

IN SEARCH OF THE CHEAPEST COST AVOIDER: ANOTHER VIEW OF THE ECONOMIC LOSS RULE

Catherine M. Sharkey*

INTRODUCTION

The economic loss rule—a topic of ever-increasing significance in commercial litigation—has received less than its due attention in the academy, in part because business torts (and, to a lesser extent, remedies) have all but disappeared from the law school curriculum.¹ That may be changing, in part due to the American Law Institute’s (ALI) ongoing *Restatement (Third) Torts: Liability for Economic Harm* project,² as well as a burst of tort-based claims in commercial cases between contracting parties in the wake of the 2008 global financial crisis.³ The change is welcome. For even apart from its real-world significance, the topic engages two fundamental theoretical questions: (1) which interests should tort law protect; and, more pointedly, (2) how should we think about claims that arise along the boundary line between tort and contract?

Before presenting “another” view of the economic loss rule, I should begin with the conventional take. The economic loss rule is a judicially created doctrine invoked in strict liability or negligence (i.e., not intentional) tort cases to preclude tort liability in certain situations where a victim has suffered purely financial losses (i.e., no physical injury or damage to property). The exclusion for intentional torts is key because no one seriously questions that recovery for purely financial losses is

* Crystal Eastman Professor of Law, New York University School of Law. This paper is adapted from the Marx Lecture, which I delivered at the University of Cincinnati School of Law on February 11, 2016. I received helpful feedback from participants at the NYC Torts Group, the NYU Faculty Workshop, the Private Law Theory Workshop at Tel Aviv University, and the University of Chicago Law & Economics Workshop. I am especially grateful to Hanoeh Dagan, Oren Bar-Gill, Avihay Dorfman, Nora Engstrom, Richard Epstein, Greg Keating, Ariel Porat, Arthur Ripstein, and Ben Zipursky for comments. Adrienne Lee Benson (NYU 2015) and Caleb Seeley (NYU 2017) provided excellent research assistance. The Filomen D’Agostino and Max E. Greenberg Research Fund provided generous summer research support.

1. Cf. Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735, 735 (2006) (“It is surprising that the economic literature of the economic torts is so sparse relative to the economic literature on the physical torts—torts involving personal injury or property damage—including the wrongful taking of property (conversion).”).

2. I have served as an academic adviser to this project since its inception, from 2005 to 2007 (with Mark Gergen as Reporter) and 2011 to present (with Ward Farnsworth as Reporter).

3. The fall 2008 global financial crisis placed banks, bank subsidiaries, and investment managers in the crosshairs as investors lost hundreds of millions of dollars arising from allegedly inadequately monitored, overly risky investment vehicles. With increasing frequency, investors have sued financial service industry defendants not only for breach of contract, but also tort.

appropriate in cases of fraud.⁴ But beyond this common ground, the origins of the economic loss rule are disputed, as are its parameters and scope.⁵ In 1985, the New Jersey Supreme Court characterized it as “a virtually *per se* rule barring recovery for economic loss unless the negligent conduct also caused physical harm.”⁶ In sharp contrast, in 2013, the Florida Supreme Court declared that it was a narrow rule pertaining only to products liability cases, with no application outside of that realm.⁷ Unfortunately, the scope of the economic loss rule, which can have tremendous impact on a plaintiff’s potential recovery, finds no clear definition across jurisdictions.

This Article advances two claims that aim to clarify this controversial, often misunderstood doctrine. First, it is imperative to distinguish what I will term the “stranger paradigm” from the “consensual paradigm.” The specter of the economic loss rule is raised in different categories of cases: products liability, contracting party, third party, and stranger. It should not be surprising that the economic loss rule plays out differently and has different ramifications across these categories.⁸ As an initial cut, classifying such categories of cases as either “stranger” or “consensual” (and treating them accordingly) helps clarify doctrinal confusion. More specifically, holding firm to such a distinction should prevent conventional rationales for the economic loss rule developed in stranger cases—such as the floodgates or limitless liability rationale—from being imported *vel non* into two-party contracting cases that comprise the bulk of commercial torts. It would also expose the flaw in courts’ holdings that the economic loss rule applies full stop in the products liability realm, yet has no application in two-party contracting cases, thus failing to recognize the common thread connecting these cases, both of which fit on

4. See ROBERT L. DUNN, RECOVERY OF DAMAGES FOR FRAUD 20 (3d ed. 2003).

5. See, e.g., *Moransais v. Heathman*, 744 So. 2d 973, 979 (Fla. 1999) (“The exact origin of the economic loss rule is subject to some debate and its application and parameters are somewhat ill-defined.”).

6. *People Express Airlines v. Consol. Rail Corp.*, 495 A.2d 107, 109 (N.J. 1985).

7. *Tiara Condo. Ass’n, Inc., v. Marsh & McLennan Cos., Inc.*, 110 So. 3d 399, 407 (Fla. 2013).

8. Scholars have duly noted that there are actually different strands of the economic loss rule, or perhaps different rules that operate with a similar result. See, e.g., Dan B. Dobbs, *An Introduction to Non-Statutory Economic Loss Claims*, 48 ARIZ. L. REV. 713, 733 (2006) (“It seems impossible to formulate a single economic loss rule. Instead, the problem of recovery for pure economic loss that is unaccompanied by physical harm to person or property occurs in a number of contexts that may invoke differing concerns of policy.”); Victor P. Goldberg, *Recovery for Economic Loss Following the Exxon Valdez Oil Spill*, 23 J. LEGAL STUD. 1, 2–3 (1994) (“The *Robins* rule lumps together a number of very different problems But the grounds for shielding *Robins* are not the same as those for shielding the accountant, building contractor, or turbine manufacturer. Nor do the arguments for denying recovery to any of these injured parties carry over to the claims of the Exxon Valdez victims.” (internal citations omitted)); Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 ARIZ. L. REV. 857, 859–60 (2006); Gary T. Schwartz, *Economic Loss in American Tort Law: The Examples of J’Aire and of Products Liability*, 23 SAN DIEGO L. REV. 37 (1986).

a continuum within the consensual paradigm.

Second, and more ambitiously, I depart from conventional justifications and develop a unifying theoretical justification for the economic loss rule based on cheapest cost avoider principles that *does* apply across the categories of cases—albeit with less determinacy in the stranger paradigm than the consensual one. This framework also provides a way to resolve third-party cases, which straddle the stranger/consensual dividing line. That the cheapest cost avoider rationale can be applied across case categories and paradigms lends further weight to its promise as a unifying theoretical justification for the economic loss rule in tort.

I. THE STRANGER PARADIGM

Stranger cases are those in which the plaintiff victim and defendant tortfeasor are not in any consensual (contractual or quasi-contractual) relationship.⁹ The typical stranger economic loss rule case features a defendant who commits a negligent act that injures a third party's person or property and thereby causes various financial losses to the plaintiff, who has no contractual relationship with the defendant. This domain has attracted the lion's share of scholarly attention.¹⁰ I begin with the two canonical cases (featured prominently in most torts casebooks), followed by the justifications put forth by scholars and courts.

A. Two Canonical Cases

*People Express Airlines*¹¹ and *532 Madison Avenue Gourmet*¹² have achieved canonical status in torts. *People Express* is typically considered

9. See Dobbs, *supra* note 8, at 715 (“The first of the economic loss rules (the stranger rule), . . . is that, subject to some qualifications, a defendant owes no duty to exercise reasonable care for the pure stand-alone economic interests of strangers—that is to persons with whom the defendant has no relationship by contract, undertaking, or specific legal obligation.”).

10. It is striking to see the extent to which theorists (of all stripes) use as their centerpiece a 1945 New Jersey case, *Rickards v. Sun Oil Co.*, 41 A.2d 267 (N.J. 1945), in which the defendant's barge negligently destroyed a bridge that was the only means of access to six plaintiffs' retail businesses. Thus was born the scholars' canonical stranger case. Arthur Ripstein's account is illustrative:

If my factory closes down because your barge destroys the public bridge that provides the only access to the island on which it is located, I cannot recover my losses from you, even though you could have foreseen the harm that befell me, and even though you would have been liable for those losses had I owned the bridge you destroyed.

Arthur Ripstein, *Philosophy of Tort Law*, in THE OXFORD HANDBOOK OF JURISPRUDENCE AND PHILOSOPHY OF LAW 656, 683 (Jules Coleman & Scott Shapiro, eds., 2002) [hereinafter Ripstein, *Philosophy of Tort Law*]; see also Benjamin C. Zipursky, *Rights, Wrongs, and Recourse in the Law of Torts*, 51 VAND. L. REV. 1, 31–32 (1998) (using *Rickards* as the centerpiece of a discussion of negligently-inflicted economic harm).

11. *People Express Airlines, Inc. v. Consol. Rail Corp.*, 495 A.2d 107 (N.J. 1985).

12. *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*, 750 N.E.2d 1097 (N.Y. 2001).

an outlier in finding liability for purely economic losses, whereas 532 *Madison Avenue Gourmet* represents the traditional rule of no liability.¹³

1. *People Express Airlines*

In *People Express*, a fire started at the defendant's freight yard located across the street from the Newark Airport terminal in which People Express Airlines operated.¹⁴ A tank containing volatile chemicals was punctured, requiring closure of the terminal for fear of an explosion.¹⁵ As a result, plaintiff, People Express Airlines, suffered business interruption losses and sued the owner/operator of the freight yard and the owner of the tank car.¹⁶

The New Jersey Supreme Court noted that the "no duty" economic loss rule can function as a "convenient clamp on otherwise boundless liability," but suggested that the doctrine of proximate cause better served this function.¹⁷ The court held that the defendant owed a duty to avoid negligently inflicting economic losses on "plaintiffs comprising an identifiable class with respect to whom defendant knows or has reason to know are likely to suffer such damages from its conduct."¹⁸ Adding a further restriction, the court insisted that the identifiable class must be "particularly foreseeable in terms of types of persons or entities comprising the class."¹⁹ The court concluded that the airline was within this particularly foreseeable, identifiable class given the "close proximity" of the airline terminal to the freight yard and "the obvious nature of the plaintiff's operations and particular foreseeability of

13. The Third Restatement characterizes *People Express* as a distinct outlier. See, e.g., RESTATEMENT (THIRD) TORTS: LIAB. FOR ECON. HARM § 7 cmt.a ("Contrary positions have been taken only occasionally in the case law.") (citing *People Express*, 495 A.2d 107; *Mattingly v. Sheldon Jackson College*, 743 P.2d 356 (Ala. 1987)).

14. *People Express*, 495 A.2d at 108.

15. *Id.*

16. *Id.*

17. *Id.* at 110. The court reads the floodgates concern broadly to include "fear of fraudulent claims, mass litigation, and limitless liability, or liability out of proportion to the defendant's fault." *Id.* The court also makes a direct analogy to emotional distress damages claims. *Id.* ("[W]e have subordinated the threat of potential baseless claims to the right of an aggrieved individual to pursue a just and fair claim for redress attributable to the wrongdoing of another."). The court reasons that "[t]he troublesome concern reflected in cases denying recovery for negligently-caused economic loss is the potential for infinite liability, or liability out of all proportion to the defendant's fault. This objection is . . . not confined to negligently-caused economic injury." *Id.* The court then notes that "[p]roximate or legal cause has traditionally functioned to limit liability for negligent conduct." *Id.*

18. *People Express*, 495 A.2d at 116.

19. *Id.* The court makes an unconvincing attempt to distinguish the case at hand from *Rickards*: "This result may be explained in terms of the disproportionate extent of liability, which could not have been anticipated, and that the economic losses, while generally foreseeable, did not suffice to establish the requisite knowledge or particular foreseeability for recovery." *Id.* at 117.

economic losses resulting from an accident and evacuation.”²⁰

2. 532 Madison Avenue Gourmet

In *532 Madison Avenue Gourmet*, defendants’ negligence caused the south wall of a building to partially collapse during a construction project.²¹ As a result, fifteen heavily trafficked blocks of a prime commercial area were closed off.²² The plaintiff, a twenty-four-hour deli located half a block south of the collapsed building, was forced to close for five weeks.²³ The plaintiff sued the building owner, the ground floor lessees, and the managing agent for economic losses due to their negligence.²⁴

The New York Court of Appeals, concerned about “unlimited liability to an indeterminate class” and emphasizing the need to avoid “crushing exposure to the suits of millions,” held that there was no liability for these negligently inflicted, purely economic losses.²⁵ The court simultaneously distinguished and then rejected *People Express*.²⁶ The court conceded that its “policy-driven line drawing is to an extent arbitrary because, whenever the line is drawn, invariably it cuts off liability to persons who foreseeably might be plaintiffs.”²⁷ But the court concluded that “limiting the scope of defendant’s duty to those who have, as a result of these events, suffered personal injury or property damage . . . affords a

20. *Id.* at 118.

21. *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*, 750 N.E.2d 1097, 1099 (N.Y. 2001).

22. *Id.*

23. *Id.*

24. *Id.* at 1099–1100. A companion case, *5th Ave. Chocolatiere v. 540 Acquisition*, was brought against the same defendants. Plaintiffs were retailers two blocks south of the building, suing on behalf of themselves and a putative class of similarly situated businesses in a geographically defined area. A third case, *Goldberg Weprin & Ustin v. Tishman Construction*, involved a separate collapse of a forty-eight-story construction elevator tower in the heart of Times Square. In this case, three actions were consolidated; plaintiffs were a law firm, a public relations firm, and a clothing manufacturer, all located in an area affected by street closings. The law firm sued on behalf of itself and a proposed class of all similarly situated businesses in the affected area.

25. *Id.* at 1101–02 (discussing *Strauss v. Belle Realty Co.*, 482 N.E.2d 34 (N.Y. 1985), in which the court “restricted liability for damages in negligence to direct customers of the utility in order to avoid crushing exposure to the suits of millions of electricity consumers in New York City and Westchester”); *see also id.* at 1102 (discussing *Milliken & Co. v. Consolidated Edison Co.*, 644 N.E.2d 268 (N.Y. 1994), in which the court “circumscribed the ambit of duty to avoid limitless exposure to the potential suits of every tenant in the skyscrapers embodying the urban skyline”).

26. *532 Madison Ave. Gourmet*, 750 N.E.2d at 1103 (“The New Jersey court acknowledged . . . that the presence of members of the public, or invitees at a particular plaintiff’s business, or persons traveling nearby, while foreseeable, is nevertheless fortuitous, and the particular type of economic injury that they might suffer would be hopelessly unpredictable We see a like danger in the urban disasters at issue here, and decline to follow *People Express*.”)

27. *Id.*

principled basis for reasonably apportioning liability.”²⁸

B. Justifications

Tort scholars have justified the economic loss rule in stranger cases on corrective justice and economic deterrence grounds. Neither has gained much traction in courts, which tend to defend the rule on more pragmatic grounds.

1. Philosophical Theory

The conventional philosophical take is that tort law protects a hierarchy of interests, in which harms to the body and to property are prioritized over economic (as well as emotional) harms.²⁹ In elaborating a theory where negligence sets limits on the risks that people may impose on each other, such accounts seek to specify which interests count and also to assign relative weight to various interests. Security and liberty interests feature prominently in such accounts.³⁰ Indeed, “[t]he common law’s standard of reasonable care, and the familiar figure of the reasonable person through which that standard is expressed, provide a way of striking the appropriate balance between liberty and security.”³¹ Elaborating one such hierarchy-driven approach, Mark Geistfeld has proposed a “worst go first” principle whereby those with physical injuries deserve priority to recover monetary compensation before a defendant goes bankrupt.³²

Corrective justice and civil recourse scholars have further developed such accounts. John Goldberg and Ben Zipursky, founders of civil recourse theory, argue that the addition of duties not to inflict harms to economic (and emotional) well-being would be enormously burdensome and overly restrictive of one’s liberty interests.³³ At the extreme,

28. *Id.*

29. See, e.g., Greg Keating, *Is Cost-Benefit Analysis the Only Game in Town?* 19 (Univ. S. Cal. Ctr. for Law & Soc. Sci., Research Paper Series No. CLASS16-33, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2880697 (“The dominant conception . . . of ‘harm’ [is] a setback to an ‘interest,’ with an interest being something in which someone has a ‘genuine stake.’”) (citing JOEL FEINBERG, *SOCIAL PHILOSOPHY* 19 (1973) (“A humanly inflicted harm is conceived as the violation of one of a person’s interests, an injury to something in which he has a genuine stake.”). As Keating explains, “Harm so conceived is a comparative phenomenon, a worsening of one’s position.”).

30. See, e.g., Ripstein, *Philosophy of Tort Law*, *supra* note 10, at 681 (“[A]ll people have an interest in being able to pursue their ends free from the interference of others, and all have an interest in security in their persons and property.”).

31. *Id.* at 663.

32. MARK A. GEISTFELD, *TORT LAW: THE ESSENTIALS* 165, 169–70 (2008); see also Mark A. Geistfeld, *The Principle of Misalignment: Duty, Damages, and the Nature of Tort Liability*, 121 *YALE L.J.* 142, 156–57 (2011) (discussing courts’ limitation of duty in pure economic loss cases).

33. See John C.P. Goldberg & Benjamin C. Zipursky, *The Moral of MacPherson*, 146 *U. PA. L. REV.* 1733, 1833 (1998). Goldberg and Zipursky explain tort law’s need to prioritize physical injury and

according to corrective justice scholar Arthur Ripstein, “[t]he possibility of others relying on things going in a certain way is so pervasive that to require people to take account of it would narrow the range of freedom to almost nothing.”³⁴

More recently, Arthur Ripstein has shifted from an interest-based to a rights-based approach,³⁵ which boldly asserts that “the law of torts protects what you already have.”³⁶ He elaborates: “I wrong you only by interfering with . . . something you already have. You already have your person (including your body, mental capacities, and reputation) and your property.”³⁷ On Ripstein’s account, one’s person and property are means that an individual alone (and not others) can decide how to use.³⁸ Ripstein draws a sharp distinction between cases where another has “used [] or damaged my means” to which I have a right (and thus wronged me) and

property damage over economic (as well as emotional) harms:

The idea of prioritization can first help explain the general rule that there is no duty to take care to avoid causing another emotional or economic harm. Our duties to take reasonable care not to cause physical injury or property damage to others are quite burdensome To add to these duties other general duties to take care to avoid causing emotional and economic injuries would be enormously burdensome. Indeed, it would arguably be so burdensome that it would undercut the capacity of the sense of duty to prioritize and to focus.

Id. Arthur Ripstein previously endorsed a similar account, arguing that, even if such a duty to avoid economic losses could be reciprocally imposed, it would nonetheless be too demanding:

The prospect of economic loss to others provides the basis for a possible norm of conduct: someone towing a barge in fog can take account of the fact that a variety of people rely on the bridge that he might hit [S]uch a norm need not violate the condition of reciprocity, because a norm requiring that each person take account of all possible effects on others could be applied to all equally. But although such a norm is possible, it would be too demanding. That is why the law supposes that the fact that people depend on other people, and on the continued availability of things in various ways, provides no reason to take extra precautions.

Ripstein, *Philosophy of Tort Law*, *supra* note 10, at 682.

34. *Id.* at 683.

35. ARTHUR RIPSTEIN, PRIVATE WRONGS 29–52 (2016) [hereinafter RIPSTEIN, PRIVATE WRONGS] (ch.2 “What You Already Have, Part 1: Your Body and Property”). Ripstein is adamant that his new rights-based account is distinct from an interest-based account that is concerned with excessive burdens to freedom. *Id.* at 68–73. Invoking the familiar *Rickards* trope of “damaging the bridge on which you depend,” Ripstein claims that there is no wrong to those who use the bridge but do not own it. *Id.* at 63 (“If I damage the bridge on which you depend, but which you do not own, you have no cause of action against me for the loss of your customers, even though anyone who gave it a moment’s thought would realize that people cross bridges, and even though I was already under a duty to the bridge owner to avoid damaging it, so that giving you an additional claim against me would not prevent me from doing anything I was entitled to do.”). Nor is it based on a hierarchy of concerns: “Absent a violation of any personal or property right, the law pays no attention to economic losses, yet ordinarily the loss of income is a serious setback to a person’s well-being.” *Id.* at 72; *id.* at 69–70 (“Interests matter only if a right to body . . . or property already protects them . . .”).

36. *Id.* at 79.

37. *Id.* at 29.

38. *Id.* at 30 (“Your body and property are just what you use in deciding what purposes to pursue Nobody else is in charge of your body or property. That is, no other person gets to determine the purposes they are used to pursue.”).

cases that “change the world in which I use them” (and thus have not wronged me).³⁹ For him, cases involving purely economic losses thus fall on the “no wrong” side of the ledger.⁴⁰

But these philosophical accounts of the economic loss rule only go so far. The interest-based account cannot really explain the distinction between property and economic loss, since each contributes in the same ways, at least potentially, to whatever interest is served by having them.⁴¹ As Greg Keating has argued, the philosophical conception of harm, which is concerned with harm to persons,⁴² does not explain why damage to property should also be prioritized.⁴³ Even if one fully embraces an interest-based approach and agrees that protection of physical bodily integrity is paramount, one does not therefore inexorably believe that damage to property is of greater concern than infringements on economic interests. On Ripstein’s rights-based account, it is difficult to see why, if property is entitled to special protection because it is a “means through

39. *Id.* at 54; *id.* at 31 (“This fundamental distinction, which I describe in terms of the difference between wronging someone and merely failing to provide a favorable context in which that person sets and pursues purposes, is one of the organizing distinctions of tort law.”).

40. Ripstein provides several examples: “There are lots of bad things that one person can do to another that do not count as a tortious wrong: I can ruin your plans, spoil your view, block your access, lure away your customers [T]hey are not private wrongs, because I have not interfered with anything you already had.” *Id.* at 29. And similarly, “one person’s careless or reckless conduct might make it impossible for someone else to deliver something such as raw materials or electricity. But you have no claim that any other person uses his or her means in ways that provide you with a favorable context for another to deliver something to you.” *Id.* at 32.

41. Ripstein put the point slightly differently—namely, from the point of view of interests, there can be no distinction between what you currently have and the prospect of something. In other words, any interest-based theory of tort law ultimately focuses on the setback that the defendant’s wrongful conduct caused to the plaintiff’s protected interest. From the standpoint of any such view, it is fair to ask what the difference is between the interest you have in something you already have and the interest that you have in the prospect of something. See RIPSTEIN, PRIVATE WRONGS, *supra* note 35, at 71–72.

42. Keating, *supra* note 29, at 20–21 (“The philosophical conception of harm is concerned only with harm to persons.”). Keating has developed an “impaired condition” account, whereby: “The core cases of concern to law and morality—cases such as physical disabilities, broken, deformed, and lost limbs, chronic pain and serious developmental disabilities—constitute a narrower set of impaired conditions. In these core cases, basic powers of normal human agency are seriously compromised.” *Id.* According to Keating, physical harm impairs human agency: “Broken bones, severed limbs, disabilities of sight and hearing, diseased organs and disfigured body parts all compromise physical capacities through which we act. Those capacities play central, foundational roles in normal human lives.” *Id.* at 21.

43. Nor have I discovered a convincing justification elsewhere in the literature or courts’ jurisprudence. In tracing the origins of the products liability economic loss rule, the exclusion of property damage in addition to physical injury is never fully justified. In his influential article, *The Fall of the Citadel*, William Prosser points out that when strict liability was only applied to food and cosmetics, property became involved when poisonous food caused the death of livestock (property). William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791, 821 (1965) [hereinafter Prosser, *The Fall of the Citadel*]. And the United States Supreme Court (in *East River Steamship*, a seminal products liability economic loss case discussed below) simply asserted (without any justification): “For similar reasons of safety, the manufacturer’s duty of care was broadened to include protection against property damage.” *E. River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858, 867 (1986).

which you set and pursue your own purposes,”⁴⁴ the same could not be said for money itself, or other economic interests, which likewise might function as a means to pursue one’s purposes.⁴⁵

2. Law and Economics Theory

There is another justification for the economic loss rule, grounded in law and economics. The economic approach to tort law seeks to minimize the total costs of accidents, which include the costs of harms, the costs of preventing harms, and administrative costs. The economic approach considers costs and benefits on both sides of the “v”—not just risks and harms to the plaintiff victim, but also risks to the defendant, as well as risks to third parties who may depend upon the plaintiff or defendant. The economic approach does not sharply distinguish between harms to bodies, property, and economic interests—in other words, they all count (albeit not necessarily equally) in most social welfare functions. For this reason, the economic loss rule in its per se form—precluding recovery in tort for financial losses absent physical injury or property damage—presents somewhat of a puzzle.

In a seminal 1982 article, William Bishop proposed a social loss theory to explain the economic loss rule in the context of stranger cases.⁴⁶ Bishop began from the premise of economic deterrence theory that tort law imposes liability for the social costs of accidents to ensure that actors take optimal care. His key insight was to distinguish private losses to individuals from social losses to society. As a general matter, he argued, economic harms inflicted by tortious acts impose private, but not social, losses given that the same tortious act typically results in a corresponding private gain to someone else.⁴⁷ Consider, for example, the losses suffered

44. RIPSTEIN, *PRIVATE WRONGS*, *supra* note 35, at 39 (“Your body and property are protected because they are the means through which you set and pursue your own purposes.”).

45. Nor do I find persuasive Ripstein’s attempt to distinguish between how one might alter a person’s “means” (i.e., his body, mental capacities, reputation, and property) as distinct from “the context in which you use your means”—which he classifies as purely economic interests. *Id.* at 32. Ripstein asserts:

Anything you do, you do with your body Your mental and physical powers are the preconditions of your setting and pursuing any purposes. Although you can fantasize about, entertain, or wish for things without moving your body, the only way you can pursue purposes is with your body. And you (your body) can also use other means, most prominently property.

Id. at 39–40. But it is not obvious at all to me why property is a means entitled to special protection that would not extend to other economic interests which might likewise function as a means by which one pursues one’s purposes.

46. William Bishop, *Economic Loss in Tort*, 2 OXFORD J. LEGAL STUD. 1 (1982).

47. *Id.* at 4. In cases of physical injury and destruction of property, there is not only a private loss, but also a deadweight loss to society. Regardless of any hierarchy of interests or rights, or views regarding corrective justice, a physical injury is a private loss that does not have a corresponding private gain.

by 532 Madison Avenue Gourmet deli. While the deli lost business during the five-day shut-down, its thwarted customers presumably frequented other delis outside the closed-off zone, who thus experienced a boost in business and corresponding additional profits. In other words, 532 Madison Avenue Gourmet deli's private loss was another deli's private gain—and thus a transfer of wealth with distributional consequences, as opposed to a deadweight social loss, as would be the case if the deli were razed to the ground and its capital destroyed. Imposing tort liability for the infliction of such purely economic harms, Bishop argued, would lead to over-deterrence of socially valuable activities.⁴⁸

Bishop's social loss theory has been challenged on theoretical grounds. First, even if the private losses of the victim do not translate completely into social losses, given the corresponding private gain to a competitor, there is nonetheless some amount of social loss.⁴⁹ The thwarted customers, after all, preferred 532 Madison Avenue Gourmet and, in light of the shut-down, are relegated to a less-preferred choice.⁵⁰ Second, if a market participant (such as 532 Madison Avenue Gourmet deli) is a recurring victim (e.g., of frequent shut-downs of commercial blocks due to negligent construction operations), a no-liability regime could suppress the business activity level of such an actor. Third, the destruction of input might increase the marginal cost of production, leading to a production

48. *Id.* at 4–6. In response to Bishop, Mario Rizzo presented an alternative (one might say, complementary) theory of economic loss. Mario J. Rizzo, *A Theory of Economic Loss in the Law of Torts*, 11 J. LEGAL STUD. 281 (1982). Rizzo begins with a fairly simple model that the goal of courts is to reduce litigation costs. *Id.* at 282. And he argues that the work required to determine social costs is too costly for the imposition of liability. *Id.* at 283. He thus suggests that the economic loss rule is better explained by a channeling function: namely it reduces the number of potential suits by channeling tort liability through a small class of plaintiffs, who typically (but not always) have suffered physical injury. The property owner who recovers losses, for example, can then reimburse contractors and others for increased costs of completion under the contract. Rizzo suggests that such a channeling theory is intimated by the courts in *Robins Dry Dock* and *Cattle v. Stockton Waterworks*.

Victor Goldberg has developed a variant of this channeling theory. In his discussion of the commercial fishermen exception to the economic loss rule, Goldberg argues that a key element should be whether the harmed asset is owned or unowned, such that commercial fishermen might serve as proxy owners of a harmed resource: “If there are no owners to sue for the direct damage, then the injurer might not bear the full consequences of his tortious act. This suggests that indirect victims might be allowed to recover as surrogate owners” Goldberg, *supra* note 8, at 3. Such a channeling theory is in fact an instantiation of the generalized cheapest cost avoider rationale I develop below.

49. *E.g.*, Rizzo, *supra* note 48, at 286 (“Most cases of ‘pure economic loss’ constitute, from the perspective of economic theory, true social costs. They are not losses that are, in some sense, made up by gains to people elsewhere in the economy.”).

50. RICHARD A. EPSTEIN & CATHERINE M. SHARKEY, *CASES AND MATERIALS ON TORTS* 1128 (11th ed. 2016) (“[S]ome social loss always remains because the substitute performance is more costly than that originally contemplated—otherwise, the plaintiff would not have obtained the business in the first place.”).

decrease and corresponding higher prices.⁵¹ Notwithstanding these critiques on the margin, Bishop's social loss theory has had staying power with economic deterrence tort theorists⁵²—but virtually no influence, at least explicitly, on courts.

3. Pragmatism-Based Account

Fleming James, in his 1972 article, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, aptly (and presciently) captured the ethos of the judicial embrace of the economic loss rule in stranger cases.⁵³ James suggested that “[t]he reasons for this difference in treatment of indirect economic loss and physical damage do not derive from theory or the logic of tort law.”⁵⁴ Instead, it is grounded in a pragmatic “floodgates” concern with the specter of limitless liability. Whereas the physical consequences of negligence are typically limited, James argued, the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended.⁵⁵ Picking up on James' account, Robert Rabin has argued that the purpose of the economic loss rule is not to define duties from an *ex ante* perspective, but instead to provide a way to limit seemingly indefinite liability *ex post*.⁵⁶

51. Mario J. Rizzo, *The Economic Loss Problem: A Comment on Bishop*, 2 OXFORD J. LEGAL STUD. 197, 201 (1982).

52. See, e.g., Giuseppe Dari Mattiacci, *The Economics of Pure Economic Loss and the Internalisation of Multiple Externalities*, in WILLEM VAN BOOM ET AL., PURE ECONOMIC LOSS (2004). Mattiacci expands on Bishop's account by demonstrating the difficulty of traditional tort liability rules in providing the correct economic incentives in economic loss cases. He argues that because economic losses to one party usually result in a gain to a third party, tort law, which normally only focuses on the internalization of negative externalities, must incorporate both positive and negative externalities in its liability rule if optimal behavior is to be incentivized in the actor, potential victim, and third parties. See also Mauro Bussani et al., *Liability for Pure Financial Loss in Europe: An Economic Restatement*, 51 AM. J. COMP. L. 113 (2003).

53. Fleming James, Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43 (1972).

54. *Id.* at 44.

55. *Id.* at 45. James elaborated:

The explanation for this reluctance [on the part of judges to allow recovery for indirect economic loss] is a pragmatic one: the physical consequences of negligence usually have been limited, but the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended. As Cardozo put it in a passage often quoted, liability for these consequences would be “liability in an indeterminate amount for an indeterminate time to an indeterminate class.”

Id.; see also Rabin, *supra* note 8, at 861–62 (discussing the concern about the “ripple effect” in a highly connected and interdependent society). Anita Bernstein raises another pragmatic justification—namely the comprehension level of laypersons who decide cases. On Bernstein's account, the economic loss rule reflects the simplicity of reasoning by jurors (or laypersons) and plaintiffs with a limited legal and moral education and is therefore administrable in our jury system. See Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773 (2006).

56. Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37

The fear of unlimited liability arises not only due to the risk of potentially fraudulent claims but also due to the sheer number of even concededly meritorious claims.⁵⁷ This floodgates concern in the realm of economic harms has a long history. In a 1903 case, *Byrd v. English*, the Georgia Supreme Court worried that establishing a tort duty owed to a third party who was not party to the contract that was negligently breached would “invite a system of litigation more portentous than our jurisdiction has yet known.”⁵⁸ Expanding upon this rationale, Justice Oliver Wendell Holmes, in *Robins Dry Dock & Repair Co. v. Flint*, proclaimed “[t]he law does not spread its protection so far,” because “a tort to the person or property of one man does not make the tort-feasor liable to another merely because the injured person was under a contract with that other, unknown to the doer of the wrong,” thus denying liability on the grounds of foreseeability.⁵⁹ With this famous sentence—“The law does not spread its protection so far.”—Justice Holmes thus shut the door on any such rippling effect.⁶⁰

Judge Benjamin Cardozo put his everlasting imprint on the floodgates concern with his famous line in *Ultramares v. Touche*.⁶¹ In this third-

STAN. L. REV. 1513, 1514–15 (1985) (“It is my thesis that an identifiable type of economic loss case raises the specter of widespread tort liability—a characteristic which in itself has never been uniquely confined to economic loss situations—and that economic loss cases lacking this feature do not receive distinctive treatment.”). While Rabin emphasizes this pragmatic consideration, he also argues that physical harms are, in general, normatively different from, and more serious than, pure economic loss. *Id.* at 1534–38.

57. Economic harms are seen as susceptible to widespread ripple effects as a negligent act may impact the economic wellbeing of individuals many steps removed from the tortfeasor. The doctrine of proximate cause seems to exist for exactly this reason, to indicate when the cause of the injury is so remote that there is no liability.

58. 43 S.E. 419, 421 (Ga. 1903).

59. *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303, 309 (1927). *Robins* was a classic third-party case involving a third-party to a contract attempting to sue to recover economic loss. It involved a suit by charterers of a steamship against a dry dock (with whom they had no contract) for damages for the loss of use of the vessel from a delay in repairs due to the dry dock’s negligence. It could hardly be gainsaid that the charterers’ loss of business from the dry dock’s negligent delay in repairing was foreseeable, but so would have been the charterers’ clients’ loss of business, and those relying on the clients, and so on and on.

60. *Id.* While Holmes’ reasoning is short (and cryptic), this interpretation gains significance when read against the backdrop of the lower court opinion, which rejected the argument that the indirect economic losses were too remote. According to the Second Circuit, “The conceptions of remote result and proximate cause are, however, not fixed and permanent; in the development of legal principles and their adjustment to social needs, the boundary lines have been and will continue to be extended.” *Flint v. Robins Dry Dock & Repair Co.*, 13 F.2d 3, 6 (2d Cir. 1926), *rev’d*, 275 U.S. 303 (1927). The court invoked an analogy from adulterated food:

In our day the damages suffered by one who eats diseased food intended by the manufacturer to be marketed as pure food are deemed to be the proximate result of the manufacturer’s negligence, and therefore recoverable from the manufacturer, even though the injured person had direct relations only with an intermediate and independently contracting dealer.

Id. at 11–12.

61. *Ultramares Corp. v. Touche, Niven & Co.*, 174 N.E. 441 (N.Y. 1931).

party negligent misrepresentation claim against auditors, he warned of the potentially disastrous effects of imposing “liability in an indeterminate amount for an indeterminate time to an indeterminate class.”⁶²

Many scholars and courts trace the origins of the economic loss rule to *Robins* and *Ultramares* and build their doctrinal edifice from there.⁶³ The key to understanding their focus on the rule as a means to stem potentially limitless liability is to recognize that their attentions are limited to the stranger or third-party context.

II. THE CONSENSUAL PARADIGM

The most prominent scholarly justifications for the economic loss rule (including the philosophical and economic theories recounted above) were developed in the stranger context. In this regard, they exhibit to varying degrees what Gary Schwartz called “tort tunnel vision”⁶⁴ in their approach to recovery for pure economic losses. Such theories avoid engagement at the interface or borderland between tort and contract law. My goal in this Article is to explore this borderland. In order to do so, I focus on the relatively ignored “consensual” context⁶⁵—a context that

62. *Id.* at 444 (“If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.”).

63. Scholars who start with *Robins Dry Dock* generally proceed to fill out the doctrinal framework with the concerns raised in *Ultramares v. Touche* about limitless liability for accountants that led Judge Cardozo to restrict the reach of *Glanzer v. Shepard*, 135 N.E. 275 (N.Y. 1922). See, e.g., Jane Stapleton, *Comparative Economic Loss: Lessons from Case-Law-Focused “Middle Theory”*, 50 UCLA L. REV. 531, 562 (2002); see also David Gruning, *Pure Economic Loss in American Tort Law: An Unstable Consensus*, 54 AM. J. COMP. L. 187, 189 (2006) (“[T]he starting point for discussion of the economic loss rule remains the decision of the Supreme Court in *Robins Dry Dock*.”); Ronen Perry, *The Deepwater Horizon Oil Spill and the Limits of Civil Liability*, 1 WASH. L. REV. 1, 10–11 (2011) (calling *Robins Dry Dock* the “leading authority for the exclusionary rule” in the United States); Robert J. Rhee, *A Production Theory of Pure Economic Loss*, 104 NW. U. L. REV. 49, 50 (2010) (“The pure economic loss rule derives its modern authority from Oliver Wendell Holmes’s opinion in *Robins Dry Dock & Repair Co. v. Flint*, wherein the Supreme Court held that a charterer could not recover for economic loss resulting from negligent harm to the owner’s boat.”).

64. Schwartz, *supra* note 8, at 78.

65. The rule’s role in protecting the tort-contract boundary has attracted some scholarly attention. See, e.g., Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813, 814 (2006) (“A commonly litigated instance of the two-party cases—which may involve products liability law as well as breach of contract—is product-related economic loss, in which the breach of contract is due to a defective product.”); Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 528 (2009) (“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. 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.”). Mark Gergen’s three-factor test for the application of the economic loss rule also distinguishes between the indefinite liability (stranger, third-party cases) and private-ordering rationales for the rule (contract cases).

encompasses products liability cases and contracting parties cases—and propose a new rationale for the economic loss rule that will extend to these cases in a coherent way. As an initial matter, in this Part, I set forth the origins and operation of the economic loss rule in products liability and contracting party cases.

A. Products Liability Economic Loss Rule

Products liability, governed primarily by contract law at the outset of the twentieth century, is now squarely governed by tort. The dramatic fall of the “citadel” of privity (represented by the 1842 English case, *Winterbottom v. Wright*⁶⁶) is generally understood to have occurred with Judge Cardozo’s 1916 decision in *MacPherson v. Buick*,⁶⁷ holding that a car manufacturer had a duty, regardless of contract or warranty, to avoid negligence in the manufacture of its potentially dangerous products.⁶⁸ Having abandoned the privity limitation for physical injuries caused by the defective automobile, *MacPherson* set the stage for the subsequent expansion of the contractual theory of implied warranty of merchantability beyond retailers and buyers as well as the revolutionary rise of the tort theory of strict products liability. Here is not the place to rehearse the familiar story linking the fall of privity in *MacPherson* to the rise of strict products liability in tort, from Justice Roger Traynor’s influential 1944 concurrence in *Escola v. Coca Cola Bottling Co.*⁶⁹ to the California Supreme Court’s embrace of strict products liability in Justice Traynor’s 1963 decision in *Greenman v. Yuba Products*.⁷⁰ But I do want to highlight that this momentum, pushing product defect cases across the boundary line from contract law into tort, was driven by the development and acceptance of the argument that risks of physical injury (and, to a lesser extent, property damage) created by automobiles and other products demanded the imposition of non-disclaimable, public-policy based tort duties.⁷¹

Moreover, it is significant that the products liability economic loss rule

See Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749, 750–51 (2006) (describing the factors precluding liability as “(1) imposing liability for such harm would expose an actor to indeterminate liability . . . ; (2) alternative means exist to prevent or redress the harm[; and] . . . (3) an actor’s liability is traditionally resolved by another body of law”). But none of these accounts aims to provide a unifying theoretical justification for the rule’s operation across domains.

66. [1842] 152 Eng. Rep. 402; 10 Meeson & Welsby 109.

67. *MacPherson v. Buick Motor Co.*, 111 N.E. 1050 (N.Y. 1916).

68. See Prosser, *The Fall of the Citadel*, *supra* note 43, at 793.

69. *Escola v. Coca Cola Bottling Co.*, 150 P.2d 436, 461–68 (Cal. 1944) (Traynor, J., concurring).

70. *Greenman v. Yuba Power Prods., Inc.*, 377 P.2d 897 (Cal. 1963).

71. *Id.* at 901 (“The purpose of such [strict products] liability is to insure that the costs of injuries resulting from defective products are borne by manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves.”).

rears its head in the mid-1960s, right at the triumphant moment for strict products liability, as well as concurrent with the widespread adoption of the Uniform Commercial Code's set of warranties between retailers and buyers. The products liability economic loss rule thus emerges to reestablish a "privity-like" dividing line, protecting contract law, in the words of the U.S. Supreme Court in *East River Steamship* from "drown[ing] in a sea of tort."⁷² The products liability economic loss rule is best understood as a rearguard defender of privity in a post-*MacPherson* world,⁷³ imposed to prevent the migration of all warranty-based claims from contract into tort.

Indeed, the seminal 1965 case establishing the products liability economic loss rule (though not in so many words), *Seely v. White Motor Co.*, is authored by Justice Traynor, the chief architect of the theory of strict products liability in tort.⁷⁴ *Seely* involved a defective truck purchased by a consumer that overturned and was damaged. The plaintiff sued for damages from disappointed expectations for the value of the truck, lost profits, and damage to the truck caused by the accident. The California Supreme Court stated (albeit in dicta) that the manufacturer could not be strictly liable in tort for any purely economic losses.⁷⁵

Conventional justifications for the products liability economic loss rule rest on two pillars: limitless liability (the paramount concern in the stranger context, as discussed above) and deference to contract (a rationale not applicable in the stranger context). In *Seely*, Justice Traynor alluded to both. He raised a concern that if a manufacturer could not limit the "scope of his responsibility for harm caused by his products," it "would be liable for damages of unknown and unlimited scope."⁷⁶ In

72. In *East River Steamship*, the Court considered "whether a commercial product injuring itself is the kind of harm against which public policy requires manufacturers to protect, independent of any contract[]." *E. River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858, 866 (1986). The Court held "a manufacturer in a commercial relationship has no duty under either negligence or a strict products-liability theory to prevent a product from injuring itself." *Id.* at 871.

73. See Catherine M. Sharkey, *The Remains of the Citadel (Economic Loss Rule in Products Cases)*, 100 MINN. L. REV. 1845, 1849 (2016) ("Whereas the fall of privity and rise of strict products liability enabled product defect cases to move from contracts into torts, the economic loss rule forged a new dividing line, keeping purely financial cases within the domain of contract. From this vantage point, the economic loss rule emerged to protect the 'remains' of the citadel of privity.").

74. *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

75. *Id.* at 151.

76. *Id.* at 150–51; see also Friedrich Kessler, *Products Liability*, 76 YALE L.J. 887, 892 (1967) ("Properly understood, privity is only a means of protecting a party guilty of breach against losses suffered by remote parties which are unanticipated and therefore not included in the calculation of costs."); Richard E. Speidel, *Warranty Theory, Economic Loss, and the Privity Requirement: Once More Into the Void*, 67 B.U. L. REV. 9, 24 (1987) ("Where there is no privity . . . there is concern that liability imposed upon the remote manufacturer will result in unanticipated and extensive economic losses which may kill an otherwise useful goose who lays an occasional unmerchantable egg."). Indeed, this concern dates back to *Winterbottom*—the canonical case representing the strength of the privity barrier in the nineteenth century—where Lord Abinger warns that any plaintiff injured in any capacity by the product may be able

addition to the floodgates rationale, Justice Traynor also relied heavily on a separate, deference to contract rationale: “the history of the doctrine of strict liability in tort indicates that it was designed, not to undermine the warranty provisions of the sales act or of the Uniform Commercial Code but, rather, to govern the distinct problem of physical injuries.” Contract, at its core, protects economic expectations, and, according to Justice Traynor, the consumer can “be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will.”⁷⁷

By placing products cases within the consensual paradigm (and linking them with contracting party cases), I wish to emphasize the deference to contract rationale over the floodgates concern. The floodgates rationale has particular force in the stranger paradigm, where there is no way for the tortfeasor to recover the costs of tort liability. Moreover, the floodgates concern is typically addressed via proximate cause (and foreseeability) limitations; it does not provide the strongest rationale for separating tort from contract law.⁷⁸

B. Contracting Party Economic Loss Rule

In the contracting party realm, there is no floodgates concern. Instead, the key justification for the economic loss rule is deference to contract. This rationale is a key link between the products liability economic loss rule and the contracting party economic loss rule, which becomes readily visible when viewed through the lens of the consensual paradigm.⁷⁹

to sue, leading to “the most absurd and outrageous consequences, to which I can see no limit.” *Winterbottom v. Wright* [1842] 152 Eng. Rep. 402, 405; 10 Meeson & Welsby 109, 114.

77. *Seely*, 403 P.2d at 151. The U.S. Supreme Court picked up this rationale in *East River Steamship*, when it concluded that “[d]amage to a product itself is most naturally understood as a warranty claim.” 476 U.S. 858, 872 (1986). The Court elaborated: “The maintenance of product value and quality is precisely the purpose of express and implied warranties Therefore, a claim of a nonworking product can be brought as a breach-of-warranty action or, if the customer prefers, it can reject the product or revoke its acceptance and sue for breach of contract.” *Id.*

78. *See also* Sharkey, *supra* note 73, at 1869–71 (discussing floodgates rationale in products liability cases).

79. Several courts have recognized the link between the economic loss rule in products cases and two-party contract cases. *See, e.g.*, *Flagstaff Affordable Hous. Ltd. P’ship v. Design All., Inc.*, 223 P.3d 664, 669–70 (Ariz. 2010) (reasoning that the policy of upholding parties’ expectations has even greater force in construction contracts as compared to product defect cases, given that the parties negotiating the contract are in closer privity and more sophisticated); *Town of Alma v. AZCO Constr., Inc.*, 10 P.3d 1256, 1262 (Colo. 2000) (“[A]lthough originally born from products liability law, the application of the economic loss rule is broader, because it serves to maintain a distinction between contract and tort law. The essential difference between a tort obligation and a contract obligation is the source of the duties of the parties.”); *Anderson Elec., Inc. v. Ledbetter Erection Corp.*, 503 N.E.2d 246, 249 (Ill. 1986) (treating damages due to negligent performance of the contract as identical to the “purely economic losses due to defeated expectations of a commercial bargain,” which were barred by the products liability economic loss rule); *id.* at 250 (Simon, J., specially concurring) (agreeing that the failure to meet expectations in

Courts have long recognized that “a breach of contract does not connote wrongdoing,” and “consequential damages will not be awarded unless the defendant was put on notice of the special circumstances giving rise to them,”⁸⁰ a concept traced back to the 1854 English case of *Hadley v. Baxendale*.⁸¹ The articulation of a contractual privity economic loss rule, motivated by deference to contract law and private ordering, and grounded in the English common law restriction on liability for consequential damages attendant to a contract, is of more recent vintage.⁸² In the early 1980s, courts showed increasing uneasiness with the blurring of contract and tort.⁸³ In the subsequent decades, a number of courts expressly adopted a contractual privity economic loss rule.⁸⁴

The recent ALI *Restatement (Third) Torts: Liability for Economic Harm* embraces this contracting party economic loss rule. Section 3 provides: “there is no liability in tort for economic loss caused by the negligence in the performance or negotiation of a contract between the parties.”⁸⁵ The Restatement does contain a significant carveout from the contractual privity economic loss rule, namely the “professionals”

performance of a contract is similar to the failure of a product to live up to its promise, and “is only an invasion of a contract-like interest”).

80. *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 955–56 (7th Cir. 1982).

81. 156 Eng. Rep. 145 (1854).

82. The Third Restatement recognizes a 1982 case as providing the “leading judicial discussion of the rationale for the [economic loss rule] between contracting parties.” RESTATEMENT (THIRD) TORTS, *supra* note 13, § 3 (citing *Isler v. Texas Oil & Gas Corp.*). The earliest reference to an “economic loss rule” appears to be in *Flintoke Co. v. Dravo Corp.*, 678 F.2d 942 (11th Cir. 1982).

83. *See, e.g., Smith v. Price’s Creameries*, 650 P.2d 825, 828 (N.M. 1982) (“Failing a showing of ambiguity in a contract, or evidence of fraud, where the parties are otherwise competent and free to make a choice as to the provisions of their contract, it is fundamental that the terms of contract made by the parties must govern their rights and duties.”). These principles led the Tenth Circuit to hold that “contract is the consensual formation of relationships with bargained-for duties,” and that contractual duties should not be confused with tort duties “[u]nless such bargains are against public policy (covered either by prohibitory statutes or well-defined, judge-made rules such as unconscionability)” *Isler v. Texas Oil & Gas Corp.*, 749 F.2d 22, 23 (10th Cir. 1984).

84. *See, e.g., Filak v. George*, 594 S.E.2d 610 (Va. 2004) (reasoning that the contractual privity economic loss rule stems from *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 374 S.E.2d 55 (Va. 1988), which applied the products liability economic loss rule to a pool installation); *Grynberg v. Questar Pipeline Co.*, 70 P.3d 1, 10–11 (Utah 2003) (“While Wyoming has not addressed the precise issues raised in this case, it has clearly adopted the rule that when a conflict arises between parties to a contract regarding the subject matter of that contract, ‘the contractual relationship controls, and parties are not permitted to assert actions in tort in an attempt to circumvent the bargain they agreed upon.’”); *Saltiel v. GSI Consultants, Inc.*, 788 A.2d 268, 280 (N.J. 2002) (“Under New Jersey law, a tort remedy does not arise from a contractual relationship unless the breaching party owes an independent duty imposed by law.”); *Town of Alma v. Azco Constr., Inc.*, 10 P.3d 1256, 1262 (Colo. 2000) (stating that the “essential difference between a tort obligation and a contract obligation is the source of the duties of the parties”); *Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc.*, 463 S.E.2d 85 (S.C. 1995).

85. RESTATEMENT (THIRD) TORTS, *supra* note 13, § 3 (“Except as provided elsewhere in this Restatement, there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties.”).

exception in section 4.⁸⁶

The Restatement's articulation of a contractual privity economic loss rule is a positive development. But throughout, it nonetheless emphasizes the conventional justifications for barring recovery for economic harms: unlimited liability concerns and deference to contract.⁸⁷ The Restatement acknowledges these justifications may operate on a sliding scale and will be more or less relevant depending on the factual scenario at issue. But this approach lends itself to misapplication and misunderstanding on the part of courts. What is needed instead is a doctrinal framework that distinguishes the stranger paradigm from the consensual one.

III. PARADIGM CONFUSION

The stranger paradigm starts with the "no duty" default premised primarily on unlimited liability concerns; the identification of a "special relationship" between the parties will, however, lead to imposition of a duty of care. The consensual paradigm starts from a very different premise, namely that there is a duty owed by the contracting (or quasi-contracting) parties, but the key question is whether, and the extent to which, there is a public-policy imposed tort duty above and beyond any contractual duties.

The choice of paradigm is key. If the stranger paradigm is deployed across all domains (as some courts and scholars do), then the "[t]he requirement of an intimate nexus [i.e., special relationship] is satisfied by contractual privity or its equivalent."⁸⁸ In this case, there is no longer a fear of unlimited liability, which is at the heart of the no duty default, and thus no need for an economic loss rule barring tort recovery. But, such a conclusion is directly at odds with the starting point of the consensual paradigm, namely that the contractual privity economic loss rule establishes a default of no tort liability, based upon a separate deference to contract rationale, which can be overcome only in certain limited situations.

A. Does New York Recognize the Contracting Party Economic Loss Rule?

Given New York's status as the commercial center of the United States, it might be surprising to learn that the status of the economic loss rule under New York law in cases between contracting parties is not settled

86. *Id.* § 4 ("A professional is subject to liability in tort for economic loss caused by the negligent performance of an undertaking to serve a client.").

87. *See id.* § 1.

88. *L & P Converters, Inc. v. Alling & Cory Co.*, 642 A.2d 264, 267 (Md. 1994).

law. In fact, for this reason, commercial parties in a recent business dispute litigated simultaneously in New York and London sought expert opinions on the issue.⁸⁹

Ben Zipursky, a tort law scholar who has developed, along with John Goldberg, the civil recourse theory of tort law, was retained as one of the experts. He opined that New York recognizes the economic loss rule only in the realm of products liability.⁹⁰ In his view, the main justification for limiting recovery for economic losses outside the domain of products cases is the floodgates concern. His approach drew heavily on *Ultramares v. Touche*, the third-party negligent misrepresentation case, in which Judge Cardozo—who warned that “liability in an indeterminate amount for an indeterminate time to an indeterminate class” would result from imposing liability for negligent misrepresentation on accountants—limited the scope of duty owed to those in “near privity” with the accountants.⁹¹ Applying this rationale to the two-party contracting situation in the case at hand, Zipursky argued that, if liability for pure economic loss is appropriately imposed in “near privity” situations, then, *a fortiori*, it should be imposed in actual privity situations, where there is

89. In *Deutsche Bank AG v. Sebastian Holdings, Inc.* [2013] EWHC 3463 (Comm), Sebastian Holdings, Inc. (SHI) alleged that Deutsche Bank AG (DB) negligently performed risk management undertaken by its prime brokers and private bankers.

90. *Id.* at [296], [322]–[323]. Some (including Zipursky) have (mis)read the New York Court of Appeals as limiting the economic loss rule to the products context, based upon a footnote in *532 Madison Avenue Gourmet*, which reads: “The ‘economic loss’ rule . . . has no application here [in a stranger case]. That [products liability economic loss rule] case stands for the proposition that an end-purchaser of a product is limited to contract remedies and may not seek damages in tort for economic loss against a manufacturer.” *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*, 750 N.E.2d 1097, 1101 n. 1 (N.Y. 2001). Apart from the general response that, semantics aside, *532 Madison Avenue Gourmet* actually stands for the proposition that there is no recovery for negligently inflicted economic harms in such a stranger case, the New York Court of Appeals has also cited products liability economic loss cases when denying recovery in tort in two-party contract cases. *See, e.g.*, *Sommer v. Fed. Signal Corp.*, 593 N.E.2d 1365, 1369 (N.Y. 1992) (citing *Bellevue S. Assocs. v. HRH Constr. Corp.*, 579 N.E.2d 195, 199–201 (N.Y. 1991)); *New York Univ. v. Cont’l Ins. Co.*, 662 N.E.2d 763, 767–68 (N.Y. 1995) (citing *Sommer*, 593 N.E.2d at 1369; *Bellevue*, 579 N.E.2d at 199–201).

91. *See Deutsche Bank AG* [2013] EWHC 3463 (Comm) [297], [304], [335]. Zipursky relied heavily on a second foundational Cardozo opinion, *Glanzer v. Shepard*, 135 N.E. 275 (N.Y. 1922). *Id.* at [332]–[335]. *Glanzer* was a third-party negligent misrepresentation case in which the defendant public bean weigher contracted with the sellers (not the plaintiff buyer) to weigh the beans, and the buyer sued the weigher for misrepresentation of the weight. The court concluded:

The plaintiffs’ use of the certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which, to the weighers’ knowledge, was the end and aim of the transaction One who follows a common calling may come under a duty to another whom he serves, though a third may give the order or make the payment.

Glanzer, 135 N.E. at 275–76.

Both *Glanzer* and *Ultramares* conclude that pure economic loss is not recoverable to those not in “near privity” with the defendant. Implicit from the sufficiency of “near privity” is that actual privity (i.e., an actual contractual relationship) is sufficient to generate a duty of care with respect to economic loss.

no threat of unlimited liability or ripple effect.⁹² According to Zipursky, the contractual relationship between the parties therefore made it far *more* appropriate for courts to recognize a negligence claim.⁹³ Thus, Zipursky concluded—both as a matter of New York doctrinal law and theoretical justification—that banks and financial advisers owe a tort duty of care to those who rely upon the competent performance of all duties they have undertaken to perform.⁹⁴ In his view, the fact that the parties are in a contractual relationship is either a matter of no consequence or else actually bolsters the case for negligence-based tort liability.⁹⁵

To my mind, Zipursky fell prey to a kind of paradigm confusion. It is true that, under the stranger paradigm, the key question is whether there is any duty of care whatsoever owed by the defendant to the plaintiff (or to a class of which the plaintiff is a member)—and courts have indeed justified such “no duty” rulings for fear of unlimited liability, as elaborated in *Ultramares*. But, such a stranger paradigm is not appropriate for resolving contracting party cases, where the key question is not whether any duty whatsoever is owed, but rather whether the duty is owed in tort rather than (or in addition to) contract. To resolve this question, one must switch to the consensual paradigm. As I argued (as the competing tort law expert), as a general matter, the existence of the parties’ contract strengthens the case for deferring to their own, bargained-for allocation of rights and responsibilities and thus weakens the case for tort (all else, including the parties’ relative sophistication and bargaining power, equal).⁹⁶ Here, as in the products liability realm, the economic loss rule polices the tort/contract boundary.⁹⁷

This paradigm confusion likewise lies behind the disarray across jurisdictions on the fundamental question whether the economic loss rule is limited to products cases, or should instead be extended further.

92. See *Deutsche Bank AG* [2013] EWHC 3463 (Comm) [297], [335].

93. *Id.* at [297], [312].

94. *Id.* at [304]. In other words, Zipursky argued that banks or investment management companies have a duty of care to a wide range of affected parties that rely upon the bank’s or investment manager’s exercise of due care.

95. *Id.* at [304], [324].

96. *Id.* at [297], [301], [304].

97. A much more difficult question is, nonetheless, raised by recalling the very malleability of the boundary line, aptly illustrated by the historical evolution of strict products liability, enabling product defect cases to cross over from contract into torts. Just as Judge Cardozo considered the introduction of the mass-produced automobile as posing a new kind of risk in industrialized society, which called for the imposition of a public-policy imposed tort law duty to protect against the signature risks of such a dangerous product to society, one might claim that the prospect of widespread financial turmoil—i.e., negative effects going far beyond the contracting parties at issue—that could arise from negligent risk management likewise calls for a public-policy imposed tort duty.

B. Should the Economic Loss Rule Be Limited to Products Cases?

A 2013 Florida Supreme Court case, *Tiara Condominium*,⁹⁸ illustrates another permutation of paradigm confusion. Recall, in the case discussed above, Zipursky attempted to apply the stranger/third-party paradigm—and cases arising therein—to resolve a commercial case between contracting parties. In *Tiara Condominium*, the Florida Supreme Court makes a similar paradigm mistake, drawing an ill-justified line for the economic loss rule at products cases, failing to recognize that the consensual paradigm should apply to both products and contracting party cases.

In *Tiara Condominium*, a condominium sustained damage caused by two hurricanes in 2004; an insurance coverage dispute ensued over whether the coverage was “per occurrence” or in the aggregate.⁹⁹ Tiara, the condominium association, sued Marsh, its insurance broker, for breach of contract and for negligence on account of Marsh’s failure to advise Tiara of its complete insurance needs and failure to apprise Tiara that it was underinsured.¹⁰⁰

The Eleventh Circuit Court of Appeals, consistent with its understanding that Florida had adopted a contractual privity economic loss rule, certified to the Florida Supreme Court the question whether an insurance broker is a “professional” subject to a carveout from the economic loss rule. The Florida Supreme Court seized the opportunity to stem the tide of the economic loss rule.¹⁰¹ It restated the certified question as whether the economic loss rule applies outside the realm of products cases and answered in the negative.¹⁰²

98. *Tiara Condo. Ass’n, Inc. v. Marsh & McLennan Cos., Inc.*, 110 So. 3d 399 (Fla. 2013).

99. *Id.* at 400.

100. *Id.* 400–01.

101. *Id.* at 406 (lamenting the “over-expansion of the economic loss rule”).

102. The impact of this holding remains to be seen. On remand, the court held that insurance brokers were liable in tort, given that they owe a fiduciary duty of care to the insured. The court reasoned that, while the economic loss rule was restricted to products liability, tort claims could still be “barred by Florida’s independent tort rule, which posits that a party to a contract can recover economic loss in tort against the other contracting party only when there is additional, wrongful conduct chargeable to that party which amounts to a tort independent and separate from the claimed contract breach.” *Tiara Condo. Ass’n v. Marsh, USA, Inc.*, 991 F. Supp.2d 1271, 1279 (S.D. Fla. 2014). But, the court conceded that the “‘independent tort rule’ is but a preliminary version, or simple predecessor, of what later became known as the ‘contractual privity economic loss rule’—a rule which similarly posits, ‘[A] tort action is barred where a defendant has not committed a breach of duty apart from a breach of contract.’” *Id.*

Should a court decide that the independent tort rule falls along with the economic loss rule, then the *Tiara* holding would have far greater impact. *See, e.g.*, *Lamm v. State St. Bank & Trust*, 749 F.3d 938, 947 (11th Cir. 2014) (noting that “the exact contours of [the independent duty rule] limitation, as applied post-*Tiara*, [are] . . . still unclear”); *Great Wall De Venezuela C.A. v. Interaudi Bank*, 117 F. Supp. 3d 474, 491 (S.D.N.Y. 2015) (“[T]he Florida Supreme Court’s recent decision in *Tiara*, which restricted the application of the economic loss rule to cases involving products liability, swept with it the corollary concept of the ‘independent tort rule’ such that the independent tort rule now applies only in

Here again, an appreciation of the consensual paradigm that links the products cases to the contracting party cases would refute drawing a line in the sand separating the two categories of cases.

IV. CHEAPEST COST AVOIDER RATIONALE AS A UNIFYING THEORETICAL RATIONALE

Resolving this paradigm confusion is the first step towards imposing clarity on the muddled economic loss rule case law. However, even still, thornier doctrinal questions remain. For example, how should the Restatement's "professionals" exception to the contracting party economic loss rule be defined? More difficult still, how to account for the third-party cases, which straddle the stranger/consensual paradigm? As a descriptive doctrinal matter, whether courts adopt the stranger paradigm or the consensual paradigm to resolve economic loss cases can be outcome determinative. But what should drive courts' paradigm choice?

Here, I propose, as a normative matter, a cheapest cost avoider rationale as a unifying theory applicable across paradigms. As developed further below, this approach will generally lead to increased instances of tort liability in the stranger paradigm and decreased instances of tort liability in the consensual paradigm, as compared with application of more conventional rationales. But, more significantly, applying such a rationale could lead courts to make inroads in resolving some of the most perplexing questions implicated by the economic loss rule at the borderland between tort and contract.

A. The Doctrinal Relevance and Possibility of a Unified Theory for Economic Harms

Here I propose a cheapest cost avoider rationale that (unlike the existing philosophical and law and economics accounts discussed in Part I) furnishes a potential unifying theoretical rationale for all cases across the spectrum (stranger, third-party, contracting parties, and products liability) and one that, moreover, could have doctrinal payoff. While I do not engage here in the broader normative debate between corrective justice and economic deterrence accounts of tort law, I nonetheless must dispel the strong-form corrective justice critique that asserts that "the Learned Hand test [the centerpiece of economic deterrence theory] retains

products liability cases."); *see also* BVI Marine Constr. Ltd. v. ECS-Florida, LLC, No. 12-80225-CIV, 2013 WL 6768646, at *5 (S.D. Fla. Dec. 20, 2013) (rejecting tort claims added to a breach of contract claim after the *Tiara* decision on the ground that "[t]here is no indication yet that admiralty law will follow the direction of Florida in limiting application of the economic loss rule").

its hold on American legal scholarship, not on the conduct of the courts.”¹⁰³

People Express and *532 Madison Avenue Gourmet*—the canonical economic loss stranger cases—are powerful counterexamples. Both courts (despite reaching opposite conclusions on the tort liability question) embrace the economic deterrence (not the corrective justice) approach to tort. Both cases begin from the premise that the imposition of tort liability should deter negligent conduct by creating incentives to minimize the risks and costs of accidents.¹⁰⁴ In *People Express*, the New Jersey Supreme Court observed that the “underlying policy of negligence doctrine” is that “the imposition of liability should deter negligent conduct by creating incentives to minimize the risk and costs of accidents.”¹⁰⁵ In *532 Madison Avenue Gourmet*, the New York Court of Appeals proclaimed: “At its foundation, the common law of torts is a means of apportioning risks and allocating the burden of loss.”¹⁰⁶ The court further reasoned that “special relationships” may impose duties on defendants “because the special relationship puts them in the best position to protect against risk”—in other words, liability is properly imposed on them, as they are the cheapest cost avoiders.¹⁰⁷ So, as a preliminary matter, it is not out of place to suggest that cheapest cost avoider principles hold out the promise of consistency and predictability, particularly in the area of economic losses—not only for scholars, but for courts as well.¹⁰⁸

More significantly, unlike the existing proposed rationales (from either a philosophical or law and economics perspective) for the stranger economic loss rule, the cheapest cost avoider rationale works well in the contexts of both the stranger paradigm and the consensual paradigm. Philosophical accounts fixate on the stranger context; they have comparatively little to say about cases of special relationships—and almost nothing to say regarding contracting parties in particular.¹⁰⁹ The

103. RIPSTEIN, *PRIVATE WRONGS*, *supra* note 35, at 114.

104. Nor do these cases stand alone in embracing the Hand formula approach. *See also* Aikens v. Debow, 541 S.E.2d 576, 581 (W. Va. 2000) (“[B]eyond the question of foreseeability, the existence of duty also involves policy considerations underlying the core issue of the scope of the legal system’s protection. Such considerations include the likelihood of injury, the magnitude of the burden of guarding against it, and the consequences of placing that burden on the defendant.”).

105. *People Express Airlines v. Consol. Rail Corp.*, 495 A.2d 107, 117 (N.J. 1985).

106. *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*, 750 N.E.2d 1097, 1101 (N.Y. 2001).

107. *Id.* at 1101.

108. Indeed, the absence of corrective justice based concerns with economic losses in the wider corpus of cases is noteworthy.

109. A notable exception is Stephen R. Perry, *Protected Interests and Undertakings in the Law of Negligence*, 42 U. TORONTO L.J. 247, 265–66 (1992) (arguing that invited reliance in two-party cases should allow for tort liability).

significance and distinctiveness of the special relationship context is clear: namely, it flips the no-recovery rule. In other words, “[i]n cases of special relationships, interests that would otherwise be excluded, such as prospective financial gain, will be protected.”¹¹⁰ Notwithstanding the significance, comparatively little attention has been devoted to defining the metes and bounds of such special relationships.¹¹¹ On the one hand, depending on the breadth of the “special relationships” carveout, tort duties might be imposed in a wide range (if not all) of two-party contracting situations. For, where the special relationship imposes a duty, that duty is not abrogated merely because parties have a business or contractual relationship. But, on the other hand, whether such tort liability is nonetheless subject to contractual disclaimer is left unaddressed.

Turning to law and economics approaches, Bishop’s social loss theory likewise comes up short in the contracting party context. For example, imagine that two parties, A and B, decide to contract for liability over negligently inflicted losses. It is of course possible that the parties can assume greater duties by agreement than those imposed by law. While Bishop would term these “private” losses, there is nothing that would stop the parties from writing such a contract, even if it would mean stymying the positive externalities that would otherwise flow to C (a third party, such as a restaurant competitor). Nor would tort law intervene in any way to preclude such a contractual undertaking, even if there is a thwarted private gain that would outweigh the cost to B of preventing economic losses to A.

Unlike the social loss theory—which does not hold in this context because there is no guarantee that contracting parties will only recognize liability for social losses (as opposed to private ones)—the cheapest cost avoider principles carry forward from the stranger context, with even greater force into the consensual paradigm, where they serve as information-forcing default rules.

110. RIPSTEIN, *PRIVATE WRONGS*, *supra* note 35, at 70.

111. Ripstein posits that special relationships are distinctive because the defendant, through some deed or undertaking, takes charge of some specific aspect of the plaintiff’s affairs; in other words, he takes responsibility for a risk for which he was not otherwise responsible. Ripstein thereby acknowledges that “special relationships—for example, a professional undertaking to provide special care or expert advice—can generate duties to specific persons with respect to actions in addition to the ordinary duty to be careful around the person and property of others.” *Id.* at 99 (“The most familiar, and to some, puzzling example of this sort is liability of those holding themselves out as experts in making recommendations with respect to specific transactions.”). *Glanzer v. Shepard* (discussed *supra* note 91)—a third-party case where a public weigher is held liable for plaintiff’s reliance on a representation made about the weight of beans—is the prototypical example.

B. Stranger Paradigm

The conventional justification for the stranger economic loss rule (most emphatically in the courts) rests on fears of unlimited liability.¹¹² The cheapest cost avoider rationale focuses instead on which party can most effectively minimize the total costs of accidents.¹¹³ The cheapest cost avoider rationale posits that, in some situations, it is preferable for victims to be incentivized to allocate risks and responsibilities via first-party insurance or other precautionary measures.

In the stranger cases—such as *People Express* and *532 Madison Avenue Gourmet*—it could be argued that the business victims are in a better position than the potentially negligent stranger tortfeasor to assess the cost and to mitigate *ex post* any business interruption due to negligence.¹¹⁴ As an initial matter, business interruption insurance is readily available to the putative victims.¹¹⁵ Moreover, certain particular features of these economic losses likewise tip the balance in favor of the victim as cheapest cost avoider.¹¹⁶ First, business interruption losses are the kind of losses that occur regularly even absent any wrongdoing; putative victims thus develop experience and expertise in terms of managing and reducing them. Second, such losses tend to accumulate over time; as a result, victims tend to operate over a long term horizon in terms of mitigating them.¹¹⁷ Taken together, the victim can structure its operations—for example, by maintaining spare parts, excess capacity, and alternative operating modes—so as to minimize any compounding of losses.¹¹⁸ Seen in this light, the economic loss rule provides incentives

112. In this respect, the courts' analyses in *People Express* and *532 Madison Avenue Gourmet* are representative of a much wider trend. For example, in *Dundee Cement Co. v. Chem. Labs, Inc.*, 712 F.2d 1166 (7th Cir. 1983), the court applies the stranger economic loss rule, but never inquires if the defendant—whose negligence resulted in the closure of part of a state highway and business losses to the plaintiff—would have been in a better position to avoid the losses than the plaintiff. Instead, the court notes that the ripple effect of an accident will be far greater for purely economic injury than for physical damage and rests its decision on a “legitimate fear that a crushing burden of litigation would result.” *Id.* at 1172. Similarly, some courts simply assert that the “connection between the defendants’ negligence and the claimants’ damages is too tenuous and remote to permit recovery,” *Petitions of Kinsman Transit Co.*, 388 F.2d 821, 825 (2d Cir. 1968), with no examination of why the line must be drawn at economic injury, even when that injury falls on a foreseeable class of individuals, *id.* at 825 n.8.

113. Moreover, the administrative and litigation related costs from placing liability on one party or the other should be considered.

114. Moreover, “[h]olding the manufacturer responsible for losses to the buyer’s business is inherently inefficient because of problems of adverse selection.” William K. Jones, *Product Defects Causing Commercial Loss: The Ascendancy of Contract over Tort*, 44 U. MIAMI L. REV. 731, 766 (1990).

115. In contrast, “[t]he manufacturer-seller cannot obtain insurance against noncasualty losses to the buyer’s business.” *Id.* at 765.

116. See Ariel Porat, *Economics of Remedies*, in 2 THE OXFORD HANDBOOK OF LAW & ECONOMICS 308, 320 (Parisi, ed. 2017).

117. See *id.*

118. See Jones, *supra* note 114, at 765–66.

for potential plaintiffs to exercise optimal care and to self-insure efficiently.

But the case for a per se stranger economic loss rule based on cheapest cost avoider principles is not airtight. Such a blanket no-duty rule could lead unprotected plaintiffs to take excessive precautions that are far costlier than substitute precautions available to the negligent defendant tortfeasor.

The application of cheapest cost avoider principles in the stranger paradigm is thus indeterminate. It would not support the majority no-duty rule espoused in *532 Madison Avenue Gourmet* (which the court grounded on alternative grounds, namely fear of unlimited liability). But it would at least direct courts to consider which party is the cheapest cost avoider, taking into consideration the availability of relevant insurance markets, the feasibility of precautionary measures, as well as the likelihood that the potential tortfeasor would be sufficiently deterred. As mentioned above, the cheapest cost avoider theory might incorporate Mario Rizzo's channeling theory.¹¹⁹ Indeed, such a theory provides the most plausible justification for the *People Express* liability finding. In this regard, *People Express*'s "particular foresight" rule for purely economic losses bears a close affinity to the "special damage" rule for public nuisance.¹²⁰ The channeling insight is that those few persons who suffer substantial economic loss, like the airline in *People Express*, may recover while the multitude of others whose losses are indirect (e.g., customers) cannot.¹²¹

To be sure, this is a tall task—but far from impossible. The Ninth Circuit's decision in *Union Oil Co. v. Oppen* provides an apt illustration.¹²² While acknowledging that "fixing the identity of the best or cheapest cost-avoider is more difficult than might be imagined," the court articulated several relevant factors: (1) excluding as cost-avoiders those who "could avoid accident costs only at an extremely high expense"; (2) evaluating administrative costs on each party; (3) avoiding imposing costs on activities unrelated to the accident; and (4) allocating the loss to the "party who can best correct any error in allocation."¹²³ Applying these factors, the court imposed tort liability where an oil spill caused purely economic harm to commercial fishermen.¹²⁴

119. See *supra* note 48.

120. EPSTEIN & SHARKEY, *supra* note 50, at 1133.

121. *Id.* at 1128–29.

122. *Union Oil Co. v. Oppen*, 501 F.2d 558, 569 (9th Cir. 1974); see also EPSTEIN & SHARKEY, *supra* note 50, at 1133–34.

123. *Union Oil Co.*, 501 F.2d at 569–70.

124. *But see* *Barber Lines A/S v. M/V Donau Maru*, 764 F.2d 50 (1st Cir. 1985) (finding no liability where an oil spill prevented other boats from docking, causing increased unloading costs). In *Barber Lines*, the court finds it unsurprising that, given the complicated economic incentives, "courts have neither

C. Consensual Paradigm

To pick up on a theme from Part II, the invocation of the consensual paradigm, where appropriate, should reorient focus away from the concern regarding limitless liability in the direction of deference to contract. Cheapest cost avoider principles provide a more robust theoretical justification for deference to contract than do conclusory assertions about the primacy of contract over tort. Moreover, such principles help answer the difficult questions at the boundary line of tort and contract.

1. Products

In *East River Steamship*, the defendant manufactured defective turbines, which, once installed in plaintiffs' boats, malfunctioned.¹²⁵ The plaintiffs lost significant income and sued the defendant in tort on a products liability theory. The U.S. Supreme Court described the task at hand as "charting a course between products liability and contract law, [where] we must determine whether injury to a product itself is the kind of harm that should be protected by products liability or left entirely to the law of contracts."¹²⁶ The Court held that "a manufacturer in a commercial relationship has no duty under either a negligence or strict-products liability theory to prevent a product from injuring itself."¹²⁷ The Court reasoned that tort liability is imposed in products cases "because 'public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market.'"¹²⁸ Moreover, according to the Court, the law of warranty is better suited to address a plaintiff's contractual disappointments. In its famous, enduring line, the Court refused to let contract "drown in a sea of tort."¹²⁹

The Court thus made clear that courts should not ask tort law to perform

enforced one clear rule nor considered the matter case by case." *Id.* at 55–56. Instead, the "exceptions seem designed to pick out broad categories of cases where the 'administrative' and 'disproportionality' problems intuitively seem insignificant or where some strong countervailing consideration militates in favor of liability." *Id.* at 56. The court acknowledges the empirical difficulties in finding the most efficient location for liability on a case-by-case basis and uses that as a rationale for adopting and applying the per se stranger economic loss rule. *Id.*

125. *E. River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858, 859–61 (1986).

126. *Id.* at 859.

127. *Id.* at 871. In so holding, the Court embraced *Seely* over *Santor*. See *Santor v. A&M Karagheusian, Inc.*, 207 A.2d 305 (N.J. 1964) (finding strict liability for economic losses even from disappointed expectations without analyzing which party had knowledge or could insure against the magnitude of such a loss). Thereafter, most states followed its lead.

128. *E. River S.S. Corp.*, 476 U.S. at 866.

129. *Id.* at 866.

a job that contract law might perform better. But—and here the Court was far less pellucid—what precisely falls within the wheelhouse of contract or warranty law and thus outside of tort?

More than a decade later, in *Saratoga Fishing Co. v. J.M. Martinac & Co.*¹³⁰ (a case far less prominent than *East River Steamship*), the Court provided the beginning of an answer. Significantly, according to the Court, the answer did not hinge on the “mere possibility of such a contract term.”¹³¹ In other words, tort liability will not be blocked simply because the parties theoretically could have contracted in order to allocate the risk.

In *Saratoga Fishing*, a shipbuilder sold a fishing vessel with a defective hydraulic system to an initial user.¹³² The first user added equipment to the vessel and then sold it to a subsequent purchaser.¹³³ The vessel caught fire and sank due to the defective hydraulic system and destroyed the added equipment.¹³⁴ The Court held that the added equipment was “other property” and thus fell outside the products liability economic loss rule that would have precluded recovery for damage to the product, absent physical injury or damage to other property.¹³⁵ According to the Court, unlike the situation in *East River Steamship*, warranty law—even if theoretically available on offer from the first user—was ill-suited to protect against a malfunctioning product that causes physical damage to user-added items.¹³⁶ For, as the Court explained, while initial users of products seek warranties depending upon a manufacturer’s ability to create finished products, and while manufacturers and component suppliers can allocate risk through contract, initial users are poorly positioned to do so when they sell to subsequent purchasers.¹³⁷

The Court’s analysis tracks a cheapest cost avoider analysis—with an emphasis on the institutional reality of which party is best able to offer protection against economic harms.

2. Contracting Parties

Cheapest cost avoider principles provide an underlying theoretical justification behind the conventional “deference to contract” rationale, which typically merely asserts the primacy of contract. The conventional view asserts that “[c]ontract law, and the law of warranty in particular, is

130. *Saratoga Fishing Co. v. J. M. Martinac & Co.*, 520 U.S. 875 (1997).

131. *Id.* at 882.

132. *Id.* at 877.

133. *Id.*

134. *Id.*

135. *Id.* at 884–85.

136. *Saratoga Fishing Co.*, 520 U.S. at 882–83.

137. *Id.*

well suited to commercial controversies . . . because the parties may set the terms of their own agreements.”¹³⁸

A cheapest cost avoider framework highlights how the economic loss rule functions as an information-forcing default rule. It incentivizes the party with superior knowledge of the nature and depth of its potential injury to share that information with the party that may be liable for such harm. In other words, the victim often has superior information and ability to minimize financial losses.¹³⁹

Courts have embraced aspects of this rationale in both the products liability¹⁴⁰ and contracting party realms.¹⁴¹ The Colorado Supreme Court acknowledged that the purpose of the economic loss rule is not only to “enforce expectancy interests of the parties so that they can reliably allocate risks and costs during their bargaining; [but also] . . . to encourage the parties to build the cost considerations into the contract.”¹⁴² And Judge Richard Posner of the Seventh Circuit has explained that “it is in contractual settings that the potential victim ordinarily is best able to work out alternative protective arrangements and need not rely on tort law.”¹⁴³ Which party is in the best position to avoid an accident depends not only on knowledge of the *class* of persons to which plaintiffs may belong or the category of harm that may be inflicted by the defendant’s

138. *E. River S.S. Corp.*, 476 U.S. at 872–73; *id.* at 873 n.8 (“[T]he main currents of tort law run in different directions from those of contract and warranty, and the latter seem to us far more appropriate for commercial disputes.”); *see also* Craig K. Lawler, *Foreseeability and the Economic Loss Rule—Part I*, 33 COLO. L.J. 81, 83 (2004) (“In the context of commercial sales, contract law is paramount because the framework of the Uniform Commercial Code, as statutory law, preempts common law tort doctrines.”).

139. *See, e.g.*, Jones, *supra* note 114, at 766 (arguing that the no recovery rule avoids demanding “a degree of knowledge not available to [potential defendants]: information about the nature of each buyer’s operations, not only at the time of sale, but subsequent to the sale (as long as the buyers do not change their operations so dramatically as to afford the manufacturer a defense of unforeseeability)”).

140. In *Seely v. White Motor Co.*, for example, the court’s holding of no liability for purely economic harms from disappointed expectations of a product was based in part on its recognition that, otherwise, manufacturers would have to understand the specific needs of individual businesses “even though those needs were communicated only to the dealer.” *Seely v. White Motor Co.*, 403 P.2d 145, 150 (Cal. 1965).

141. For example, a D.C. federal district court described the purpose of the economic loss rule as follows: “(1) to maintain the fundamental distinction between tort law and contract law; (2) to protect commercial parties’ freedom to allocate economic risk by contract; and (3) to encourage the party best situated to assess the risk of economic loss, the commercial purchaser, to assume, allocate, and insure against the risk.” *Nat’l Tel. Coop. Ass’n v. Exxon Corp.*, 38 F. Supp.2d 1, 14 (D.D.C. 1998) (quoting *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 573 N.W.2d 842, 846 (Wis. 1998)). The court acknowledged that, with respect to products liability and contracting party cases, the cheapest cost avoider of economic harms is typically the victim. However, instead of following through with a cheapest cost avoider analysis in this third-party scenario, the court held that the economic loss rule did not apply where “parties lack any commercial relationship” and have “no opportunity to bargain.” *Id.* at 15.

142. *BRW, Inc. v. Dufficy & Sons, Inc.*, 99 P.3d 66, 72 (Colo. 2004). While the court emphasized that there was “opportunity to allocate the risks,” *id.* at 73, it nonetheless failed to elaborate how the nonliability default would either force self-help or information-sharing on the part of a potential victim.

143. *Rardin v. T&D Mach. Handling, Inc.*, 890 F.2d 24, 29 (7th Cir. 1989).

activities, but requires an examination of who is aware of both the *probability* and the *magnitude* of harm and can most readily act to decrease the risks of accident through insurance or self-help.

Unlike the primacy of contract rationale, the cheapest cost avoider rationale directs attention to the fact that the party in the best position to reduce economic risks should take responsibility for taking affirmative steps to avoid such losses, whereas imposition of tort liability could place the burden on a party who must either take difficult or expensive measures to ascertain the risks present. Moreover, switching the default rule—but allowing for contractual disclaimers of economic losses—would not be an equivalent option, given the asymmetries of information. A difficult case is presented by situations in which parties have significantly unequal bargaining positions, but I do not think this should affect the central conclusion (unless a persuasive case can be made that such bargaining asymmetries have wider society-wide repercussions).¹⁴⁴

Incentivizing parties to consider such issues when forming their contract is even less costly than in the products realm, given that they are already in a consensual, contracting relationship; parties to the contract can reliably allocate risks and costs during the bargaining process. Moreover, the benefits in terms of preventing end-runs around existing

144. *See id.* at 26 (“The fact that B would in all likelihood refuse to give such a guaranty for a consideration acceptable to A is evidence that liability for all the consequences of every negligent act is not in fact optimal.”).

A convincing case could nonetheless be made that extra-contractual duties arise from the public-policy interest in protecting a contracting party who lacks equal footing with his or her counterparty. But I do not think this is a sufficient basis to warrant the importation of tort law to the contractual relationship. Various doctrines within contract law exist to address these types of bargaining failures—from *contra proferentem* to the unconscionability doctrine. Moreover, these contracting “failures” should be policed from within and addressed within the regime of contract, given that they do not externalize risks onto third parties or the public more generally.

That said, some jurisdictions explicitly recognize that disparities in sophistication or expertise can undermine the effectiveness of bargaining power and justify an exception to the economic loss rule. For example, New Mexico cabins the economic loss rule to “commercial transactions, where there is no great disparity in bargaining power of the parties.” *Utah Int’l, Inc. v. Caterpillar Tractor Co.*, 775 P.2d 741, 744 (N.M. Ct. App. 1989). Colorado has recognized that a builder’s tort duty “to act without negligence in the construction of a home is independent of contractual allegations such as an implied warranty of habitability” and is “based primarily on the view that unsophisticated homebuyers cannot adequately protect themselves from economic loss through their contractual dealings with sophisticated construction professionals.” Lawler, *supra* note 138, at 22. As the U.S. Supreme Court explained in *East River Steamship*, “[s]ince a commercial situation generally does not involve large disparities in bargaining power, we see no reason to intrude into the parties’ allocation of the risk.” *E. River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 873 (1986). *Cf.* Benjamin J. McDonnell, *Finding A Contract in the “Muddle”: Tracing the Source of Design Professionals’ Liability in the Construction Context Under Washington’s Independent Duty Doctrine*, 48 GONZ. L. REV. 627, 642–43 (2013) (discussing Washington state case law in which “the Court reasoned that allowing a sophisticated general contractor—who understood the economic risk inherent in its profession—to recover economic loss in tort against a design professional would be inconsistent with cases under the [state products liability statute] that deny unsophisticated consumers an economic loss remedy”).

contracts and the long-term unraveling of reliance on contract are significantly higher. Thus, in the realm of contracting parties (unlike the stranger context), cheapest cost avoider principles suggest that the economic loss rule can function as a blanket no-duty rule, with a significant caveat—namely, where the contract imposes significant negative externalities upon those not party to the contract and wider society.

As a doctrinal matter, cheapest cost avoider principles will generally lead to fewer instances of tort liability in contracting party cases. This rationale provides support for the Third Restatement's section 3 preclusion of tort liability between contracting parties. But it puts pressure on the lack of theoretical justification for the "professionals" carveout in Restatement section 4. Most jurisdictions have historically included doctors, lawyers, and accountants as professionals subject to concurrent liability in contract and tort.¹⁴⁵ Liability for engineers, architects, and design professionals developed much later.¹⁴⁶ The

145. As Prosser noted, "The earliest cases arising in the borderland [between contract and tort] were those of negligence on the part of persons engaged in a trade or calling." William L. Prosser, *The Borderland of Tort and Contract*, in *SELECTED TOPICS ON THE LAW OF TORTS* 381 (1953) [hereinafter Prosser, *Borderland*].

It may well be that jurisdictions today simply recognize professional liability for the sake of "tradition" and history. See, e.g., *Collins v. Reynard*, 607 N.E. 2d 1185, 1186 (Ill. 1992) ("Our ruling [that legal malpractice claims can be pursued in tort as well as contract] is grounded on historical precedent rather than logic. If something has been handled a certain way for a long period of time and if people are familiar with the practice and accustomed to its use, it is reasonable to continue with that practice until and unless good cause is shown to change the rule.").

146. In 1965, a commentator remarked: "The field of law involving architects is young in comparison with the law developed as to the liability of the doctor and lawyer; open season on the architect has just begun." Bibb Allen, *Defense of the Architect in Personal Injury Cases*, 31 *INS. COUNSEL J.* 240, 249 (1964). A review of multiple treatises on the law of architects and engineers from early to mid-twentieth century shows no mention of tort liability for economic loss apart from intentional torts. The treatises discuss remedies for defective construction or design sometimes available under warranty—which extended only to the immediate purchaser. See, e.g., C. FRANK ALLEN, *BUSINESS LAW FOR ENGINEERS* (1917); SIMPSON & DILLAVOU, *LAW FOR ENGINEERS AND ARCHITECTS* (2d ed. 1937); SIMPSON & DILLAVOU, *LAW FOR ENGINEERS AND ARCHITECTS* (3d ed. 1946). A 1946 treatise did briefly discuss liability for defects in design arising under a contract in the context of discussing "defects and maintenance clauses" in architectural contracts, and explained that "in the absence of a 'defects and maintenance clause,' the employer . . . may deduct from the contract price the 'reasonable' charges of another contractor for making good; further, if payment has already been made, the employer may sue for damages for defective work." W.T. CRESSWELL, *LAW RELATING TO BUILDING AND ENGINEERING CONTRACTS* 142–43 (4th ed. 1946). However, "it was not until the 1950s that professional liability insurance was considered a necessity" even for personal injury liability. A.F. Early, Note, *Liability of Architects and Engineers to Third Parties: A New Approach*, 53 *NOTRE DAME L. REV.* 306, 307 (1977) (citing Smay, *A New Look at Professional Liability Insurance*, 28 *A.I.A.J.* 455 (1957)). Many more design professionals were purchasing liability insurance by the mid-1960s, especially in response to liability for negligent preparation of plans and specifications. See Norbert A. Drake, *Adjusting and Defending Claims Under Architects' and Engineers' Professional Liability Policies*, 1964 *INS. L.J.* 466 (1964). By the late 1980s, a leading treatise on construction law had an entire chapter on negligence liability, including exceptions to the economic loss rule for design professionals, and explained that the applicability of the economic loss rule to design professionals varied widely across jurisdictions. Kenneth

Restatement hedges on its definition of professionals, but includes lawyers, accountants, engineers and architects. But, more significantly, it offers scant theoretical justification for the carveout.¹⁴⁷

The cheapest cost avoider rationale reframes the carveout in terms of the need to impose tort liability on account of significant negative externalities. Seen in this light, tort liability serves a function tantamount to public regulation of contracting parties. Professionals are not only skilled experts, but hold themselves out as such to the public—not just the individuals with whom they contract—and thus have a corresponding responsibility to the public.¹⁴⁸ William Prosser remarked on the fact that

I. Levin & Robert F. Cushman, *Liability for Negligence*, in ARCHITECT AND ENGINEER LIABILITY: CLAIMS AGAINST DESIGN PROFESSIONALS 131–32 (Robert F. Cushman & Thomas G. Bottum, eds. 1987); see also Jeff Sobel, *Architect Tort Liability in Preparation of Plans and Specifications*, 55 CAL. L. REV. 1361, 1375 (1967).

147. The Third Restatement defends the professionals carveout on the ground that “most clients do not know enough to protect themselves by inspecting the professional’s work.” RESTATEMENT (THIRD) TORTS, *supra* note 13, § 4 cmt.1; see also *id.* cmt.e (noting that the “imbalance” in knowledge between professionals and their clients “often causes courts to look askance at exculpatory agreements that such parties sign”).

To the extent that a professional is a fiduciary for his/her client—that is, charged with acting in the client’s best interests—that would qualify as an independent tort. The fiduciary rationale is not the typical justification for the professionals carveout, but it is perhaps the strongest. In New York, for example, a professional relationship is “one of trust and confidence, carrying with it a duty to counsel and advise clients.” *Chase Sci. Research, Inc. v. NIA Group, Inc.*, 96 N.Y.2d 20, 29–30 (2001). *But see* Posner, *supra* note 1, at 745 (“[T]he unsatisfactory answer is that the lawyer is a fiduciary of his client rather than merely a seller of services, and breach of a fiduciary obligation is a tort.”). Judge Posner asks: “[W]ouldn’t it make more sense to say that a fiduciary duty (basically the duty to treat the obligee as well as you would treat yourself, rather than at arm’s length) is an implicit term of some contracts, rather than use the presence of such a duty to change a dispute arising out of contractual relation from a breach of contract case to a tort case?” *Id.*

148. As far back as the fourteenth through sixteenth centuries, if someone held himself out to the public for hire in the context of a “common calling,” there was a presumption of a general *assumpsit* implied by that common calling. See OLIVER WENDELL HOLMES, THE COMMON LAW 184 (1881) (“If damage had been done or occasioned by the act or omission of the defendant in the pursuit of some of the more common callings, such as that of the farrier, it seems that the action could be maintained, without laying an *assumpsit*, on the allegation that he was a ‘common’ farrier. The latter principle was also wholly independent of bailment. It expressed the general obligation of those exercising a public or ‘common’ business to practice their art on demand, and show skill in it.”).

Commentators disagree about whether this duty arose from tort or contract (i.e., in case or in *assumpsit*; and whether the general *assumpsit* of the common calling should be understood as a tort action). Compare J.B. Ames, *The History of Assumpsit*, 2 HARV. L. REV. 1, 5 (1888) (“The action against a bailee for negligent custody was looked upon, like the action against the surgeon or carpenter for active misconduct, as a tort, and not as a contract. The immediate cause of the injury in the case of the bailee was, it is true, a nonfeasance, and not, as in the case of the surgeon or carpenter, a misfeasance. And yet, if regard be had to the whole transaction, it is seen that there is more than a simple breach of promise by the bailee. He is truly an actor.”), and EDWIN HAMLIN WOODRUFF, 1 SELECTED CASES ON THE LAW OF QUASI-CONTRACTS 654 (1905) (“The statement of the *assumpsit* of the defendant was for centuries, it is true, deemed essential to the court. But the actions were not originally, and are not to-day, regarded as actions of contract. They have always sounded in tort.”), and Prosser, *Borderland*, *supra* note 145, at 384 (“The action was still in tort, and it would lie even against a gratuitous bailee; but the allegation of an undertaking was considered essential, except in the case of one engaged in a common calling and liable

“[w]ith the passage of time [courts’] emphasis was shifted from the holding out of skill to the undertaking of a *responsibility toward the public*.”¹⁴⁹ What is missing thus far is an argument explicitly linking the special expertise and skill of the professional to duties owed toward the public. The externalities rationale, namely that the contracting parties would fail to take into account the affected interests of others in society, fits here. Using tort in the public, regulatory guise is, I would argue, implicit in what Prosser characterized as the skilled person’s “responsibility toward the public.” But, this rationale has hitherto been largely embedded in the expertise rationale and not further justified. Rarely do courts explicitly invoke such an externalities justification for professional liability. The Wisconsin Supreme Court in 1974 came close to articulating such a rationale:

The very essence of a profession is that the services are rendered with the understanding that the duties of the profession cannot be undertaken on behalf of a client without *an awareness and a responsibility to the public welfare*. The entire ambit of state regulations as they apply to the profession of architecture are intended, not solely for the protection of the person with whom the architect deals, but for the protection of the world at large. Professionalism is the very antithesis to irresponsibility to all interests other than those of an immediate employer.¹⁵⁰

The very definition of “professionalism” implicates interests beyond those of the contracting parties. A professional’s “responsibility to the public welfare” is linked to the existence of state professional regulations designed to protect these wider societal interests. Liability in tort between a professional and client (or the professionals carveout to the contracting party economic loss rule) is thus a form of public regulation of the

under the older rule.”), with, Norman F. Arterburn, *The Origin and First Test of Public Callings*, 75 U. PA. L. REV. 411, 413 (1927) (“The records from 1367 to 1518 show a well recognized liability of those engaged in a trade, because of the custom of the realm or public policy. In no case is mention made of an undertaking or assumpsit.”). See also Francis H. Bohlen, *The Basis of Affirmative Obligations in the Law of Tort*, 53 AM. L. REG. 209, 218 (1905) (“Affirmative action could only be required when it was assumed or imposed as a duty; such duties were only assumed or imposed for a consideration, a benefit conferred, as their price.”).

149. Prosser, *Borderland*, *supra* note 145, at 389 (emphasis added); see, e.g., *McAlvain v. Gen. Ins. Co.*, 554 P.2d 955, 958 (Idaho 1976) (holding that an insurance agent could be liable in tort for failure to provide complete coverage because a “person in the business of selling insurance *holds himself out to the public* as being experienced and knowledgeable in this complicated and specialized field”) (emphasis added); *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 677 P.2d 1292, 1295 (Ariz. 1984) (“Design professionals have a duty to use ordinary skill, care, and diligence in rendering their professional services This duty extends to those with whom the design professional is in privity . . . and to those with whom he or she is not . . .”).

150. *A.E. Inv. Corp. v. Link Builders, Inc.*, 214 N.W.2d 764, 769 (Wis. 1974) (emphasis added).

contracting parties—which must be justified, if at all, as necessary in light of the existence of other forms of public regulation of the parties (such as those imposed by state and federal regulatory bodies).

D. Third-Party Cases

Third-party cases are the most challenging, as they straddle the line between the stranger and consensual paradigms. Third-party cases might be classified along with stranger cases as nonprivity cases. Alternatively, they might merge into the consensual framework along with products and contracting parties in that they involve not strangers, but parties connected via a web of contracts.¹⁵¹ As we saw above, some doctrinal clarity may result from simple acknowledgement of the existence of the alternative paradigms.

California's approach in third-party scenarios has been dramatically shaped by its steadfast adherence to the stranger paradigm. In *J'Aire Corp. v. Gregory*, the California Supreme Court approached the negligent breach of a contract as a question that turned on a single issue: "whe[ther] there is a duty of care owed by the defendant to the plaintiff or to a class of which the plaintiff is a member."¹⁵² From this starting premise, courts do not inquire whether contract, instead, may be the preferable remedial avenue.¹⁵³

But, moving beyond this "tort tunnel vision" approach, the paradigm choice (stranger or consensual) will often be outcome-determinative, leading to liability under the stranger framework (at least where a sufficient nexus or special relationship exists between the parties)¹⁵⁴ and

151. See, e.g., Lawler, *supra* note 138, at 84 ("Parties are encouraged to 'channel' their claims for economic loss through contract actions against intermediary parties and through assignments, indemnification, and third-party beneficiary claims.")

152. *J'Aire Corp. v. Gregory*, 598 P.2d 60, 62 (Cal. 1979). The court acknowledged fear of unlimited liability but suggested that several enumerated factors focus attention on the foreseeability of injury and the nexus between the defendant's conduct and the plaintiff's injury and thus are adequate to limit liability without an absolute rule barring recovery. The enumerated factors include: (1) the extent to which the transaction was intended to affect the plaintiff; (2) the foreseeability of harm to the plaintiff; (3) the degree of certainty that the plaintiff suffered injury; (4) the closeness of the connection between the defendant's conduct and the injury suffered; (5) the moral blame attached to the defendant's conduct; and (6) the policy of preventing future harm. *Id.* at 63. Note that the New Jersey Supreme Court in *People Express* cited *J'Aire* approvingly. *People Express Airlines v. Consol. Rail Corp.*, 495 A.2d 107, 114–15 (1985) ("These exceptions expose the hopeless artificiality of the per se rule against recovery for pure economic losses. When the plaintiffs are reasonably foreseeable, the injury is directly and proximately caused by defendant's negligence, and liability can be limited fairly, courts have endeavored to create exceptions to allow recovery.") (citing *J'Aire*, 598 P.2d 60).

153. Gary Schwartz lamented the lack of attention to "relationships between tort and contract in an economic loss setting," and specifically charged that "this was an opportunity that the [California Supreme Court in *J'Aire*] chose largely to squander." Schwartz, *supra* note 8, at 50.

154. A common third-party scenario involves construction contractors and design professionals. The split in jurisdictions on this question can be explained (at least in part) in terms of adoption (typically

no liability under the consensual one.¹⁵⁵ There is a danger that courts, acknowledging the alternative paradigms—and appropriately linking the products liability and contracting party economic loss rules—will blithely exclude third-party scenarios on the simple ground that they involve non-contracting parties and thus belong in the stranger paradigm. For example, the Minnesota Supreme Court, starting from the products liability economic loss rule and a strong deference to the Uniform Commercial Code in that realm, reasoned nonetheless that the web of contracts for a service was far removed from this deference to contract rationale.¹⁵⁶ And the Arizona Supreme Court likewise categorically refused to extend the economic loss rule to non-contracting parties.¹⁵⁷

Thus, it is necessary to probe the underlying rationale driving the paradigm choice. Here, the cheapest cost avoider rationale—which cuts across the paradigms—may provide some traction. It is here, then, in the third-party scenario where the greatest promise may lie for a unifying theoretical rationale; regardless of whether third-party cases belong in the

implicitly) of the stranger versus consensual paradigm. Wielding the stranger paradigm, the key question is whether the relationship between the parties (each of whom contracts separately with a third party, such as a homeowner) implies a tort duty of care. Thus, for example, the West Virginia Supreme Court affirmed the imposition of tort liability, given “the special relationship that exists between the [design and construction professionals].” *E. Steel Constructors, Inc. v. City of Salem*, 549 S.E.2d 266 (W.Va. 2001); *see also* *A.R. Moyer, Inc. v. Graham*, 285 So. 2d 397 (Fla. 1973); *Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc.*, 463 S.E.2d 85 (S.C. 1995); *Craig v. Everett M. Brooks Co.*, 222 N.E.2d 752 (Mass. 1967); *Forte Bros. v. Nat’l Amusements*, 525 A.2d 1301 (R.I. 1987); *Bilt-Rite Contrs., Inc. v. Architectural Studio*, 886 A.2d 270 (Pa. 2005).

Other courts have held that no such special relationship exists. *E.g.*, *BRW, Inc. v. Dufficy & Sons, Inc.* 99 P.3d 66 (Colo. 2004); *Hercules & Co. v. Shama Restaurant Corp.*, 566 A.2d 31 (D.C. 1989); *Fireman’s Fund Ins. Co. v. SEC Donohue, Inc.*, 689 N.E.2d 1197 (Ill. 1997); *Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass’n*, 560 N.E.2d 206 (Ohio 1990); *SME Indus., Inc. v. Thompson, Ventulett, Stainback, & Assocs., Inc.*, 28 P.3d 669 (Utah 2001); *Blake Constr. Co. v. Alley*, 353 S.E.2d 724 (Va. 1987); *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P.2d 986 (Wash. 1994); *Excel Constr., Inc. v. HKM Eng’g, Inc.*, 228 P.3d 40 (Wyo. 2010).

155. Approaching the issue under the consensual paradigm, the starting point is the extent to which the web of contracts linking the third parties warrants deference to contract. From this perspective, the Texas Supreme Court refused to impose tort liability in a three-sided construction dispute. *LAN/STV v. Martin K. Eby Constr. Co., Inc.*, 435 S.W.3d 234, 248 (Tex. 2014) (relying on “who will buy business protection insurance”).

156. *Prichard Bros., Inc. v. Grady Co.* 428 N.W.2d 391 (Minn. 1988).

157. *Sullivan v. Pulte Home Corp.*, 306 P.3d 1, 3 (Ariz. 2013) (“declin[ing] to extend the [economic loss rule] doctrine to non-contracting parties”). The court noted that the economic loss rule “serves to encourage the private ordering of economic relationships, protect the expectations of contracting parties, ensure the adequacy of contractual remedies, and promote accident-deterrence and loss-spreading.” *Id.* These rationales flowed directly from the adoption of the economic loss rule in the products liability scenario, and, in the court’s opinion, have no application in the stranger and third-party contexts. Nonetheless, on remand, the court refused to find a tort duty of care between the parties. *Sullivan v. Pulte Home Corp.*, 354 P.3d 424 (Ariz. Ct. App. 2015). Interestingly, the court noted that its conclusion was “consistent with, though not dependent on, the [Third] Restatement.” *Id.* at 429. In dissent, Judge Norris objected to the Third Restatement, which, he argued “is grounded in large part on the view that recognizing a duty of care in this type of situation will impose indeterminate liability on a homebuilder.” *Id.* at 434 (Norris, J., dissenting).

stranger or consensual paradigm, cheapest cost avoider principles should govern. This provides the strongest critique of the California Supreme Court in *J'Aire*. The court hews to the stranger paradigm and views the issue only through the lens of foreseeability, focusing on whether the harm incurred by the injured party was foreseeable enough to have created a tort duty on the part of the defendant. The court thus entirely fails to consider which party would be the cheapest cost avoider, in particular by examining the burden placed on the contractor to avoid or insure against a third party's potential losses.¹⁵⁸

Judge Posner applied such principles in *Rardin v. T & D Machine Handling, Inc.*, which rejected the prospect of tort liability in a third-party case involving a mover who damaged a printing press and, in turn, caused business losses to the purchaser.¹⁵⁹ As Judge Posner recognized, cheapest cost avoider principles apply between contracting parties or parties in near-privity even when the class of persons potentially injured is known with certainty, in situations where "A could by his contract with B have protected himself against the consequences of C's negligence."¹⁶⁰ Third-party scenarios, then, would share the indeterminacy of the stranger paradigm, but would not be exempted altogether from application of the contracting party economic loss rule, at least where justified on cheapest cost avoider principles.

158. The court fails to consider the fact that the restaurant may be the cheapest cost avoider. Not for the primacy of contract rationale—namely that the restaurant has a contract with the landowner who contracts for repair work. But, instead, on the ground that the restaurant has superior knowledge of its potential business losses from every additional day they are not able to be open. While the contractor may be able to foresee the victim of a negligent completion of the contract, the amount of damage is unknowable to him. This places a burden on the contractor to insure for the business losses of others, or to ask the landowner to indemnify him for individual tenants. Instead, placing the burden on the individual store owners would allow them to express their preferences through their individual rent negotiations. This would avoid forcing them to insure against risks they are willing to accept, or pay less for rent in return for more variability in the maintenance of the building.

159. *Rardin v. T & D Mach. Handling, Inc.*, 890 F.2d 24 (7th Cir. 1989).

160. *Id.* at 26. Moreover, according to Judge Posner, in the case at hand, the no liability rationale was even stronger given that the negligent party did not know "how much effort to expend on being careful" because the "circumstances of the myriad [third parties]" were unforeseeable. *Id.*

Another Posner decision provides further illumination. *See, e.g.*, *Evra Corp. v. Swiss Bank Corp.* 673 F.2d 951 (7th Cir. 1982) (finding no liability for consequential business damages which were unforeseeable where a bank was negligent in making a wire transfer). Tom Miles summarizes Judge Posner's approach thusly: "the party who can avoid a loss at lowest cost should bear it, [in order to] create[] incentives for the efficient precautions against loss." Thomas J. Miles, *Posner on Economic Loss in Tort: EVRA Corp v Swiss Bank*, 74 U. CHI. L. REV. 1813, 1821 (2007). For example, a service provider may provide a warranty limited to a refund of the purchase price and exclusive of additional damages. This warranty makes economic sense, as a product user, fearing consequential damages (perhaps resulting from use of the product in an unusual way), is best poised to guard against risk of incurring such damages by taking precautionary steps. *Id.* (discussing an interpretation of *Hadley v. Baxendale* used in *EVRA* that focused on who could best avoid the loss, stating "the second lesson of *Hadley* is that the would-be plaintiff's own precautions against the risk of consequential losses may be the more efficient solution").

CONCLUSION

The *Restatement (Third) Torts: Liability for Economic Harm* provides some welcome doctrinal clarity with respect to foregrounding the existence of a contractual privity economic loss rule. But, given that the project is premised upon dual underlying justifications of preventing unlimited tort liability and of deference to contract, which are to be applied on a sliding scale, it does not address the “paradigm confusion” I have identified here, and will thus fall short of reshaping the entire economic loss rule field.

“Paradigm confusion” has led scholars and courts to import the unlimited liability rationale, developed to limit tort law duties owed to strangers, into the commercial torts realm, failing to recognize that the central question in the contracting party case is distinct: namely, is the duty concededly owed to another enforceable in tort as well as contract?

At a minimum, courts should clearly distinguish between the stranger paradigm and the consensual paradigm, which, in turn should be understood to include products and contracting party cases. In each of these realms, the economic loss rule enforces a boundary between torts and contracts.

But an optimal approach goes beyond this determination of the applicable paradigm, and the attendant presumptive applicability or inapplicability of the economic loss rule. The cheapest cost avoider analysis offered here promises a more coherent and predictable economic loss rule doctrine and, in turn, a greater understanding of where the boundary between tort and contract is properly drawn.