U.C.C.]." B. CLARK & C. SMITH, *supra* note 185, § 2.04(2)(b)(iv), at 2-31. The authors note further that even in cases involving the sale of software alone, several courts have applied article 2 provisions without much analysis:

The courts appear to be moving in this direction in spite of the counter argument that, by strict application of the predominant element test, the intangible intellectual product will far exceed in value the relatively inexpensive disc, tape, drum, or other physical embodiment of the ideas.

Id.; *see also* cases cited *id.* at nn. 146, 148. The authors also note that when computer programs are part of the contract for the computer itself, and are delivered some time after delivery of the computer, the courts have held the programs to be incidental to the sale of the hardware, thus bringing the transaction within the scope of article 2. *Id.* § 2.04, at 2-30 (citing as examples *Carl Beasley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325 (E.D. Pa. 1973), *aff'd*, 493 F.2d 1400 (3d Cir. 1974); *Burroughs Corp. v. Joseph Uram Jewelers, Inc.*, 305 So. 2d 215 (Fla. Dist. Ct. App. 1974)). *See also* *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604 F.2d 737 (2d Cir. 1979); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 479 F. Supp. 738 (D.N.J. 1979), *aff'd*, 635 F.2d 1081 (1980), 670 F.2d 1304 (1982), *cert. denied*, 102 S. Ct. 2918 (1982); *W.R. Weaver Co. v. Burroughs Corp.*, 580 S.W.2d 76 (Tex. Civ. App. 1979).

In *Samuel Black Co. v. Burroughs Corp.*, 33 U.C.C. REP. SERV. (Callaghan) 954 (D. Mass. 1981), involving a hardware-software package deal, the court held that even if article 2 did not literally apply to the software component of the transaction, the Code warranty provisions should be invoked by analogy. The court gave full effect to the warranty disclaimers and limitations of remedy clause on the face of the software agreement.

The general rule in sales transactions that economic losses cannot be recovered on a theory of negligent design or manufacture but only on a theory of breach of warranty is probably consistent with the expectations of the parties in the simple retail sale involving no significant services element. Even in transactions involving a significant element of services, the general rule seems consistent with the reasonable expectations of the parties where the achievement of a successful outcome is not inherently problematic—that is, where the involved services are such that, so long as the manufacturer/seller exercises due care, a successful result is likely to follow. In such cases the chief hazard to avoid is a failure to exercise due care, and the purchaser would therefore have some reason to know that, if the contract disclaims warranties, that the manufacturer/seller will probably expect to avoid liability for negligence.²¹⁰

The general rule may also be consistent with the reasonable expectations of the parties when they contract with respect to an existing product. Even if complex engineering or design activities were required to produce the product, those activities were not undertaken for the particular purchaser. Moreover, any such “services” would have been completed prior to the parties’ entering into the contract and would have “merged” into the final product. Furthermore, it is the final product upon which the parties are likely to focus. In such circumstances it seems unlikely that the purchaser would develop any expectations about the design and manufacturer of the product apart from expectations as to whether the product will actually work. Consequently, a bargained disclaimer of warranty would be likely to suggest to a buyer that he was accepting the risk of product failure from whatever cause.²¹¹

When a purchaser contracts to have a product specially designed and manufactured, however, denial of a cause of action in negligence may be inconsistent with the reasonable expectations of the parties. Contracts for custom-designed products may involve complex design and engineering services, and the success of the product may depend on factors in addition to the manufacturer/seller’s exercise of due care.²¹² In such circumstances, the analogy to professional service contracts is very appealing and suggests the applicability of negligence liability to the services portion of the transaction.²¹³

210. This would also seem to be true in pure service contracts where the most likely cause of any problems would be carelessness by the party performing the services. This seems like a plausible explanation in a number of service contract cases where courts have denied a cause of action for negligence. See *infra* note 220.

211. The results in *Clark*, 99 Idaho 326, 581 P.2d 784, and *Moorman Mfg.*, 91 Ill. 2d 69, 435 N.E.2d 443, may be correct on this basis. These cases are discussed *supra* text accompanying notes 133-45.

212. See *supra* note 208.

213. Some courts have imposed negligence liability for services which were part of a mixed transaction where the services involved were not rendered in connection with the production or

Just as an attorney, physician or other professional is unlikely to give a warranty of result, a manufacturer/seller may well be unwilling to guarantee a product which might not work despite exercise of due care in its design and manufacture. Nevertheless, when a manufacturer/seller undertakes to perform sophisticated engineering and design services as part of a sales transaction, the same natural inference arises as in a professional service contract—that the services will be performed with due care. The inclusion of a disclaimer of warranty would not necessarily negate that inference because a disclaimer is necessary for the manufacturer/seller to avoid even the absolute liability of the implied warranties of merchantability²¹⁴ and fitness of purpose.²¹⁵ The manufacturer/seller's reluctance to guarantee a product absolutely, like an attorney or physician's reluctance to give a warranty of result, is perfectly consistent with an undertaking to exercise due care. Thus, liability in negligence for failure to exercise due care may be equally consistent with the parties' expectations in the "mixed transaction" involving sophisticated design and engineering services as in the professional service contract, and a disclaimer of warranty does not necessarily indicate otherwise.

A disclaimer of warranty is not the only provision in a sales contract that could be undermined by recognition of a cause of action in negligence. Provisions for limited or exclusive remedies,²¹⁶ exclusions of consequential damages²¹⁷ and clauses liquidating damages²¹⁸ raise similar problems. Only a disclaimer of warranty, however, is potentially inconsistent with a cause of action in negligence altogether. The issues raised by these other contractual

manufacture of the product. *See, e.g., Consol. Edison Co.*, 567 F. Supp. 358 (S.D.N.Y. 1983) (court distinguished between services that were involved in the production of the product (i.e., part and parcel of the sale of the product), and services that are not separable from the production of the product (installing the finished product, for example), and was willing to impose negligence liability only with respect to the latter); *Peak Alarm Co.*, 663 P.2d 433.

214. Section 2-314 of the Uniform Commercial Code imposes an implied warranty of merchantability in all sales transactions in which the seller is a merchant, subject to certain exceptions. Section 2-316 of the Uniform Commercial Code provides that the implied warranty of merchantability may be excluded or modified in the contract but only by language which uses the word "merchantability." Furthermore, if the disclaimer is in writing, it must be conspicuous.

215. Section 2-315 of the Uniform Commercial Code provides: "Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose." Section 2-316 of the Uniform Commercial Code provides that any implied warranty of fitness may be excluded only by a writing and that any such writing must be conspicuous.

216. Section 2-719 of the Uniform Commercial Code permits the parties to modify or limit the remedies available for breach.

217. Section 2-719 of the Uniform Commercial Code also permits the parties to limit or exclude liability for consequential damages except where such limitation would be unconscionable.

218. Section 2-718 of the Uniform Commercial Code permits the parties to liquidate damages.

provisions relate to whether they should apply only to contract claims or whether they should apply also to any cause of action permitted in negligence.²¹⁹ Whether the parties in any given case would be likely to expect or understand that such clauses apply to a cause of action in negligence would seem to depend on the same kinds of factors as their expectations regarding the effect of a disclaimer of warranty. Where a sales transaction involves complex design or engineering services and the successful outcome of the project is inherently problematic, it is reasonable for the manufacturer/seller to seek to avoid the risk of problems which may arise despite his best efforts. That a manufacturer/seller has sought to avoid such risks, however, does not necessarily suggest that he is also unwilling to bear responsibility for failure to exercise due care. Consequently, under such circumstances, a disclaimer of warranty may well be understood to exclude only liability without fault and may not negate the natural inference that the involved services will be performed in a careful manner. A limitation of remedy, exclusion of consequential damages or a provision for liquidated damages, which simply provides a more limited form of protection for the manufacturer/seller, may reasonably be understood in the same way for the same reason.

On the other hand, in a transaction where the outcome depends for the most part upon the manufacturer/seller's exercise of due care, a disclaimer of warranty, and likewise a limitation of remedy, exclusion of consequential damages or a provision for liquidated damages, would seem more likely to be understood to apply to a cause of action in negligence. Where the failure of the manufacturer/seller to exercise due care is the major problem to be avoided, the purchaser would have reason to know that a limitation of liability is intended to apply to such failure.²²⁰

219. A party might seek to bring an action in tort rather than in contract in hopes of avoiding contractual provisions limiting remedies or excluding consequential damages. *See, e.g., Orkin Exterminating Co. v. Walters*, 466 N.E.2d 55 (Ind. Ct. App. 1984) (homeowners cannot avoid limitation of liability clause in contract by bringing the action in tort rather than in contract).

220. *See, e.g., id.* In *Walters*, the court permitted an action in tort but held that the limitation of damages clause in the contract applied to the tort action.

Other cases have reached similar results by denying a cause of action in tort altogether, often on the basis that the defendant was guilty only of nonfeasance as opposed to misfeasance. *See, e.g., Orkin Exterminating Co. v. Stevens*, 130 Ga. App. 363, 203 S.E.2d 587 (1973). The distinction between nonfeasance and misfeasance, however, is elusive and difficult to apply. *See generally* PROSSER, *supra* note 1, at 373-85, 660-64. Prosser notes that this distinction is not a clear one, and observes that "[t]here has been little consideration of the problem of just where inaction ceases and 'misfeasance' begins." *Id.* at 661. A comparison of the *Walters* and *Stevens* cases demonstrates this difficulty. In *Walters* the court characterized the defendant's conduct as misfeasance, while the court in *Stevens* characterized similar conduct as nonfeasance. Another case with facts similar to those in *Stevens* and *Walters* is *Allred v. Dobbs*, 137 Ga. App. 227, 223 S.E.2d 265 (1976). The court in *Allred* characterized the defendant's conduct as misfeasance and permitted a tort action. Although the court in *Allred* attempted to distinguish

The argument that recognition of a cause of action for negligent design or manufacture where the losses are purely economic would undermine or be inconsistent with the bargain of the parties must be premised on an assumption that the bargain of the parties²²¹ excludes such liability. To make that assumption in the absence of an explicit statement in the contract excluding such liability is inconsistent with the way courts have generally dealt with disclaimers of negligence. Although negligence liability can be disclaimed in many circumstances, courts have usually required that a disclaimer be very clear.²²² To deny a cause of action in negligence on the grounds that it is inconsistent with the bargain of the parties may be appropriate in the context of a simple retail sale. In a mixed transaction involving a significant element of sophisticated services, however, denial of a cause of action in negligence may actually contravene rather than effectuate the parties' expectations.

2. Negligence and the U.C.C.

The second principal argument against permitting tort recovery of economic losses in products cases is that recognition of a cause of action in tort would be inconsistent with the scheme of article 2 of the U.C.C.²²³

Stevens, it has been observed that, "[e]fforts to distinguish the two cases are artificial at best." *Synthetic Indus. v. Whitlock, Inc.*, 439 F. Supp. 1297, 1301 (N.D. Ga. 1977). Interestingly, in *Allred*, there was no contractual limitation of liability.

It is submitted that the approach taken in *Walters* offers a more persuasive explanation for the result. By permitting a tort action and framing the issue in terms of whether a contractual clause limiting liability should apply to the tort action, the court focused attention on the expectations of the parties rather than on the confusing distinction between nonfeasance and misfeasance. Moreover, it seems that in the *Stevens* ease as in the *Walters* ease it would have been appropriate to interpret the damage limitation clause as applying to a negligence action as well as to a contract action. If an attempt to exterminate termites is not successful, carelessness on the part of the exterminator seems not to be an unlikely explanation. Consequently, the plaintiffs, when entering into the contracts, would have had reason to realize that the defendants, in seeking limitations on liability, would expect them to apply even to damages due to their carelessness. This is probably the explanation for the court's reluctance in both cases to permit the plaintiff to circumvent the damage limitation clauses by bringing their actions in tort.

221. The Uniform Commercial Code in § 1-201(3) (1977) defines agreement as follows: "'Agreement' means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance. . . ."

222. PROSSER, *supra* note 1, at 482-84. See, e.g., *Miller Indus.*, 733 F.2d 813, 817-18 (11th Cir. 1984); *Jig the Third Corp.*, 519 F.2d 171, 178-79 (5th Cir. 1975); see *supra* note 177.

223. "The UCC provides the proper framework for a purchaser's recovery of economic losses. Allowing an aggrieved party to recover under a negligence theory for solely economic loss would constitute an unwarranted infringement upon the scheme provided by the UCC." *Moorman Mfg. Co.*, 91 Ill. 2d at 88, 435 N.E.2d at 452; see also *Jones & Laughlin Steel Corp.*, 626 F.2d at 289 (strict liability and negligence); *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279, 285-86 (Alaska 1976) (strict liability and the UCC); *Clark*, 99 Idaho at 335, 581 P.2d at 793 (negligence); *Ohio Steel Tube Co.*, 213 Neb. at 789-90, 332 N.W.2d at 44 (strict liability and negligence); *Star Furniture Co.*, 297 S.E.2d at 859-60 (strict liability); see *supra* note 157 (commentary on the inconsistency between the UCC and tort recovery in economic loss cases).

Under article 2 a seller may become liable for economic losses resulting from a product's failure to perform as desired by a buyer if the sales contract provides for warranty liability.²²⁴ If the seller gives a warranty that the product will perform in a certain way, the seller will be liable for breach of warranty simply upon a showing that the product failed to perform in accordance with the warranty.²²⁵ Warranty liability, in other words, is strict liability. However, article 2 does not impose warranty liability upon the seller as a matter of law. Rather, under article 2 warranty liability depends on the agreement of the parties. Article 2, at least in theory, permits a seller to avoid warranty liability altogether if the parties so agree.²²⁶ Thus article 2 commits to the process of private agreement the question of whether and to what extent a seller will be liable solely for the reason that a product does not perform to the level expected or desired by the buyer.

Extension of strict tort liability to economic loss would be inconsistent with this scheme. Strict tort liability, like warranty liability, imposes liability without fault.²²⁷ Strict tort liability would, therefore, be a very close functional substitute for warranty liability if it were extended to economic loss.²²⁸ Moreover, because strict tort liability cannot be disclaimed,²²⁹ liability for losses due to inadequate product performance would be imposed upon sellers

224. U.C.C. §§ 2-313, 2-314, 2-315 (1977).

225. See *supra* note 187 and accompanying text.

226. U.C.C. § 2-316 (1977). However, it may be very hard to eliminate all warranties in practice. Section 2-313(1)(b), entitled *Express Warranties by Affirmation, Promise, Description, Sample*, provides:

(1) Express warranties by the seller are created as follows:

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

Moreover, comment 4 to § 2-313 provides in part:

Thus, a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under section 2-316.

Finally, § 2-316(1) provides:

§ 2-316. Exclusion or Modification of Warranties

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but . . . *negation or limitation is inoperative to the extent that such construction is unreasonable.*

Id. (emphasis added).

Thus, although sellers and manufacturers can significantly limit their warranty liability, see Special Project, *Article Two Warranties in Commercial Transactions*, 64 CORNELL L. REV. 30, 170 (1978), it may in fact be very difficult to get rid of all warranties.

227. See *supra* note 178.

228. "Except in these areas which the drafters have given rather explicit meaning to 402A by their comments, and except for the fact that 402A would not normally apply to economic losses, we believe that the two standards [i.e., strict liability and the implied warranty of merchantability] are interchangeable." J. WHITE & R. SUMMERS, *supra* note 12, at 355-56.

229. See *supra* note 176.

as a matter of law rather than pursuant to agreement. Extension of strict tort liability to economic loss would thus undermine the scheme of article 2 which permits the parties, by agreement, to define the scope and extent of warranty liability.

Although extension of strict liability to economic loss would be inconsistent with article 2, recognition of a cause of action in negligence for such loss would not disturb the scheme of article 2. First, recognition of such a cause of action would not impose any liability upon sellers as a matter of law. To the contrary, negligence liability, like warranty liability, could be disclaimed in the contract.²³⁰ Recognition of a cause of action in negligence would not interfere with the basic policy of article 2 to permit the parties by agreement to define the scope and extent of a seller's liability for the level of performance of his products. Rather, recognition of a cause of action in negligence would merely permit courts to hold the seller liable for negligence when that was consistent with the agreement of the parties. In addition, liability for negligence is not a functional substitute for warranty protection. If a buyer obtains a warranty that a product will perform in a particular manner, the seller becomes liable merely upon a showing that the product failed to perform as warranted. In the absence of a warranty, a buyer could not hold a seller liable without showing, in addition, that the product's failure was caused by the seller's negligence. Thus, there is no inherent inconsistency between the existence of a cause of action in negligence for economic loss in sales cases and article 2, as there is between extension of strict tort liability to economic loss and article 2.

Moreover, article 2 itself does not preclude recognition of a cause of action for negligence for economic loss. Nothing in the warranty provisions of article 2 suggests that the possibility of creating warranty liability is meant to preempt the possibility of liability in negligence.²³¹ Indeed, comment 2 to section 2-318 mentions that the extension of warranties given to the buyer to certain other beneficiaries is not meant to be in derogation of any rights resting on negligence.²³² Finally, section 1-103 provides that other supplementary principles of law remain applicable "unless displaced by the particular provisions of this Act" The fact that no provision in article 2 provides for a cause of action in negligence should not be deemed important,

230. See *supra* note 177.

231. See U.C.C. §§ 2-313, 2-316, 2-318 (1977).

232. Comment 2 to § 2-318 states in part: "The purpose of this section is to give certain beneficiaries the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to 'privity.' It seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence." Only one of the three alternative versions of § 2-318 deals with economic loss for remote plaintiffs not in privity of contract with the defendant. This comment, therefore, must also be applicable to parties that are in privity of contract.

for article 2 makes no specific mention of a number of legal principles which are routinely applied to sales contracts.²³³

The notion that tort recovery of economic loss in sales cases is inconsistent with the scheme of article 2 of the U.C.C. is based on the idea that recognition of a cause of action in tort would undermine the allocation of the risks relating to product performance by private agreement. This concern is well justified with respect to extension of strict tort liability to economic loss but not with respect to recognizing a cause of action in negligence.

3. Negligence and the Potential for Indefinite Liability

The third principal argument against permitting tort recovery for economic loss in products cases is that such liability could be unforeseeable and unlimited in scope.²³⁴ This concern, of course, is the basic concern behind the broader rule, discussed in the first section of this article, that negligently inflicted economic loss is not actionable in general.²³⁵ That general rule, however, is subject to a number of exceptions in circumstances where inherent limitations on the class of potential plaintiffs eliminate the problem of indefinite liability.²³⁶ One of the important exceptions exists where there is some special relationship, such as a contractual relationship, between the parties.²³⁷ Thus, in service contracts the general rule has not usually been applied as between the immediate parties to the contract.²³⁸

In products cases, as in service transactions, there may be a problem of unlimited liability where the parties are not in privity. A manufacturer may negligently design a mass produced item which would then be sold through numerous retail outlets. If the manufacturer is liable for economic loss suffered by one ultimate purchaser it would seem he would be liable for the losses of all.²³⁹ Those losses might in turn cause other losses to parties even

233. Promissory estoppel, restitution, mistake, fraud and misrepresentation are perhaps the most common legal principles routinely applied to sales contracts even though not provided for in article 2. See, e.g., *Braud, Inc. v. White*, 486 P.2d 50, 56 (Alaska 1971) ("[t]he Code [U.C.C.] does not preclude the common law remedy of reformation for mutual mistake"); *Prince v. LeVan*, 486 P.2d 959 (Alaska 1971) (where specific provisions of U.C.C. article 2 apply to a transaction, they control and displace any general principles of law that might be applicable to the transaction; general legal principles supplement the U.C.C. only when no codal provisions specifically apply to the issue); *Saberton v. Greenwald*, 146 Ohio St. 414, 66 N.E.2d 224 (1946) (provision in Uniform Sales Code similar to U.C.C. § 1-103 that in cases not provided for, the rules relating to principal and agent and to the effect of fraud and misrepresentation should continue to apply to sales of goods, allows an action *ex delicto* against a seller who induces a sale by fraud or misrepresentation).

234. See *supra* note 174 and accompanying text.

235. See *supra* notes 79-97 and accompanying text.

236. See *supra* notes 88-93 and accompanying text.

237. See *supra* notes 37-58 and accompanying text.

238. See *supra* notes 191-204 and accompanying text.

239. *Seely*, 63 Cal. 2d at 17, 403 P.2d at 150, 45 Cal. Rptr. at 22.

further removed from the manufacturer. If recovery is limited to parties in privity, however, the problems of unlimited liability are largely avoided.²⁴⁰ The class of potential plaintiffs would have a specific and finite limit. The limit would be the same as that in service contracts where courts have not hesitated to impose liability. Concern that negligence liability for economic loss in products cases would lead to problems of indefinite liability is simply unwarranted so long as liability is limited to cases of custom-manufactured goods.

CONCLUSION

Sales transactions and service transactions have traditionally been treated differently under the law. Many sales transactions, nevertheless, involve services as well as goods. In theory, it would be possible to apply sales law to the goods element but not to the services element of such a mixed transaction. The law, however, has not developed in that way. Instead, courts determine whether the "essence of the transaction" is sale of goods, or services, and then either apply article 2 to the entire transaction or to none of it.²⁴¹

Whether article 2 applies to a particular transaction may be important for a number of reasons. If article 2 applies and the seller is a merchant, the U.C.C. imposes an implied warranty of merchantability.²⁴² No similar provision exists for service transactions. Nevertheless, many service transactions involve goods as well as services. For example, the "services" of a beautician may involve the "sale" of various beauty products.²⁴³ Twenty-five years ago

240. In some of the earlier negligence cases seeking recovery for economic losses, the courts adverted to the absence of privity as at least one of the bases for denying the action. *See, e.g., Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, 1 Misc. 2d 477, 482, 148 N.Y.S.2d 284, 290 (Sup. Ct. 1955) ("[i]f the ultimate user were allowed to sue the manufacturer in negligence merely because an article with latent defects turned out to be bad when used in 'regular service' without any accident occurring, there would be nothing left of the citadel of privity"). More recent cases, however, have eschewed privity as a dispositive factor in their denying a cause of action in negligence. *See, e.g., Clark*, 99 Idaho at 336, 581 P.2d at 794 ("[r]ather than obscure fundamental tort concepts with contract notions of privity, we believe it is analytically more useful to focus on the precise duty of care that the law of negligence, not the law of contract or an agreement by the parties, has imposed on the defendant") (the court here denied the negligence suit for economic loss on the grounds that no independent tort duty was owed by defendant, and stressed that to impose negligence liability in this situation would undermine the scheme of the U.C.C.); *see also supra* note 34.

241. *See supra* note 207.

242. U.C.C. § 2-314 (1977).

243. *See, e.g., Epstein v. Giannattasio*, 25 Conn. Supp. 109, 197 A.2d 342 (1963) (court held that the transaction was in the nature of a service and that the use of the hair color product in the course of the beauty treatment did not amount to a sale of goods under the U.C.C.) (criticized in R. NORDSTROM, *LAW OF SALES* 46-47 (1970)). The courts have taken the same approach in suits involving transfusions of polluted blood, and have held that those transactions involve services rather than sales. *See, e.g., Lovett v. Emory Univ.*, 116 Ga. App. 277, 156 S.E.2d 923 (1967); *Perlmutter v. Beth David Hosp.*, 308 N.Y. 100, 123 N.E.2d 792 (1954); R. NORDSTROM, *supra*, at 247-50.

Professor Farnsworth pointed out that to say that a warranty is implied in a sale does not necessarily mean that one is not implied if there is not a sale.²⁴⁴ Professor Farnsworth argued that in many transactions which are not considered sales for purposes of article 2 there may be a sufficient, though incidental, "sale" of goods to justify implication of a warranty of quality with respect to those goods.²⁴⁵

To a large extent the argument made in this article is the converse of Professor Farnsworth's argument. Just as many service transactions involve a significant "sale of goods" element, many sales transactions involve a significant "services" element. Just as implication of a warranty of quality of goods should not artificially be limited to goods in transactions where the transaction as a whole is governed by article 2, liability for negligent performance of services should not artificially be limited to transactions which, as a whole, are not sales.

The economic loss rule as applied in products cases is designed to protect the bargain of the parties, and in most instances the rule accomplishes this purpose. However, due to the tendency of courts to categorize transactions in their entirety as either sales or services, contracts calling for custom-designed and manufactured goods are often treated as sales even though they require sophisticated design and engineering services. In this limited context, the economic loss rule, rather than effectuating the agreement of the parties, may actually undermine it.

244. Farnsworth, *supra* note 207.

245. *Id.* at 665-74.