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The Economic Loss Rule

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THE ECONOMIC LOSS RULE

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The emergence and evolution of the economic loss rule is the most important development of the past generation in the American common law of torts. It has also been the most confusing development. Courts have struggled to define the rule and have assigned it different boundaries in different states, making it a frequent source of puzzlement and dread for lawyers. The American Law Institute's *Restatement Third, Torts: Liability for Economic Harm* has set out to assign the economic loss rule an accurate meaning and a useful purpose, and to clarify the scope of liability in tort for pure economic loss generally. This purpose of this Article is to concisely explain the reasoning behind those efforts and the outcome of them.

To summarize: "Pure economic loss" means a financial loss unaccompanied by personal injury or property damage—in other words, a loss of money and nothing else. A vanished investment, a decline in business, or a lost inheritance are typical examples. Pure economic loss is the typical result of a breach of contract, but sometimes—and perhaps at the same time—it may be caused by negligence and therefore become the subject of efforts to recover in tort. Indeed, plaintiffs recover in tort for pure economic losses every day, and suits of that kind are also dismissed every day. Courts have made various rules recognizing, denying, or limiting tort liability for the infliction of economic loss, but the rules have been stated in many different ways, some of them broad, some narrow, many confusing.

Most notably, some courts have offered an "economic loss rule" that states there is generally no recovery in tort for pure economic loss caused by a defendant's negligence. The exceptions to such a statement have turned out to be too numerous and unwieldy to make that version of the rule useful, as has become evident by hard experience. While there often is good reason not to allow recovery in tort for pure economic loss, an overbroad formulation of the rule to that effect can sweep away claims or call liability into doubt in circumstances where the good reasons are not present and where liability is well justified.

A much narrower form of "economic loss rule," however, is both accurate and worth stating. It is that there is no liability in tort for pure economic loss resulting from negligence in the negotiation or performance

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of a contract. Several associated rules have also evolved that make clear the existence of duties, or the non-existence of them, in most situations in which pure economic loss is common. On the side of liability, for example, it safely may be said that claims to recover for economic loss may be brought in tort against professionals by their clients, and against a defendant who has acted for the purpose of providing the plaintiff with a basis for reliance (and on whose words or acts the plaintiff did reasonably rely). Conversely, there is no liability in tort for pure economic loss caused to a plaintiff by a personal injury or property damage to a third party.

The rules just summarized are consistent with the best rationales for denying liability in tort when a defendant has negligently caused pure economic loss to a plaintiff. The first of those rationales is deference to a contract in cases where the plaintiff and defendant have one, or where future parties in their circumstances can reliably be counted on to protect their interests in that way. The second rationale is the undesirability of imposing runaway or indeterminate liability on a defendant. The rules summarized above and explained herein reflect several important categorical judgments about when those rationales call for liability and when they do not. Claims outside those categories are relatively infrequent and miscellaneous. They are best resolved by directly considering how the general policies just stated bear upon them. That inquiry is necessarily performed case by case until results accumulate in sufficient numbers to allow recognition of additional crystallized rules.

I. THE TRIBUTARIES

The efforts to state an "economic loss rule" have resulted from the confluence of three or four doctrinal tributaries. The tributaries are discrete doctrines that regulate the ability of a plaintiff to recover in tort for pure money losses caused by negligence. The "economic loss rule," whatever it may mean, is typically an effort to sum up these different doctrines and generalize from them.[1] Each of the tributaries might be (and has been) the subject of long disquisitions, but for our purposes a brief summary of them will do. We are not concerned here with their details or with their rationales, which will be considered later. The point is just to see the different patterns and results that some courts have been moved to capture with various statements of a general rule.

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[1] For influential prior discussions, see JAY FEINMAN, ECONOMIC NEGLIGENCE § 1.3.2 (1995); Fleming James Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 45 (1972); Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513, 1513–14 (1985); Jane Stapleton, *Comparative Economic Loss: Lessons From Case-Law-Focused "Middle Theory,"* 50 UCLA L. REV. 531, 533 (2002).

A. Products

As the law of products liability expanded in the 1960s, courts also developed a limiting principle: plaintiffs cannot collect in tort when a product merely disappoints their economic expectations. An exploding toaster entitles anyone it injures to collect tort damages from the seller; if the toaster won't toast, however, the remedies must be found under the law of contract. This doctrine is commonly associated with *Seely v. White Motor Co.*,[2] a 1965 opinion of the California Supreme Court written by Chief Justice Roger Traynor. The decision explained that while public policy called for a right to recover in tort for all who suffered personal injuries on account of a defective product, the law of warranty is sufficient to handle claims that a product's defects caused only economic loss. That principle has since been accepted in all states. It also has been frequently supplemented by the proposition that while property damage caused by a defective product may be redressed in tort, the damage must occur to property other than the product. When a product causes damage just to itself, the resulting harm is considered economic in character.

B. Service Contracts

The rule just stated for cases that involve products is related to a larger and older pattern that might be considered distinct. Sometimes a party will be negligent in performing a contract and will breach it as a result. In addition to suing the promisor for breach of contract, can the promisee bring a claim in tort to recover for the negligence? The answer has long been yes when the breach causes personal injury to the promise: you hire a mover to put your goods onto a truck, and he promises to do it carefully; he is careless, and drops a box on your foot; he breached his contract, but you have the option of suing in tort to recover for your injuries.[3] The point is not that the contract creates obligations enforceable in tort. The point, rather, is that duties in tort to avoid the infliction of personal injury exist independently and are not extinguished by the existence of a contract between the parties (unless the contract contains an explicit and enforceable disclaimer to that effect). But the answer is otherwise when the contractor hired to build your house negligently delays or otherwise

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2 403 P.2d 145, 152 (Cal. 1965); *see also* East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 872 (1986).

3 Stiver v. Parker, 975 F.2d 261, 272 (6th Cir. 1992); Taylor v. Herbold, 483 P.2d 664, 669 (Idaho 1971); Finnell v. Seismic, 67 P.3d 339, 344 (Okla. 2003); Montgomery Ward & Co. v. Scharrenbeck, 204 S.W.2d 508, 510 (Tex. 1947); Colton v. Foulkes, 47 N.W.2d 901, 903–04 (Wis. 1951); *see also* Dunn v. Praiss, 638 A.2d 875, 882 (N.J. Super. Ct. App. Div. 1994), *rev'd on other grounds*, 656 A.2d 413 (N.J. 1995).

bungles the work. Your remedies are on the contract, not in tort.[4] (And yet you can recover for money losses without personal injury when the negligent breach of a contract is committed by your lawyer, your accountant, or another professional—for reasons to be discussed below.)

C. *Breach of a Contract Between Other Parties*

Suppose you are hurt as a side effect of one party's breach of contract with another. If you suffer personal injury or property damage, then once again your ability to sue in tort is clear. (So if the mover you've hired drops a box on a bystander's foot, the bystander can sue the mover without controversy.) If you suffer money losses without personal injury, sometimes you can sue in tort and sometimes you can't. A town hires you to do a construction job, and then also hires a consultant to evaluate your work. The consultant negligently and incorrectly reports that your work was substandard, so you are forced to spend money redoing it. The negligent report was a breach of the consultant's contract with the town, and it made you worse off, but you can't sue the consultant to recover in tort.[5] The contract between them was not made for your benefit, and you did not rely on it—or if you did, your reliance was incidental; the purpose of their contract was to serve the town's interest, not yours. On the other hand, suppose that a firm, eager to persuade you to buy shares of its stock, hires an accountant to perform an audit of its financial statements. The accountant produces a favorable report, and the firm sends it to you. You find the report convincing, you buy the shares, and the company then goes bankrupt; the accountant turns out to have been negligent. You can sue the accountant,[6] and the common law has occasionally recognized liability on other such patterns.[7] Again, the reasons will be considered in due course.

D. *Personal Injury or Property Damage to Another Party*

Suppose, finally, that a plaintiff suffers money losses as a side effect of a tort that the defendant committed against a third party. A trucker negligently tries to pass under a low bridge and destroys it; a restaurant on the far side of the bridge loses business as a result.[8] Or the goalie of a hockey team is run over by a bus, and the owner of the team suffers losses

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4 *See, e.g.*, EBWS, LLC v. Britly Corp., 928 A.2d 497, 506 (Vt. 2007).
5 Plourde Sand & Gravel v. JGI Eastern, 917 A.2d 1250, 1255–56 (N.H. 2007).
6 *See, e.g.*, Bily v. Arthur Young & Co., 834 P.2d 745, 772–74 (Cal. 1992).
7 A famous instance is *Glanzer v. Shepard*, 135 N.E. 275, 276–77 (N.Y. 1922).
8 Rickards v. Sun Oil Co., 41 A.2d 267, 270 (N.J. 1945).

when attendance at the team's games goes down.[9] It has generally been the rule at common law that the owner of the restaurant or the hockey team cannot recover in tort against the negligent parties in these circumstances.[10]

II. THE FLOOD

Courts have observed the patterns just set forth and have sought to generalize from them. Each of the patterns sets a limit on a plaintiff's ability to recover in tort for pure economic loss. A number of courts have therefore announced an "economic loss rule" to the effect that there is, in general, no recovery in tort for pure economic loss resulting from negligence.[11] A statement that broad must be swiftly and extensively qualified, and so it has been: The rule does not apply to claims of negligent misrepresentation.[12] The rule does not apply when the parties have a special relationship.[13] The rule does not apply to claims against professionals.[14] The rule does not apply to claims by fishermen.[15] The rule does not apply when a lawyer botches the drafting of a will and is sued by someone who otherwise would have inherited a bequest but did not.[16] And so on. These exceptions have drained the general rule of much of its clarity and utility. A long list of exceptions, especially when the list is unsettled, makes it hard for the lawyer or judge to keep the law straight or to advise about it with confidence.

The problems have been made worse by a massive explosion in the reliance on the so-called economic loss rule and by inconsistency in its meaning. The expression "economic loss rule," or "economic loss

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9 Phoenix Prof'l Hockey Club v. Hirmer, 502 P.2d 164, 165 (Ariz. 1972).

10 *See Hirmer*, 502 P.2d at 165; *Rickards*, 41 A.2d at 268.

11 *See, e.g.*, Blahd v. Richard B. Smith, Inc., 108 P.3d 996, 1000 (Idaho 2005); Nebraska InnKeepers, Inc. v. Pittsburgh-Des Moines Corp., 345 N.W.2d 124, 126 (Iowa 1984); Indianapolis-Marion Cty. Pub. Lib. v. Charlier Clark & Linard, P.C., 929 N.E.2d 722, 729 (Ind. 2010); Local Joint Exec. Bd. of Las Vegas, Culinary Workers Union, Local No. 226 v. Stern, 651 P.2d 637, 638 (Nev. 1982); Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n 560 N.E.2d 206, 208 (Ohio 1990); Springfield Hydroelectric Co. v. Copp, 779 A.2d 67, 70 (Vt. 2001); W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS 657 (W. Page Keeton et al. eds., 1984).

12 *See, e.g.*, Annett Holdings, Inc. v. Kum & Go, L.C., 801 N.W.2d 499, 504 (Iowa 2011); *Indianapolis-Marion Cty. Pub. Lib.*, 929 N.E.2d at 730.

13 *See, e.g.*, *Blahd*, 108 P.3d at 1001; Aikens v. Debow, 541 S.E.2d 576, 589 (W. Va. 2000).

14 *See* McStowe v. Bornstein, 388 N.E.2d 674, 676 (Mass. 1979); Hutchinson v. Smith, 417 So.2d 926, 929 (Miss. 1982); Billings Clinic v. Peat Marwick Main & Co., 797 P.2d 899, 913 (Mont. 1990); Shoemake ex rel. Guardian v. Ferrer, 225 P.3d 990, 992 (Wash. 2010).

15 *See, e.g.*, Curd v. Mosaic Fertilizer, LLC, 39 So.3d 1216, 1223 (Fla. 2010).

16 *See* Harrigfield v. J.D. Hancock, 90 P.3d 884, 888 (Idaho 2004); Calvert v. Scharf, 619 S.E.2d 197, 203 (W. Va. 2005).

doctrine," appeared fewer than thirty times in American cases before 1985; since then they have been used in more than 5000 cases. But the cases do not all describe the scope of the rule in the same way. Some courts mention more exceptions of the kind recited in the previous paragraph, and some mention fewer. Some use the expression just to refer to one or two of the four patterns listed in the previous section; they treat the phrase as referring to the rule in products cases,[17] or just to the rule that prevents a party from suing in tort over a breach of contract.[18] This, too, has made life difficult for lawyers. They may know that a given jurisdiction claims to subscribe to the economic loss rule, but be unclear on what its implications are—and the courts in the state may not be sure themselves. A practitioner can then be put in the unsatisfactory position of advising a client that the courts of a state are hostile to tort claims for pure economic loss, but without being able to specify where the hostility starts and stops.

Stating a broad rule against recovery for pure economic loss in tort has an additional worrisome consequence beyond the confusion it has caused. It creates a presumption against liability in cases that don't fit into one of the well-defined exceptions. This can cause legitimate claims to be snuffed out inadvertently by the sweep of the rule in the background. Trouble predictably results when a rule is recited and extended without attention to its rationale; sure enough, some states have found themselves in difficult and embarrassing positions when they stated aggressive versions of the economic loss rule and then discovered that the "rule" they had stated had implications they did not intend or came to regret.[19] A presumption against liability for economic loss is unobjectionable if there are good reasons for it. But if the "rule" is nothing but a generalization about those four categories listed above, it should not result in a presumption with respect to any cases that the categories do not include; and the categories themselves must be defined and qualified with care.

Pressing in the other direction, however, may be a nagging suspicion that the economic loss rule really *should* reach beyond the categories that gave rise to it, and should suggest a general resistance toward the recovery in tort for the loss of money without physical harm. That general resistance, untethered to any specific policy or factual setting, is hard to defend. As an instinctive matter it might seem tempting to regard pure financial losses, however regrettable, as naturally a lesser priority for the

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17 *See, e.g.*, Oceanside at Pine Point Condo. Owners Ass'n v. Peachtree Doors, 659 A.2d 267, 270 (Me. 1995); Waggoner v. Town & Country Mobile Homes, Inc., 808 P.2d 649, 653 (Okla. 1990); Sapp v. Ford Motor Co., 687 S.E.2d 47, 49 (S.C. 2009).

18 *See, e.g.*, Flagstaff Affordable Housing Ltd. P'ship v. Design Alliance, Inc., 223 P.3d 664, 669 (Ariz. 2010); General Elec. Co. v. Lowe's Home Ctrs., Inc., 608 S.E.2d 636, 637 (Ga. 2005).

19 See Tiara Condo. Ass'n, Inc. v. Marsh & McLennan Cos., Inc., 110 So.3d 399, 404 (Fla. 2013).

law of torts than protection against personal injury. "It's only money," one might say, and while everyone would much prefer to have more of it rather than less, surely we all are more concerned about protecting the personal safety of potential victims than we are about protecting their bank accounts. But this is mostly nonsense. Money is just a placeholder for property, and thus for the time, choices, and opportunities of its owners. It requires no tutoring to see that a purely monetary loss can be as serious to its victim as any other kind, and indeed that a serious monetary loss may be a far graver thing than a less substantial personal injury. (Ask any victim of Bernard Madoff's.)

The point of these observations is not that purely financial interests should always receive the same protection from the law of tort as the interest in safety from physical harm. They should not and do not. The point, rather, is that the different treatment should depend on specific reasons why tort is a more or less advantageous way to regulate the risks involved in a case, particularly as compared to alternative sources of protection such as contract.[20] This point is worth emphasizing because the economic loss rule is often intoned without reflection on its rationale, as if we all know that tort law isn't really meant to fix financial mishaps. But sometimes tort law *is* meant for that purpose; and understanding why it may be, and why not, is essential when resolving close cases in this corner of the law.

In sum, the economic loss rule has become an important proposition in the tort jurisprudence of nearly every state. But it has meant different things in different places, and in some states it has been said to mean things that aren't clear, or that can't be right, or that lack a clear justification. And yet the desire to state such a rule is understandable. The various doctrines that determine when plaintiffs can recover in tort for pure economic loss do have points in common, and they invite a rational and simple account of their relationships if one can be devised. The task at hand, then, is to see what generalizations might fairly be made about recovery in tort for pure economic loss—generalizations broad enough to be useful but narrow enough to be accurate without requiring so many exceptions that the value of generalizing is lost. And we should seek to base those generalizations on clearly defensible policies, so that whatever the law may do can be explained on better grounds than a conclusory "because it's economic loss."

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[20] See Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 547–48 (2009); Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 ARIZ. L. REV. 857, 869 (2006).

III. THE RATIONALES

As already noted, financial losses can be just as devastating to their victims as losses of other kinds, but they are less likely than physical harms to be redressable in tort. In this Section we will consider the policies that might reasonably lie behind those various limitations.

A. *Deference to Contract*

Pure economic losses are often better suited than physical harms to management by contract. First, economic loss without physical injury does not usually befall a plaintiff randomly in the way that ordinary accidents might. While the scenarios that produce pure economic loss are wide-ranging in their details, most of them have this in common: they arise from a transaction. The plaintiff is buying a house or a car or is making an investment, or is entering a partnership, or is making a hire (or is being hired). The economic loss results when the transaction goes badly. The transactional setting of these situations gives the potential victim an ability to consider the risks at issue in advance, and with a deliberation not available to the usual victim of an accident. That consideration might lead to various steps: the buyer might decide to purchase insurance, or draft a more careful contract with the seller, or make deeper investigation of the subject matter of the deal.

The kinds of self-protective measures just noted are especially likely to be appealing when a buyer is confronted with financial risk. While money losses may be just as serious as physical injuries, they are more easily remedied with money. A party who suffers a financial loss but is reimbursed for it by insurance or in some other way is likely to be left indifferent, or at any rate far closer to indifferent than a party who receives monetary compensation for loss of limb. A buyer might therefore have fairly specific ideas about how to deal with the risk of financial disappointment resulting from a deal, and might well prefer to handle it in some way other than by allocating responsibility for it to the seller. A contract can capture those preferences.

We worry less about these points when considering risks of physical harm. If a patient makes a contract with a doctor to perform an operation, we are reasonably confident about where responsibility for the doctor's due care should lie: with the doctor, who therefore will buy insurance and may pass that cost on to the patient (or the patient's insurer) without many doubts on either side about the desirability of that allocation of risk. When a buyer makes a business deal with a seller, our sense of certainty about where to assign responsibility for the risks at stake is much less clear. Letting the buyer decide by making whatever contractual arrangements seem best is thus more appealing than asking a court to make the determination in response to a tort suit.

In addition, the law of contract is better equipped than the law of tort to redress a buyer's financial disappointment when a deal turns out badly. On an economic view the law of tort often is viewed as a set of rules to govern the obligations of parties who do not have contracts; tort law provides substitutes for the contracts that the parties do not have and cannot easily make, but likely would if they could.[21] Tort law also has evolved largely to address cases like the medical situation described a moment ago—cases in which considerations of public policy make the correct assignment of responsibility clear. The law of contract is designed to address a different set of interests and advance a different set of policies. It assumes that the parties know best how to allocate the risks that confront them, and it creates a framework of doctrines to decide whether and how those allocations have been effectively made. That aptly describes the positions of parties who enter a transaction and are looking for ways to protect themselves against financial disappointment. The law of contract also has elaborate and refined doctrines for the calculation of damages. Those doctrines are very useful when a party suffers financial loss because a transaction has gone wrong. The doctrines that govern damages in tort have been developed mostly in response to cases that involve physical injuries. Applying those doctrines to cases involving financial loss from a breach of contract is a bit like trying to turn a screw with a pair of pliers. The tool was not made for the job, and we have other tools that were.

The claim I mean to press is not just that contract law is more sensitive than tort law to the interests involved when a transaction leads to financial disappointment, though that much is true. It is also that using tort law to address such cases can affirmatively interfere with the operation of contract law, making contracts a less dependable instrument for settling commercial relations with finality. Using contract law to govern commercial transactions lets parties and their lawyers know where they stand and what they can expect to follow legally from the words they have written. But if a disappointed buyer has the option of abandoning the contract and suing in tort, the significance of the contract is diminished and the doctrines that protect the integrity of the contractual process are reduced in importance. Parties wrangle over integration clauses to make clear that their obligations are the ones stated in the contract and nothing else; the point of bothering about such matters becomes unclear if a

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21 *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 323 (2010).

disappointed party can later invoke an outside set of obligations that are imposed on the promisor and defined by the law of tort.

B. Indeterminate and Disproportionate Liability

The discussion so far has explained the usefulness of contract, and the frequent inaptitude of tort, for allocating risks of economic loss when a party enters a transaction. But there is another set of reasons why courts are sometimes reluctant to impose liability in tort for pure economic loss. It involves the potential for economic losses to proliferate in ways that physical damage does not. Most accidents result in damage that is limited and determinate in time, in space, and in the number of victims involved. There are famous exceptions—some colorful cases in which property damage has spun out of control to a surprising degree, and cases as well in which negligent conduct has turned out to imperil an unexpectedly large number of plaintiffs.[22] But medical malpractice, a badly-driven car, and a slippery sidewalk typically imperil those nearby and nobody else. Economic losses can ripple out in a much different way.

This concern typically arises when the plaintiffs in a case were made worse off by a tort that the defendant committed against a third party. The tort might be the aforementioned destruction of a bridge that the plaintiff did not own but that the plaintiff's customers relied upon to reach the plaintiff's business—and every other business in the neighborhood.[23] The concern can also arise when the plaintiff is made worse off by the defendant's breach of contract with a third party. If by some negligence I fail to perform my contractual obligation to deliver goods to you, then you can't deliver them to your retailer, and the retailer can't deliver them to its customers. All of them may have economic losses, all of which were foreseeable when I committed my breach. Imposing liability for such harms, even limited by the criterion of foreseeability, would result in a great increase in the litigation over many negligent incidents. The costs of that litigation do not seem likely to be justified by a commensurate improvement in safety or security.[24] On the contrary, the indeterminate scope of such liabilities might well put an exaggerated pressure on some potential defendants to avoid activities altogether if those ripple effects are a possible consequence.[25]

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22 *See, e.g.*, Petition of Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821, 822–23 (2d Cir. 1968).

23 *See* Rickards v. Sun Oil Co., 41 A.2d 267, 268 (N.J. 1945); 532 Madison Ave. Gourmet Foods, Inc., v. Finlandia Ctr., Inc., 750 N.E.2d 1097, 1099–1100 (N.Y. 2001).

24 For discussion, see *Barber Lines A/S v. M/V Donau Maru*, 764 F.2d 50 (1st Cir. 1985).

25 *See* Greycas, Inc. v. Proud, 826 F.2d 1560, 1564 (7th Cir. 1987); William Bishop, *Negligent Misrepresentation Through Economists' Eyes*, 96 L. Q. REV. 360, 365–66 (1980).

It is further the case that potential victims of "rippling" economic losses can often (though not always) seek protection by other means, many of them involving contracts of one sort or another. Suppose the plaintiffs were injured economically because they had contracts with the party who was the immediate victim of the defendant's breach; in that case they can use those contracts to collect damages from whoever lies between them and the defendant. If the plaintiff lost business because the defendant's negligence destroyed a nearby bridge or otherwise obstructed access by its customers, the contractual solution might be business-interruption insurance purchased in advance. These options may not be enough to make "deference to contract," in itself, an appealing ground for withholding tort liability from such plaintiffs when they suffer economic losses. But they suggest that withholding such liability on other grounds—that is, because the defendant's exposure would become indeterminate, and perhaps crushing—is not necessarily as hard a blow as it may seem. Such plaintiffs frequently have other possible recourse.

C. *Private vs. Social Cost*

A final reason why the law might not want to recognize tort liability for pure economic loss has been suggested by economists.[26] It is that many cases of economic loss to one party involve an offsetting economic gain to another. If customers cannot reach a restaurant because the bridge leading to it has been destroyed by the defendant's negligence, other restaurants will probably capture their business. The loss of business for the first restaurant is painful for its owner, but the gain of business by the second restaurant is delightful to the same extent for *its* owner. So the world is about as happy and wealthy a place after the accident as beforehand. Well, not quite; the customers' disappointment at having to settle for their second choice of restaurant is a real loss. But it is a mild one from a social standpoint, and bears no particular connection to the damages suffered by the restaurant owner who brings suit. The same might be said if a lawyer's mistake causes a bequest to be left to the wrong heir. It is too bad for the intended heir, but great news for the unintended one.

The point is not that the law should be indifferent to destroyed bridges or lawyers' mistakes. It is that rectifying the economic losses felt by the losers in these situations is not a high priority. We can leave redress to the destroyed bridge to a suit brought by the bridge's owner and not worry about the restaurant at the end of the road, and we can leave redress

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26 *See* William Bishop, *Economic Loss in Tort*, 2 OXFORD J. L. STUD. 1, 1 (1982); Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735, 740 (2006).

against the bad lawyer to his client or perhaps let the intended heir sue the unintended one in restitution. There is no need for tort law.

So goes the economist's reasoning; but the importance to be assigned to that perspective is a matter of debate. The most familiar objection is that courts deciding tort cases, even when they involve pure economic loss, are not only interested in minimizing social losses.[27] They are concerned as well with unjust transfers of wealth. Whether for that reason or others, courts have not seen fit to rely on this justification when they deny recovery in tort to a plaintiff in a case where the economist's reasoning might apply. We therefore will not assign much weight to this argument, but note it as a possible source of reinforcement of the other points made here.

IV. THE RESULTS

We have seen several sound reasons why courts might legitimately hesitate before recognizing liability in tort for pure economic loss. The principal ones can be summarized as deference to contract law and fear of disproportionate or indeterminate liability. Equipped with these policies, we are in a position to consider what doctrines would sensibly advance them. It is clear that the policies are broad enough to cut across a wide range of situations, and might bear on all four of the patterns discussed at the outset of this Article. But it is also clear—or soon will be evident—that their force is stronger in some circumstances than in others, and in some cases may be nonexistent. Our goal will be to state principles that can be justified by reference to the specific policies outlined above rather than by a blanket hostility to recovery for economic loss in tort. And in undertaking this exercise we should be mindful of some more general policies as well: the values of clarity and simplicity. Complicated and subtle doctrines are expensive. They make outcomes of cases hard for lawyers to predict, and so make it hard for clients to plan, and they increase the likelihood of error in their application. A set of rules that can be explained and understood in five minutes is better—and not trivially better, but importantly better—than a set that takes hours.

In pursuit of these objectives, the American Law Institute has settled on the following set of principles.

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27 *See* Rabin, *supra* note 20, at 863.

A. *Duties to Avoid Causing Economic Loss Must Be Specifically Established*

Duties to avoid negligently causing *physical* harm are general: they arise when anyone takes action that creates a risk of harm to others.[28] Duties to avoid causing economic loss do not work that way. They have to be established on some particular ground. This is not *quite* the same as saying that there is a general "no duty" rule with respect to economic loss. That way of speaking would create a presumption against liability in new cases, and no such presumption is warranted or intended. It is better just to say that duties to avoid causing economic loss have to be specifically found and justified, that only a few such duties have been recognized thus far, and that new cases will be dealt with from an initial position of agnosticism. But not all cases are new cases; indeed, most are not. Generalizations have crystallized concerning the treatment of the most common situations that give rise to economic loss. When cases fall within those generalizations, they can be resolved by rule rather than by analysis of how the policies in this field apply to the facts. The established and available rules are set forth under the following headings.

B. *A Plaintiff Cannot Recover in Tort for Pure Economic Loss Caused by Negligence in the Negotiation or Performance of a Contract Between the Parties*

This is the principle to which the ALI applies the label "economic loss rule." It is more modest than some other statements of the rule that courts have announced. But it is also more defensible and more robust. (It has just one principal exception, which will be stated in a moment.) If two parties have a contract, the rationale for keeping tort law out of their affairs is at its strongest. Denying a tort remedy means that parties who allocate financial risks by contract need not fear that their settlements will be undone later by judgments in tort that have nothing to do with their agreements but instead reflect social judgments about negligence.

And let us recall that negligence is our subject here. A defendant who commits fraud in the making or performance of a contract may be sued in tort. The economic loss rule does not enter in to such a case, nor does the rest of the apparatus set out in this Article. The reason is that most parties don't treat the chance that they are lying to each other as an ordinary subject for their contract to allocate. They assume honesty in each other as a backdrop to their dealings. Letting them sue for fraud therefore does not interfere with the contractual allocation of risks between them. (If

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[28] *See* RESTATEMENT THIRD, TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 6 (Proposed Final Draft No. 1 April 6, 2005).

sophisticated parties clearly *do* allocate the risk of fraud in their contract, then that allocation should be respected.) Risks of negligence are different. Everyone understands that honest mistakes are part of commercial life, and there is nothing odd about allocating the risk of them away from oneself or in any given direction. That is why negligence in the performance of a contract is considered a matter for resolution under the terms of the contract. This principle covers and explains the rule of *Seely v. White Motor Co.*, but also many other cases that do not involve products.

Here is an example.[29] Buyer purchases a house from Seller. Seller assures Buyer that the septic system is in good working order. Buyer moves in and discovers that the septic system doesn't work at all; Seller's assurance was incorrect and negligent—but not (let us assume) fraudulent. Buyer has a good contract claim against Seller, but not a claim in tort. One might wonder why it matters; so long as Buyer can recover on one theory or another, what difference does it make which it is? If Buyer's contract remedy is available, then indeed the availability of a tort claim for negligence shouldn't matter. The difficulties arise when something goes wrong with the contract claim. Perhaps local law (or the contract itself) gave Buyer only a short time to complain about incorrect assurances that Seller made in their purchase and sale agreement. The contract claim is then in trouble, so Buyer might naturally like to turn for help to the law of tort. After all, Seller was negligent, and negligence is the stuff of tort claims. But letting Seller take that route would render pointless the various constraints on Buyer's contract claim. The time limits for suit on a contract become impotent if a party frustrated by them can simply sue in tort to recover for what amounts to the same conduct that the contract suit would have redressed.

This doctrine can still call for some judgments in application. The fact that two parties have a contract does not mean that all tort claims for economic loss between the two of them are foreclosed. The claims must arise within the scope of their contract. If one side negligently misleads the other about a matter outside their agreement, the misled party may have a good claim to recover for the losses that result (under the logic of item [4] below).[30] On the other hand, the economic loss rule is broad enough to exclude from tort all claims between contracting parties that are addressed by the law of contract. Thus consider the same facts sketched above in which Buyer is disappointed with the septic system after Seller negligently promised that it worked. Suppose Seller's promise wasn't

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29 Based on *Alejandre v. Bull*, 153 P.3d 864 (Wash. 2007).

30 *See* Trytko v. Hubbell, Inc., 28 F.3d 715, 719, 729 (7th Cir. 1994); Geosearch, Inc. v. Howell Petroleum Corp., 819 F.2d 521, 523–24 (5th Cir. 1987).

made in writing; it was an oral assurance, and the local law of contract would treat the assurance as unenforceable under the parol evidence rule. Letting the plaintiff sue in tort for negligence would be an end run around the parol evidence rule and would tend to eviscerate it. Some might welcome that result: maybe the parol evidence rule is being applied too harshly in such a case, or is largely foolishness in general. If so, however, the best course of action is to reform the rule, not to gut it, and retard the development of sound contract law, by letting parties escape from it into the law of tort.

The same principles apply to claims that arise from negotiations that never ripen into contracts. The law of contract and the law of restitution provide remedies for parties who suffer economic loss on account of other parties' statements in contract negotiations. If those remedies are insufficient, they should be improved, not avoided by basing tort claims on the same facts. A fine example is furnished by the *Red Owl* case that first-year law students read in their contracts class.[31] The plaintiff is led on by representatives of a chain of grocery stores who cause him to think that he will be given a franchise to operate one if he takes various onerous and expensive steps. He takes the steps and never gets the franchise. The representations that the defendants made might have been negligent, but the Buyer has no claim in tort. The representations were made in the course of negotiating a contract, so the Buyer's remedy is under that body of law alone. It may be a case of promissory estoppel, as the Wisconsin Supreme Court supposed.

Some observers, of course, have considered promissory estoppel to resemble liability in tort and have wondered whether the doctrine should be considered an instance of tort rather than contract. But the Second Restatement of Contracts laid claim to promissory estoppel,[32] and in my judgment is welcome to it. Whatever one may think about promissory estoppel in general or the *Red Owl* decision in particular, the law of contract and the law of restitution have rules and case law that speak directly to the conduct of parties when they negotiate contracts. Those bodies of law specify remedies to which such parties are entitled if the contract is not concluded.[33] The law of tort has nothing useful to add to them, and so should stand aside.

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[31] Hoffman v. Red Owl Stores, Inc., 133 N.W.2d 267, 276–77 (Wis. 1965).

[32] *See* RESTATEMENT SECOND, CONTRACTS § 90 (1981).

[33] *See, e.g.*, RESTATEMENT THIRD, TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 4 (Proposed Final Draft No. 1 April 6, 2005).

C. *There Is an Exception to the Economic Loss Rule for Claims Brought Against Professionals by Their Clients*

A rule with no exceptions would be perfect. A rule with one principal exception is still quite good.[34] The principal exception to the economic loss rule involves suits for professional negligence, otherwise known as malpractice. Simply put, lawyers and accountants and others like them can be sued in tort (as well as contract) if they negligently cause economic harm to their clients.[35]

The reasons are easy to explain. A "professional" is a member of an occupational group that typically requires formal training and a license to join, that has its own internal code of conduct, and that calls for complex discretionary judgments from its members in the course of their work.[36] When defendants fall into that category, the law is not so inclined to defer to the contracts they may have with their clients. The licensing requirements serve as evidence that the legal system is not content to let the parties' obligations be defined by their contracts; evidently there is a social interest in insuring that the professional use due care. And a profession's internal code of conduct suggests that its members themselves do not consider contracts a reliable way to determine their own professional obligations. Put differently, the correct allocation of the risk of negligence between the parties is clear as a matter of public policy. It belongs with the professional. If the job requires formal training and calls for complex judgments, a client is unlikely to be in a position to negotiate effectively with the professional anyway, so we don't lose much—we probably lose nothing—by recognizing tort liability on top of whatever allocation of risks they might have made in their contract.

Another part of the rationale for the exception might be found in the other policy behind limitations on liability for economic loss: concern for indeterminate and disproportionate liability. Those worries are not likely to be serious in a case of malpractice because the defendant's liability is limited to the client—probably a single defendant (and not, in any event, a vast or unpredictable number of defendants), and probably for an amount that the professional could have calculated in advance if foresight of his potential exposure was felt to be important.

This exception to the economic loss rule is too entrenched to remove from American jurisprudence, but no great harm would result if it were. A plaintiff who suffers economic loss as a result of professional's

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[34] Note unsettled areas that could ripen into additional exceptions—bailments, principal/agent.

[35] *See* RESTATEMENT THIRD, TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 4(a) (Proposed Final Draft No. 1 April 6, 2005).

[36] *Id.*

negligence invariably has a contract claim; whatever their written agreement may have said, an obligation of due care will be considered at least an implied term, and efforts to disclaim that obligation will rarely be given effect.[37] So while it is an exception that must be recognized, the stakes of it are typically low. It matters a great deal in those occasional cases in which the plaintiff reaps an incidental advantage from the tort claim, such as a longer statute of limitations by virtue of the discovery rule applicable in tort but not in contract. But the availability of a tort suit to collect for pure economic loss is not systematically important to the malpractice victim.

D. Liability in Tort Is Recognized When Economic Loss Results From Invited and Reasonable Reliance on the Words or Acts of the Defendant (Outside any Contract With the Plaintiff)

Now suppose that the plaintiff and defendant *didn't* have a contract and so aren't subject to the economic loss rule. When can the plaintiff sue to recover for economic loss caused by the defendant's negligence? The largest and most important answer involves cases in which the defendant acts for the purpose of inducing the plaintiff's reliance on something the defendant says or does. The plaintiff reasonably does rely and suffers losses as a result. The classic example, mentioned earlier, is the accountant hired by a firm to produce an audit report that will satisfy the firm's potential investors. The investors have no contract with the accountant, but the purpose of the accountant's work is to provide a basis on which they may rely. If the accountant's negligence causes the investors to lose their money, they can recover in tort. The name of the claim is negligent misrepresentation, and it has become very important in commercial disputes. (Before 1980 the phrase "negligent misrepresentation" appeared in American case law about 1000 times. Since 1980 it has appeared about 25,000 times.) If the reliance is on the defendant's defective performance of an act rather than on negligently spoken or written words, the general theory of recovery is the same. The causes of action have various detailed elements that will not be recited here; the interested reader is referred to the sources in the notes.[38] The important point for now is to understand why claims with this structure are good candidates for liability in tort.

The result might be explained by saying simply—perhaps too simply—that the law need not defer to contract in such a case because there isn't a contract between the parties. The explanation is too simple

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37 *See, e.g.*, Bishop v. Owens, 272 P.2d 1247, 1251 (Idaho 2012); Spencer v. Barber, 299 P.3d 388, 392 (N.M. 2013).

38 *See* Bily v. Arthur Young & Co., 834 P.2d 745, 760–61 (Cal. 1992); RESTATEMENT THIRD, TORTS: LIABILITY FOR ECONOMIC HARM OF TORTS § 5 (tentative draft 2012).

because the parties *could* have written a contract. Some have argued in favor of extending the economic loss rule in this way, so that it forecloses tort claims for economic loss not just between parties who made contracts but between parties who could have made them.[39] In the long run, and maybe sooner, such a rule would induce parties to write agreements that allocate all risks between them, and so would spare the courts the expensive and error-prone exercise of figuring out after calamity strikes what would have been reasonable for the defendant to do. This is a plausible position. For the sake of creating a useful incentive, however, this broader rule would create hard results in many cases where parties did not realize that they needed a contract to protect themselves.

Consider a case from a different corner of the world. Owner—perhaps a town—hires Architect to design a building, then puts out the resulting plans for bids from contractors. Builder submits the winning bid, gets then job, and soon discovers that Architect's plans contain flaws that will make the project much more expensive than it appeared. The question is whether Builder can sue Architect in tort. The case is structurally very similar to the claim against the accountant described a moment ago, and is typically (but not in all states) treated the same way.[40] Architect understood that the plans would be used to provide a basis for bids by contractors, just as the accountant understood the audit would be used to provide a basis for reliance by investors. Either can be sued in tort by the party who relied.

But put aside the resemblance between the architect and the accountant, and consider the construction case just from the standpoint of policy. Builder and Architect have no contract. But they both have contracts with Owner and could have used those contracts to work out obligations and indemnities that would have covered possible glitches in Architect's plans. Why not force them to do it? That is indeed the way it works in some states: the tort claim is not recognized, so the lawyers must be careful to specify all contingencies of this kind when they write agreements running in various directions.[41] This is well and good when a

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39 *See* Posner, *supra* note 26, at 739.

40 *See* Donnelly Construction Co. v. Oberg/Hunt/Gilleland, 677 P.2d 1292, 1297 (Ariz. 1984); A.R. Moyer, Inc. v. Graham, 285 So.2d 397, 402 (Fla. 1973); Craig v. Everett M. Brooks Co., 222 N.E.2d 752, 754–55 (Mass. 1967); Prichard Bros., Inc. v. Grady Co., 428 N.W.2d 391, 392 (Minn. 1988); Bilt-Rite Contractors, Inc. v. The Architectural Studio, 866 A.2d 270, 288 (Pa. 2005); Forte Bros., Inc. v. National Amusement, Inc., 525 A.2d 1301, 1303 (R.I. 1987); Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 87 (S.C. 1995); Eastern Steel v. City of Salem, 549 S.E.2d 266, 268 (W. Va. 2001).

41 A leading case for denying recovery is *Berschauer/Phillips Construction Co. v. Seattle School District*, 881 P.2d 986, 996 (Wash. 1994). For a survey of case law both ways, see Marc M. Schneier, Annotation, *Tort Liability of Project Architect or Engineer for Economic Damages Suffered by Contractor or Subcontractor*, 61 A.L.R.6th 445 (2011).

project is large enough to command the time of sophisticated lawyers, or indeed any lawyers. But now let Owner be a mere homeowner rather than a town, and let Builder be replaced by Artisan, who again relies heavily on Architect's negligent guidance. It might well come as a nasty surprise to Artisan to learn that he has no rights against Architect unless they make a contract of their own. Those surprises may not be too large or very frequent, but they are unpleasant and probably inevitable when the law is not intuitive. It is not intuitive to deny all relief to someone who is invited to rely on the work of another, who reasonably does rely, and who suffers financial loss when the work is carelessly done.[42]

And for all that, it might be more efficient just to recognize the tort claim and save everyone in these situations the bother of anticipating such issues in their contracts. The reasonableness required by the law of torts from the architect or accountant is likely to be what everyone in the picture wants from them anyway. If they don't wish to bear the risk that sort of liability, they are free to make contracts saying so and insisting on indemnification from whoever hires them. In effect the tort liability is a default rule, and a substitute for contracts between parties who might find them inconvenient or outright infeasible to make. When the lawyers involved are sophisticated, the Coase theorem suggests that they will reach the same allocation of risks whether tort liability runs in the background or not.[43] When the lawyers involved are not sophisticated (or there aren't any lawyers), allowing the tort claim gives the parties the allocation of risk they most likely would have expected and wanted if they had reflected on the question in advance.

So deference to contract is, on balance, an unpersuasive reason to turn down claims in tort to recover for financial loss caused by negligent misrepresentations. What about the other policy in play—the concern for disproportionate and indeterminate liability? That is a legitimate worry. A negligent misrepresentation may be heard and induce action by large numbers of people, and may then be repeated to still more.[44] The resulting liabilities for an ill-considered statement could thus be massive and cause parties accustomed to speaking to curtail their activity unduly. If a newspaper were subject to large-scale liabilities for misprinting a stock price, for example, it would need to think twice about printing them at

42 For further discussion of the meaning of "invited" reliance, see Mark Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749, 752–59 (2006).

43 *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 44 (1960).

44 *See* Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931) (Cardozo, J.) ("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.").

all.[45] But this problem is best addressed not by rejecting liability but by defining the tort in a manner that limits the risk of such outcomes. Thus liability for negligent misrepresentation requires a statement directed to a limited audience for a limited purpose.[46] This requirement has an arguable perversity about it; it means that a very widely distributed misstatement—say, the mistake in the morning paper—produces no liability, whereas liability is intact when the same misstatement is made to one or two people. But it makes sense as a matter of policy. The speaker to a limited audience can make a rational estimate of his potential liabilities and take appropriate precautions in response. The speaker to a huge audience would have a harder time doing that, and the cost to the public if that speaker goes silent as a result may be substantial.[47]

E. *There Is No Liability in Tort for Economic Loss Caused to a Plaintiff by Injury to the Person or Property of Another Party*

This rule might almost go without saying, because it is a rule against liability rather than in favor of it. Since liability for economic loss has to be established on some particular ground, why bother explaining the non-existence of liability in any given area? But remember that Rule 1 is not a general statement of "no duty." It just states that duties have to specifically established. It is very helpful to the cause of clarity when we can round up common categories of economic loss and say whether any duty of care exists with respect to them. In this instance we can take a good-sized set of problems and deal with them at once. The rule stated here, in other words, removes a large category of potential claims from the case-by-case analysis that is called for when a fact pattern falls outside any settled category. This category exists, and is settled.[48]

We have seen the outlines of this rule at other points in the Article: the restaurant that cannot be reached after the defendant knocks down a nearby bridge cannot sue the defendant for damages; only the owner of the bridge can sue. The primary reasons for the rule are concerns about indeterminate and runaway liability. An act of negligence that damages property may cause inconvenience and financial loss to countless others

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45 *See* Gutter v. Dow Jones, Inc., 490 N.E.2d 898, 898 (Ohio 1986); *see also* Stancik v. CNBC, 420 F. Supp. 800, 801 (S.D. Ohio 2006); Ginsburg v. Agora, Inc., 915 F. Supp. 733, 739–40 (D. Md. 1995); Daniel v. Dow Jones & Co., 520 N.Y.S.2d 334, 340 (N.Y. Civ. Ct. 1987).

46 *See* RESTATEMENT THIRD, TORTS: LIABILITY FOR ECONOMIC HARM § 4(b) (tentative draft 2012).

47 *See* Greycas, Inc. v. Proud, 826 F.2d 1560, 1564–65 (7th Cir. 1987).

48 For leading statements, see *Louisiana ex rel. Guste v. M/V Testbank*, 752 F.2d 1019, 1027 (5th Cir. 1985) (en banc); *Barber Lines A/S v. M/V Donau Maru*, 764 F.2d 50, 52 (1st Cir. 1985); *532 Madison Avenue Gourmet Foods, Inc., v. Finlandia Ctr., Inc.*, 750 N.E.2d 1097, 1103 (N.Y. 2001); *Aikens v. Debow*, 541 S.E.2d 576, 581 (W. Va. 2000).

who would have found the property useful. Deference to contract is not an issue in quite the sense we have seen before; allowing liability in these cases is not especially likely to interfere with allocations of risk that parties have otherwise made. But as observed earlier, the hard-luck features of a case in this category can sometimes be mitigated by a prudent use of contract, either as a vehicle for insurance or as a vehicle for direct recovery from the party who suffered physical injury. An illustration may be built from the well-known case of *Robins Dry Dock & Repair Co. v. Flint*.[49] A bystander negligently breaks a propeller on a ship that is in dry dock for repairs, and this causes losses to a shipper who had been hoping to rent the vessel a week later. The disappointed shipper can't collect from the bystander, because the shipper doesn't own the ship or the propeller. But of course the *owner* of the ship can sue the bystander in tort for breaking the propeller; and if the shipper had a contract to hire the ship, and the ship is no longer available, the shipper can sue the owner in contract.

A striking feature of this branch of our subject is its inflexibility. One could well imagine courts looking at such cases one at a time and allowing plaintiffs to proceed when their facts seem to be outside the reasons for the general rule against recovery. That is not the American preference. The doctrine is a rule, not a standard.[50] Courts have not felt that they can distinguish in a sufficiently principled manner between those who are inside and outside the rule's rationale. This might seem a harsh approach, and one that allows a legal rule to run too far out in front of the policies behind it. But perhaps the unbending character of the rule is better viewed as giving effect to other important other policies—namely clarity, simplicity, and predictability. If the cost of this rigidity seems too high, relief can be provided selectively by statute, as was done in the Oil Pollution Act of 1990.[51]

In many cases that fall under this rule, a "best" plaintiff—or in any event a plaintiff better than those who suffered pure economic loss—is positioned to sue the negligent party: the owner of the damaged boat can sue whoever broke the propeller, the owner of the bridge can sue the owner of the boat that collided with it, and so on. The threat of a suit by that party provides the potential tortfeasor with salutary pressure to take care, and relieves the pressure to allow claims by others whose losses came later and were economic in character. But sometimes there is no better plaintiff than one who has suffered pure economic loss. That is so when

49 275 U.S. 303 (1927) (Holmes, J.).

50 The arguments for and against the inflexibility are well expressed by the majority and dissenting opinions in *Louisiana ex rel. Guste*, 752 F.2d at 1019.

51 33 U.S.C. §§ 2701–61 (1994); *see also* John C.P. Goldberg, *Liability for Economic Loss in Connection with the Deepwater Horizon Spill*, 30 MISS. COLL. L. REV. 335, 384–86 (2011).

the defendant damages property that has no owner. A spill of oil or other toxins into a waterway is the classic example. It may occur in waters that are used by many but in which no plaintiff has a proprietary interest sufficient to support a tort claim for physical injury. Some solace in these circumstances, however, can be found in the law of public nuisance, which allows a plaintiff with purely economic injuries to sue a defendant who damages a public resource.[52]

Recognizing claims of public nuisance to recover for pure economic loss can create the same worries about runaway liability that we have already seen; the potential for an oil spill to affect many thousands of victims is well known and has been demonstrated many times.[53] Letting all of them sue might create substantial burdens for courts. Some of those burdens could no doubt be relieved by a thoughtful use of the class action and other forms of aggregate litigation,[54] but often the many victims of a public nuisance have individualized claims that would make aggregation difficult. The common law addresses these difficulties by use of a strategy that by now is familiar: it limits recovery to those plaintiffs who have "special" injuries—that is, injuries different in kind from those suffered by members of the affected community in general.[55] The requirement is analogous to the rule in cases of negligent misrepresentation that the defendant can be held liable for utterances made to limited audiences but not to large ones.[56] It may seem strange for the law to show such solicitude for the "big time" tortfeasor who injures immense numbers of people, but again there are practical policies at stake. Courts do not want to be inundated with an unmanageable number of suits; they would prefer to insist that a "best plaintiff" be found to collect from the defendant and create an incentive for better care next time, even if that means no recovery for anyone when no such plaintiff can be found.

No discussion of liability for injury to property that the claimant does not own would be complete without a reference to a famous supposed exception to the rules on point: fishermen. Courts in a prominent line of cases have allowed fishermen to recover when their catch is diminished

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52 *See* RESTATEMENT THIRD, TORTS: LIABILITY FOR ECONOMIC HARM § 8 (tentative draft 2012).

53 *See, e.g.*, Exxon Shipping Co. v. Baker, 554 U.S. 471, 478 (2008); In re Deepwater Horizon, 732 F.3d 326, 341–43 (5th Cir. 2013).

54 As discussed in *Akau v. Olohana Corp.*, 652 P.2d 1130, 1135–36 (Haw. 1982).

55 *See* Harbor Beach Surf Club, Inc. v. Water Taxi of Ft. Lauderdale, Inc., 711 So.2d 1230 (Fla. Dist. Ct. App. 1998); 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc., 750 N.E.2d 1097, 1100–04 (N.Y. 2001); In re One Meridian Plaza Fire Litigation, 820 F. Supp. 1460, 1480 (E.D. Pa. 1993); Denise E. Antolini, *Modernizing Public Nuisance: Solving the Paradox of the Special Injury Rule*, 28 ECOLOGY L.Q. 755, 761, 816–18 (2001).

56 *See* RESTATEMENT THIRD, TORTS: LIABILITY FOR ECONOMIC HARM OF TORTS § 5 (tentative draft 2012).

by a tortfeasor's damage to the boat on which they are traveling or to the waters in which they are fishing.[57] These results might seem inconsistent with the general rule against recovery by plaintiffs for harm done to property they do not own. But the inconsistency is superficial. In the well-reasoned cases, fishermen recover on either of two implied or express theories. In the first they are working on a lay agreement in which they receive little or no money up front; the owner of the boat instead pays them a share of the catch brought in on the trip. The boat is then damaged by the defendant, destroying (let us imagine) the prospects for a productive fishing trip. The boat's owner plainly can sue the defendant for the harm done to it; and if he does, some of the damages he wins for lost profits from the voyage rightfully belong to the crew (since they had a contractual entitlement to a share of the profits under their lay agreement). The crew's award can be secured by a constructive trust imposed on a share of the owner's winnings;[58] or the crew can bring a claim against the owner sounding in restitution to recover for his unjust enrichment; or finally, and of most interest here, the crew can be allowed to skip the middleman and sue the defendant directly.[59] This latter step is best understood as a procedural convenience rather than as an meaningful exception to the usual rule against liability for economic loss caused by damage to someone else's property. Allowing the fishermen to sue whoever damaged the boat does not enable the fishermen to recover more than they would have been able to obtain anyway by constructive trust or by a claim for restitution from the ship's owner.

In the other set of cases won by fishermen, they are suing for public nuisance and claiming that their injuries are distinct in kind from those suffered by others who enjoyed benefits from the same waterways.[60] Often they make that argument effectively. The courts are no doubt attracted to the notion of letting *someone* bring suit against whoever spoiled a local waterway. The businesses adjacent to the water are numerous and hard to distinguish from one another; letting the local fishermen sue is an easy way to achieve some justice and to draw, between those who can and cannot sue, a line that at least is familiar even if not deeply defensible. At any rate, recognizing claims by fishermen in this way makes them beneficiaries of the rules governing public nuisance, not

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57 *See* Yarmouth Sea Prods. Ltd. v. Scully, 131 F.3d 389, 398–99 (4th Cir. 1997); Carbone v. Ursich, 209 F.2d 178 (9th Cir. 1953); Burgess v. The M/V Tamano, 370 F. Supp. 247, 250 (D. Me. 1973), *aff'd*, 559 F.2d 1200 (1st Cir. 1977).

58 See discussion in *Jensen v. Goresen*, 881 P.2d 1119, 1123–24 (Alaska 1994).

59 *Carbone*, 209 F.2d at 182 makes clear the link between the fishermen's rights against the owner of the vessel and their right to sue the tortfeasor directly.

60 *See Burgess*, 370 F. Supp. at 250–51; *see also* Curd v. Mosaic Fertilizer, 39 So.3d 1216, 1223–28 (Fla. 2010); Leo v. Gen. Elec. Co., 538 N.Y.S.2d 844, 846–47 (N.Y. 1989).

an exception to them, let alone an exception to the general rule that a tort claim for negligence cannot be brought against a party who injured someone else. Going forward, then, the less said the better about any general "fisherman's exception" to the rules governing liability for economic loss.[61] That expression has its charms, but it leaves the misleading impression that the law has a general desire for fishermen to make out better than other plaintiffs—a silly proposition.

F. Decide Remaining Cases by Direct Application of the Policies Bearing on Recovery for Economic Loss

The patterns discussed so far account for most situations in which the negligence of one party causes pure economic loss to another. But various other such cases arise on a miscellaneous or "one-off" basis, and they are best resolved by asking directly whether it is reasonable to expect the parties to protect themselves by contract, whether recognizing the claim in tort would create risks of indeterminate liability, and whether liability is necessary to advance any other interest, such as the preservation of a tortfeasor's incentives to be more careful next time. Let us consider some examples.

a. A lawyer is hired to write a will for a client and commits some blunder that is found, after the client dies, to have made the will ineffective. The client wanted the estate to pass to one heir, but instead it passes to another. Some courts would leave the disappointed heir to argue for a remedy as a third-party beneficiary of the contract between the lawyer and client;[62] assume this won't work, either on the particular facts of the case or in general, because the disappointed heir does not meet the requirements of third-party beneficiary doctrine (neither the lawyer nor the client meant to give that heir the right to sue anyone). Should the unhappy party be able to sue the lawyer in tort? Probably so.[63] Yes, it is a claim for pure economic loss founded on negligence. But note that the case is not governed by any of the general rules yet articulated. First, the parties—that is, the intended heir who brings the suit and the lawyer who wrote the will—had no contract, so the economic loss rule does not touch the case. Nor, secondly, does the exception apply that allows

[61] A notion aptly criticized in *Casado v. Schooner Pilgrim, Inc.*, 171 F. Supp. 78, 79–80 (D. Mass. 1959).

[62] *See* Hale v. Groce, 744 P.2d 1289, 1292 (Or. 1987) (Linde, J.); Joan Teshima, Annotation, *What Constitutes Negligence Sufficient to Render Attorney Liable to Person Other Than Immediate Client*, 61 A.L.R.4th 464 §§ 1–3 (1988).

[63] *See* Harrigfield v. Hancock, 90 P.3d 884 887–88 (Idaho 2004); Schreiner v. Scoville, 410 N.W.2d 679, 682–83 (Iowa 1987); Ogle v. Fuiten, 466 N.E.2d 224, 226–27 (Ill. 1984); Pizel v. Zuspann, 795 P.2d 42, 51 (Kan. 1990); Mieras v. DeBona, 550 N.W.2d 202, 212 (Mich. 1996); Calvert v. Scharf, 619 S.E.2d 197, 208–09 (W. Va. 2005).

professionals to be sued by their clients (the client is dead). Third, the lawyer's purpose was not to create a basis for reliance by the plaintiff (and anyway the plaintiff did not rely). Finally, the plaintiff did not suffer economic loss on account of personal injury or property damage to someone else. Since the rules yet crystallized do not settle the case, we undertake direct consideration of how the policies at stake in this field bear on it.

Begin by observing that the plaintiff's claim creates no significant risk of indeterminate liability. On the contrary, the lawyer who takes on a job of this kind can see from the start the size of the stakes involved and his possible exposure if he errs. He can buy insurance accordingly. Deference to contract is not an issue, either, because the disappointed heir has no contract with the lawyer (and probably couldn't have made one). The party who did have a contract with the lawyer is, by assumption, dead, so there is no risk that a tort suit by the disappointed heir will interfere with enforcement of that contract. And the client's unavailability also supports liability in another sense: if the disappointed heir cannot sue the lawyer, probably no one can. But someone should. So there are good reasons to allow the suit and no particular reasons to object to it. The plaintiff has a good claim. This is not an exception to the economic loss rule or any other rule. It is simply a decision about a specific fact pattern made by applying the policies that govern the existence of liability in tort for pure economic loss.

b. Buyer of a house discovers an expensive defect in it that was caused by negligence on the part of Builder. Buyer wants to sue Builder but has no contract with him; Buyer bought the house from a previous owner (who in turn had bought it from Builder). What result? Again, the case is not addressed by the economic loss rule or any of the other rules yet stated. After application of the policies behind those rules, however, the best answer is no liability in tort.[64] This case is unlike the earlier ones involving accountants and architects because here the builder's purpose was not to provide a basis for reliance by the eventual buyer. This case is more similar to one in which the purchaser of a product finds that it does not perform well and is confined to the law of contract for any remedies. It may help to recall that the mere absence of a contract between Buyer

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[64] *See* Casa Clara Condo. Ass'n, Inc. v. Charley Toppino and Sons, Inc., 620 So.2d 1244, 1246–47 (Fla. 1993); Assoc. of Apartment Owners of Newtown Meadows ex rel. its Bd. of Dirs. v. Venture 15, Inc., 167 P.3d 225, 278–80 (Haw. 2007); Redarowicz v. Ohlendorf, 441 N.E.2d 324, 331 (Ill. 1982); Moglia v. McNeil Co., Inc., 700 N.W.2d 608, 614–17 (Neb. 2005); Calloway v. City of Reno, 993 P.2d 1259, 1266 (Nev. 2000); Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, 221 P.3d 234, 242–43 (Utah 2009); Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 374 S.E.2d 55, 57–58 (Va. 1988); Stuart v. Coldwell Banker Commercial Grp., Inc., 745 P.2d 1284, 1289–91 (Wash. 1987).

and Builder does not mean that Buyer has no way to protect himself. Buyer has a contract with the owner who sold him the house. Perhaps that previous owner had a warranty from Builder that is transferable.

c. Subcontractor A's work is made more expensive by the blunders of Subcontractor B on a construction job. Note, first, that the economic loss rule does not touch the case because Subcontractors A and B do not have a contract with each other. This might seem to resemble the cases in which an architect and a builder have no contract with each other but both have contracts with the owner of a construction project. Here the two subcontractors may have contracts with the same prime contractor. But the resemblance is only superficial because subcontractors do not ordinarily invite reliance by each other; to put it in the language of the Restatement, Subcontractor A does not act for the purpose of providing a basis for reliance by Subcontractor B. Rather, Subcontractor A acts primarily for the benefit of Contractor—but his negligence may well have expensive side effects for B. The absence of invited reliance removes an important limiting idea from this case that was present in the earlier ones.

d. Consider, finally, an especially difficult scenario. Firm hires Tester to test Firm's employees for drug use. Tester negligently reports a false positive on Worker, who is then fired. Worker wants to sue Tester. The economic loss rule does not apply because Worker and Tester have no contract. Nor was Tester seeking to provide a basis for reliance by Worker. We are again left to apply the policies at issue in cases of economic loss directly to the facts. Indeterminate liability doesn't seem to be a problem; Tester can estimate its possible error rate and the stakes of litigation that will result if it makes mistakes. Nor is deference in order to any contract between Worker and Tester, since they have none. But contract does play an important role in the case. Tester had a contract with Firm, and breached it. Firm can sue Tester, and should; and Worker could have bargained for protections against wrongful dismissal in any employment contract with Firm. So if Tester is negligent, Tester pays Firm and Firm pays Worker. Contracts running between them solve the problem, and that process of contracting is entitled to deference.

Alas, this account is too optimistic at every juncture. "Worker" in a case of this kind is often an at-will employee who cannot feasibly obtain contractual protections from Firm. And Firm may well have little incentive to pursue possible claims that Tester's negligence has caused one of Firm's employees to be needlessly discharged.[65] Firm may reason that there are plenty more employees where Worker came from, and perhaps Tester's rate of error is tolerably low. So Worker can't sue Firm and Firm

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65 *See* Posner, *supra* note 26, at 742–43; Rabin, *supra* note 20, at 867–69.

won't bother to sue Tester. The actual efficacy of contract to control this situation is therefore very questionable. On the other hand, allowing Worker to sue Tester creates odd effects of its own. If Firm does its own in-house testing, rules of agency and employment law will prevent an at-will Worker from suing Firm or the fellow employee who negligently performed the test.[66] Why should the result be different when Firm hires an outside company to do the testing?

In the end, the policies bearing on this fact pattern are so finely balanced that a result either way is defensible, so it is no surprise that courts have reached a range of results in handling it.[67] The important point to observe in this discussion is that when a claim for pure economic loss arises outside the established rules that govern the most familiar patterns, analysis of how the relevant policies apply is not an abstract exercise. It calls for close engagement with the details of the situation and a realistic look at whether the problems at stake are likely to be solved by contract if liability in tort is not available.

V. CONCLUSION

Some courts have suggested, in effect, that the "economic loss rule" means there is no recovery in tort for pure economic loss, except when there is. The exceptions are then very numerous and confusing. The question is not the accuracy of such a statement but the utility of it. Courts taking that position have been motivated by a commendable desire to clarify and simplify the law, but the resulting cases have tended to be unwieldy as well as inconsistent across jurisdictions. This Article, which summarizes the conclusions reached after investigation by the American Law Institute, has set forth a version of the economic loss rule that is safer to state and considerably more useful: There is no liability in tort for pure economic loss resulting from negligence in the negotiation or performance

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66 *See* RESTATEMENT THIRD, EMPLOYMENT LAW § 6.04 (2015).

67 For cases declining to find a duty of care, see *Erpelding v. Lisek*, 71 P.3d 754, 760 (Wyo. 2003); *SmithKline Beecham Corp. v. Doe*, 903 S.W.2d 347, 353–54 (Tex. 1995); *Devine v. Roche Biomedical Laboratories, Inc.*, 637 A.2d 441, 447–48 (Me. 1994); *Rand v. Miller*, 408 S.E.2d 655, 657–58 (W.Va. 1991); *Felton v. Schaeffer*, 229 Cal. Rptr. 229, 239 (Cal. 1991); *Herbert v. Placid Reference Co.*, 564 So. 2d 371, 373–74 (La. 1990); *Hall v. United Parcel Service of America*, 555 N.E.2d 273, 276–77 (N.Y. 1990). For cases and arguments in favor of liability on similar or analogous facts, see *Sharpe v. St. Luke's Hospital*, 821 A.2d 1215, 1218–21 (Pa. 2003); *Duncan v. Afton, Inc.*, 991 P.2d 739, 742–46 (Wyo. 1999); *Merrick v. Thomas*, 522 N.W.2d 402, 405–07 (Neb. 1994); Amy Newman & Jay M. Feinman, *Liability of a Laboratory for Negligent Employment or Pre-Employment Drug Testing*, 30 RUTGERS L.J. 473 (1999). For additional discussion and authorities both ways, see Claudia G. Catalano, Annotation, *Employee's Action in Tort Against Party Administering Polygraph, Drug, or Similar Test at Request of Actual or Prospective Employer*, 89 A.L.R.4th 527, §§ 1(a)–15(b) (1991).

of a contract between the parties. Many other cases of pure economic loss can also be resolved by rule. A professional can be held liable for negligent performance of a contract with the plaintiff (notwithstanding the economic loss rule). If the parties do not have a contract, liability is found when a defendant has acted for the purpose of providing the other with a basis for reliance and the other then reasonably relied. Finally, a plaintiff cannot collect in tort for economic loss caused by injury to the person or property of a third party.

Each of the rules just set forth can be made the subject of more detailed explanation and qualification, of course, but the qualifications do not impair their fundamental accuracy. Those rules cover most of the common cases in which plaintiffs suffer economic loss on account of a defendant's negligence. Most importantly, they are consistent with the policies at stake in the field: deference to contract, avoidance of indeterminate liability, and due regard for the values of clarity and predictability. Remaining cases that arise outside the rules just summarized are best resolved by direct application of those same policies one case at a time until the results crystallize into further rules of their own.