Washington and Lee Law Review

Volume 66 | Issue 2 Article 2

Spring 3-1-2009

The Boundary-Line Function of the Economic Loss Rule

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I. The Rise of the Economic Loss Rule

In an effort to resolve its uncertainties, tort scholars and jurists have recently focused on what is often called "the economic loss rule."[1] According

1. *See* Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813, 813–26 (2006) (describing the history, rationale, application, and debates about the economic loss rule); Oscar S. Gray, *Some Thoughts on "The Economic Loss Rule" and Apportionment*, 48 ARIZ. L. REV. 897, 897–903 (2006) (discussing the economic loss rule in the context of the proposed Restatement); *see also* Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773, 774–809 (2006) (discussing the justifications for the economic loss rule); Ellen M. Bublick, *Economic Torts: Gains in Understanding Losses*, 48 ARIZ. L. REV. 693, 696–712 (2006) (discussing the conflict among scholars over economic tort liability); Dan B. Dobbs, *An Introduction to Non-Statutory Economic Loss Claims*, 48 ARIZ. L. REV. 713, 713–33 (2006) (summarizing the economic loss rules); Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749, 749–71 (2006) (suggesting "general criteria to define when an actor is subject to negligence liability for pure economic loss"); David Gruning, *Pure Economic Loss in American Tort Law: An Unstable Consensus*, 54 SUPP. AM. J. COMP. L. 187, 188–208 (2006) (discussing the economic loss rule in American tort law); Thomas J. Miles, *Posner on Economic Loss:* EVRA Corp v. Swiss Bank, 74 U. CHI. L. REV. 1813, 1813–29 (2007) (clarifying the economic loss rule through examination of an opinion by Posner); Ellen S. Pryor, *The Economic Loss Rule and Liability Insurance*, 48 ARIZ. L. REV. 905, 906–24 (2006) (examining "how the liability insurance regime fails to effectively translate . . . the structure and purposes of the economic loss rule"); Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 ARIZ. L. REV. 857, 858–69 (2006) (commenting on the economic loss rule and its rationale). Authorities use the terms "economic loss rule" and

to some authorities, the rule holds that tort law offers no redress for negligence that causes only economic losses[2] unaccompanied by personal injuries or property damages.[3] However, whether a rule so expansive is part of American tort law is still open to doubt.[4] There are many variations of the

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"economic loss doctrine" interchangeably.

2. *See* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 873 (9th Cir. 2007) ("The term 'economic loss' refers to damages that are solely monetary, as opposed to damages involving physical harm to person or property.").

3. *See* Adams v. Copper Beach Townhome Cmtys., L.P., 816 A.2d 301, 305 (Pa. Super. Ct. 2003) (stating that "[t]he Economic Loss Doctrine provides that no cause of action exists for negligence that results solely in economic damages unaccompanied by physical injury or property damage," and that employees' claims for lost wages resulting from the shutdown of a plant caused by flooding were barred); Zurich Am. Ins. Co. v. Hughes, Watters & Askanase, L.L.P., No. 11-05-00044-CV, 2006 WL 1914689, at *2 (Tex. App. July 13, 2006) (stating that "[t]he economic loss rule provides that, in tort cases, economic damages are not recoverable unless they are accompanied by actual physical injury or property damage"); *see also* Sovereign Bank v. BJ's Wholesale Club, Inc., 533 F.3d 162, 175–78 (3d Cir. 2008) (holding that the economic loss rule barred a negligence claim by a bank against a merchant that failed to protect cardholder information because the action sought damages only for economic losses, including the costs of issuing new debit cards and reimbursing cardholders for unauthorized charges); *In re* TJX Cos. Retail Sec. Breach Litig., 524 F. Supp. 2d 83, 92 (D. Mass. 2007) (same); Banknorth, N.A. v. BJ's Wholesale Club, Inc. 442 F. Supp. 2d 206, 208 (M.D. Pa. 2006) (same); Pa. State Employees Credit Union v. Fifth Third Bank, 398 F. Supp. 2d 317, 326–30 (M.D. Pa. 2005) (same); 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc., 750 N.E.2d 1097, 1103 (N.Y. 2001) (holding, in a case where a construction collapse resulted in street closures and adversely affected the plaintiffs' local businesses, "plaintiffs' negligence claims based on economic loss alone fall beyond the scope of the duty owed them by defendants and should be dismissed"). *See generally* Feinman, *supra* note 1, at 813 (opining that "[t]he most general statement of the economic loss rule is that a person who suffers only pecuniary loss through the failure of another person to exercise reasonable care has no tort cause of action against that person"); Ann O'Brien, Note, *Limited Recovery Rule as a Dam: Preventing a Flood of Litigation for Negligent Infliction of Pure Economic Loss*, 31 ARIZ. L. REV. 959, 959 (1989) ("Under the majority rule, a plaintiff may recover economic losses for negligence only when there is accompanying physical damage to person or property.").

4. *See Giles*, 494 F.3d at 874–75 (noting that "many courts have stated in overly broad terms that purely economic losses cannot be recovered in tort" and that "[s]uch broad statements are not accurate").

Professor Oscar S. Gray, a leading torts scholar, has expressed misgivings about attempts to formulate a unified economic loss rule. *See* Gray, *supra* note 1, at 901–02. He wrote:

> I had not previously thought that there was any such thing as a single "economic loss rule." Instead, I had thought that there was a constellation of somewhat similar doctrines that tend to limit liability, in the case of purely economic loss, from what might have been expected under *Palsgraf* in the case of physical loss. These doctrines seemed to work in somewhat different ways in different contexts, for similar but not necessarily identical reasons, with exceptions where the reasons for limiting liability were absent.

Id. at 898 (citations omitted).

rule,[5] and courts often discuss its parameters only in relationship to products liability or contractual performance.[6] As one scholar remarked, the law of tort liability for purely economic losses is "much less well settled and less uniform than one might wish it to be."[7]

A. Three Areas of Concern

An examination of the economic loss rule entails at least three areas of concern. The first is whether purely economic losses caused by a defective product are recoverable under tort law. As discussed below, there is a high degree of agreement that the answer to this question is "no" absent personal injury or damage to other property.[8]

The second area of concern relates to whether a tort claim for economic damages is viable when there is some other contract between the parties (e.g., a service contract or a contract relating to non-defective goods or real estate) that allocates or could have allocated the risks of economic loss. As to these matters, there is a consensus that the breach of a purely contractual duty is not actionable as a tort if the only consequences are economic losses.[9] However, that modicum of agreement quickly dissolves as application of the rule is charted. There are numerous competing formulations. For example, Colorado holds that "a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law."[10] Wisconsin, taking a different tack, says the economic loss doctrine bars a plaintiff's tort cause of action if the "claimed damages are the result of disappointed expectations of a bargained-for product's performance."[11] In Washington state, "the purpose of the economic loss rule is to bar recovery for alleged

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5. *Cf.* Pryor, *supra* note 1, at 915 (reporting that "different versions of the economic loss rule exist").

6. *See* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 543 (Fla. 2004) (holding that cases falling outside of the products liability or contracts context "should be decided on traditional negligence principles of duty, breach, and proximate cause").

7. Herbert Bernstein, *Civil Liability for Pure Economic Loss Under American Tort Law*, 46 AM. J. COMP. L. 111, 125 (1998).

8. *See infra* Part II.C.2 (discussing recovery for "product-related economic losses").

9. *See infra* Part III.C.2 (discussing "purely contractual duties").

10. Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1264 (Colo. 2000).

11. *See* Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005) (holding that tort claims relating to injuries sustained by calves who were fed with a defective milk substitute were barred by the economic loss rule).

breach of tort duties where a contractual relationship exists and the losses are economic losses."[12] Some states endorse the view that "the economic loss doctrine is inapplicable to claims for the negligent provision of services,"[13] and thus apply the rule only in cases involving contracts for the sale of goods.[14]

The remaining area of concern is all of the rest of tort law, everything beyond defective product- or contract-related claims. In this vast residual territory,[15] the operation of the economic loss rule is not well mapped, and whether there is a "rule" at all is a subject of contention.[16] The Supreme Court of Florida has expressly held that the economic loss rule does not apply outside the defective product or contract contexts.[17] Other courts state the rule so broadly that they seem certain that it applies to cases in this third category that have not yet been conceived.[18] In most states, there is precedent

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12. Alejandre v. Bull, 153 P.3d 864, 868 (Wash. 2007).

13. Ins. Co. of N. Am. v. Cease Elec. Inc., 688 N.W.2d 462, 472 (Wis. 2004); *see also* Indem. Ins. Co. of N. Am.v. Am. Aviation, Inc., 891 So. 2d 532, 544–45 (Fla. 2004) (Cantero, J., concurring) (stating that "the economic loss rule does not apply in the services context unless a contract exists and none of the established exceptions to the rule apply" and indicating that "[t]he vast majority of states restrict the rule to products cases, at least in the absence of a contract"). *But see* Banknorth, N.A. v. BJ's Wholesale Club, Inc. 442 F. Supp. 2d 206, 212 (M.D. Pa. 2006) (agreeing "that the economic loss rule can be extended to service contracts"); Fireman's Fund Ins. Co. v. SEC Donohue, Inc., 679 N.E.2d 1197, 1200 (Ill. 1997) ("The policy interest supporting the ability to comprehensively define a relationship in a service contract parallels the policy interest supporting the ability to comprehensively define a relationship in a contract for the sale of goods" and "[i]t is appropriate, therefore, that [the economic loss doctrine] should apply to the service industry").

14. The product versus service distinction is also crucial in the law of products liability, and the jurisprudence from that area would presumably inform cases dealing with the same issue for purposes of the economic loss rule. *See* Charles E. Cantu, *A New Look at an Old Conundrum: The Determinative Test for the Hybrid Sales/Service Transaction Under Section 402A of the Restatement (Second) of Torts*, 45 ARK. L. REV. 913, 915–16 (1993) (discussing the decision of courts to apply strict liability in the product, but not services, context).

15. *See* Bernstein, *supra* note 1, at 782–93 (discussing the taxonomy of claims for unintentionally inflicted economic loss and identifying, beyond the category of cases involving "a contract-like relation between plaintiff and defendant," two other categories involving "impediments to the plaintiff's regular business operations" and "emotions mixed with financial loss").

16. *But see* Dobbs, *supra* note 1, at 714 (asserting that "[s]ubject to qualifications, one not in a special or contractual relationship owes no duty of care to protect strangers against stand-alone economic harm").

17. *See Aviation*, 891 So. 2d at 543 (holding that cases that do not fall into the categories of products liability and contractual privity "should be decided on traditional negligence principles of duty, breach, and proximate cause"); *see also* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 873 (9th Cir. 2007) ("Some jurisdictions have yet to apply the economic loss doctrine outside the product liability context.").

18. *See* Adams v. Copper Beach Townhome Cmtys., L.P., 816 A.2d 301, 305 (Pa. Super.

sympathetic to the idea that the economic loss rule might apply in this residual field, such as the decisions holding that negligent interference with contract is not actionable,[19] or case law that saves persons who cause transportation accidents from liability for the economic losses of persons relegated to alternate routes.[20] But it is far from resolved whether these pockets of no liability mean that there is a general rule, broadly applicable,[21] against tort liability for purely economic losses in contexts unrelated to product defects or contractual performance.[22]

B. Types of Tort Claims Barred

The economic loss rule, to the extent that it is recognized, is even more expansive than first stated.[23] The rule generally bars strict liability[24] claims, as well as negligence.[25] This makes sense because strict liability, at least in the defective products, misrepresentation, and hazardous activities contexts, is merely a doctrinal substitute for negligence principles, which may make resolution of liability issues

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Ct. 2003) (stating the rule broadly and barring a claim for lost wages resulting from a plant shutdown).

19. *See* RESTATEMENT (SECOND) OF TORTS § 766C (1979) (stating that a person "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" interfering with the other's contract).

20. *See* Kinsman Transit v. City of Buffalo (*Kinsman No. 2*), 388 F.2d 821, 824–25 (2d Cir. 1968) (denying recovery of alternate transportation costs incurred by third parties as the result of the negligent destruction of a bridge).

21. *Cf.* Bernstein, *supra* note 1, at 809 ("Economic loss is a category of encyclopedic breadth within Torts. Because business entities as well as human beings can experience economic loss, the number of potential litigants and the dollar value of damages that could be alleged are both larger than their counterparts in personal-injury litigation.").

22. *Cf.* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 542 (Fla. 2004) (emphasizing the "genuine, but limited" value of the economic loss rule).

23. *See* Stewart I. Edelstein, *Beware the Economic Loss Rule*, TRIAL, June 2006, at 42, 42 (2006) (stating that under the economic loss rule "[d]amages for economic loss are not recoverable on [any] tort theory when unaccompanied by physical property damage or personal injury").

24. *See* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 876 (1986) (rejecting a strict products liability claim in admiralty for pure economic loss); Aldrich v. ADD Inc., 770 N.E.2d 447, 454 (Mass. 2002) (holding that in Massachusetts, in accordance with the majority of jurisdictions that have considered this issue, "purely economic losses are unrecoverable in tort and strict liability actions in the absence of personal injury or property damage," but finding that a claim against architects based on negligent design was not barred because the plaintiffs alleged that water leakage caused property damage); Grams v. Milk Prods., Inc., 699 N.W.2d 167, 169–70 (Wis. 2005) (holding that claims for "strict liability tort" and "strict responsibility misrepresentation" were barred).

25. *See* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 873–75 (9th Cir. 2007) (stating that courts apply the economic loss doctrine to negligence claims).

more efficient or more certain.[26] In cases where purely economic losses are caused by a defective product, misrepresentation,[27] or an abnormally dangerous activity, it is logical that if tort claims based on negligence are barred by the rule, claims based on tort strict liability should be foreclosed, too.

Some authorities have taken the extreme position that the economic loss rule precludes recovery even for purely economic losses caused by intentionally tortious conduct.[28] Not surprisingly, other decisions employing various rationales are to the contrary.[29] In cases where economic losses are deliberately and tortiously inflicted there is little reason to save the defendant from liability, whether under the economic loss rule or otherwise.[30]

C. Doubts and Exceptions

Doubts about the coherence of a generally applicable economic loss rule have frequently been raised.[31] Those concerns are bolstered by the fact that any broad

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26. *See* VINCENT R. JOHNSON & ALAN GUNN, STUDIES IN AMERICAN TORT LAW 657 (3d ed. 2005) (discussing the policy basis for strict liability).

27. *See* Alejandre v. Bull, 153 P.3d 864, 872–73 (Wash. 2007) ("[W]e hold that the economic loss rule applies and forecloses the buyers' claim that the seller negligently misrepresented the condition of the septic system.").

28. *See Grams*, 699 N.W.2d at 169–70 (holding that a claim for intentional misrepresentation was barred). *But see* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 543 n.3 (Fla. 2004) ("Intentional tort claims such as fraud, conversion, intentional interference, civil theft, abuse of process, and other torts requiring proof of intent generally remain viable either in the products liability context or if the parties are in privity of contract" because "a rule barring recovery for economic loss 'is not an escape hatch from intentional commercial torts'").

29. *See* Gulf Coast Produce, Inc. v. Am. Growers, Inc., No. 07-80633-CIV, 2008 WL 660100, at *4 (S.D. Fla. Mar. 7, 2008) (stating that the economic loss rule is inapplicable to a conversion claim); Carran v. Morgan, 510 F. Supp. 2d 1053, 1060–61 (S.D. Fla. 2007) (stating that the economic loss rule is inapplicable to breach of fiduciary duty, constructive trust, fraud, and conversion claims); *see also Giles*, 494 F.3d at 875 ("Many courts have explicitly refused to extend the economic loss doctrine beyond the product liability context or beyond claims for negligence and strict liability.").

30. *See* Gruning, *supra* note 1, at 187 ("Sometimes compensation for economic losses presents no special difficulty. This is so, for example, when economic losses follow an intentional tort whose goal was to produce that very harm.").

31. *See* Colleton Preparatory Acad., Inc. v. Hoover Universal, Inc., No. 26535, 2007 WL 5433193, at *3 (S.C. Aug. 25, 2008) (noting that the court had "continually expressed uneasiness with the economic loss doctrine" and that, as a result, the court had "partially rejected the rule in the residential home building context, leaving it viable in situations where a builder violates only a contractual duty"). Some courts have argued that the term "economic loss rule" causes confusion. *See* Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1262–63 (Colo. 2000) ("The phrase 'economic loss rule' necessarily implies that the focus of the inquiry under its analysis is on the type of damages suffered by the aggrieved party. However, the

statement of the rule must be qualified by important, well-recognized exceptions.[32] Not the least of these qualifications are the causes of action imposing liability for negligent misrepresentation,[33] defamation,[34] professional malpractice,[35] breach of

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relationship between the type of damages suffered and the availability of a tort action is inexact at best."); *see also* Pryor, *supra* note 1, at 905 (noting that one of the challenges to restating the economic loss rule is "whether its normative bases are coherent (both for the rule and for its 'exceptions')").

32. *See generally* Vincent R. Johnson, *Cybersecurity, Identity Theft, and the Limits of Tort Liability*, 57 S.C. L. REV. 255, 302–03 (2005) (discussing exceptions and limitations to the economic loss rule).

33. *See, e.g.*, Level 3 Commc'ns, LLC v. Liebert Corp., 535 F.3d 1146, 1161 (10th Cir. 2008) (finding that the economic loss rule did not bar a negligent misrepresentation claim); ATM Exch., Inc. v. Visa Int'l Serv. Ass'n, No. 1:05-CV-00732, 2008 WL 3843530, at *14 (S.D. Ohio Aug. 14, 2008) (same); *In re* TJX Cos. Retail Sec. Breach Litig., 524 F. Supp. 2d 83, 91–92 (D. Mass. 2007) (same); Bilt-Rite Contractors, Inc. v. The Architectural Studio, 866 A.2d 270, 285 (Pa. 2005) (same); *see also* Robert A. Prentice & Veronica J. Finkelstein, *Architects Lose the Economic-Loss Rule Shield in Pennsylvania*, 76 PA. BAR ASS'N Q. 180, 182 (Oct. 2005) (discussing the impact on design professionals of judicial recognition of a negligent misrepresentation exception in some states). *But see* Smith v. John Hancock Ins. Co., No. 06-3876, 2008 WL 4072585, at *8 (E.D. Pa. Sept. 2, 2008) (holding that a claim for negligent misrepresentation was barred by the economic loss rule); Alejandre v. Bull, 153 P.3d 864, 870 (Wash. 2007) (holding that a claim for negligent misrepresentation "is not available when the parties have contracted against potential economic liability"). *See generally* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 10 (Preliminary Draft No. 1, 2005) (discussing liability for negligent misstatements).

34. The Constitution only requires proof of negligence as to falsity in a libel or slander action brought by a private person suing with regard to a matter of public concern. *See* Gertz v. Robert Welch, Inc., 418 U.S. 323, 347 (1974) (stating that "so long as they do not impose liability without fault, the States may define for themselves the appropriate standard of liability for a publisher . . . of defamatory falsehood injurious to a private individual"). The culpability requirement in cases involving matters of private concern has not been definitively resolved by the United States Supreme Court, but it is certainly not higher than negligence. *Cf.* Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc., 472 U.S. 749, 781 (1985) (Brennan, J., dissenting) (arguing that neither the parties nor the lower courts suggested that an actual malice standard applied). The damages recoverable in defamation actions where negligence is shown include economic losses. *See* Travis M. Wheeler, Note, *Negligent Injury to Reputation: Defamation Priority and the Economic Loss Rule*, 48 ARIZ. L. REV. 1103, 1103–04 (2006) (discussing the application of the economic loss rule to "cases in which plaintiffs seek reputational damages without pleading defamation"); *cf. Gertz*, 418 U.S. at 349–50 (stating that constitutional principles "restrict defamation plaintiffs who do not prove knowledge of falsity or reckless disregard for the truth to compensation for actual injury . . . [which] is not limited to out-of-pocket loss").

35. This includes legal malpractice. *See* Resolution Trust Corp. v. Holland & Knight, 832 F. Supp. 1528, 1532 (S.D. Fla. 1993) (finding the economic loss rule inapplicable); Collins v. Reynard, 607 N.E.2d 1185, 1187 (Ill. 1992) (finding the rule inapplicable); Clark v. Rowe, 701 N.E.2d 624, 627 (Mass. 1998) (stating that the "general rule in this country is that the economic loss rule is inapplicable to claims of legal malpractice"); *see also* Thorne v. Wagner, No. 2:06-CV-00942-PMP-PAL, 2007 WL 496373, at *5 (D. Nev. Feb. 13, 2007) (finding the rule inapplicable because the invalidity of a divorce did not cause "purely economic losses" as the plaintiff allegedly suffered "physical and emotional trauma requiring medical care"). *But see* Zurich Am. Ins. Co. v.

fiduciary duty,[36] nuisance,[37] loss of consortium,[38] wrongful death,[39] spoliation of

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Hughes, Watters & Askanase, L.L.P., No. 11-05-00044-CV, 2006 WL 1914689, at *4 (Tex. App. July 13, 2006) (holding that the rule barred an insurer's subrogation claim for legal malpractice). It also includes accounting malpractice. *See* Congregation of the Passion, Holy Cross Province v. Touche Ross & Co., 636 N.E.2d 503, 514 (Ill. 1994) (finding that the economic loss doctrine did not prevent plaintiff from recovering for accounting malpractice claim). Finally, this also includes engineering malpractice. *See* Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 89 (S.C. 1995) (stating that the economic loss doctrine did not bar plaintiff's engineering malpractice claim). *But see* Fireman's Fund Ins. Co. v. SEC Donohue, Inc., 679 N.E.2d 1197, 1200–01 (Ill. 1997) (stating that the economic loss rule applies to engineers); Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494 n.1 (Tex. 1991) (observing in a case involving the economic loss rule that "some contracts involve special relationships that may give rise to duties enforceable as torts, such as professional malpractice").

36. *See* Derkevorkian v. Lionbridge Techs., Inc., No. 04-CV-01160-LTB-CBS, 2007 WL 638717, at *4 (D. Colo. Feb. 27, 2007) (finding that the economic loss rule did not bar a "breach of fiduciary duty claim based on a confidential or trust relationship independent of the parties' contractual relationship"); Twin Fires Inv., LLC v. Morgan Stanley Dean Witter & Co., No. 000751F, 2001 WL 1249303, at *4–5 (Mass. Super. Ct. July 26, 2001) (stating that a claim for breach of fiduciary duty was not barred by the economic loss rule). *But see* Action Nissan, Inc. v. Hyundai Motor Am., No. 6:06-CV-1747-ORL-19KRS, 2008 WL 4093702, at *11–*12 (M.D. Fla. Aug. 29, 2008) (stating that "[w]hile the economic loss rule does not automatically bar a breach of fiduciary duty claim, the rule does apply when the claim for breach of fiduciary duty is based upon and inextricably intertwined with the claim for breach of contract," and finding that the plaintiff's claim was barred); *In re* Trade Partners, Inc. Investors Litig., No. 1:07-MD-1846, 2008 WL 3875396, at *17 (W.D. Mich. Aug. 15, 2008) (finding that because a trust agreement did not impose any duties beyond contractual duties, the plaintiff's claims for negligence, gross negligence, and breach of fiduciary duty were barred by the economic loss doctrine); PNC Bank, Nat'l Ass'n v. Colonial Bank, N.A., No. 8:08-CV-611-T-24MSS, 2008 WL 2917639, at *4 (M.D. Fla. July 24, 2008) ("[Plaintiff's] breach of trust claim is substantially indistinguishable from its breach of contract claim and is therefore barred by the economic loss rule.").

37. *See* Holcomb Constr. Co. v. Armstrong, 590 F.2d 811, 812 (9th Cir. 1979) (finding that a cause of action for nuisance was stated based on negligent damage to a bridge which compelled the plaintiff to use a "circuitous route for the transportation of materials," which resulted in "greater cost"); Burgess v. M/V Tamano, 370 F. Supp. 247, 250 (D. Me. 1973) (allowing fishermen and clamdiggers to recover economic losses resulting from water pollution); Leo v. Gen. Elec. Co., 538 N.Y.S.2d 844, 847 (App. Div. 1989) (allowing fishermen to sue for "diminution or loss of livelihood" caused by water pollution). Where the action is for public nuisance, rather than private nuisance, the plaintiff's action will fail unless the plaintiff establishes "special damages beyond those suffered by the public" in general. *See* 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc., 750 N.E.2d 1097, 1104 (N.Y. 2001) (denying recovery for economic harm to local businesses caused by a construction collapse). *See generally In re* Exxon Valdez, 104 F.3d 1196, 1197 (9th Cir. 1997) (refusing to award *noneconomic* damages based on harm to communal life resulting from a negligent oil spill, but noting that there was "no dispute concerning the Alaska Natives' right to recover economic damage flowing from loss of fishing resources").

38. *See, e.g.*, Wolfgang v. Mid-Am. Motorsports, Inc., 914 F. Supp. 434, 438 (D. Kan. 1996) (stating that "Kansas recognizes that there are economic and noneconomic components to a loss of consortium claim").

39. *See, e.g.*, Gonzalez v. N.Y. City Hous. Auth., 572 N.E.2d 598, 599 (N.Y. 1991) (approving a substantial wrongful-death award to the independent, adult grandchildren of a brutally murdered woman from whom they had previously received meals, advice, and other

evidence,[40] and unreasonable failure to settle a claim within insurance policy limits,[41] all of which may afford recovery for negligence causing purely economic losses to the plaintiff. So too, statutory causes of action, even when based on negligence[42] or strict liability[43] principles, usually trump the judicially designed economic loss rule.[44] Courts also find that negligence causing purely economic harm is actionable where there is a "special relationship" between the plaintiff and defendant.[45]

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forms of help).

40. *See, e.g.*, Holmes v. Amerex Rent-A-Car, 710 A.2d 846, 854 (D.C. 1998) (recognizing an action for economic damages caused by reckless or negligent spoliation of evidence). Some states have declined to endorse this cause of action. *See* Trevino v. Ortega, 969 S.W.2d 950, 959 (Tex. 1998) (opting for procedural sanctions for spoliation of evidence).

41. *See* Pratham Design Innovation Pvt. Ltd. v. Infovision 21, Inc., No. 07-CV-13282, 2007 WL 4557712, at *4 (E.D. Mich. Dec. 21, 2007) (stating that the "common law duty in tort arises in the insurance context" (citing Battista v. Lebanon Trotting Ass'n, 538 F.2d 111, 117 (6th Cir. 1976))).

42. For example, an Illinois statute imposes negligence-based obligations to protect data from unauthorized access and permits recovery of economic losses resulting from a breach. *See* 815 ILL. COMP. STAT. ANN. 505/10a(a) (2008).

43. *See* ALASKA STAT. § 46.03.822 (LexisNexis 2008) (providing for strict liability for certain economic losses related to the release of hazardous substances); *see also* Kodiak Island Borough v. Exxon Corp., 991 P.2d 757, 769 (Alaska 1999) (concluding that in "allowing recovery for purely economic damages, Alaska's hazardous substances statutes do not unduly interfere with the harmony or uniformity of federal maritime law").

44. *See In re* Ford Motor Co. E-350 Van Prods. Liab. Litig. (No. II), No. 03-4558, 2008 WL 4126264, at *29 (D.N.J. Sept. 2, 2008) (concluding that the economic loss rule did not bar a claim under the New Jersey Consumer Fraud Act); PNC Bank, Nat'l Ass'n v. Colonial Bank, N.A., 2008 WL 2917639, at *4 (M.D. Fla. July 24, 2008) (stating principle in dicta); Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 543 n.3 (Fla. 2004) (recognizing the principle). *But see* Butcher v. DaimlerChrysler Co., LLC, No. 1:08-CV-207, 2008 WL 2953472, at *4 (M.D.N.C. July 29, 2008) (finding that under North Carolina law, the economic loss rule bars a claim under the state deceptive trade practices act for economic losses); Natarajan v. Paul Revere Life Ins. Co., No. 8:04-CV-2612-T-17TGW, 2008 WL 2885704, at *2 (M.D. Fla. July 24, 2008) (finding that RICO claims not based on acts independent of a breach of contract were barred by the economic loss rule).

45. *See* Union Oil Co. v. Oppen, 501 F.2d 558, 565 (9th Cir. 1974) (discussing the "special relationship exception"). In *Union Oil*, the court wrote:

> Prosser recognizes that a recovery for pure economic losses in negligence has been permitted in instances in which there exists "some special relation between the parties . . . ." The failure of the plaintiff to obtain a contract because of a telegraph company's negligent transmission of a message has been held to be legally cognizable, and is cited as an example of the "special relationship" qualification . . . . Other examples which have been cited are the negligent failure to perform a gratuitous promise to obtain insurance, and the negligent delay in acting upon an application for insurance.

Id. (citations omitted).

If the economic loss rule is held to bar intentional tort claims as well as ones founded on negligence, the list of exceptions must even be greater. Intentional tort actions based on fraudulent misrepresentation,[46] tortious interference with contract[47] or with prospective advantage,[48] and

46. *See* Granite Cos. v. City Capital Corp., No. 07-3078, 2008 WL 3285914, at *3 (E.D. Pa. Aug. 8, 2008) (finding that a fraud in the inducement claim was viable); MyVitaNet.com v. Kowalski, No. 2:08-CV-48, 2008 WL 2977889, at *9 (S.D. Ohio July 29, 2008) (concluding that the plaintiff's claims for fraud and intentional misrepresentation were plausible grounds for relief because they sought "damages that extend beyond only economic loss"); EED Holdings v. Palmer Johnson Acquisition Corp., 387 F. Supp. 2d 265, 278 (S.D.N.Y. 2004) (stating that "New York courts have routinely permitted fraud and contract claims to proceed in tandem for the purpose of recovering pure economic loss" and concluding that a fraud claim was not barred by the rule); Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 274 (Cal. 2004) (holding that the economic loss rule does not bar fraud and intentional misrepresentation claims); Alejandre v. Bull, 153 P.3d 864, 866 (Wash. 2007) (recognizing that fraudulent concealment is an exception to the economic loss rule, but finding that the plaintiffs failed to prove fraud).

In some jurisdictions, fraud in the inducement may be treated differently than fraud in the performance. *See* D & M Jupiter, Inc. v. Friedopfer, 853 So. 2d 485, 487–88 (Fla. Dist. Ct. App. 2003) (stating that "'[w]hen the fraud relates to the performance of the contract, the economic loss doctrine'" limits parties to contractual remedies, but fraud from "'misrepresentations, statements, or omissions which cause the complaining party to enter into a transaction . . . is fraud in the inducement and survives as an independent tort'" (quoting Allen v. Stephan Co., 784 So. 2d 456, 457 (Fla. Dist. Ct. App. 2000))); *see also* Gen. Elec. Corp. v. BASF Corp., No. 06-CV-283-NRB, 2008 WL 4185870, at *18 (S.D.N.Y. Sept. 4, 2008) (finding that "the distinction between fraud-in-the-inducement and fraud-in-the-performance is currently the state of law in New Jersey"); *In re* Biddiscombe Int'l., L.L.C., 392 B.R. 909, 916 (Bankr. M.D. Fla. 2008) (concluding that the "economic loss rule does not bar the tort of fraudulent inducement"); Hotels of Key Largo, Inc. v. RHI Hotels, Inc., 694 So. 2d 74, 78 (Fla. Dist. Ct. App. 1997) (stating that "[m]isrepresentations relating to the breaching party's performance of a contract do not give rise to an independent cause of action in tort, . . . [as they] are indistinct from the heart of the contractual agreement," and, therefore, the economic loss rule applies and limits the parties to contractual remedies). *See generally* Christopher W. Arledge, *Is the California Supreme Court Confusing the Boundaries of the Economic Loss Rule?*, 47 ORANGE COUNTY LAWYER 22, 24 (May 2005) (criticizing a decision holding that the economic loss rule did not bar a fraud claim that arose in the context of a contract for the sale of goods); R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1789 (2000) (describing the economic loss rule as "one of the most confusing doctrines in tort law").

47. *See* Shands Teaching Hosp. & Clinics, Inc. v. Beech St. Corp., 899 So. 2d 1222, 1228–29 (Fla. Dist. Ct. App. 2005) (holding that the rule did not bar a health care provider from suing the administrator of the state's group health insurance program for tortious interference with contract); RESTATEMENT (SECOND) OF TORTS § 766 (1979) ("One who intentionally and improperly interferes with the performance of a contract . . . between another and a third person . . . is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract.").

48. *See* RESTATEMENT (SECOND) OF TORTS § 766B (1979) ("One who intentionally and improperly interferes with another's prospective contractual relation . . . is subject to liability . . . whether the interference consists of (a) inducing or otherwise causing a third person

conversion[49] routinely allow recovery of purely economic losses.[50] Moreover, theories of secondary liability, such as intentionally aiding and abetting a breach of fiduciary duty,[51] may make a defendant liable to a plaintiff for purely economic harm. This multitude of exceptions means that, contrary to the view of some writers, the economic loss rule, in operation rather than theory, does not provide a "clear and predictable limit to liability."[52]

D. One Rule or Several?

The truth may be that there is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern

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not to enter into or continue the prospective relation or (b) preventing the other from acquiring or continuing the prospective relation.").

49. *See* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 879–80 (9th Cir. 2007) (holding that conversion and fraud claims were not barred by the economic loss rule); Alex Hofrichter, P.A. v. Zuckerman & Venditti, P.A., 710 So. 2d 127, 127 (Fla. Dist. Ct. App. 1998) (stating that the economic loss rule did not bar claims for conversion, civil theft, and constructive fraud where a lawyer converted partnership funds to personal use). *But see* PNC Bank, N.A. v. Colonial Bank, N.A., No. 8:08-CV-611-T-24MSS, 2008 WL 2917639, at *3 (M.D. Fla. July 24, 2008) (finding that a conversion claim was barred by the economic loss rule where it related "directly to the performance of the Agreement and is therefore 'exactly coextensive' with . . . [the plaintiff's] breach of contract claim" (quoting Future Tech Int'l, Inc. v. Tae Il Media, Ltd., 944 F. Supp. 1538, 1569 (S.D. Fla. 1996))).

50. *See* RESTATEMENT (SECOND) OF TORTS § 774A(1) (1979) (providing that contract interference renders one liable "for damages for (a) the pecuniary loss of the benefits of the contract or the prospective relation; (b) consequential losses for which the interference is a legal cause; and (c) emotional distress or actual harm to reputation").

51. *See* Katarina P. Lewinbuk, *Let's Sue All the Lawyers: The Rise of Claims Against Lawyers for Aiding and Abetting a Client's Breach of Fiduciary Duty*, 40 ARIZ. ST. L.J. 135, 146 (2008) ("The critical distinction between a regular legal malpractice claim and a claim against an attorney for aiding and abetting her client's breach of fiduciary duty is that 'there need be no allegation that the attorney actually owed the plaintiff a direct duty of care'" (quoting David Grossbaum, Partner, Hinshaw & Culbertson LLP, *Conspiring to Commit or Aiding and Abetting a Client's Breach of Fiduciary Duty: Defending Such Claims Against Attorneys*, Presentation at Hinshaw's 2006 Legal Malpractice & Risk Management Conference, at 3 (Mar. 2, 2006))); Douglas R. Richmond, *Lawyer Liability for Aiding and Abetting Clients' Misconduct Under State Law*, 75 DEF. COUNS. J. 130, 130 (2008) ("[T]he theory gained serious traction during the savings and loan crisis of the mid- to late 1980's and early 1990's, when government regulators and private plaintiffs sued numerous law and accounting firms for their alleged roles in institutional failures principally attributable to corrupt directors and officers.").

52. *See* Daniel London, *Is the Economic Loss Rule in Peril? Courts, Negligence and the Economic Loss Wolves*, 71 DEF. COUNS. J. 379, 380 (2004) (discussing the historical continuity of courts' application of the economic loss doctrine).

recovery of economic losses in selected areas of the law.[53] For example, the rules that limit the liability of accountants to third parties for harm caused by negligence[54] or that save careless drivers from liability to the employer of a person injured in an auto accident[55] may be fundamentally distinct from the ones that bar compensation in tort for purely economic losses resulting from defective products[56] or misperformance of obligations arising only under contract.[57]

For purposes of convenience, this Article will speak of the economic loss rule in the singular, nevertheless recognizing that on the issue of whether there is one rule or several, the jury is still out. Thoughtful voices doubt whether there is a unitary theory[58] and are arguing against the "crystallization" of a single rule.[59] Indeed, the American Law Institute's project on tort liability for economic loss is now in abeyance, following the resignation of the Reporter.[60] None of the project's

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53. *See* Dobbs, *supra* note 1, at 714 (discussing two "distinct" rules); Feinman, *supra* note 1, at 813 (opining that "there is not one economic loss rule, but several"); Gruning, *supra* note 1, at 208 ("American tort law displays many economic loss rules not merely because many states contribute to their elaboration. It also displays many such rules because the problem of economic loss itself is plural and variegated.").

54. In fact, courts differ in how they articulate the limits on the liability of accountants to third parties. *See* Vincent R. Johnson & Shawn M. Lovorn, *Misrepresentation by Lawyers About Credentials or Experience*, 57 OKLA. L. REV. 529, 566–67 (2004) (indicating that the accounting liability cases tend to follow one of three views, which require either privity or near-privity between the parties, foreseeability of reliance, or reliance by "one of a limited group of persons for whose benefit the information was supplied").

55. *See* Castle v. Williams, 788 N.E.2d 421, 424 (Ill. Ct. App. 2003) ("[A] person who tortiously causes physical harm to an agent is not liable to the principal for the harm thereby caused to him"); *see also* Lauria v. Mandalay Corp., No. 07-817, 2008 WL 3887608, at *2 (D.N.J. Aug. 18, 2008) (stating that in the context of a slip and fall accident that "neither New Jersey nor Nevada law would permit an employer to recover under a negligence theory for economic losses solely derived from an injury to an employee").

56. *See infra* Part II.C.2 (discussing the boundary-line function in products liability cases).

57. *See infra* note 109 and accompanying text (discussing parties' ability to bargain for protection from economic harm).

58. *See* Rabin, *supra* note 1, at 859 (opining that "the constraints imposed by the economic loss rule do not . . . reflect any single normative principle" and "the cases do not comprise a single generic category guided by a unified set of underlying policy considerations").

59. *See, e.g.*, Gray, *supra* note 1, at 899 (claiming a singular expression of the economic loss rule is neither dictated by precedent—given the diversity of rules articulated by courts—nor desirable); Rabin, *supra* note 1, at 859 (suggesting that "attempts to generate a single rationale for what the courts are doing run the risk of oversimplifying the policy concerns at stake").

60. According to the American Law Institute:

> The Council approved the start of the project in 2004. Thus far, no part of the work has been approved by the Council or by the membership. Professor Mark Gergen resigned as the project's Reporter in late 2007; the project is in abeyance while the

initial drafts[61] were approved by the Institute.[62] The confusing[63] mass of precedent relating to tort liability for economic loss has yet to be disentangled and expressed with the clarity commonly found with respect to other tort law topics.

E. Abundant Litigation

The terms and scope of the economic loss rule may be the subject of disagreement, but there is no dispute as to the underlying reality; recovery in tort actions today for purely economic losses is often difficult to obtain.[64] Indeed, the obstacles posed by the economic loss rule or related principles seem to loom ever larger.[65] The economic loss rule was not even taught in

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Director seeks a successor Reporter.

The American Law Institute, Current Projects, http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=15 (last visited Nov. 10, 2008) (on file with the Washington and Lee Law Review).

61. Two drafts were submitted to the Members Consultative Group addressing the economic loss rule. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 (Preliminary Draft No. 1, 2005) ("An actor who accidentally causes pecuniary harm to another that does not result from a wrongful injury to the person or property of the other is subject to liability in tort for neglect of a duty of care to the other only as stated in §§ 9–21."); RESTATEMENT (THIRD) OF TORTS: ECON. TORTS AND RELATED WRONGS § 8(3) (Preliminary Draft No. 2, 2006) ("An actor is subject to liability for solely pecuniary harm resulting from the actor's breach of a duty of care . . . or resulting from the actor's unreasonable conduct, abnormally dangerous activity, or defective product."). Focusing on third-party cases, one leading scholar described the position of Preliminary Draft No. 1 as "extreme" and Draft No. 2 as "less restrictive" and "narrower." Feinman, *supra* note 1, at 820. Two drafts were submitted to the Council of the Institute. *See* RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8(3) (Council Draft No. 1, Oct. 2, 2006) ("An actor who unintentionally causes pure economic loss is subject to liability in tort as described in §§ 9–21."); RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8(1) (Council Draft No. 2, Oct. 5, 2007) ("In general, there is no liability in tort for pure economic loss caused unintentionally and without dishonesty or disloyalty except as stated in §§ 9–23.").

62. *See* The American Law Institute, *supra* note 60 (stating that "[t]hus far, no part of the work has been approved by the Council or by the membership").

63. *See* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 536 (Fla. 2004) (asserting that "there has been much confusion about the scope of this doctrine"); Barton, *supra* note 46, at 1789 (describing the economic loss rule as "one of the most confusing doctrines in tort law").

64. *See* Bernstein, *supra* note 7, at 112 (opining that American law is "generally opposed to recovery [for pure economic loss] on a negligence theory"); Gruning, *supra* note 1, at 187 (stating that "even clearly demonstrable economic losses that cannot be characterized as dependent on physical harm to the plaintiff are generally not compensated").

65. *See, e.g.*, Emily Kuwahara, *Torts v. Contracts: Can Microsoft Be Held Liable to*

law schools as substantial legal principle a generation ago.[66] However, today it is covered in many tort casebooks[67] and presumably taught in many classes.

Home Consumers for Its Security Flaws, 80 S. CAL. L. REV. 997, 1025–31 (2007) (suggesting that the economic loss rule would bar tort claims related to three forms of software-related cyber attacks: deletion of files, misappropriation of data, and denial of service).

66. *See* Pryor, *supra* note 1, at 905 ("Over the past 25 years, the 'economic loss rule' has created a sprawling caselaw, which has elevated it from its once-provincial role in products liability to a dominant argument in all manner of economic harm cases."); *see also* Feinman, *supra* note 1, at 815–17 (discussing the historical background of liability for third-party economic loss and stating that "[u]ntil the 1950s, limiting doctrines such as privity and restrictive liability rules in misrepresentation and negligence made it virtually impossible for a third party to recover for negligently-inflicted economic loss").

The historical origins of the economic loss rule depend on the branch of the rule with which one is concerned. The branch of the rule denying compensation for negligently caused interference with contract has been traced to *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927) (Holmes, J.). *See* Gruning, *supra* note 1, at 189–90 (discussing *Robins*). The *Robins* line of development is reflected in the *Restatement (Second) of Torts* § 766C. *See* RESTATEMENT (SECOND) OF TORTS § 766C (1979) ("One is not liable to another for pecuniary harm . . . result[ing] from the actor's negligently (a) causing a third person not to perform a contract with the other, or (b) interfering with the other's performance of his contract . . . , or (c) interfering with the other's acquiring a contractual relation with a third person.").

The branch of the rule denying compensation under tort law for harm caused by defective products originated with *Seely v. White Motor Co.*, 403 P.2d 145, 151 (Cal. 1965) (Traynor, J.). *See* Congregation of the Passion, Holy Cross Province v. Touche Ross & Co., 636 N.E.2d 503, 512 (Ill. 1994) (discussing *Seely*); Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1259–61 (Colo. 2000) (discussing the origins of the economic loss rule and explaining it as a limited principle that preserved a proper sphere for contract law after the adoption of strict products liability).

A pivotal event in the recent development of the economic loss rule was Justice Harry Blackmun's opinion in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 876 (1986), which held that "whether stated in negligence or strict liability, no products-liability claim lies in admiralty when the only injury claimed is economic loss." *Id.* That decision, together with the previously established rule that negligent interference with contract or prospective advantage is not actionable, catalyzed efforts to articulate a grander formulation of an economic loss rule that applies beyond the fields of products liability or tortious interference. *See* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 873 (9th Cir. 2007) ("The 'economic loss doctrine' as a separately named and articulated doctrine dates only from the last half century.").

67. *See, e.g.*, DAN B. DOBBS & ELLEN M. BUBLICK, CASES AND MATERIALS ON ADVANCED TORTS: ECONOMIC AND DIGNITARY TORTS 441–53 (2006) (discussing "products and the Economic Loss Rule(s)"); JERRY J. PHILLIPS ET AL., TORT LAW: CASES, MATERIALS, PROBLEMS 518–28 (3d ed. 2002) (discussing economic loss as a result of negligence); DAVID W. ROBERTSON ET AL., CASES AND MATERIALS ON TORTS 253–71 (3d ed. 2004) (discussing "economic loss without physical injury"); AARON D. TWERSKI & JAMES A. HENDERSON, TORTS: CASES AND MATERIALS 318–36 (2003) (discussing "limitations on recovery for pure economic loss").

Litigants regularly assert the economic loss rule as a barrier to liability,[68] often with success.[69] So great is the ferment that Chief Justice Shirley S. Abrahamson of the Supreme Court of Wisconsin noted that the economic loss doctrine was an issue before her state high court or intermediate court forty-seven times in a recent five-year period.[70] She lamented that at "the current pace, the economic loss doctrine may consume much of tort law if left unchecked."[71]

F. The Limits of the Economic Loss Rule

Of course, the obstacles to recovery posed by the economic loss rule should be no greater than the justifications upon which the rule is founded. *Cessante ratione legis cessat et ipsa lex.*[72] Not surprisingly, the confusion over the terms of the rule is accompanied by further uncertainty as to the reasons for the rule.[73]

Part II of this Article considers the justifications advanced in support of the economic loss rule, and in particular the argument that the rule performs a useful boundary-line function by determining when contract-law principles supplant the law of torts. Focusing on the boundary-line rationale, this

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68. *See, e.g.*, *In re* Adelphia Commc'ns Corp., No. 02-B-41729, 2008 WL 3919198, at *4 n.3 (S.D.N.Y. Aug. 22, 2008) (finding it unnecessary to address the appellee's arguments that certain tort claims were barred by the economic loss rule, because the appellants conceded they were not seeking tort damages); Mason v. Chase Bank, No. 05-07-01513-CV, 2008 WL 3412212, at *2 (Tex. App. Aug. 13, 2008) (noting the defendant's assertion that the rule was grounds for summary judgment in a suit relating to a construction loan); King v. Rice, 191 P.3d 946, 951–52 (Wash. Ct. App. 2008) (holding that the economic loss rule did not bar negligence and malicious mischief claims related to destruction of a modular living unit).

69. *See, e.g.*, Bryan's Quality Plus, LLC v. Shaffer Builders, Inc., No. 07-CV-2311, 2008 WL 3523935, at *5 n.10 (E.D. Pa. Aug. 12, 2008) (noting that claims relating to a construction dispute were barred by the economic loss rule).

70. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005) (Abrahamson, C.J., dissenting) (citing a study of cases from 2000 to 2004).

71. *Id.* at 181 (Abrahamson, C.J., dissenting).

72. *See* Vargo v. Schwartz, 81 Pa. D. & C.4th 1, 12 n.7 (Pa. Com. Pl. 2007) (providing the translation for the maxim as "where stops the reason, there stops the rule") (citing Brinkley v. King, 701 A.2d 176, 181 (Pa. 1997)); BLACK'S LAW DICTIONARY App. B at 1708 (8th ed. 2004) (translating the maxim as "[w]hen the reason of the law ceases, the law itself also ceases").

73. *Cf.* Bernstein, *supra* note 1, at 774 (stating that "pure economic loss 'remains a backwater within the discourse of American tort law'" (quoting Gary T. Schwartz, *American Tort Law and the (Supposed) Economic Loss Rule*, *in* PURE ECONOMIC LOSS IN EUROPE 94, 96 (Mauro Bussani & Vernon Palmer eds., 2003))).

Article addresses the application of the economic loss rule in a particular range of cases. That range includes only those cases where the question is whether the defendant owes the plaintiff no duty under tort law because a particular contract (either with the plaintiff or with a third-party) defines the extent of the defendant's obligation or because contract law generally is the sole source of remedies for the harm of which the plaintiff complains. Thus, in reference to the three categories of concern mentioned above,[74] the analysis relates mainly to categories one (sales of defective products) and two (other contractual arrangements), and not to category three (the residual range of tort cases where contractual principles are not being asserted as a limit on duty). More specifically, because the law governing claims related to defective products is so well established,[75] the focus here is primarily on category two.

Part III of this Article probes the limits of the economic loss rule in reference to its boundary-line function in three particular respects. First, the Article argues, as some courts have recognized, that the rule generally should not be an obstacle to recovery if the plaintiff was not a party to a contract with the defendant that is alleged to be the exclusive source of duty.[76] Not all courts have agreed with this contention.

Second, the Article asserts that hypothetical remedies under contracts that were never entered into should not bar recovery under tort principles.[77] If there was never an exercise of freedom to contract, there is no reason for tort law to defer to private ordering. In many instances, but certainly not all, tort law is an appropriate vehicle for remedying purely economic loss. Hypothetical remedies under nonexistent contract should not preclude courts from addressing the issue of whether the defendant breached a duty under tort law.

Third, courts have sometimes erred in ruling broadly that claims related to independent tort duties[78] are barred if the damages relate to the subject matter

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74. *See supra* Part I.A (defining the three areas of concern as product defects, torts involving contractual obligations between the parties, and a residual category—inclusive of all other tort claims not encompassed by the first two situations).

75. *See infra* Part II.C.2 (describing the economic loss rule as providing a clear boundary line in product defects cases, allowing recovery in tort for defects causing physical harm, and limiting a party to contractual remedies where the only harm suffered is economic).

76. *See infra* Part III.A (discussing cases where courts allow recovery in tort because the plaintiff and defendant were not in privity).

77. *See infra* Part III.B (criticizing a court's decision barring a plaintiff from seeking relief in negligence as contrary to American tort law and "com[ing] perilously close to saying that contract law is the exclusive source of protection from economic losses").

78. *See infra* Part III.C.1 (discussing cases where courts trace the source of the alleged duty owed, finding the economic loss rule does not apply if the defendant owed the plaintiff a

of an existing contract,[79] are based on the same facts as a breach of contract claim,[80] or involve "disappointed" commercial expectations[81] related to the contract. This Article contends that the operation of the economic loss rule in these kinds of cases (and whether relief in tort based on an independent duty should be available notwithstanding the parties' contract) should be guided by the principles that generally determine whether one body of law displaces another.[82] These principles can be deduced from the jurisprudence that determines whether federal law preempts state law, whether statutory provisions replace common law, and whether a contractual release from liability effectively waives tort rights. Remedies otherwise available under tort law should not be foreclosed merely because a claim relates to the subject matter or factual context of a contract or the expectations arising therefrom. Rather, whether contract principles displace remedies based on an independent tort duty should depend on the terms of the parties' agreement and whether those terms are consistent with public policy. Only where a contract expressly or by necessary implication elects to replace tort principles actually or potentially establishing an independent duty should relief under tort law for purely economic losses be barred by the economic loss rule. Finally, Part VI urges courts to be vigilant in ensuring that an unrealistic and unwarranted endorsement of contract principles does not undermine the fault and deterrence policies that animate American tort law.

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duty independent of contractual obligations).

79. *See infra* Part III.E.1 (disagreeing with cases—where the parties were contractually linked but the duty breached arose in tort—denying recovery in tort because the losses related to the subject matter of the parties' contract).

80. *See infra* Part III.E.3 (suggesting the economic loss rule is misunderstood and misapplied in cases where recovery in tort is denied because the same facts arise out of breach of contract claim).

81. *See infra* Part III.E.2 (claiming that disappointed expectations should not be categorically excluded as insufficient grounds for a suit).

82. *See infra* Part III.D (analogizing traditional notions of preemption to the displacement of tort law by contract law).

II. The Policy Basis for the Economic Loss Rule

A. Broad, Speculative, Disproportionate, or Insurable Liability

A variety of reasons have been offered to justify the economic loss rule,[83] although those reasons "have not traditionally been clear."[84] It is said, for example, that liability for negligence that causes only

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83. *See generally* Gruning, *supra* note 1, at 206–08 (explaining various policy rationales advanced in support of the economic loss rule); Vincent R. Johnson, *Standardized Tests, Erroneous Scores, and Tort Liability*, 38 RUTGERS L.J. 655, 680–84 (2007) (discussing the economic loss rule in the context of standardized test mis-scoring litigation).

Three purported justifications for the economic loss rule that are not discussed in the text concern simplicity, similarity, and social loss. Some writers argue that the economic loss rule reflects a preference for keeping the cases that fall within the purview of tort law simple. *See* Bernstein, *supra* note 1, at 777 ("Tort law refuses to recognize actions for pure consequential financial loss because these claims are not easy enough to follow . . . . To remain intelligible to prospective plaintiffs, tortfeasor-defendants, and (in the United States) jurors, tort law must articulate its demands simply, with a relatively low common denominator in mind."). Other writers argue that pure economic loss is not actionable because, unlike personal injury or property damage, it is too similar to the types of losses that capitalism takes for granted. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 cmt. b (Preliminary Draft No. 1, 2005) ("Some believe solely pecuniary harm merits less legal protection than harm to person or property because pecuniary losses often are not social losses. One firm's lost profit is likely to be another firm's profit gained."). The social-loss rationale is a theory that seems to have little impact on the adjudication of real cases. Courts rarely mention this idea in their opinions.

84. Gray, *supra* note 1, at 898. Addressing the foundational uncertainty surrounding the various limitations on tort liability for economic loss, Professor Oscar Gray wrote:

> Perhaps there is here a flavor of a "standing" issue—a difference sensed between a complaint about harm to one's own property as compared with harm to another's. Perhaps, similarly, there is a concern with the possibility of duplicative claims, if these boundary lines are crossed. Fear of "indeterminate" or "incalculable" damages is sometimes expressed, for reasons not specified—perhaps concern about actuarial unmanageability, that is, non-insurability, except at exorbitant premiums, or subject to unwelcome restrictions, such as deductibility requirements.
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> . . . .
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> These concerns are often coupled with references to the expected "ripple-effects" in the economic impacts from negligence, where the expected physical effects would be more limited.
>
> [Another reason is that] . . . [a] paradoxical situation can arise where there is a very large number of potential victims (as in conflagration cases, in the realm of physical damages) and better risk distribution may be obtained by leaving losses to lie where they fall than by attempting to concentrate them on an injurer–even if the injurer is to some extent insured.

Id. at 898–99.

The high-water mark in opaque jurisprudence relating to liability for economic loss may have been the famous case of *Kinsman Transit Co. v. City of Buffalo* (*Kinsman No. 2*), 388 F.2d

economic harm must be uncompensable under tort law because allowing such recovery would:

- expose defendants to an unlimited scope of liability;[85]
- impose liability for damages that are speculative;[86]

821, 824–25 (2d Cir. 1968). The plaintiffs were the owners of wheat stored aboard a ship which could not navigate the river because of the wreckage of a collapsed bridge. *Id.* at 822. They brought suit to recover the costs of being forced to transport the wheat via an alternative route. *Id.* at 822–23. The court held that even though it was foreseeable that commerce on the river would be disrupted and that some parties would incur such costs, the relationship of those costs to the defendants' negligence was "too tenuous and remote" to permit recovery. *Id.* at 825. Prosser said that just what this phrase means "would appear to be anybody's guess." *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON TORTS 297 (5th ed. 1984). *Kinsman No. 2* contains a famous footnote. Writing for the court, Judge Irving Kaufman stated in dicta:

> To anyone familiar with N.Y. traffic there can be no doubt that a foreseeable result of an accident in the Brooklyn Battery Tunnel during rush hour is that thousands of people will be delayed. A driver who negligently caused such an accident would certainly be held accountable to those physically injured in the crash. But we doubt that damages would be recoverable against the negligent driver in favor of truckers or contract carriers who suffered provable losses because of the delay or to the wage earner who was forced to 'clock in' an hour late.

Kinsman No. 2., 388 F.2d at 825 n.8.

85. *See* Aikens v. Balt. & Ohio R. Co., 501 A.2d 277, 279 (Pa. Super. Ct. 1985) (rejecting employees' claim for lost wages caused by plant damage from a train derailment because permitting recovery "for negligent causation of purely economic loss would be to open the door to every person in the economic chain of the negligent person or business to bring a cause of action"); *see also* David B. Gaebler, *Negligence, Economic Loss, and the U.C.C.*, 61 IND. L.J. 593, 611–12 (1986) (stating that "Professor [Fleming] James noted that as a practical matter the physical consequences of negligence are usually limited, but that 'the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended'" (quoting Fleming James, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 45 (1972))); Johnson, *supra* note 32, at 296–97 (asserting that "somewhat crudely, the economic-loss rule protects potential defendants from the risk of a disproportionately wide range of liability" (citing JAY M. FEINMAN, ECONOMIC NEGLIGENCE: LIABILITY OF PROFESSIONALS AND BUSINESSES TO THIRD PARTIES FOR ECONOMIC LOSS §§ 1.2 & 1.3.2 (1995))); Pryor, *supra* note 1, at 907 (noting that "[t]he economic loss rule rests in part on considerations that also have insurance implications, such as unpredictability about the extent and scope of purely economic ripple effects"). *See generally* Banknorth, N.A. v. BJ's Wholesale Club, Inc., 442 F. Supp. 2d 206, 213–14 (M.D. Pa. 2006) (rejecting the plaintiff's arguments related to unlimited liability concerns "because there are many rationales for the economic loss rule").

Professor Herbert Bernstein suggests that defenders of the economic loss rule erroneously assume that "widespread liability is a serious concern only in nonphysical harm cases, and that widespread liability is generally of no concern when negligence has caused personal injury or physical damage to property." Bernstein, *supra* note 7, at 127. Under their view, "more than 150 years of rapid industrialization with the attendant phenomenon of mass torts involving physical injuries of sometimes staggering proportions go virtually unnoticed." *Id.*

86. *See* Johnson, *supra* note 32, at 297–98 ("[L]ost economic opportunities are often not

- result in liability that is disproportionate to fault;[87] or
- have a "chilling effect on non-negligent conduct."[88]

These considerations carry weight, at least under some circumstances. Yet, whether they justify a general rule denying liability for negligently caused economic losses unaccompanied by personal injury or property damage is open to question. It may simply be that liability should be denied whenever damages are speculative or excessive, or where harm to the plaintiff was insufficiently foreseeable or was otherwise outside the scope of risks as to make it fair to hold the defendant liable. Indeed, general principles of damages and proximate causation already recognize these concepts, and rules are in place to guard against liability for speculative,[89] excessive,[90] or unforeseeable losses[91] or losses outside the scope of risks that made the defendant's conduct negligent.[92] Because that is true, these considerations offer dubious justification for erecting

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readily susceptible to precise calculation . . . [and by] ruling out litigation in a huge range of cases (suits involving no personal injury or property damage), the economic-loss rule helps to ensure (. . . somewhat crudely) that compensation is not awarded for [speculative] amounts.").

87. *See Aikens*, 501 A.2d at 279 (stating that "allowance of a cause of action for negligent interference with economic advantage would create an undue burden upon industrial freedom of action, and would create a disproportion between the large amount of damages that might be recovered and the extent of the defendant's fault" (citing RESTATEMENT (SECOND) OF TORTS § 766C, cmt. a (1979))); *see also* Kevin J. Breer & Justin D. Pulikkan, *The Economic Loss Rule in Kansas and Its Impact on Construction Cases*, 74 J. KAN. B.A. 30, 31 (June 2005) ("The primary motivation behind the economic loss rule is the fear that allowing a party to proceed in tort would result in 'crushing useful activity by a liability.'" (quoting Gunkel v. Renovations Inc., 797 N.E.2d 841, 844 (Ind. Ct. App. 2003))); London, *supra* note 52, at 381 (discussing the risk that liability for economic loss will result in over-deterrence); Rabin, *supra* note 1, at 862 ("[I]t is critical to note that the concern over ripple effects is not synonymous with a crushing liability concern.").

88. *See* Gaebler, *supra* note 85, at 612 (noting that because the line between negligent and non-negligent conduct is not clearly delineated, the deterrent effect of open-ended liability is thwarted because it would prevent useful activity as well).

89. *See, e.g.*, Health Call v. Atrium Home & Health Care Servs., Inc., 706 N.W.2d 843, 852 (Mich. App. 2005) ("The general rule is that remote, contingent, and speculative damages cannot be recovered in Michigan in a tort action.").

90. *See, e.g.*, Johansen v. Combustion Eng'g, Inc., 170 F.3d 1320, 1328 (11th Cir. 1999) (stating that "when a court finds that a jury's award of damages is excessive, it may grant the defendant a new trial").

91. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON TORTS 280–81 (5th ed. 1984) (discussing the general policy of limiting tort liability for unforeseeable consequences of negligent conduct).

92. *Cf.* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL HARM § 29 (Proposed Final Draft No. 1, 2005) ("An actor's liability is limited to those physical harms that result from the risks that made the actor's conduct tortious.").

a general economic loss rule. Moreover, while there is a risk that liability for negligent conduct might have a chilling effect on non-negligent conduct, "because the line between negligent and non-negligent conduct is not a clear one,"[93] there is no reason to think that that problem is any greater in cases involving purely economic losses than in the great mass of cases in which liability for negligence (including economic loss damages) is routinely imposed.

Courts also sometimes find that liability for negligently caused economic losses should be denied because those losses were more readily insurable by the plaintiff than the defendant.[94] This is an important consideration, for the ability to spread a loss broadly and thereby minimize its costs has been an important consideration in shaping the American tort rules governing liability.[95] However, it is not always the case that a negligently caused economic loss is more insurable by the plaintiff than the defendant.[96] Moreover, the spreading of losses is only one of many considerations that needs to be taken into account in determining whether a duty of care should be recognized.[97] While the spreading principle can explain the rulings of courts in particular situations,[98] it

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93. Gaebler, *supra* note 85, at 612.

94. *See* Castle v. Williams, 788 N.E.2d 421, 424 (Ill. App. Ct. 2003) (denying recovery of negligently caused economic losses resulting from injury of a key employee in an auto accident because "employers are in the better position to insure against such a loss through the purchase of 'key man' insurance and business management").

95. *See, e.g.*, GUIDO CALABRESI, THE COSTS OF ACCIDENTS 45, 55–64 (1970) (discussing the reasons that private insurance gives rise to inadequate loss spreading); Johnson, *supra* note 83, at 669 n.91 (discussing spreading as it relates to products liability and *respondeat superior*); Johnson, *supra* note 32, at 276 (asserting that, in addressing unsettled questions of duty, "[c]ourts sometimes . . . consider 'the availability, cost, and prevalence of insurance for the risk involved,' with the assumption being that insurability of the risk makes imposition of a duty more palatable because of the cost-spreading ability of insurance" (quoting Rowland v. Christian, 443 P.2d 561, 564 (Cal. 1968))).

96. *Cf.* Pryor, *supra* note 1, at 918 ("[O]ne is hard-pressed to argue that pure economic loss is uninsurable. Perhaps the strongest insurability concern would be moral hazard. If the loss is the failure to live up to the contract's performance obligations, resulting in a diminished value or quality of service, then the presence of insurance could reduce the insured's incentives to live up to the contract."). *But see* London, *supra* note 52, at 383 (discussing the types of insurance available for economic loss and arguing that third-party insurance may be undesirable).

97. *Cf.* Vincent R. Johnson & Claire G. Hargrove, *The Tort Duty of Parents to Protect Minor Children*, 51 VILL. L. REV. 311, 329 (2006) ("Whether a device for spreading losses (such as insurance) is available is only significant if the loss is of the kind that should be spread. Losses caused by highly blameworthy conduct are not of that variety.").

98. *See* Edward F. Heimbrock Co. v. Marine Sales & Serv., Inc., 766 S.W.2d 70, 72 (Ky. Ct. App. 1989) (denying recovery to an employer for economic losses stemming from injuries to

cannot justify a generalized theory denying recovery for negligently caused pure economic losses in a wide range of cases.

B. Avoiding Losses and Promoting a "Healthy Attitude"

Courts also assert, in contractual contexts, that the "[a]pplication of the economic loss doctrine to tort actions between commercial parties is . . . [intended] to encourage the party best situated to assess the risk of economic loss, the commercial purchaser, to assume, allocate, or insure against that risk."[99] This, too, is an important consideration. "[T]ort law should encourage individuals to employ available resources to protect their own interests, rather than depend upon others to save them from harm."[100] Obviously, the policy has force with respect to the purchase of goods. However, outside of that arena, it is difficult to generalize because, in some cases, risks may be more foreseeable to the person engaging in an injurious activity than to the victim. Thus, one court held that defendants were "under a duty to commercial fisherman to conduct their drilling and production in a reasonably prudent manner so as to avoid the negligent diminution of aquatic life" because the defendants were "unmistakably . . . the best cost-avoider."[101]

Writers sometimes suggest that the economic loss rule promotes a sort of individual responsibility by encouraging injured persons "to make up the economic loss by doing more work the next day,"[102] rather than through

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an employee because "employers . . . are in a better position to insure against loss"); Ferguson v. Green Island Contracting Corp., 355 N.Y.S.2d 196, 198 (App. Div. 1974) (same).

99. Daanen & Janssen, Inc. v. Cedarapids, Inc., 573 N.W.2d 842, 846 (Wis. 1998); *see also* Evra Corp. v. Swiss Bank Corp., 673 F.2d 951, 957 (7th Cir. 1982) (holding that the bank was not liable for the consequences of negligently failing to transfer funds). Judge Posner, writing for the Seventh Circuit, noted that "the costs of the untoward consequence of a course of dealings should be borne by that party who was able to avert the consequence at the least cost and failed to do so." *Id.* at 757 (citing Hadley v. Baxendale, (1854) 56 Eng. Rep. 145). Given this common law standard of liability for consequential damages, the court found that:

> It was imprudent thereafter for [the plaintiff], having narrowly avoided cancellation and having . . . been put . . . on notice that the payment provision of the Charter would be strictly enforced thereafter, to wait till arguably the last day before payment was due to instruct its bank to transfer the necessary funds overseas.

Id. (internal quotations omitted).

100. JOHNSON & GUNN, *supra* note 26, at 9.

101. *See* Union Oil Co. v. Oppen, 501 F.2d 558, 570 (9th Cir. 1974) (extensively discussing the economic theories of Guido Calabresi).

102. London, *supra* note 52, at 381–82 (quoting Lord Denning in *Spartan Steel & Alloys Ltd. v. Martin & Co.*, (1973) 1 Q.B. 27, 38).

litigation. There is merit to this idea, too, at least where the economic loss is slight. But the "healthy attitude" rationale[103] is hardly the basis on which to construct a rule that bars recovery for all negligently caused losses, regardless of how foreseeable or avoidable to the defendant or how damaging to the plaintiff.

C. The Boundary-Line Function

1. When Contract Principles are Prime

If there is a convincing rationale for the economic loss rule, it is that the rule performs a critical boundary-line function, separating the law of torts from the law of contracts.[104] More specifically, "[t]he underlying purpose of the economic loss rule is to preserve the distinction between contract and tort theories in circumstances where both theories could apply."[105] This paper will focus on the meaning and implications of the boundary-line rationale. Further exploration of the other justifications for the economic loss rule noted above (relating to overly broad, speculative, disproportionate, or insurable liability or to who is the best risk avoider or what promotes a "healthy attitude") will be left to other authors[106] or another occasion.

Purely economic losses, authorities urge, are more properly subject to resolution under contract principles, which defer from private ordering, than by reference to tort standards.[107] Under the logic of private ordering, "individuals

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103. *See id.* at 382 ("The line between 'healthy attitude' that bears the cost of economic loss and economic loss worthy of compensation is unclear. The economic loss rule takes the line-drawing function away from the trier of fact and denies any recovery for economic loss.").

104. *See* Level 3 Commc'ns, LLC v. Liebert Corp., 535 F.3d 1146, 1162 (10th Cir. 2008) ("'Broadly speaking, the economic loss rule is intended to maintain the boundary between contract law and tort law.'" (quoting Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1259 (Colo. 2000))); Colleton Preparatory Acad., Inc. v. Hoover Universal, Inc., 666 S.E.2d 247, 250 (S.C. 2008) ("The purpose of the economic loss rule is to define the line between tort and contract recovery."); Grams v. Milk Prods., Inc., 699 N.W.2d 167, 169 (Wis. 2005) ("The economic loss doctrine is a judicial doctrine intended to preserve the fundamental distinction between contract and tort.") (citations omitted).

105. Edelstein, *supra* note 23, at 43; *see also* Alejandre v. Bull, 153 P.3d 864, 867 (Wash. 2007) ("The economic loss rule applies to hold parties to their contract remedies when a loss potentially implicates both tort and contract relief.").

106. *See* Gruning, *supra* note 1, at 191–206 (discussing nine fact situations, generally not involving an agreement between the plaintiff and defendant, where compensation is often, but not always, denied for purely economic loss).

107. *See* N.Y. State Elec. & Gas Corp. v. Westinghouse Elec. Corp., 564 A.2d 919, 925

are the best judges of their own interests; individuals maximize those interests through contracts; the expectation and reliance interests created by contracts deserve protection; promoting private contracting produces a social benefit; contract law provides the framework through which the individual and social benefits are realized in practice."[108]

If a person wishes to be protected from economic harm, it is argued, he or she must bargain for protection and pay the price of securing those benefits.[109] One who fails to do so has no right to complain that another has neglected to exercise care to save him or her from non-physical harm. Put differently, the economic loss rule performs critical bargain-forcing functions.[110] On one hand,

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(Pa. Super. Ct. 1989) (stating that "the law of contract is the proper arena for redressing the harm because in such a case the damages alleged relate specifically to the product quality and value as to which the parties have had the opportunity to negotiate and contract in advance"); *see also* RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. a (1998) ("[P]roducts liability law lies at the boundary between tort and contract" and some categories of loss, "including those often referred to as 'pure economic loss,' are more appropriately assigned to contract law and the remedies set forth in Articles 2 and 2A of the Uniform Commercial Code"); Feinman, *supra* note 1, at 814 (asserting that "[i]n economic loss cases, private ordering is advanced when courts recognize contract law as the primary structure for regulating relationships"); JOHNSON & GUNN, *supra* note 26, at 738 ("Traditionally, tort covers cases in which the parties cannot be expected to agree in advance about the rules that will apply."). Johnson and Gunn provide an example:

> [I]t would be absurd to think that motorists and pedestrians could get together in advance of accidents and agree on who should pay what if someone is hit by a car. Contract, by contrast, applies to cases in which the parties can and do deal in advance: if *A* wants *B*'s house, the way to get it is for *A* to agree to buy the house from *B*, not for *A* to sue *B* on the theory that it would be more "reasonable" for *A* to own the house than for *B* to continue to own it . . . . The law . . . leaves questions of whether a product is "good enough" to the law of contract as a rule, but treats the issue as a tort issue when personal injury or (some kinds of) property damage occur.

Id.

108. Feinman, *supra* note 1, at 814.

109. *See* Bay State-Spray & Provincetown S.S., Inc. v. Caterpillar Tractor Co., 533 N.E.2d 1350, 1354–55 (Mass. 1989) ("The commercial user can protect himself by seeking express contractual assurances concerning the product (and thereby perhaps paying more for the product) or by obtaining insurance against losses."); *cf.* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 872–73 (1986) ("Contract law, and the law of warranty in particular, is well suited to commercial controversies . . . [where a defective component of a product injures only the product itself] because the parties may set the terms of their own agreements."). The Court noted that by reducing the cost of the product to the consumer, the "manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies." *Id.* at 873.

110. Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1262 (Colo. 2000). In *Town of Alma*, the court wrote:

the economic loss rule forces (or at least encourages) the parties to a contract to think about and bargain over the economic losses that may arise from the contract.[111] "There is no requirement that a risk of loss must be expressly allocated in a contract before a tort claim based on that loss will be precluded under the economic loss rule."[112] "Courts reason . . . that the economic loss rule applies where the parties could or should have allocated the risk of loss, or had the opportunity to do so."[113] On the other hand, the economic loss rule ensures respect for decisions made by the parties with respect to loss allocation. "The prohibition against tort actions to recover solely economic damages for those in contractual privity is designed to prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort."[114]

The boundary-line justification for the economic loss rule is plausible both in common sense terms and on closer analysis. A person who teaches or practices tort law would be quite apt to explain that body of legal principles (in contrast to contract liability) as the law governing compensation for personal injuries or property damages.[115] While compensation is sometimes afforded by tort law for economic losses not involving personal injury or property damage, to state broadly that tort law offers redress for carelessly caused pure economic

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> Limiting the availability of tort remedies . . . [for economic loss related to product defects] holds parties to the terms of their bargain. In this way, the law serves to encourage parties to confidently allocate risks and costs during their bargaining without fear that unanticipated liability may arise in the future, effectively negating the parties' efforts to build these cost considerations into the contract. The economic loss rule thus serves to ensure predictability in commercial transactions.

Id.

111. *See* Alejandre v. Bull, 153 P.3d 864, 868 (Wash. 2007) ("'A bright line distinction between the remedies offered in contract and tort with respect to economic damages . . . encourages parties to negotiate toward the risk distribution that is desired or customary.'" (quoting Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1, 881 P.2d 986, 992 (1994))).

112. *Id.* at 866.

113. *Id.* at 870. Following the legal precedents of other jurisdictions, the court held that "the economic loss rule applies regardless of whether the specific risk of loss at issue was expressly allocated in the parties' contract." *Id.* at 871.

114. Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 536 (Fla. 2004). "Underlying this rule is the assumption that the parties to a contract have allocated the economic risks of nonperformance through the bargaining process." *Id.*

115. *See, e.g.*, JOHNSON & GUNN, *supra* note 26, at 3 ("In general, tort law is a vehicle of legal redress for victims of physical injury or damage to tangible property. It also, on occasion, provides compensation or other relief for such diverse forms of harm as mental distress, impairment of reputation, and non-tangible economic injuries.").

losses would be both imprecise and over-inclusive. In addition, while there are certainly cases when tort law and contract law can and should offer overlapping, alternative remedies,[116] there must be a point at which tort law leaves off and only contract law governs. Otherwise "contract law would drown in a sea of tort,"[117] since tort law frequently offers potential plaintiffs more generous terms of recovery.[118] There would indeed be no sensible stopping point if a party to a contract could recover under tort principles merely because the other party failed to exercise care to avoid causing the first party losses of a purely economic nature.

2. Product-Related Economic Losses

The boundary-line function of the economic loss rule is most clearly established in the field of products liability.[119] If a defective product causes *physical* harm to a person or to property *other than the product itself*, a tort action may be brought.[120] In contrast, if the loss is solely of an economic

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116. *See* Johnson, *supra* note 83, at 679 ("In many areas of the law, such as products liability, a plaintiff has the option of asserting a breach-of-contract claim, or tort claims based on negligence or strict liability, or all of those theories. Similarly, a client harmed by the conduct of a lawyer, ordinarily may sue for breach of contract, as well as on a tort theory, such as professional negligence, fraud, or breach of fiduciary duty.").

117. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986).

118. *See* Grams v. Milk Prods., Inc., 699 N.W.2d 167, 171 (Wis. 2005). ("Tort law generally offers a 'broader array' of damages than contract."). The *Grams* court explained:

> For example, punitive damages and attorney fees are sometimes available in tort actions, but generally cannot be had in breach of contract claims. Contracts give the parties an opportunity to limit the scope and amount of liability. Further, the nature of a claim, tort or contract, may affect whether a particular person or entity is eligible as a defendant and whether a particular claim is covered by insurance.

Id. at 171 n.4; *see also* Alejandre v. Bull, 153 P.3d 864, 874 (Wash. 2007) (Chambers, J., concurring) ("Tort remedies are often, perhaps always, significantly larger than contract remedies.").

119. *Cf.* Banknorth, N.A. v. BJ's Wholesale Club, Inc., 442 F. Supp. 2d 206, 211 (M.D. Pa. 2006) (noting that the Supreme Judicial Court of Maine had "addressed the economic loss rule in only one context, a products liability claim"). *See generally* Gaebler, *supra* note 85, at 594 ("[M]ost courts refuse to recognize a cause of action in negligence for purely economic losses in products liability cases."); Gennady A. Gorel, Note, *The Economic Loss Doctrine: Arguing for the Intermediate Rule and Taming the Tort-Eating Monster*, 37 RUTGERS L.J. 517, 550 (2006) (criticizing majority rule on grounds that it fails to incentivize safer product manufacturing procedures, and proposing an intermediate rule which would afford courts greater discretion to review similar causes of actions on a case-by-case basis).

120. *See* Murray v. Ford Motor Co., 97 S.W.3d 888, 893 (Tex. App. 2003) (holding, in a tort action involving a truck that caught fire, that the plaintiff could recover $453.25 for

nature, such as when a product defect injures the product itself[121] or impairs the product's value,[122] the plaintiff ordinarily is relegated to compensation under contract principles.[123] Illustratively, if a person buys a can of paint and applies

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damages to other property, but nothing for the loss of the truck).

121. *See* Colleton Preparatory Acad., Inc. v. Hoover Universal, Inc., 666 S.E.2d 247, 250 (S.C. 2008) ("The economic loss rule generally provides there is no tort liability for a defective product if the product damages only itself."); *see also* Turbomeca, S.A. v. French Aircraft Agency, Inc., 913 So. 2d 714, 716–17 (Fla. Dist. Ct. App. 2005) (holding that the rule barred a helicopter owner from recovering from engine manufacturer on a negligence theory for the loss of the helicopter in a crash); Progressive Ins. Co. v. Gen. Motors Corp., 749 N.E.2d 484, 486–88 (Ind. 2001) (holding that an automobile, which caught fire as a result of allegedly defective wiring, was to be viewed as a single unit and that therefore there was no damage to "other property" that would support a products liability claim); Bocre Leasing Corp. v. Gen. Motors Corp., 645 N.E.2d 1195, 1197–98 (N.Y. 1995) (holding that buyer of a used helicopter could not recover in tort from engine manufacturer for losses caused by a defect in the engine which resulted only in damage to the helicopter).

Numerous cases discuss the distinction between "the product itself" and "other property." *See, e.g.*, Jimenez v. Super. Ct., 58 P.3d 450, 457–58 (Cal. 2002) (discussing the process of determining which product is at issue and holding that economic loss rule did not bar a homeowner's recovery in tort for damage that a defective window caused to other parts of the home in which it was installed); Foremost Farms USA Coop. v. Performance Process, Inc., 726 N.W.2d 289, 294–95 (Wis. Ct. App. 2006) (discussing "integrated system" test: "[O]nce a part becomes integrated into a completed product or system, the entire product or system ceases to be 'other property' for purposes of the economic loss doctrine." (quoting Selzer v. Brunsell Bros., 652 N.W.2d 806, 818 (Wis. Ct. App. 2002))). *See generally* Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 884–85 (1997) (holding that equipment added to a boat was not part of the product itself and, therefore, the economic loss rule did not bar recovery); Reyton Cedar Knoll, LLC v. HPG Int'l, Inc., No. 07-2955, 2008 WL 3823922, at *2 (3d Cir. Aug. 18, 2008) (treating an entire shopping mall as a "product"); Int'l Flavors & Fragrances, Inc. v. McCormick & Co., No. 06-2655, 2008 WL 4183907, at *9 (D.N.J. Sept. 12, 2008) (holding that defective paprika incorporated into barbeque seasoning injured only the product itself); RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. a (1998) (discussing liability for harm to the defective product itself).

122. *See* Vigilant Ins. Co. v. SPX Corp., No. 06-23, 2008 WL 723318, at *2 (W.D. Pa. Mar. 14, 2008) (holding that the economic loss rule barred a subrogation claim based on negligence and strict liability seeking damages for cost of replacing defective television antenna); *cf.* Ziegelmann v. DaimlerChrysler Corp., 649 N.W.2d 556, 561 (N.D. 2002) (rejecting a claim by group of vehicle owners seeking damages resulting from automaker's failure to equip vehicles with parking brake interlock on the grounds that the resulting economic harm in the form of loss of resale value was too speculative to be actionable).

123. Some courts have ruled that the economic loss rule does not bar recovery of purely economic damages if the defendant's conduct posed a serious risk of personal injury or property damage, even if that risk did not come to fruition. *See* Colleton Preparatory Acad., Inc. v. Hoover Universal, Inc, 666 S.E.2d 247, 249 (S.C. 2008) (involving a defective roof truss system that had to be replaced for safety reasons); *see also* Palmeri v. LG Elecs. USA, Inc., No. 07-5706 2008 WL 2945985, at *5 (D.N.J. July 30, 2008) (recognizing the serious risk of harm exception to the economic loss doctrine).

the paint to a door, the person has a potential tort claim (and perhaps a contract claim as well based on breach of warranty) if toxic odors from the paint make the plaintiff sick or if the paint eats away at the door and damages that "other" property. However, if the paint simply fails to adhere to the door effectively and flakes off, or quickly discolors, causing no other damage but making the paint's purchase a waste of money, the buyer's sole avenue for recovery is rooted in contract principles.[124]

The economic loss rule operates sensibly in the products liability field because the commercial nature of the underlying transaction means that a contract-law remedy is not only feasible, but routinely available. The sale that produces the distribution of the defective product allows the parties to determine how economic risks relating to the quality of the product should be allocated and supplies default rules relating to warranties that resolve disputes if the parties do not specify particular terms of recovery.[125] In addition, the ubiquitous adoption of the Uniform Commercial Code (UCC) means that there is a carefully crafted statutory mechanism available for resolving economic loss claims. Various courts have found the applicability of the UCC to be pivotal.[126] In explaining its decision not to apply the economic loss rule to service contracts, the Supreme Court of Wisconsin wrote:

> Central to our decision was the fact that no body of law similar to the UCC applies to contracts for services.... [T]he UCC provides a "comprehensive system for compensating consumers for economic loss arising from the purchase of defective products...."

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124. *See* VINCENT R. JOHNSON & ALAN GUNN, TEACHING TORTS 269 (3d ed. 2005) (stating a hypothetical based on these facts).

125. *Cf.* Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 880 (1997). The Court stated:

> The commercial buyer and commercial seller can negotiate a contract—a warranty—that will set the terms of compensation for product failure. If the buyer obtains a warranty, he will receive compensation for the product's loss, whether the product explodes or just refuses to start. If the buyer does not obtain a warranty, he will likely receive a lower price in return. Given the availability of warranties, the courts should not ask tort law to perform a job that contract law might perform better.

Id.

126. *See, e.g.*, Gen. Elec. Corp. v. BASF Corp., No. 06-283, 2008 WL 4185870, at *16 (S.D.N.Y. Sept. 4, 2008) ("The New Jersey Supreme Court grounded the economic loss doctrine in a number of policy concerns, including maintaining the Uniform Commercial Code . . . as a 'comprehensive statutory scheme.'") (citing Spring Motors Distribs. Inc. v. Ford Motor Co., 98 N.J. 555, 557 (1985)).

> Concern about duplicating or overriding UCC provisions was an important reason this court chose to adopt the economic loss doctrine in the first place . . . .[127]

The abundance of products available in the American market theoretically makes it possible for buyers to bargain for the level of economic loss protection they desire. Referring again to the previous example, a consumer can elect to purchase cheap paint or expensive paint or something in between. It is neither surprising nor unfair if "you get what you pay for."

As explained by then-Chief Justice Benjamin K. Miller of the Supreme Court of Illinois:

> The [economic loss] doctrine reflects the principle that there are varying degrees of quality, all commercially acceptable, that parties to a commercial transaction are free to bargain over if they choose . . . . Disputes later arising from the character of the materials used should be determined under principles of contract law, and should be controlled by the requirements imposed by the parties' own undertaking. In that instance, the contract itself serves best to define the parties' respective rights and obligations.[128]

Nevertheless, important principles limit the scope of the economic loss rule in reference to its boundary-line function. In some situations, the plaintiff never assented to the terms of the contract that the defendant asserts is the exclusive measure of duty. The question then is whether the plaintiff's rights should be limited by the terms of such an agreement. In other cases, no contract with a third person other than the defendant was ever entered into by the plaintiff to mitigate or eliminate the risk of economic loss, but theoretically there could have been a contract. The issue is whether the pre-loss availability of that hypothetical remedy bars recovery in tort. Finally, in other situations, the parties to a contract are subject to independent duties under tort law, but difficult questions arise as to whether the terms of a contract, or contractual silence, override those otherwise enforceable obligations. These matters are discussed below.

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127. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 171–72 (Wis. 2005) (citations omitted).

128. Collins v. Reynard, 607 N.E.2d 1185, 1188 (Ill. 1992) (Miller, C.J., specially concurring).

III. Limits on the Boundary-Line Function of the Economic Loss Rule

A. Claims by Persons Not in Privity

1. Contract Law as the Exclusive Source of Duty

A number of courts have rejected arguments that contract principles define the extent of the duty where the economic injurer and victim were not in privity.[129] For example, in *Russo v. NCS Pearson, Inc.*,[130] students who took the Scholastic Aptitude Test (SAT) sued a national testing service for economic losses caused by the negligent scoring and misreporting of SAT results.[131] The testing service, which was under contract with the College Board, but not with the individual test takers, argued that the plaintiffs' claims were not actionable in tort because they were based on the testing service's misperformance of contractual obligations.[132] The Federal District Court for the District of Minnesota rejected that defense and found that the plaintiffs stated a claim for negligence.[133] The opinion explained "it strikes the Court as unfair to

129. *See* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 534 (Fla. 2004) ("[The] 'economic loss rule' bars a negligence action to recover solely economic damages only in circumstances where the parties are either in contractual privity or the defendant is a manufacturer or distributor of a product, and no established exception to the application of the rule applies."); *see also* S. Farm Bureau Life Ins. Co. v. Banko, No. 8:06CV840T27EAJ, 2006 WL 2935281, at *1 (M.D. Fla. Oct. 13, 2006) (holding the rule did not bar a suit by a mother against an insurance company for negligently failing to provide her son with information relevant to changing his beneficiary designation, thereby causing the mother to be excluded as a beneficiary after her son filed the form with defendant's local agent rather than home office); Advisor's Capital Invs., Inc. v. Cumberland Cas. & Sur. Co., No. 8:05-cv-404-T-23MAP, 2006 WL 1428490, at *3 (M.D. Fla. May 22, 2006) (holding that when parties were not in contractual privity, otherwise viable tort claims were not barred by the economic loss rule); Output, Inc. v. Danka Bus. Sys., Inc., No. 4D07-2008, 2008 WL 4057754, at *3 (Fla. Dist. Ct. App. Sept. 3, 2008) (holding that a fraud claim related to contractual performance was not barred by the economic loss rule because plaintiff was not a party); Biscayne Inv. Group, Ltd. v. Guarantee Mgmt. Servs., Inc., 903 So. 2d 251, 255 (Fla. Dist. Ct. App. 2005) (holding that the economic loss rule did not bar negligence action by a condominium developer against management company with which it was not in privity).

130. *See* Russo v. NCS Pearson, Inc., 462 F. Supp. 2d 981, 986 (D. Minn. 2006) (denying plaintiff-students' motion for temporary injunction requesting re-reporting of certain students' SAT score results).

131. *Id.* at 986–87.

132. *Id.* at 994 ("The College Board responds that . . . a plaintiff is not entitled to recover tort damages save for exceptional cases in which a breach of contract 'constitutes or is accompanied by an independent tort.'" (quoting Wild v. Rarig, 234 N.W.2d 775, 789–90 (Minn. 1975))).

133. *Id.* at 995.

hold . . . , as a matter of law, that Plaintiffs lack a tort remedy because the alleged tort arose in the context of the performance of a contract to which they were strangers."[134] The court was not persuaded that defendant's contract with a third party defined the full extent of its obligations.[135]

Similarly, in *A.C. Excavating v. Yacht Club II Homeowners Ass'n*,[136] the Supreme Court of Colorado held that although "subcontractors [had] assumed contractual obligations with the developer and general contractor, these obligations did not and could not relieve the subcontractors of their independent duty [under state court decisions] to act without negligence in constructing the development."[137] Consequently, the economic loss rule did not bar a negligence action by a homeowners association against the subcontractors seeking recovery for economic losses.[138]

Recognizing third-party rights under tort law in these types of cases does not undermine the public policy in favor of private ordering. Rather, it merely recognizes that private ordering takes place not in a vacuum, but within a context of other obligations.[139] When the issue of whether economic losses are compensable relates to third-party protection, the intent of the parties is not the only relevant consideration:

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134. *Id.* at 1001. The test takers also sued the College Board, with whom they were in privity of contract, alleging numerous causes of action, including breach of contract, negligence, defamation, and statutory claims. *Id.* at 988–89. The College Board argued that the negligence claim was barred by the Minnesota version of the economic loss rule. *Id.* at 994. The court determined that it would be premature to dismiss the test takers' negligence claim because it was uncertain whether an exception applied. *Id.* at 995–96. Ultimately, the claims against the College Board settled. *See SAT Administrators Settle Lawsuit for $3 Million*, ALBANY UNION TIMES, Aug. 26, 2007, 2007 WLNR 16662300. *See generally* Johnson, *supra* note 83, at 680–84 (explaining why the economic loss rule should not bar recovery of purely economic losses in cases involving harm caused by erroneous scoring of standardized tests).

135. *Id.* at 1000–01.

136. *See* A.C. Excavating v. Yacht Club II Homeowners Ass'n, 114 P.3d 862, 870 (Colo. 2005) (addressing a case in which a homeowners association brought suit in negligence against entities involved in construction of housing development).

137. *Id.*

138. *See id.* ("[W]e find that the independent duty [of the subcontractors] exists and places this case beyond the scope of the economic loss rule.").

139. *Cf.* Jesse Howard Witt, *The Spearin Doctrine and the Economic Loss Rule in Residential Construction*, 35 COLO. LAW. 49, 57 (July 2006) ("[I]t is . . . important to consider the limits of . . . negotiations [between the parties to a construction contract] when the ultimate harm may fall on parties outside the commercial setting. Contractors should not bid on any project in a vacuum, and the cost of protecting consumers from poor designs and substandard work cannot be ignored.").

> Fundamental tort policies are implicated as well: compensating victims of harm; deterring wrongful conduct and providing incentives for reasonable conduct; placing losses on those who can best bear or distribute them; and fairness . . . [in] redressing harm caused to innocent parties and imposing the burden of harm on the parties responsible for it.[140]

With respect to the boundary-line function of the economic loss rule, decisions holding that third-party claims are not foreclosed by the rule make sense. If there is no agreement between the parties to a lawsuit, there is no risk that recognizing tort obligations will violate the parties' freedom to contract,[141] because there never was an effort to exercise such freedom. If the parties are not in privity, contract law does not potentially afford a remedy, except in the relatively rare case of a third-party beneficiary.[142] Thus, respect for contract principles and private ordering does not require that the economic loss rule bar the claims of persons not standing in a contractual relationship. The purpose of the economic loss rule is not to leave injured persons remediless for economic losses but to ensure respect for private ordering by relegating a plaintiff to contract remedies in cases where there is an agreement between the parties allocating economic risks.[143] If there is no contract between the parties to litigation, there is no boundary-line function to be performed by the economic loss rule.

The reason that a third person physically injured by a defective product is permitted to sue in tort for resulting damages is that such a person "generally had neither the bargaining power nor the opportunity to bargain with its manufacturer or seller and so could not reasonably provide himself with the

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140. Feinman, *supra* note 1, at 821.

141. *See* Daanen & Janssen, Inc. v. Cedarapids, Inc., 573 N.W.2d 842, 846 (Wis. 1998) ("Application of the economic loss doctrine to tort actions between commercial parties is . . . [intended] to protect commercial parties' freedom to allocate economic risk by contract.").

142. *See, e.g.*, Weathers Auto Glass, Inc. v. Alfa Mut. Ins. Co., 619 So. 2d 1328, 1329 (Ala. 1993) ("A party claiming to be a third-party beneficiary of a contract must establish that the contracting parties intended, upon execution of the contract, to bestow a direct, as opposed to an incidental, benefit upon the third party."); Pelham v. Griesheimer, 440 N.E.2d 96, 98 (Ill. 1982) (stating that a breach of contract claim may be brought under a third-party beneficiary theory of recovery if the contract was entered into for the "direct benefit" of the plaintiffs).

143. In *Miller v. U.S. Steel Corp.*, 902 F.2d 573, 575–76 (7th Cir. 1990), which held that the economic loss rule barred a claim for product related economic damages, the court seemed to find it significant that there was a contract between the parties and there "was no gap in liability—no danger that the . . . [plaintiffs] would fall between the stools of tort and contract." *Id.* at 575. *But see* Banknorth, N.A. v. BJ's Wholesale Club, Inc., 442 F. Supp. 2d 206, 213 (M.D. Pa. 2006) (rejecting the plaintiff's argument that "Maine law bars a negligence claim only when the party has an alternative warranty or contract claim" because the plaintiff cited "no authority for this proposition").

same kind of protection that a purchaser of goods could."[144] Similarly, nonparties to a contract typically have no real opportunity (and often little power[145]) to bargain over protection from economic losses caused by negligent performance of the agreement. Nonparties therefore should not be precluded from suing in tort for resulting damages.

As noted above, a third-party beneficiary may have enforceable rights under contract law, even though not a party to the agreement. Does that mean that a tort claim by this category of plaintiff against a party to the contract should be barred by the economic loss rule? Presumably, the answer is no. It is one thing to defer to private ordering when the question concerns the rights of parties to an agreement. It is something else entirely to say that two parties to an agreement may limit the rights of third parties (even third-party beneficiaries) who never participated in the negotiation of the contract. If established tort principles entitle a third party to protection under tort law for economic loss, an agreement to which the third party never assented should not be permitted to vitiate his or her right to tort remedies.

2. *Recovery by Purchasers Against Defendants Not in Privity*

Occasionally, courts have held that the economic loss rule bars a tort claim related to a contract even where the parties to the lawsuit are not in privity.[146] These decisions can sometimes be explained as a natural application of the economic loss rule in the context of a sale of goods, as where a disappointed purchaser of a product sues the manufacturer or wholesaler of the goods (rather than the retailer).[147] A purchaser seeking purely economic losses should not be permitted to complain, under tort principles, against anyone in the chain of distribution that the product the plaintiff bought was not better (i.e., more effective, more valuable, or more "reasonable") than what the plaintiff

144. Bay State-Spray & Provincetown S.S., Inc. v. Caterpillar Tractor Co., 533 N.E.2d 1350, 1355 (Mass. 1989).

145. *See infra* Part III.F (discussing lack of bargaining power).

146. *See* Pa. State Employees Credit Union v. Fifth Third Bank, 398 F. Supp. 2d 317, 329 (M.D. Pa. 2005) (rejecting the plaintiff's argument that a negligence claim for economic losses is barred only when the parties are in privity of contract); Plourde Sand & Gravel Co. v. JGI E., Inc., 917 A.2d 1250, 1254 (N.H. 2007) (same).

147. *See* Daanen & Janssen, Inc. v. Cedarapids, Inc., 573 N.W.2d 842, 852 (Wis. 1998) (holding that the economic loss rule barred recovery in tort from a manufacturer, "even in the absence of privity").

bargained for under the law of contract.[148] Absent fraud[149] or some other breach of an independent duty,[150] contract principles normally are the buyer's sole remedy for purely economic loss related to purchased goods, regardless of whether the suit is against the retailer, with whom the purchaser was in privity, or against a wholesaler or manufacturer up the chain of distribution.[151] In this type of case, it is the defendant (the manufacturer or wholesaler), rather than the plaintiff (the purchaser), who is the stranger to the final contract of sale. With respect to purely economic loss, it is ordinarily fair to bind the plaintiff by the terms of the agreement to which the plaintiff assented.

3. Tort Duty Related to Performance of a Contract with Another

Questions arise as to whether a potential defendant's negligent performance of a contractual obligation owed to the third party can also be a breach of a tort duty to a person not in privity (the potential plaintiff).[152] Some cases answer this question in the negative[153] and inappropriately invoke the economic loss rule as a reason for denying recovery. One such case is *Plourde Sand & Gravel Co. v. JGI Eastern, Inc.*[154] This decision is difficult to understand from the perspective of the boundary-line function of the economic loss rule.

In *Plourde Sand & Gravel*, Hiltz, a subcontractor for a private construction project in the Town of Pembroke, hired the plaintiff to supply

148. *See id.* at 848 ("'[P]arties factor risk allocation into their agreements and . . . the absence of comprehensive warranties is reflected in the price paid. Permitting parties to sue in tort when the deal goes awry rewrites the agreement by allowing a party to recoup a benefit that was not part of the bargain.'" (quoting Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1230 (W.D. Wis. 1997))).

149. *See supra* note 46 and accompanying text (discussing fraud).

150. *See infra* Part III.C.1 (discussing independent duties under tort law).

151. *Id.*

152. In Part III.A.1, see the discussion of *Russo v. NCS Pearson, Inc.*, 111 F. Supp. 2d 981 (D. Minn. 2006) and *A.C. Excavating v. Yacht Club II Homeowners Ass'n*, 114 P.3d 862 (Colo. 2005).

153. *See* Gaebler, *supra* note 85, at 601 ("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.").

154. *See* Plourde Sand & Gravel Co. v. JGI E., Inc., 917 A.2d 1250, 1254 (N.H. 2007) (holding that plaintiff's claim for economic damages was barred by the economic loss rule despite a lack of privity with defendant).

gravel for the purpose of constructing a roadway.[155] Engineers employed by the town hired the defendant to test the gravel to determine whether it met the town's specifications.[156] The defendant erroneously determined that the plaintiff's gravel was inadequate and the plaintiff therefore was forced to incur the costs of removing and replacing the gravel.[157] The Supreme Court of New Hampshire held that because the plaintiff's negligence claim against the defendant sought only economic damages, it was barred by the economic loss rule, regardless of the fact that there was no contract between the plaintiff and defendant that could have dictated the terms of a contractual remedy.[158]

It is hard to understand the basis for the court's decision. The court's rationale was as follows:

> The policy behind . . . [the economic loss rule] is to prevent potentially limitless liability for economic losses . . . .
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> . . . .
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> Moreover, permitting economic loss recovery in tort here would blur the distinction between contract and tort law. The plaintiff is essentially alleging that the defendant negligently performed its duties under its contract with another party and that as a result, the plaintiff has lost the benefit of its bargain with Hiltz . . . .
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> . . . .
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> . . . . The economic loss the plaintiff suffered in removing and replacing the gravel arose "solely from disappointed commercial expectations" in that the plaintiff "lost the anticipated profits of its contract" with Hiltz . . . . Imposing a tort duty upon the defendant in this case would disrupt the contractual relationships between and among the various parties.[159]

The court's reasoning is questionable on several grounds. First, this was not a case of "potentially limitless liability."[160] It seems entirely clear from the

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155. *Id.* at 1252.

156. *Id.*

157. *Id.*

158. *Id.* at 1254.

159. *Id.* at 1254–57.

160. *See id.* at 1254 ("Many courts . . . have expanded the economic loss doctrine to bar economic recovery in tort cases where there is no contract and thus no privity. The policy behind this principle is to prevent potentially limitless liability for economic losses . . . .") (citations omitted).

facts that if the testing of the gravel was negligently deficient, it would affect the provider of the gravel, not some vast class of potential plaintiffs, and that the economic losses would extend only as far as the cost of the materials involved in the job, and no further.[161] Moreover, allowing a negligence claim would not "disrupt the contractual relationships between and among the various parties"[162] because the only duty that negligence law would impose on the defendant would be to exercise care in testing the gravel. That duty would have been entirely consistent with the obligations that the defendant had already obliged itself to perform pursuant to its contract with the engineers. This is not the case of whether the court should recognize an inconsistent, competing obligation that might interfere with contractual performance.

More importantly, for purposes relating to the boundary-line function of the economic loss rule, allowing the plaintiff in *Plourde Sand & Gravel* to sue for negligence would not "blur the distinction between contract and tort law."[163] Contractual performance always takes place within a matrix of other legal obligations, including those imposed by the law of torts. For example, it is no defense to a tort claim alleging negligent misrepresentation causing economic loss that, at the time of the erroneous statement, the defendant was acting pursuant to a contractual relationship between the defendant and some other person.[164] Parties to contracts have obligations beyond those imposed by the terms of their agreements.

To be sure, in cases like *Plourde Sand & Gravel*, there is a valid question concerning whether performance (or misperformance) of a contractual

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161. The issue in *Plourde Sand & Gravel* is not unlike the one raised in *Glanzer v. Shepard*, 135 N.E. 275, 275–76 (N.Y. 1922) (Cardozo, J.), which dealt with the compensability of economic losses that arose in the context of a negligent representation made in the course of contractual performance. *Id.* at 275. *Glanzer* involved a public weigher who had negligently overstated the weight of a shipment of beans, to the detriment of the purchaser. *Id.* The court held that because the defendant knew that the plaintiff would rely on the certificate of weight in paying the seller who had arranged for the weighing, and had in fact sent a copy of the certificate to the plaintiff, there should be liability. *Id.* at 275–76. The purchase by the plaintiff was the "end and aim" of the transaction. *Id.* at 277. In *Plourde Sand & Gravel*, the plaintiff argued that the negligent misrepresentation exception to the economic loss rule applied. Plourde Sand & Gravel Co. v. JGI E., Inc., 917 A.2d 1250, 1254 (N.H. 2007). The court rejected that argument, finding that the information was communicated to the plaintiff only indirectly and plaintiff did not claim that "*it* relied upon the report." *Id.* at 1258 (emphasis in original).

162. *Id.* at 1257.

163. *Id.* at 1256.

164. *See, e.g.*, Trust Co. of La. v. N.N.P. Inc., 104 F.3d 1478, 1488 (5th Cir. 1997) (holding an attorney liable to non-clients for negligently misrepresenting the enforceability of a settlement agreement).

obligation owed to one person creates a tort duty of care to a third person who foreseeably may be injured.[165] This type of question is not uncommon in tort law. Cases often present the issue of whether a person performing a contractual duty owed to one person has a duty to act to prevent *physical harm* to a third person. Courts have held, for example, that mental health professionals who learn in the course of a therapeutic relationship that a patient poses a threat of physical harm to a third person have a duty to exercise reasonable care to prevent that harm from occurring.[166] Similarly, physicians have been found to have a duty to warn third persons that a patient has a communicable disease[167] or to inform the subject of a physical exam conducted pursuant to a contract with an employer of a diseased condition detected during the examination.[168]

Other cases raise the question of whether a person performing a contractual obligation owed to one person has an additional tort duty to another person to exercise reasonable care to prevent harm to the third person's *economic interests*.[169] The drug testing cases offer a good illustration. If a testing service hired by an employer negligently performs a drug test on an employee or job applicant, the affected test subject may be

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165. *See* Fireman's Fund Ins. Co. v. SEC Donohue, Inc., 679 N.E.2d 1197, 1200–02 (Ill. 1997) (holding that the economic loss rule barred the subrogee of a subcontractor from recovery in tort against an engineering firm for the costs of repair work to an underground water system that were allegedly caused by the subcontractor's reliance on negligently prepared engineering plans for the system); Anderson Elec., Inc. v. Ledbetter Erection Corp., 503 N.E.2d 246, 249 (Ill. 1987) (denying recovery from both a contractor and subcontractor for the costs of redoing work because those costs "were purely economic losses" which "arose solely from disappointed commercial expectations").

166. *See, e.g.*, Tarasoff v. Regents of Univ. of Cal., 551 P.2d 334, 347 (Cal. 1976) (stating that the exercise of reasonable care to protect the threatened victim requires the therapist to warn the endangered party or those who can reasonably be expected to notify him and that there is "no sufficient societal interest that would protect and justify concealment"); *see also* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL HARM § 41 reporter's note to cmt. g (Proposed Final Draft No. 1, 2005) ("A substantial number of courts, and legislatures enacting statutes, limit the duty to warning the potential victim.").

167. *See* Vincent R. Johnson & Brian T. Bagley, *Fighting Epidemics with Information and Laws: The Case of SARS in China*, 24 PENN ST. INT'L. L. REV. 157, 170 n.97 (2005) (collecting cases pro and con).

168. *See* Webb v. T.D., D.C., 951 P.2d 1008, 1014 (Mont. 1997) (holding that a physician who independently examined a worker at the request of her employer's workers' compensation carrier owed a duty to the worker to exercise ordinary care to discover conditions posing imminent danger to the worker's physical or mental well-being and to take reasonable steps to communicate the conditions to the worker).

169. *Cf.* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4) (2000) (recognizing that lawyers who represent fiduciaries often have duties to prevent economic harm to the nonclients to whom the fiduciaries have obligations).

fired or rejected for employment, and in either case will suffer economic losses. A number of courts, influenced perhaps by the reduced risk of indeterminate liability[170] or the fact that the parties to the contract could allocate losses relating to inadvertent errors,[171] permit the test subject to sue the testing agency for negligence, even though there was no contract between the parties and only economic losses resulted.[172] A minority of courts are to the contrary.[173] The point here is that it is appropriate for courts to consider these types of duty questions within the context of tort jurisprudence.[174] Depending on the facts and the interests at stake, some duty claims will be found to be meritorious and others will not. Blindly applying the economic loss rule to bar all third-party claims related to contractual performance precludes courts from undertaking a thoughtful assessment of whether a

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170. *See* Amy Newman & Jay M. Feinman, *Liability of a Laboratory for Negligent Employment or Pre-Employment Drug Testing*, 30 RUTGERS L.J. 473, 484 (1999) (stating that "[t]he imposition of liability arises only in relationships where the number of parties is fixed" and that the "laboratory's potential liability will extend no farther than the number of samples it contracts to test").

171. *See* Rabin, *supra* note 1, at 868. Professor Rabin explains:

> [T]he critical point is that in fact the case for making promotion of private ordering a salient consideration in the negligent drug-testing cases cuts . . . in favor of recognizing the tort obligation of the service provider. It is the service provider and the employer—those in contractual privity—who can take account of the risk of inadvertent error in conducting the testing and provide for loss allocation in negotiation of the service agreement.

Id.

172. *See* Wilson v. Compass Vision Inc., No. C07-3431 BZ, 2007 WL 4570613, at *1 (N.D. Cal. Dec. 27, 2007) (finding that defendants who performed drug testing on the plaintiff at the request of the Board of Registered Nurses owed a duty of care to the plaintiff, who was discharged followed the reporting of false positive results); Sharpe v. St. Luke's Hosp., 821 A.2d 1215, 1220–21 (Pa. 2003) (holding that a hospital, under contract with the plaintiff's employer to perform drug testing, owed the plaintiff a duty of reasonable care and could be liable for economic losses resulting from termination); Duncan v. Afton, Inc., 991 P.2d 739, 744–46 (Wyo. 1999) (holding that, based on policy considerations relating to deterrence and other factors, a collection company hired by employer owed a duty of care to the employee when handling urine specimens that ultimately led to the employee's termination); *see also* Merrick v. Thomas, 522 N.W.2d 402, 406–07 (Neb. 1994) (holding that a merit commission owed a duty not only to the sheriff, but also to the plaintiff job applicant, to score a test accurately).

173. *See* SmithKline Beecham Corp. v. Doe, 903 S.W.2d 347, 352–54 (Tex. 1995) (holding that a laboratory, under contract with an employer to perform applicants' drug tests, had no duty to a prospective employee to enquire into matters that could trigger false positive results).

174. *See* Gray, *supra* note 1, at 900–02 (suggesting that courts should remain free to recognize cases where liability for economic loss is appropriate).

tort duty should be recognized and how far liability should extend. Moreover, it does so without justification. Under principles of private ordering, parties to a contract may allocate risks among themselves, but they have no right to strip third parties of whatever protection tort law provides for valuable personal interests, including interests related to purely economic harm.

B. Hypothetical Remedies Under Nonexistent Contracts

Cases purporting to apply the economic loss rule for boundary-line reasons sometimes seize upon the fact that the plaintiff could have contracted with a third person to address the risk that gave rise to economic loss as a reason for denying recovery in tort.[175] Thus, some courts hold that a hypothetical contract remedy makes relief in tort unavailable.[176] From the standpoint of the boundary-line rationale, applying the economic loss rule in this manner is seriously questionable.

In *Banknorth, N.A. v. BJ's Wholesale Club, Inc.*,[177] a merchant failed to protect the personal information of Visa cardholders.[178] The data was then hacked by a third party and misused in unauthorized transactions.[179] The foreseeable result of the merchant's negligence was that a card issuer (a bank with whom the merchant had no contract) incurred huge economic losses related to reissuing cards and reimbursing cardholders for fraudulent charges, as the bank was required to do by its agreement with Visa.[180] The Federal District Court for the Middle District of Pennsylvania held that the negligent merchant bore no liability for the bank's losses because the economic loss rule barred the claim.[181] The court did not find that contract principles, rather than

175. *Id.*

176. *See* Foremost Farms USA Coop. v. Performance Process, Inc., 726 N.W.2d 289, 297 n.8 (Wis. Ct. App. 2006) ("Some economic loss doctrine cases seemingly suggest that the contract bargaining contemplated when addressing the 'disappointed expectations' test need be only hypothetical.").

177. *See* Banknorth, N.A. v. BJ's Wholesale Club, Inc., 442 F. Supp. 2d 206, 213–14 (M.D. Pa. 2006) (holding that the economic loss rule barred a claim by issuing bank against a merchant that allowed cardholder information to be hacked, despite lack of privity between the parties).

178. *Id.* at 207.

179. *Id.*

180. *Id.* at 209.

181. *Id.* at 208.

tort law, governed the liability of the merchant to the plaintiff.[182] There was no contract between the plaintiff issuing bank and the defendant merchant.[183] Rather, the court's ruling was based on the fact that the bank "could have bargained for allocating the risk of fraudulent transactions *with Visa* before signing its Visa contract."[184] From the perspective of tort jurisprudence, this is hardly a persuasive reason for extending the economic loss rule to bar the claim of a party not in privity with the defendant. Considerations relating to both fault and deterrence argued in favor of imposing liability on the negligent merchant.[185] The effect of the court's decision was to leave blameworthy conduct unpunished and undeterred and a foreseeable victim uncompensated—all on the highly speculative ground that the plaintiff bank could have convinced a third-party, Visa, at some earlier date, to change its policy on issuer reimbursement of fraudulent charges.[186] Tort liability should be imposed to encourage safe practices, not to ensure that careless conduct goes unremedied. Using the economic loss rule to insulate blameworthy persons, such as a negligent merchant, from liability for economic losses foreseeably caused to a third person does not defer to private ordering. Instead, it undercuts important public policies relating to fault, deterrence, and compensation that are the basis of American tort law.

The decision of the *Banknorth* court to deprive the plaintiff of relief in a negligence action against the defendant, merely because the plaintiff could have, hypothetically, contracted with a third party (there, Visa) to reduce or eliminate its risk of economic losses from fraudulent transactions, comes perilously close to saying that contract law is the exclusive source of protection from economic losses.[187] That, emphatically, is not the law. American tort law

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182. *See id.* at 213 (acknowledging that "liability [for economic losses] to third parties of those who provide a service [may exist] . . . when the third party was an intended beneficiary of the service or it was well recognized that the third party would rely on the work performed").

183. *Id.* at 208.

184. *Id.* at 213 (emphasis added); *see also id.* at 214 (opining that the bank "could have bargained against the risk it incurred, but did not").

185. *See* Vincent R. Johnson, *Economics of Injury to Injury to Persons, Property, and Relations*, *in* ENCYCLOPEDIA OF LAW AND SOCIETY 769, 769 (David S. Clark ed., 2007) ("By requiring actors to bear the costs of resulting harm . . . tort law affects the types of activities persons engage in and the precautions they employ to avoid causing harm.").

186. *See* Banknorth, N.A. v. BJ's Wholesale Club, Inc., 442 F. Supp. 2d 206, 213 (M.D. Pa. 2006) ("Banknorth could have bargained for allocating the risk of fraudulent transactions with Visa before signing its Visa contract.").

187. *Cf. id.* ("[T]he point of the rule . . . [is] that in a commercial context parties are expected to allocate the risk of loss through their contract, not supplement the contract with a tort remedy.").

routinely provides compensation for economic losses, such as lost wages and diminished earning potential in cases of physical injury,[188] as well as awards of solely pecuniary damages in cases involving negligent misrepresentation, professional malpractice, defamation, breach of fiduciary duty, conversion, loss of consortium, wrongful death, tortious interference, and unreasonable failure to settle an insurance claim within policy limits, as mentioned earlier.[189] Some of those actions are based on intentionally tortious conduct, but others are founded on negligence. Tort law compensates economic losses in these cases because, within limits and subject to restrictions, it imposes duties not to inflict economic losses. While compensation for economic losses is sometimes incidental to certain forms of personal injury or property damage, either to the plaintiff or to another, many times it is not. "Tort law has traditionally protected individuals from a host of wrongs that cause only monetary damage."[190] Contract law is not the only source of compensation for economic losses, and it makes little sense to interpret the economic loss rule as though that were the presumption.

In cases such as *Banknorth*, involving extensive pecuniary harm caused by negligent data security,[191] there may need to be limits on the liability of a defendant who acts carelessly in order to protect the defendant from liability disproportionate to fault. Cardozo's language from *Ultramares Corp. v. Touche*[192] comes to mind. He wrote that law should not impose "liability in an indeterminate amount for an indeterminate time to an indeterminate class."[193] The point here is not that there should be liability without limits, but that the economic loss rule should not be invoked

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188. *See, e.g.*, Anderson v. Sears, Roebuck & Co., 377 F. Supp. 136, 139–40 (E.D. La. 1974) (allowing recovery for lost earning capacity); *see also* Union Oil Co. v. Oppen, 501 F.2d 558, 567 (9th Cir. 1974) ("The right to recover for economic losses which are parasitic to an injury occurring to person or property is not questioned.").

189. *See supra* Part I.C (describing a variety of tort claims under which plaintiffs have recovered for economic losses).

190. Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 875 (9th Cir. 2007).

191. Some cases involving breaches of data security result in personal injury in the form of emotional distress. *See* Scott v. Minneapolis Pub. Sch., Special Dist. No. 1, No. A05-649, 2006 WL 997721, at *1–2 (Minn. Ct. App. Apr. 18, 2006) (affirming a substantial award of damages for past and future for pain, embarrassment, and emotional distress resulting from improper disposal of educational records). Many data security cases concern economic loss. *See generally* Vincent R. Johnson, *Data Security and Tort Liability*, J. INTERNET L., Jan. 2008, at 22, 26–30 (discussing the economic loss rule and credit monitoring damages).

192. *See* Ultramares Corp. v. Touche, 174 N.E. 441, 448–49 (N.Y. 1931) (holding that an accountant's liability for negligence was "bounded by contract [with his employer]," whereas liability for fraud could extend to creditors and investors relying upon accountant's certification).

193. *Id.* at 444.

based on the hypothetical possibility that the loss could have been prevented by a contract that was never formed to foreclose an inquiry into the issues of tort duty and scope of liability.

In every situation where economic losses occur, it is possible to say that the plaintiff could have entered into some type of contractual arrangement—e.g., an insurance policy, an indemnity agreement, or a release from liability—that would have mitigated the damage. To seize upon those hypothetical actions, which never came to pass, as a reason for applying the economic loss rule is to substitute imaginary remedies for real ones and pretend that the facts were other than those that actually occurred. The boundary line drawn by the economic loss rule should be between the real exercise of freedom of contract and relief under tort principles. Imaginary remedies have no place in the analysis.

In *Saratoga Fishing Co. v. J.M. Martinac & Co.*,[194] the Supreme Court of the United States addressed a boundary-line issue relating to the economic loss rule. The question was whether the builder of a vessel was liable for the destruction of equipment that had been added to the vessel by an initial purchaser before it was resold to the plaintiff.[195] The court held that the added equipment was "other property"[196] and that the economic loss rule did not bar recovery of tort damages.[197] In reaching that conclusion, the court found that hypothetical contracts that might have been entered into by the builder or the purchasers were essentially irrelevant to the analysis of the case. The court wrote:

> Of course, nothing prevents a user/reseller from offering a warranty. But neither does anything prevent a Manufacturer and an Initial User from apportioning through their contract potential loss of any other items—say, added equipment or totally separate physical property—that a defective manufactured product, say, an exploding engine, might cause. No court has thought that the mere possibility of such a contract term precluded tort recovery for damage to an Initial User's other property. Similarly, in the absence of a showing that it is ordinary business practice for user/resellers to offer a warranty comparable to those typically provided by sellers of new products, the argument for . . . replacing tort law with contract law . . . is correspondingly weak. That is to say, respondents have not explained why the ordinary rules governing the manufacturer's tort liability should be

194. *See* Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 877–78 (1997) (holding that the economic loss rule barred recovery against a ship builder by a second owner for damages to the ship itself but not for "other property" added to the ship by the first owner).

195. *Id.* at 877.

196. *See supra* Part II.C.2 (discussing the liability for harm to "other" property).

197. *Saratoga Fishing*, 520 U.S. at 877.

> supplanted merely because the user/reseller may in theory incur an overlapping liability in contract.[198]

The economic loss rule should defer actual private ordering, not to a supposed preference for contract principles that is inconsistent with a wealth of tort precedent that imposes liability for economic losses (including sometimes pure economic losses) and with the important public policies that animate American tort law.

C. Noncontractual Sources of Duty

1. Independent Duties Under Tort Law

In their efforts to articulate the limits of the economic loss rule, courts have focused on the source of the duty allegedly violated for the purpose of drawing a distinction.[199] Often, they have articulated a bright-line test.[200] Thus, the Supreme Court of Colorado wrote broadly:

> Where there exists a duty of care independent of any contractual obligations, the economic loss rule has no application and does not bar a plaintiff's tort claim because the claim is based on a recognized independent duty of care and thus falls outside the scope of the economic loss rule.[201]

Elaborating on this theme, the Supreme Court of Pennsylvania quoted a decision of the Supreme Court of South Carolina with approval:

> The question . . . is not whether the damages are physical or economic. Rather, the question of whether the plaintiff may maintain an action in tort for purely economic loss turns on the determination of the source of the duty plaintiff claims the

198. *Id.* at 882–83.

199. *See, e.g.*, Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1262 (Colo. 2000) ("[W]hether the plaintiff may maintain an action in tort for purely economic loss turns on the determination of the source of the duty [the] plaintiff claims the defendant owed."). The *Alma* court goes on to explain that "[a] breach of a duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie. A breach of a duty arising independently of any contract duties between the parties, however, may support a tort action." *Id.*

200. *See* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 537 (Fla. 2004) ("The economic loss rule has not eliminated causes of action based upon torts independent of the contractual breach even though there exists a breach of contract action.").

201. A.C. Excavating v. Yacht Club II Homeowners Ass'n, 114 P.3d 862, 866 (Colo. 2005); *see also* Congregation of the Passion v. Touche Ross & Co., 636 N.E.2d 503, 514 (Ill.1994) ("[T]he doctrine is applicable to the service industry only where the duty of the party performing the service is defined by the contract that he executes with his client. Where a duty arises outside of the contract, the economic loss doctrine does not prohibit recovery in tort for the negligent breach of that duty.").

> defendant owed. A breach of a duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie. A breach of duty arising independently of any contract duties between the parties, however, may support a tort action.[202]

Taking this approach, courts have held, for example, that actions for negligent misrepresentation[203] and conversion[204] are not barred by the economic loss rule because the duties not to mislead or steal are rooted in general tort principles rather than in the terms of the parties' agreement. Conversely, if the plaintiff alleges a breach of fiduciary duty, but there is no fiduciary relationship independent of the defendant's contractual obligations, the claim will be barred by the economic loss rule.[205]

2. Purely Contractual Duties

Focusing on the source of duty is useful for various reasons, including the fact that doing so weeds out cases involving nothing more than an allegedly negligent failure to perform a purely contractual duty—a duty that would not otherwise exist.[206]

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202. Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 288 (Pa. 2005) (quoting Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 88 (S.C. 1995)).

203. Highland Crusader Offshore Partners, L.P. v. LifeCare Holdings, Inc., No. 3:08-CV 0102-B2008, 2008 WL 3925272, at *14 (N.D. Tex. Aug. 27, 2008). The court wrote:

> If the defendant's duty to the plaintiff arises only from the contract between the parties, plaintiff's claim is usually a contractual claim only. . . . On the other hand, if the contract does not create the defendant's duty to the plaintiff, then the claim may sound in tort as well as in contract.

Id. The *Highland* court found that tort claims relating to an amendment of a credit agreement were not barred by the economic loss rule because the defendant's duty to disclose did not arise from the contract. *Id.* at *15. "Instead the duty arose because the Defendants allegedly made a partial or misleading disclosure or a disclosure that later became misleading or untrue." *Id.*

204. *See* Alex Hofrichter, P.A. v. Zuckerman & Venditti, P.A., 710 So. 2d 127, 128–29 (Fla. Dist. Ct. App. 1998) (rejecting the defendant's argument that "where there is a contractual relationship between the parties, a claim for civil theft will not lie absent a showing that the loss from the theft is separate and distinct from the loss flowing from the breach of contract").

205. *See* Action Nissan, Inc. v. Hyundai Motor Am., No. 6:06-CV-1747-Orl-19KRS, 2008 WL 4093702, at *12 (M.D. Fla. Aug. 29, 2008) (granting summary judgment).

206. *Cf.* Taylor, Bean & Whitaker Mortg. Corp. v. GMAC Mortg. Corp., No. 5:05-CV-260-OC-GRJ, 2008 WL 3200286, at *3 n.27 (M.D. Fla. Aug. 6, 2008) ("Pennsylvania courts . . . recognize the economic loss rule, which generally 'prohibits plaintiffs from recovering in tort economic losses to which their entitlement flows only from contract.'" (quoting Werwinski v. Ford Motor Co., 286 F.3d 661, 671 (3rd Cir. 2002))); Kennedy v. Columbia Lumber & Mfg. Co., 384 S.E.2d 730, 737 (S.C. 1989) (stating in a case involving the construction of residential housing that the "economic loss" rule bars claims based on duties "created solely by contract").

Those types of cases should be governed by contract law.[207] Indeed, for that very reason, some authorities say that the "economic loss doctrine" should be termed the "commercial loss doctrine."[208]

Suppose, for example, that economic losses are caused by the defendant's failure to publish a Yellow Pages ad[209] or monitor an alarm system[210] pursuant to a contract between the parties. It makes sense that the plaintiff cannot sue for negligence, for the only duties that have been breached are those created by the agreement.[211] Similarly, emotional distress and negligence claims arising solely from a defendant's misperformance of obligations under a mortgage contract have been held to be barred by the economic loss rule.[212]

a. Fraud Relating to a Contract

Courts have struggled with the issue of whether recovery in tort is barred by the economic loss rule when the plaintiff alleges that fraud was committed in the context of a contractual relation. Fraud in the inducement is generally actionable because pre-contractual misrepresentation violates obligations arising from tort principles that are independent of the terms of the agreement the parties ultimately reach.[213] In contrast, claims for fraud in the performance of a contract are sometimes barred, presumably on the theory that they relate to

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207. *See* Alejandre v. Bull, 153 P.3d 864, 868 (Wash. 2007) ("The rule prohibits plaintiffs from recovering in tort economic losses to which their entitlement flows only from contract because tort law is not intended to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement.") (internal quotations omitted).

208. *See* Triton Realty Ltd. P'ship v. Almeida, No. 04-2335, 2005 WL 1984454, at *3 n.3 (R.I. Super. Ct. Aug. 17, 2005) ("One court has noted that the doctrine could also be termed the 'commercial loss' doctrine, explaining that a major justification of the doctrine 'is the desirability of confining remedies for contract-type losses to contract law.'" (citing All-Tech Telecom., Inc. v. Amway Corp., 174 F.3d 862, 865 (7th Cir.1999) (Posner, J.))); *see also Alejandre*, 153 P.3d at 873 (Chambers, J.) (opining that "[t]he economic loss rule is a misnomer").

209. *See* Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 495 (Tex. 1991) (holding that "failure to publish the advertisement was not a tort").

210. *See* U.S. Fire Ins. Co. v. Sonitrol Mgmt. Corp., 192 P.3d 543, 547 (Colo. App. 2008) (finding that the economic loss rule barred a negligence action because the "alleged tort duty and the duty outlined in the contract are identical").

211. *Id.*

212. Davis v. Wells Fargo Home Mortg., No. 34136-1-II, 2007 WL 2039077, at *6 (Wash. Ct. App. July 17, 2007).

213. *See supra* notes 203–04 and accompanying text (stating that negligent misrepresentation is not barred by the economic loss rule because the duty not to mislead is rooted in tort principles rather than in the terms of the parties' agreement).

purely contractual duties. For example, the United States District Court for the Middle District of Florida held that where the "alleged fraud [was] nothing more than a refusal to divulge an intent to breach the contract," such fraud was "not separate from the alleged breach," and, therefore, the fraud claim was barred by the economic loss rule.[214]

Some claims of fraud simply restate in different terms that obligations arising under the contract were breached. Thus, the economic loss rule should normally bar recovery in tort if a fraud claim alleges simply that there was misrepresentation about the characteristics or quantity of the goods sold under a contract[215] or the number of hours worked under a consulting agreement.[216] A "mere contract claim cloaked in the language of tort" should be decided under contract principles.[217] Thus, courts have stated that, in the usual case, "a claim arising out of the provisions of a contract must find remedy under contract law,"[218] and that "[t]he economic loss doctrine stands for the general rule that 'ordinarily, a breach of contract does not give rise to a tort action by the promisee against the promisor.'"[219]

Still, it is incorrect to state that claims for fraud in the performance of a contract are never actionable. Entry into a contract creates no license to commit fraud. In *Robinson Helicopter Co., Inc. v. Dana Corp.*,[220] the Supreme Court of California held that a helicopter manufacturer's fraud and intentional misrepresentation claims against a supplier of clutch parts was not barred by the economic loss rule where the supplier provided false certificates of

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214. Welnia, LLC v. Bodymedia, Inc., No. 6:08-CV-742-Orl-31DAB, 2008 WL 3155148, at *1 (M.D. Fla. Aug. 4, 2008).

215. *Cf.* Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 880 (9th Cir. 2007) (finding that a fraud claim not barred by the economic loss rule involved "extraneous" matters and did not "duplicate" a contract suit).

216. *See* Pratham Design Innovation Pvt. Ltd. v. Infovision 21, Inc., No. 07-CV-13282 2007 WL 4557712, at *5 (E.D. Mich. Dec. 21, 2007) (finding that the economic loss rule barred recovery in tort because "[a]ssuming as true that InfoVision submitted false invoices and charged for consulting work that was never performed, that is a breach of InfoVision's contractual duty to perform under their professional services agreement").

217. *Cf. Giles*, 494 F.3d at 880 (finding that a fraud claim not barred by the economic loss rule involved "extraneous" matters and did not "duplicate" a contract suit).

218. White v. Holiday Kamper & Boats, No. 7:06-02362-HFF, 2008 WL 4155663, at *5 (D.S.C. Sept. 9, 2008).

219. Johnson v. Sprint Solutions, Inc., No. 3:08-CV-00054, 2008 WL 2949253, *3 (W.D.N.C. July 29, 2008) (quoting Carolina Ports Auth. v. Lloyd A. Fry Roofing, Co., 240 S.E.2d 345, 350 (N.C. 1978)).

220. *See* Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 272 (Cal. 2004) (holding that the economic loss rule does not bar fraud and misrepresentation claims).

conformance with manufacturing specifications.[221] Under the parties' contract and applicable principles of aviation law, it was essential that the clutch parts be produced in conformance with the terms of a design certificate.[222] The defendant changed the production process without notice by grinding the clutch parts differently, thus affecting their hardness and increasing their failure rate.[223] The defendant nevertheless "continued to provide written certificates to Robinson with each delivery of clutches [which stated] that the clutches had been manufactured in conformance with Robinson's written specifications."[224] In explaining its decision holding that the economic loss rule did not bar the tort claims, the court wrote:

> Dana's tortious conduct was separate from the breach itself, which involved Dana's provision of the nonconforming clutches. In addition, Dana's provision of faulty clutches exposed Robinson to liability for personal damages if a helicopter crashed and to disciplinary action by the FAA. Thus, Dana's fraud is a tort independent of the breach.[225]

b. Informational Incentives and Other Factors

Holding that the breach of a purely contractual duty is actionable only under contract law promotes the "efficient revelation of asymmetric information."[226] This is true because in contract law there is no liability for consequential economic damages without notice of special circumstances.[227] Employing the economic loss rule to prevent recovery of economic damages in tort forces parties to a contract to reveal relevant information that enables those with whom they deal to assess how much care should be exercised to prevent a loss.[228] However, the same analysis does not apply when an independent duty

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221. *See id.* at 274 (finding that even though the tort claims related to performance of the parties' contract, they were independent of the defendant's breach of contract).

222. *Id.* at 270.

223. *Id.* at 271.

224. *Id.*

225. *Id.* at 274.

226. *See* Miles, *supra* note 1, at 1816 ("[T]he rule of no liability for consequential damages without notice of special circumstances . . . creates incentives for the efficient revelation of asymmetric information.").

227. *Id.*

228. *See* Evra Corp. v. Swiss Bank Corp., 673 F.2d 951, 958 (7th Cir. 1982) (Posner, J.) (discussing the type of costs a party to a contract might have to incur to protect itself from liability for consequential losses if applicable rules did not create incentives to reveal relevant

is imposed under tort law, because in that case there has been a judicial determination that considerations relating to fault, deterrence, personal responsibility, and compensation warrant the imposition of liability. In other words, those factors outweigh whatever other general concerns the law might have relating to the need for incentives to facilitate disclosure of relevant information.

Permitting an action for economic losses based on an independent tort duty does not necessarily mean that the defendant will be liable. Courts may still inquire into all of the considerations which are taken into account in determining whether a tort duty of care exists.[229] Absent a finding of an independent tort duty[230] (and breach[231]), the plaintiff has no cause of action.

D. Contractual Preemption of Tort Law

If tort law recognizes an independent source of duty that affords protection to the plaintiff for purely economic losses, the plaintiff should be entitled to relief for a breach of that duty unless, by entering into a contract with the defendant, the plaintiff effectively waived that protection. A useful approach to ascertaining whether contract law should displace tort principles in a case when there is an independent tort duty is to think in terms of established notions of preemption because that is what is actually taking place: Contract law is preempting tort law. Put differently, the boundary line between what is actionable in tort and what is actionable in contract is being moved.

There are at least three useful points of reference. The first concerns preemption of state law by federal law, the second concerns displacement of common law by statutes, and the third relates to written releases from tort

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information).

229. *See* A.C. Excavating v. Yacht Club II Homeowners Ass'n, 114 P.3d 862, 868 (Colo. 2005) ("Included among such factors is the risk involved, the foreseeability and likelihood of injury as weighed against the social utility of the defendant's conduct, the magnitude of the burden of guarding against injury or harm, and the consequences of placing the burden upon the defendant.") (citing Taco Bell, Inc. v. Lannon, 744 P.2d 43, 46 (Colo. 1987)).

230. *See* Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 547 (Fla. 2004) (Cantero, J.) (opining that even when the economic loss rule is restricted to limited contexts, "the duty element will continue to weed out most claims for purely economic loss").

231. *Cf.* Wrestlereunion, LLC v. Live Nation Television Holdings, Inc., No. 8:07-CV-2093, 2008 WL 3048859, at *2 (M.D. Fla. Aug. 4, 2008) (holding that although the economic loss rule does not generally bar claims alleging fraud in the inducement, there was no actionable fraud because the misrepresentations at issue were not material, and therefore claims relating to contractual performance were barred by the economic loss rule).

liability. Each of these sources of guidance suggests that preemption of established tort principles should be recognized only in limited circumstances.

Federal law does not preempt state tort law unless that is the "clear and manifest" purpose of Congress.[232] Absent such a showing, a plaintiff is not deprived of state tort claims.[233] The text of a law can expressly indicate Congress's intent to preempt or, in limited cases, that intent can be implied from the language and structure of a statute.[234] However, there is generally a presumption against preemption by federal law.[235] Recognizing that state law serves a useful purpose as the primary source of tort remedies, courts are reluctant to hold that federal preemption alters the balance between freedom of action and liability that has been carefully crafted by the matrix of state statutes and common law decisions that define tort obligations.

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232. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947) (citing Napier v. Atl. Coast Line R.R. Co., 272 U.S. 605, 611 (1926)); *see also* Bernard D. Reams & Michael P. Forest, *Threading the Eye of the ERISA Needle: ERISA Preemption and Alternative Legal Schemes to Fill the Regulatory Vacuum*, 39 ST. MARY'S L.J. 277, 282 (2007) ("Congress, finding authority in the Supremacy Clause, has the power to invalidate state laws that conflict with federal laws.").

233. *Cf. Rice*, 331 U.S. at 218 (implying that, because a showing of a clear and manifest purpose of Congress is required of federal law to preempt state tort law, a plaintiff's state tort claims survive if no such showing is made).

234. Jonathan Freuh, Comment, *Pesticides, Preemption, and the Return of Tort Protection*, 23 YALE J. ON REG. 299, 301 (2006) ("Congress's intent to preempt may be expressly stated on the face of a federal law or it may be implied in two ways."). Freuh explains the two methods as follows:

> First, preemption by implication can occur when the scope of a federal law covers the entire area that a state law regulates. Second, implied preemption can result when federal and state regulations are actually in conflict; that is, when state law either frustrates the purpose of federal law, or state and federal laws are such that an actor cannot comply with both simultaneously.

Id.

235. *See* Colacicco v. Apotex Inc., 521 F.3d 253, 262–65 (3d Cir. 2008) (finding the presumption against preemption applicable). The court in *Colacicco* went on to say:

> [The] Supreme Court has stated: [i]n all pre-emption cases, and particularly in those in which Congress has legislated in a field which the States have traditionally occupied, we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.

Id. (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)). Other cases address the same issue. *See* Munoz v. Financial Freedom Senior Funding Corp., 567 F. Supp. 2d 1156, 1159 (C.D. Cal. 2008) ("Typically, there is a presumption against federal preemption of state laws" but that "presumption does not exist . . . 'when [a] state regulates in an area where there has been a history of significant federal presence'" (quoting United States v. Locke, 529 U.S. 89, 108 (2000))).

Likewise, statutory law replaces common law principles only when that is the necessary implication of the actions of the legislature. As one contemporary authority on New York state law explains:

> Where a change in the common law is to be effectuated the legislative intent to do so must be clearly and plainly expressed. When . . . a statute is intended to abrogate a common law right or to confer a right not vested by the common law, it will be so construed as not to go beyond the letter; and not even to that extent unless it appears to be according to the spirit and intention of the act.[236]

Similarly, contractual releases from tort liability are strictly construed because they threaten to undermine the important public policies relating to fault, proportionality, deterrence, individual responsibility, and compensation that form the intellectual foundations of tort law.[237] A release from liability for physical harm is not valid unless it is clear, specific, and consistent with the public interest.[238] A release is not expansively construed to abrogate the plaintiff's rights under tort law merely because the release is a form of contract.[239] Rather, the plaintiff's rights under tort law are waived only to the extent that the release contract so provides, and only if the waiver is consistent with public policy[240] and fair to the plaintiff. If these limitations regularly apply to releases in personal injury or property damage suits, it is difficult to see why the same should not be true with respect to purely economic losses. It is hard to draw a persuasive distinction between personal injury or property

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236. *Cf.* N.Y. STAT. § 301 cmt. (2008) (noting that the legislature is presumed to be acquainted with the common law and that "statutes in derogation or in contravention" of the common law are to be strictly construed, so as to change the common law only to the extent "required by the words of the act"); *see also* Meade v. Freeman, 462 P.2d 54, 59–60 (Idaho 1969), *overruled on other grounds*, Alegria v. Payonk, 619 P.2d 135, 136 (Idaho 1980) ("The rules of the common law are not to be changed by doubtful implication. But where the implication is obvious it cannot be ignored. No statute is to be construed as altering the common law farther than its words and circumstances import." (quoting Moon v. Bullock, 151 P.2d 765, 771 (Idaho 1944))).

237. *See* JOHNSON & GUNN, *supra* note 26, at 7–10 (discussing these and other public policies that have shaped American tort law).

238. *See, e.g.*, Rice v. Harley Davidson Inc., No. 1:04-CV-0481, 2005 WL 1843250, at *2 (N.D.N.Y. Aug. 1, 2005) (noting that the courts "look with disfavor" on releases from liability); Gross v. Sweet, 400 N.E.2d 306, 309 (N.Y. 1979) (discussing the "exacting standard" by which courts measure the validity of releases).

239. *See* Dohm v. Ponderosa Riding Stables, Inc., 41 Pa. D. & C.2d 307, 309–11 (Pa. C.P. 1966) (discussing exculpatory contracts).

240. *See* Winterstein v. Wilcom, 293 A.2d 821, 824–25 (Md. Ct. Spec. App. 1972) (discussing considerations bearing upon whether a release is void as against public policy).

damage suits, on one hand, and economic loss suits, on the other, based on the degree of harm to the plaintiff.[241] Economic losses can be devastating, sometimes much more so than minor personal injury or damage to tangible personal property.

These lessons relating to federal law preemption, statutory supercision of common law, and written releases from liability suggest a useful approach to dealing with issues relating to the boundary-line function of the economic loss rule. Federal law must manifest a clear purpose to preempt state tort remedies; statutory law supersedes the common law only to the extent necessary to give effect to the statute; and a release from liability must clearly waive the plaintiff's rights in order to obviate redress under tort principles. So, too, it makes sense to hold that, with respect to the economic loss rule, the terms of a contract between the parties abrogates otherwise applicable tort principles only if the agreement clearly evidences an intent to do so or if such displacement is a necessary consequence of the validity of the agreement. Further, even if these conditions are met, relinquishment of rights under tort law should be recognized only when depriving the plaintiff of those rights is consistent with public policy.[242] Boilerplate provisions in standard-form contracts should be subject to careful scrutiny.[243] There is no reason for the law to presume that the parties to a contract have bargained to relinquish rights that arise under tort law.[244]

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241. *Cf.* Feinman, *supra* note 1, at 821 (arguing that tort policies relating to deterrence, compensation, and fairness may be weaker in cases where there is no personal injury or property damage, but they are not absent); Gaebler, *supra* note 85, at 610 ("One explanation sometimes offered . . . 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. One difficulty with this explanation is that courts do in fact protect economic interests against negligence in a number of circumstances.").

242. *Cf.* Johnson, *supra* note 32, at 300 ("[R]ights relating to protection of personal data and notification of security breaches are not proper subjects for bargaining between the parties. Many state laws . . . provide that a waiver of the data subjects' rights is against public policy, and therefore void and unenforceable.").

243. *Cf.* Feinman, *supra* note 1, at 824. Feinman states:

> [T]he most common kind of contract today involves a standard form containing many terms, which are poorly understood if read at all. A business that enters into many such deals drafts the contract and presents it to the other party on a take-it-or-leave-it basis. The law always has had difficulty accommodating adhesion contracts to the paradigm of bargained contracts, but it is increasingly deferential to them.

Id.

244. *See id.* at 823 (arguing that "[i]n many real contracting situations, . . . parties . . . frequently fail to specify performance terms and allocate risks during the contracting process").

E. Misinterpretation of Contractual Preemption

At least three lines of precedent have begun to emerge which undermine the principles relating to preemption discussed above[245] and threaten to eviscerate the independent duty rule.[246] Those lines of authority hold that the violation of an independent duty is not actionable if the claim relates to the subject matter of the contract, involves disappointed contractual expectations, or requires proof of the same facts that would establish a breach of contract.

1. Relationship to the Subject Matter of the Parties' Contract

The clarity of the independent duty rule[247] is sometimes diminished by holdings that provide that even if the breached duty arises from tort principles, rather than from the contract, a tort action is barred if losses relate to the subject matter of the contract.[248] Any such exception framed in terms of "subject matter" relationship is obviously much too broad.

Consider, for example, the case of legal representation of a client by a lawyer in a personal injury case pursuant to a retainer agreement. Conduct by the lawyer amounting to negligent misrepresentation, professional negligence, or negligently false defamatory statements may be related, in a real sense, to the subject matter of a contract. Yet, those claims are not,[249] and should not be, barred by the economic loss rule. Indeed, it would be both odd and unrealistic to expect clients to bargain with lawyers about not being misled, incompetently represented, or defamed.[250]

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245. *See supra* Part III.D (discussing the contractual preemption of tort law).

246. *See supra* Part III.C.1 (identifying the independent duties present under tort law).

247. *See supra* Part III.C.1 (explaining the independent duty rule).

248. *See* Gencor Indus., Inc. v. Fireman's Fund Ins. Co., 988 So. 2d 1206, 1208 (Fla. Dist. Ct. App. 2008) (finding that the critical inquiry is whether "the property damaged was the subject of the contract, and the negligence was not 'independent from acts that breached the contract.'" (quoting HTP, Ltd. v. Lineas Aereas Costarricenses, S.A., 685 So. 2d 1238, 1239 (Fla. 1996))). In *Gencor Industries*, a customer's subrogated property insurer brought negligence and breach of contract claims against an asphalt plant manufacturer following an explosion at a plant. *Id.* at 1207–08. The court held that any error in submitting a negligence claim to the jury was harmless, even though the claim appeared to "be barred by the economic loss rule because the parties were in contractual privity." *Id.* at 1209.

249. *See supra* Part I.C (listing several situations in which the plaintiff may recover for purely economic damages stemming from negligence).

250. *Cf.* Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 276 (Cal. 2004) ("No rational party would enter into a contract anticipating that they are or will be lied to."). Moreover, a lawyer shall not "make an agreement prospectively limiting the lawyer's liability to

Moreover, it is easy to see how an exception based on relationship to the "subject matter of the contract" could easily be improperly manipulated. In *Highland Crusader Offshore Partners, L.P. v. LifeCare Holdings, Inc.*,[251] tort claims relating to a fee triggered by an amendment to a credit agreement were allowed to go forward.[252] The federal district court for the Northern District of Texas found that because the credit agreement never mentioned or provided for an amendment fee, the plaintiffs' loss was "not the subject matter of the contract."[253] The court might just as easily have interpreted the subject matter requirement differently and concluded that the amendment and fee both related to the credit agreement, which was the subject matter of the contract, and that, therefore, the action was barred by the economic loss rule. No purpose is served by endorsement of a legal test so susceptible to manipulation. The decision in *Highland Crusader* was correct, but it would have been better to express the holding in language directly addressing whether the terms of the contract preempted enforcement of independent duties under tort law. The court found that tort remedies were available because the credit agreement never mentioned or provided for an amendment fee.[254] In effect, the court was saying that the parties' contract was insufficiently specific to displace tort remedies relating to such an amendment because the subject was never addressed.[255] There was no express or implicit preemption of tort remedies.

2. Claims Involving Disappointed Expectations

Courts sometimes hold that the economic loss rule bars relief in tort because a plaintiff's claim involves merely disappointed expectations arising from the plaintiff's bargain with the defendant.[256] At first blush, these holdings

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a client for malpractice unless the client is independently represented in making the agreement." MODEL RULES OF PROF'L CONDUCT R. 1.8(h)(1) (2008).

251. *See* Highland Crusader Offshore Partners, L.P. v. LifeCare Holdings, Inc., No. 3:08-CV-01012-B, 2008 WL 3925272, at *15 (N.D. Tex. Aug. 27, 2008) (finding that because the credit agreement never mentioned an amendment fee, the plaintiff's loss was not related to the subject matter of the contract, and, therefore, was not barred by the economic loss rule).

252. *Id.*

253. *Id.*

254. *Id.*

255. *Id.*

256. *See, e.g.*, Collins v. Reynard, 607 N.E.2d 1185, 1187–88 (Ill. 1992) (Miller, C.J., specially concurring) ("The economic loss . . . doctrine denies a remedy in tort to a party whose complaint is rooted in disappointed contractual or commercial expectations."). The argument here is a bit different that in Part III.C.2. That section considers cases where there is no source

are not surprising. In the case of a defective product, disappointed expectations arise because the defect makes the product worth less by causing purely economic losses.[257] Under well-established principles, a tort claim will not lie if a product defect causes no harm to persons or other property.[258] This is an example of disappointed expectations not being actionable. However, the example does not mean that disappointed expectations can never be the basis for suit. There are many cases where a plaintiff's commercial expectations are indeed "disappointed" and yet the economic loss rule does not bar relief in tort. For example, if a potential defendant commits fraud in the inducement incidental to a contract with the plaintiff, the plaintiff is sure to suffer "disappointed expectations" related to the contractual bargain, yet most states permit suit in tort for the fraud.[259] It would be preferable to avoid the language of "disappointed expectations" and to inquire directly into whether the harm in question was within the scope of the actual bargaining by the parties and whether recovery in tort was expressly or implicitly foreclosed by the plaintiff's entry into the contract.

Some courts interpret the "disappointed expectations" test in a way that threatens to improperly vitiate rights that otherwise independently exist under tort law. For example, in *Grams v. Milk Products, Inc.*,[260] the Supreme Court of Wisconsin addressed the issue of whether farmers who fed their calves a non-medicated version of a milk substitute could recover in tort from the product's manufacturer and distributor for physical harm (poor growth and a higher mortality rate) allegedly suffered by the calves.[261] Under the usual rules of products liability, the plaintiffs were entitled to tort compensation because the allegedly defective product had caused harm to "other property."[262] However, the majority broadly concluded that "if claimed damages are the

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of duty independent of contract law. This section focuses on cases where it is asserted that contract principles preclude consideration of whether there is an independent duty under tort law that would provide redress for economic losses.

257. *See* RESTATEMENT (THIRD) OF TORTS: PROD. LIAB. § 21 (1998) (explaining that no remedy can be sought under tort law when the defective product fails to harm a person or other property).

258. *See supra* Part II.C.2 (discussing product-related economic losses).

259. *See supra* note 46 (listing cases from a variety of states that have allowed tort claims alleging fraud in the inducement of a contract to proceed).

260. *See* Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005) (holding that because the plaintiff's claims were based on their disappointed expectations of a product, contract law, and not tort law, is the proper means to solve the dispute).

261. *Id.* at 170.

262. *See supra* Part II.C.2 (discussing liability for harm to "other" property).

result of disappointed expectations of a bargained-for product's performance . . . the plaintiff must rely upon contractual remedies alone."[263] Thus, even though the contract said nothing to preempt ordinary tort principles relating to harm to other property, the plaintiffs were barred from asserting those rights.[264]

On the facts of the case, the decision is explainable and perhaps even understandable. The plaintiffs, upon inquiring about a cheaper milk substitute, had opted to use one without medication which sold for a lower price than the medicated version.[265] The court found that the claimed economic damages were "within the scope of the bargaining"[266] between the parties. Therefore, contract law provided the exclusive remedy.[267] As the court explained:

> The record shows that the expected function of the milk replacer was to provide sustenance for the Grams' calves. The Grams expected that the . . . non-medicated replacer would properly nourish the calves, much as the old replacer had, so that the calves would grow. This bargain was not about milk replacer *per se*; it was about a product that would foster the healthy development and growth of young calves.[268]

What is troubling about *Grams* is not the result, but rather the court's endorsement of fragmentary language from a Michigan case in its statement that tort claims are barred by the economic loss rule if "the damage was within the scope of bargaining *or* . . . '*the occurrence of such damage could have been the subject of negotiations between the parties*.'"[269] Regarding harm to "other property," there is a great difference between harm that was "within the scope of bargaining" and harm that "could have been" bargained over. That difference should be legally significant. While the former situation is a proper occasion for preempting tort principles based on deference to private ordering, the latter situation is not because in that case forfeiture of tort remedies was neither expressly provided for by the agreement of the parties nor even the subject of actual bargaining. In other words, if a party to a contract has not relinquished independent tort rights through private ordering, it is unfair to say

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263. *Grams*, 699 N.W.2d at 169.

264. *Id.* at 180.

265. *Id.* at 170.

266. *Id.* at 175.

267. *Id.* at 180.

268. *Id.* at 179.

269. *Id.* at 175 (quoting Neibarger v. Universal Coops., Inc., 486 N.W.2d 612, 620 (Mich. 1992)) (emphasis added).

that those independent tort rights have been lost because they might have been bargained away.

Interestingly, the full quotation from the Michigan case, *Neibarger v. Universal Coops., Inc.*,[270] is more limited in its reach than the fragmentary, but seemingly pivotal, reference in *Grams*. The *Neibarger* court wrote "[w]here damage to other property was caused by the failure of a product purchased for commercial purposes to perform as expected, *and this damage was within the contemplation of the parties to the agreement*, the occurrence of such damage could have been the subject of negotiations between the parties."[271]

The careless, fragmentary quotation from *Neibarger* incorporated into the *Grams* decision has launched Wisconsin courts on an unfortunate and misguided line of inquiry. Courts have interpreted *Grams* to mean that:

> The "disappointed expectations" test is directed at determining whether the purchaser should have anticipated the need to seek protection against loss through contract. This test focuses on the expected function of the product and whether, from the purchaser's perspective, it was reasonably foreseeable that the product could cause the damage at issue . . . .
>
> Because the focus is on "reasonable foreseeability," it follows that an objective standard applies: Should a reasonable purchaser in the plaintiff's position have foreseen the risk?[272]

Under this formulation, there seems to be a presumption that by entry into a contract all tort rights are forfeited and that the only remedy for foreseeable harm (the traditional province of tort law) is via contractual protection. The presumption should be just the opposite. Independent duties under tort law should be presumed to be actionable, unless they have been voluntarily relinquished. The proffered formulation sweeps so widely in addressing foreseeable economic harm that it does not draw the boundary line between contract law and tort law, but rather substitutes contract law for tort law in a wholesale manner. Doing so is imprudent because it undercuts the policies on fault, deterrence, proportionality, individual responsibility, and fair compensation that properly find application in cases when questions of duty

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270. *See* Neibarger v. Universal Coops., Inc., 486 N.W.2d 612, 623 (Mich. 1992) (holding that because the "damages sought in the cases are economic losses resulting from the commercial sale of goods the plaintiff's exclusive remedies are provided by the UCC").

271. *Id.* at 620 (emphasis added). This full quotation appears elsewhere in the *Grams* opinion. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 174 (Wis. 2005).

272. Foremost Farms USA Coop. v. Performance Process, Inc., 726 N.W.2d 289, 295 (Wis. Ct. App. 2006).

and scope of liability are resolved by reference to well-established tort principles. As explained above, tort law frequently provides redress for economic harm,[273] and there is no reason to assume that pure economic harm is compensable only under contract principles.

3. *Claims Arising from the Same Facts as Contractual Breach*

Some cases hold that remedies for a violation of an independent tort duty cannot be recovered if the tort claim arises out of the same set of facts as a breach of contract claim.[274] These cases appear to reflect a misunderstanding of purpose of economic loss rule. Viewed from the boundary-line perspective, that purpose is not to relegate the parties to a contract to exclusively contractual remedies for pure economic loss. Rather, it is to ensure that the adjudication of tort remedies defers to private ordering.[275] If the parties have not, by the terms of their agreement, preempted remedies based on independent tort duties, there is no reason to hold that such relief is foreclosed merely because a claim arises from the same facts that might support a breach of contract action.

For example, in *In re Gosnell Development Corp.*,[276] the United States District Court for the District of Arizona had before it a case where the plaintiff was the general partner of a partnership involved in development of land.[277] Of course, partners are ordinarily subject to suit for breach of fiduciary duty.[278] However, the court held that the plaintiff's breach of fiduciary duty claim was barred by the economic loss rule because it arose "out of the contract and the same set of facts as its breach of contract claim."[279] In effect, the court's decision seems to have erased the law of partner fiduciary duty insofar as it applied to the parties. Yet, the partnership agreement contained no provisions

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273. *See supra* Part III.B (citing several examples of how American tort law often remedies economic harm).

274. *See, e.g., In re* Gosnell Dev. Corp., No. CV-04-998-PHX-RGS, BK-97-10778-PHX-CGC, 2007 WL 1238923, at *4 (D. Ariz. Apr. 27, 2007) (finding that a fiduciary duty claim was barred because it arose out of the same facts as a breach of contract claim).

275. *See* Feinman, *supra* note 1, at 819 (finding that the economic loss rule reflects "the normative priority of private ordering principles over public regulation and of contract law over tort law").

276. *In re Gosnell*, 2007 WL 1238923, at *4 (holding that a fiduciary duty claim was barred because it arose out of the same facts as a breach of contract claim).

277. *Id.* at *1.

278. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

279. *In re Gosnell*, 2007 WL 1238923, at *4.

that would have supported a finding that the parties intended to exempt their agreement from such basic provisions of common law.[280] The proper course would have been for the court to directly address the question of whether assertion of independent duties under partnership fiduciary-duty principles was expressly or implicitly preempted by the terms of the parties' agreement. That inquiry cannot be framed in terms of whether a claim for breach of fiduciary duty arises out of the same facts as a breach of contract claim.

F. Lack of Bargaining Power

In their construction and application of the economic loss rule, courts have repeatedly emphasized the inappropriateness of employing the rule to bar the claims of persons who never had a real opportunity to bargain for contractual protection for economic losses. Thus, the Supreme Judicial Court of Massachusetts has remarked that "[w]hen the economic loss rule has been applied, the parties usually were in a position to bargain freely concerning the allocation of risk."[281] Similarly, in another case, Chief Justice Miller of the Illinois Supreme Court explained "[t]he cases in which . . . [the economic loss doctrine] has been applied are grounded on the notion that the complaining party, if he wished protection against the particular type of harm suffered, could have bargained for a guarantee or warranty against it."[282]

Concerns about lack of bargaining power explain why many courts have found the economic loss rule inapplicable to tort actions against professionals.[283] However, the problem of lack of bargaining power is more widespread.

Although some persons have argued that contractual principles should supplant contemporary tort law in a wide range of circumstances,[284] the history

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280. *Id.* at *1.

281. Clark v. Rowe, 701 N.E.2d 624, 626 (Mass. 1998).

282. Collins v. Reynard, 607 N.E.2d 1185, 1189 (Ill. 1992) (Miller, C.J., specially concurring).

283. *See id.* ("It is difficult to apply that concept [of free bargaining for protection] in the area of legal representation, where the purpose of retaining counsel is to obtain a representative who will function as a fiduciary and will act professionally, with reasonable skill and ability, to advance the client's interests.").

284. *See* PETER W. HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES 195–227 (1988) (discussing neo-contractual principles), *reviewed in* Vincent R. Johnson, *Liberating Progress and the Free Market from the Spectre of Tort Liability*, 34 NW. U. L. REV. 1026, 1036–48 (1989).

of American law in the twentieth century[285] counsels the exercise of caution to courts and legislatures faced with those entreaties.[286] Contractual bargaining over protection from economic harm is often slow, difficult, and expensive, and, in many cases, a practical impossibility. Consumers engage in multitudinous transactions, and they often lack important information about the risks they face to be able to negotiate intelligently over protection from those dangers. As one court recently noted, "[i]t goes without saying that many individual consumers have no meaningful ability to negotiate with product manufacturers and distributors."[287] Of equal importance, the persons with whom consumers conduct transactions—cashiers at discount stores, registrars in university bursars' offices, and agents at rental apartments—typically lack authority, training, or incentives to vary the terms of what are essentially intended to be take-it-or-leave-it transactions.

Tort law can offer a more efficient path than contract law to deterring and compensating some forms of economic harm. Consider for example the problems posed by failure to protect computerized personal information and the resulting losses caused by identity theft. Because of the numerous entities which maintain databases (e.g., credit card issuers, universities, governmental agencies, and social networking websites), it would be virtually impossible for any individual to negotiate with all relevant database possessors over the duty to exercise care to protect personal information from unauthorized access. However, the recognition of a tort duty obliging database possessors to protect personalized information from hacking has the potential to encourage safe practices by a wide range of potential defendants, as well as provide a mechanism for distributing losses when they occur.[288] Contract law principles could not be nearly as efficient in performing that role.

Relegating persons to exclusively contract remedies for purely economic losses will effectively immunize defendants from liability in a wide range of

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285. *See* Vincent R. Johnson, *Tort Law in America at the Beginning of the 21st Century*, 1 RENMIN U. L. REV. 237, 264 (2000) (discussing the remarkable transformation of American tort law during the twentieth century which today means that "life is relatively safe from risks of accidental harm, and that the victims of the accidents that do occur have a reasonably fair chance of obtaining redress").

286. *See* Feinman, *supra* note 1, at 823–24 (arguing that "we are in the midst of an historical shift, in which contract law is becoming increasingly less sensitive to the complexities of private ordering").

287. Foremost Farms USA Coop. v. Performance Process, Inc., 726 N.W.2d 289, 297 n.8 (Wis. Ct. App. 2006).

288. *See* Johnson, *supra* note 32, at 272–80 (arguing in favor a common law duty to protect personal data).

cases. This is undesirable for, in many cases, unnecessary economic harm should be deterred through legal principles that create an incentive for safe practices through risk of liability.

G. Waiver of the Economic Loss Rule

Insofar as its boundary-line function is concerned, the economic loss rule is premised on a preference for private ordering.[289] It, therefore, makes sense that the protections afforded by the rule must be subject to waiver by agreement of the parties. In *PNC Bank, National Ass'n v. Colonial Bank, N.A.*,[290] a loan participation agreement expressly provided that the defendant would not be liable "except for . . . material breach of this Agreement or its own gross negligence, bad faith or willful misconduct."[291] The federal district court for the middle district of Florida concluded that the "plain meaning" of the language of the agreement controlled and, therefore, the defendant "effectively waived any protection that the economic loss doctrine may have afforded it with regard to an action based on negligence, bad faith or willful misconduct."[292]

IV. Conclusion

The economic loss rule performs a valuable function in determining which economic losses are actionable only under contract law and not under tort principles.[293] However, just as contract law should not be allowed to drown in

289. *See* Feinman, *supra* note 1, at 817 ("[T]he principal explanation for the rise of the economic loss rule . . . is a preference for private ordering over public regulation.").

290. *See* PNC Bank, Nat'l Ass'n v. Colonial Bank, N.A., No. 8:08-CV-611-T-24MSS, 2008 WL 2917639, at *5 (M.D. Fla. July 24, 2008) (allowing for the waiver of economic rule protections).

291. *Id.* at *2.

292. *Id.* at *3. Interestingly, the court did not insert the adjective "gross" before negligence, even though the loan participation agreement referred to liability for "gross negligence." *Id.*

293. *See* Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 273 (Cal. 2004) ("Quite simply, the economic loss rule 'prevent[s] the law of contract and the law of tort from dissolving one into the other.'" (quoting Rich Prods. Corp. v. Kemutec, Inc., 66 F. Supp. 2d 937, 969 (E.D. Wis. 1999))).

a "sea of tort,"[294] the principles of tort law should not be permitted to drown in a "sea of contract."[295]

In interpreting and applying the economic loss rule in cases involving contractual relationships, the rule's boundary-line function can be properly performed only by focusing on the actual conduct of the parties to the litigation. An agreement to which the plaintiff is not a party provides no basis for limiting whatever rights the plaintiff may have under tort law.[296] Hypothetical remedies under nonexistent contracts with third parties or a supposed preference for compensating pure economic loss solely under contract principles have no place in the analysis.[297] The determinative factor is the actual conduct of the parties viewed in the context of the obligations that tort law sometimes imposes.

If the defendant has breached a tort duty that arises independent of contractual obligations,[298] that breach should be actionable unless the parties' contract expressly or by necessary implication preempts such relief.[299] Absent such preemption, relief in tort should be available regardless of whether the economic losses involve disappointed commercial expectations[300] or are related to the subject matter of the contract[301] or facts which might establish breach of contract.[302] Of course, the economic loss doctrine is a judicial construct. It is, therefore, waivable by agreement of the parties.

It is essential that the economic loss rule be crafted and applied in a manner that adequately accommodates the "goals of tort [law]—deterrence of negligent conduct, interpersonal considerations of fairness, and

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294. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986); *see also* GRANT GILMORE, THE DEATH OF CONTRACT 87 (1974) (suggesting that contract law was being "reabsorbed into the mainstream of 'tort'").

295. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005) (opining that "courts . . . should be mindful to prevent . . . tort from drowning in a sea of contract").

296. *See supra* Part III.A.1 (discussing the rights of economic victims not in contractual privity with the economic injurer).

297. *See supra* Part III.B (discussing hypothetical remedies under nonexistent contracts).

298. *See supra* Part III.C.1 (discussing non-contractual duties present under tort law).

299. *See supra* Part III.D (explaining the contractual preemption of tort law).

300. *See supra* Part III.E.2 (exploring claims involving disappointed expectations).

301. *See supra* Part III.E.1 (arguing that courts sometimes mistakenly impose the contractual preemption of tort law simply because the tort claim is related to the subject matter of the contract).

302. *See supra* Part III.E.3 (arguing that relief in tort should sometimes be available even if the same facts are used to establish a breach of contract claim).

compensation—that support liability"[303] in compelling cases. Unfortunately, attainment of this objective entails a high degree of doctrinal complexity. As Professor Robert Rabin has remarked "[i]t would undoubtedly be more aesthetically satisfying to have an economic loss rule that could be invoked without micro-scrutiny of competing policy considerations. . . . But bright-line rules grounded in single-dimension justifications would lead to undesirable policy outcomes."[304]

303. Rabin, *supra* note 1, at 869.

304. *Id.*