AN INTRODUCTION TO NON-STATUTORY ECONOMIC LOSS CLAIMS

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INTRODUCTION

This Article attempts to provide an elementary summary of the economic loss rules. It is not comprehensive. It suggests some but not all of the rationales, qualifications, and expansions of the rules, in the hope that it will provide a starting place for analysis of the economic loss problems.

The stand-alone or "pure" economic loss covered by the economic loss rules refers to pecuniary or commercial loss that does not arise from actionable physical, emotional or reputational injury to persons or physical injury to property.[1] Negligently inflicted economic loss that results from some other kind of injury may be recoverable, but recovery for stand-alone economic loss is frequently rejected.

Three slightly different examples suggest some major types of economic loss. First is the case of a defendant who negligently drives his truck into a bridge, causing it to collapse and block access to the plaintiff's retail store, with concomitant loss in sales for the plaintiff.[2] In such "stranger" cases the plaintiff has suffered economic loss but no damages to *her* property or person. Second is the case of a defendant who does not threaten anyone's interests in physical security but whose legitimate economic activity causes loss to others, for example, through competition.[3] Third is the case of persons who have some kind of contractual or

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1. In the context of products liability, a defective product that causes harm to itself may count as pure economic loss rather than as property damage. *E.g.*, Fleetwood Enters., Inc. v. Progressive N. Ins. Co., 749 N.E.2d 492 (Ind. 2001).

2. *Cf.* Aikens v. DeBow, 541 S.E.2d 576 (W.Va. 2000); *see* 2 DAN B. DOBBS, THE LAW OF TORTS § 452 (2001 & Supp. 2006) [hereinafter DOBBS ON TORTS]. For a similar example, see Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735, 736 (2006).

3. Thus, competitive activity is usually protected against claims for interference with business opportunities. *See* 2 DOBBS ON TORTS, *supra* note 2, § 446.

other relationship with each other: The plaintiff may purchase goods that turn out to lack the qualities warranted or represented, as where a new vacuum cleaner doesn't get the carpet clean.[4]

Two distinct rules tend to limit recovery of stand-alone economic loss: (1) Subject to qualifications, one not in a special or contractual relationship owes no duty of care to protect strangers against stand-alone economic harm; and (2) again subject to qualifications, those in a special relationship arising out of contract or undertaking may not owe a duty of care to each other; rather, each party is limited to the contract claim, with all its limitations.

Several competing rationales have been developed for the first rule, which I will refer to as the "stranger economic loss rule," or simply the "stranger rule." Different commentators rate the rationales differently. I will emphasize primarily the "pragmatic" rationale that economic harm poses a threat of infinite economic repercussions and that a limit should be imposed by denying the negligence claim where there is a real threat of such repercussions.

In any event, there are probably qualifications or exceptions to the stranger rule. I suggest that it does not bar restitutionary claims to force disgorgement of unjust enrichment where the defendant's negligence not only causes harm to the plaintiff but results in correlative gain to the defendant. I also suggest that the concept of transferred loss deserves detailed attention. Transferred loss occurs when the defendant's negligence inflicts a *single* loss that is subsequently passed on to others. What matters is that there is no room, even theoretically, for infinite strings of liability. Finally, I will point out several instances where specific torts designed to deal with particular facts have developed to address harms that might otherwise be barred by the stranger rule. In such cases, the plaintiff should be permitted to recover in tort if she meets the requirements of those specific rules.

The contractual versions of the economic loss rule are different. Although different rationales are again possible, the one I emphasize here is that contractual provisions may expressly or impliedly foreclose a negligence claim. If the contract is valid, it prevails. We simply honor the contract itself. But it is not so clear that courts are really examining the contract; it looks rather as if they have made a rule of law irrespective of the parties' expressed intent, and that is troublesome. In fact, some judicial statements emphasize a desire to force buyers of goods to contract about the extent of liability, eliminating all negligence claims that are not somehow entirely separate from the contract.

Finally, this piece glances at the special case of misrepresentation in bargaining transactions, considering when the contractual version of the economic loss rule bars claims for negligent or intentional misrepresentation.

4. *See* Seely v. White Motor Co., 403 P.2d 145 (Cal. 1965); 2 DOBBS ON TORTS, *supra* note 2, § 352.

I. PARTIES WHO ARE STRANGERS

The first of the economic loss rules (the stranger rule), often associated with *Robins Dry Dock & Repair Co. v. Flint*,[5] 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. This version of the rule covers the first two examples above. Even if the defendant causes physical harm to someone else, the plaintiff who suffers only pure economic loss as a result of another's physical injury normally has no claim.[6] The illustration of the trucker who damages the bridge, reducing access to the plaintiff's retail store, illustrates this.

A. A Sample of Rationales

Most of the rationales for the stranger economic loss rule are subject to criticisms or limitations, some of which can be gleaned from the papers in this conference. Formulating the rationales is an important task for the new Restatement because the rationales accepted should define the scope of the rule. Some of the major justifications that may be advanced in support of the rule, omitting much detail and criticism, include the following:

1. The rule enforces the requirements of other tort law. In certain classes of cases, the rules of particular torts like libel or interference with contract are in place to deal with those specific cases. The rules of the particular torts often require something more than negligence. The rules of those particular torts should control those particular cases, not the rules of ordinary negligence law. In cases like these, the economic loss rule merely directs legal traffic for analysis under the best suited set of rules. It does so by saying negligent infliction of economic loss by strangers is no ground for recovery. This intellectual-traffic-cop effect cannot be a rationale for all cases, but it is a desirable function in many.

2. The rule represents pragmatic limits on liability. Stand-alone economic loss often spreads without limit. If I suffer economic loss as a result of your negligence, I might not pay my credit card debt; the credit card company then suffers economic loss from my nonpayment and raises interest rates for others, who suffer economic loss as a result and cut down on the purchase of hamburgers from fast food vendors. And so on indefinitely. The *foreseeably* endless nature of economic loss, it can be argued, compels us to adopt some kind of limitation less elusive than foreseeability. A counter-argument might emphasize that no such "pragmatic" limitation is needed, because the low level of loss suffered by the credit card company and subsequent victims guarantees that they will not sue

5. 275 U.S. 303 (1927).

6. It is important to point out that this Article focuses on stand-alone harm in (common law) negligence. There are important "statutory exceptions" to the economic loss rule, for example statutory wrongful death actions. *See, e.g.*, ARIZ. REV. STAT. § 12-611 (2003); *See also* Jean Braucher, *Deception, Economic Loss and Mass-Market Customers: Consumer Protection Statutes as Persuasive Authority in the Common Law of Fraud*, 48 ARIZ. L. REV. 829 (2006).

unless a class action is possible. Consequently, it could be argued, we need no special rules grounded in purely practical considerations.

3. The rule is normatively right. It is possible to assert that, as a normative matter, strangers should not usually be required to exercise reasonable care for the protection of others' economic well-being. If you are working on *O*'s vessel, you may damage it, causing loss to *O*. But maybe you should not have to consider the potential loss to non-owners, such as those who might hire the boat to haul a cargo, even if you could foresee that such people might be harmed. A rejection of the stranger rule would mean, in Cardozo's words, that

> [e]very one making a promise having the quality of a contract will be under a duty to the promisee by virtue of the promise, but under another duty, apart from contract, to an indefinite number of potential beneficiaries when performance has begun. The assumption of one relation will mean the involuntary assumption of a series of new relations, inescapably hooked together.[7]

This point has an inescapable economic tone, but it also reflects the view that the freedom to choose an obligation to *A* ought not to be constrained by forcing the contracting defendant to take on obligations to *B* and *C* as well.

4. The rule enforces the economic view that only social losses should be compensated. Some economic thinkers, like Judge Posner, hold that economic losses are not social losses and that only social losses should be compensated.[8] Judge Posner has pointed out that economic harm to one person often means economic gain to another,[9] such as a competitor of the retailer in the truck–bridge example. While the retailer at the end of the blocked bridge might lose profits, other retailers would gain sales. So overall, there is no loss. Judge Posner suggested that "since the tortfeasor is not entitled to sue for the benefits, neither should he have to pay for the losses."[10]

5. The rule encourages parties to adopt contractual solutions. This rationale applies primarily or solely when the plaintiff and defendant are in some kind of relationship, contractual or perhaps something close to it. By definition, this rationale will have little application in the case of strangers; however, it is

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7. H.R. Moch Co. v. Rensselaer Water Co., 159 N.E. 896, 899 (1928). *Moch* did not involve stand-alone economic loss but instead involved actual physical injury, so Cardozo's words may have been too extreme for that case. But they are just right to express the constraint on freedom that would be entailed if we entered into a wholesale rejection of the stranger rule.

8. Posner, *supra* note 2, at 736-37.

9. *Id.* at 737.

10. *See* All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 865 (7th Cir. 1999). It is possible to argue that there is no need to limit compensation to cases where social loss has been inflicted and that in any event at least some of the economic-loss cases entail social loss. *See* Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773, 775, 781, 799–802 (2006). For instance, if the defendant negligently damages the owner's vessel while attempting to make repairs, incapacitating the boat for a month, the spoilable cargo that would otherwise have been shipped may be lost entirely, not made up by an infinite supply of alternative spoilable goods.

worth pointing out that the application of the economic loss rule may encourage contracting in the form of insurance. Indeed, in many instances, insurance may be preferable to the tort system as a mechanism for addressing pure economic losses.[11]

B. Some Possible Qualifications or Exceptions

Stating the qualifications to this rule and formulating them correctly, at a meaningful level of abstraction, is an arduous and maybe impossible task that I gladly leave to the new Restatement. It is useful here, though, to recognize that the rule against economic loss recovery from strangers cannot be universal and to suggest some of the very general kinds of limitations on the stranger economic loss rule that we might expect or hope to find.

1. Gains to the defendant—restitution. When a defendant's negligence not only causes stand-alone economic harm to the plaintiff but results in recognizable gain to the defendant,[12] the plaintiff's claim need not be conceived as one for damages. It is instead one for "restitution," to recover the defendant's unjust enrichment. For example, if I convert your watch, even if I am innocent, I must restore it to you rather than keep the gain. If I have sold the watch for more than it is worth, I must "restore" to you the price I received because otherwise I will be unjustly enriched.

Restitution in this sense of recovering for the defendant's gains rather than for the plaintiff's losses is a large and difficult subject,[13] not to be pursued lightly or with ease. Still, if the defendant's gains are truly traceable to the plaintiff's corresponding loss, and reflect the defendant's receipt of value that in justice and good conscience belongs to the plaintiff, the economic loss rule should have no application to bar the restitutionary recovery. For the recovery of unjust enrichment, the nature of the defendant's wrongdoing as negligence or something worse is not important; indeed, if the defendant has value that equitably belongs to the plaintiff, he can be forced to disgorge it even if he committed no wrong at all.[14] This point reinforces the conclusion that the economic loss rule, focused on

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11. *See* Posner, *supra* note 2, at 738.

12. The more common case is an intentional tort, but negligent acquisition of value from the plaintiff is possible. Suppose the defendant, using a computer infected with a virus, emails the plaintiff without knowing of the virus. The virus (a) destroys all the plaintiff's customer lists and records and (b) transfers copies to the defendant's computer and integrates them seamlessly with the defendant's customer data. The defendant uses his mailing lists, unaware that they have been augmented by the plaintiff's. The defendant then receives double the usual number of orders from customers and fills them, doubling his normal profit from a mailing. The plaintiff has suffered no physical harm, no actionable emotional harm, and no reputational injury. The defendant's conduct was negligent, not an intentional wrongdoing. The example suffices to show that negligent acquisition of economic value is possible.

13. *See* 1 DAN B. DOBBS, THE LAW OF REMEDIES §§ 4.1 to 4.9 (2d ed. 1993) [hereinafter DOBBS ON REMEDIES].

14. Thus if *A* acquires values belonging equitably to *P*, *A* is liable to restore those values and so is *A*'s donee, *B*, even though *B* knew nothing of *P*'s rights. *E.g.*, *id.* § 9.6.

limiting liability for negligence, simply has no application to an otherwise valid unjust enrichment claim.

2. Transferred loss. Transferred losses occur when the defendant harms a protected interest of *A*, but because of contract, rule of law, or perhaps mistake,[15] the loss actually falls on *B* instead of *A*. The salient characteristic of transferred loss is that there is a single loss, although it may migrate from one potential plaintiff to another. The category, quite diverse in the facts, is probably important because sometimes *B* can recover for economic losses that have been transferred to him,[16] and other times not.[17]

Suppose that the owner of land has insurance covering the cost of repairs to roads or bridges on his land resulting from accident. The defendant negligently drives a bulldozer over the owner's bridge, destroying the bridge. Very likely the insurer who pays the repair will be subrogated to the owner's claim against the defendant. This is one kind of transferred loss and no one seems to object to it. The claim is one for economic loss to the plaintiff insurer, even though it originated in physical loss to another person.[18]

An important characteristic of this kind of claim is that there is only one loss. The defendant is not subject to an infinite string of potential claims. He is instead subject to only one claim, whether by the owner or by the insurer.[19] Consequently, in transferred loss claims, the pragmatic concern does not support invocation of the economic loss rule.

How far subrogation—or reallocation of the right of recovery under any other name—should be extended is an important issue here. Suppose that the owner had no insurance, but did have a contract requiring a contractor to keep the bridges on the land in repair no matter what the source of the disrepair or damage. Now the single loss—the cost of bridge repair—will ultimately fall on the contractor, not on the owner. Should the contractor be permitted to recover his

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15. If *B* mistakenly shoulders *A*'s loss he might reasonably claim against the tortfeasor, provided *B* can escape the rule that "volunteers" are to be denied restitution.

16. At least in any case where the court is willing to say that *B* is subrogated to *A*'s claim. This includes ordinary insurance cases, in which the insurer suffers a pure economic cost by paying out to its insured, but it is nonetheless allowed to recover against the negligent defendant. But subrogation originated in equity's unjust enrichment concerns, not in insurance law, so subrogation can apply whenever the actual single loss falls on a person who suffered no physical harms to person or property. *See infra* note 20.

17. *E.g.*, Fifield Manor v. Finston, 354 P.2d 1073 (Cal. 1960) (holding that subrogation for a transferee's loss would in effect permit assignment of a personal injury claim in violation of law).

18. This should not be overlooked merely because we are accustomed to the saying that the subrogated insurer "stands in the shoes" of the insured; the insurer takes the owner's claim but has not itself suffered physical harm. *See* Wausau Tile, Inc. v. County Concrete Corp., 593 N.W.2d 445 (Wis. 1999).

19. If the insurer has no subrogation right, the owner recovers under ordinary negligence law. The case will be governed by the collateral source rule (where it has not been statutorily modified) and the owner will keep his insurance payment and also recover in tort for the damage done. *See* 2 DOBBS ON TORTS, *supra* note 2, § 380; 2 DOBBS ON REMEDIES, *supra* note 13, § 8.6(3).

economic loss, either from the defendant or, if the owner has received the recovery by way of restitution, from the owner?

Subrogation rights are not solely the result of contracts. Even without contractual provisions for subrogation, courts have long recognized "equitable subrogation" in order to prevent unjust enrichment.[20] In this example, the defendant should undoubtedly be liable to someone. The question is whether liability should run to the person who suffered the loss or only to the landowner. If the owner's contract with the contractor does not imply that the owner wants the contract in order to gain a double recovery (once from the contractor's repairs and again from the tortfeasor) then it may be proper to hold that the contractor is subrogated to the owner's claim. On the other hand, the contractor was paid to take on the risk of repairs, so there may be no equity in his favor.

This example makes it clear that the outcome should turn on whether to allocate the claim to the contractor or to the owner, and not on the economic loss rule. Nothing in the pragmatic concern about potentially long strings of liability applies here any more than in the insurance example. The defendant will be liable only once.

The transferred loss situation is not necessarily limited to cases arising from physical harms. Suppose a surveyor negligently performs a survey of *A*'s real property and provides a report to *B*, a potential buyer, showing that the property contains 40 acres. Suppose that in fact the surveyor's negligence led to an overstatement of acreage by ten acres and that the market value of the land is heavily influenced by acreage. Relying on the negligent survey, *B* purchases the land for $100,000, when the market value for the 30 acres actually received is only about $75,000.

At this point we can say that *B* has suffered an economic loss, although it is an unrealized one. But suppose that *B* almost immediately resells the land to *C*, showing him the surveyor's report and *C* in reliance pays the market value for 40 acres. The loss now seems to have been shifted to *C*.[21] Again, though, the loss is a single loss, and again it cannot much matter to the defendant whether he must pay *B* or *C*, as long as he is not subjected to liability twice. Given the single nature of the loss, neither the stranger economic loss rule nor concepts of privity should get in the way of *C*'s claim. If *C*'s claim is satisfied by the surveyor, *C* would have no potential claim against *B*, so there is no risk to *B* in this procedure.

A practical reason also supports *C*'s direct claim as loss transferee. If we reject *C*'s claim and insist that *C* must sue his vendor, *B*, *C* may possibly recover from *B*. But if that happens, *B* will then claim against *his* vendor, who will then

20. To prevent unjust enrichment, subrogation is appropriate in any case where restitution is warranted because one person pays the debt of another and the remedy can be given without working an injustice. Liability is generated and measured by enrichment, not by wrongdoing. Conversely, subrogation in this sense should be denied when the court concludes that there is no unjust enrichment. 2 DOBBS ON REMEDIES, *supra* note 13, § 4.3(4).

21. If *A* or *B* are held to have warranted the acreage, *C* may ultimately have no loss because he can rescind. In that case, *B* or *A* would claim over against the surveyor.

claim against the surveyor. In that scenario, we need a series of claims to resolve the single loss. To compel this solution seems wasteful.[22]

What counts as a single and transferred loss? The plaintiff's core[23] claim should be for the identical item of harm, measured by the same rule of damages that the original victim could have claimed in the absence of a loss transfer. This is a point too easily overlooked.

For a very simple example that fails this transferred-loss test, suppose that an employee is physically injured by the defendant's negligence. The employer suffers pure economic loss in, say, lost production because of the employee's absence or the cost of finding a replacement and training her, or perhaps in the cost of medical treatment furnished by the employer. The employer could *not* recover on the ground that the loss is a single, transferred loss. The employee's loss, measured by his lost wages, medical expense, and pain, is not the employer's loss measured by cost of hiring and training a new employee, and courts in fact reject these claims.[24]

Sometimes the difference between the claims of the original victim and the secondary victim is harder to spot. Suppose the negligent defendant physically harms a vessel owned by *A* and that the necessary repair delays use of the vessel for two weeks. Since physical harm was done to *A*'s vessel, *A* has a claim for the cost of repairs or diminished value of the vessel and also a loss of use claim for the two weeks. If *A* were using the vessel in commerce, say to carry cargo, *A*'s loss of use claim might be for lost profits on cargo carriage. If *A* were merely leasing the vessel to others, his claim would not be for the profits that could have been made in carrying cargo but only for the rental value he lost, usually a much smaller sum. Now suppose that in fact the vessel was subject to a charter giving *B* no right to possession and control of the vessel, but a right to direct that *A* take on and offload cargo at specified ports.[25] Finally, suppose that *B* was obliged to and did continue to pay the rental due during the two-week delay period. That makes it apparent that the loss of rental value has been transferred to *B*, so perhaps *B* should be permitted to recover, because this is a single loss with no risk at all that the defendant will be subject to long chains of liability.

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22. *C*, of course, might sue both *B* and the surveyor, thus inviting *B* to sue *A* and *A* to cross claim against the surveyor. That might be a good solution if both vendors are subject to liability and statutes of limitation protect no one.

23. I am suggesting by "core" that the routine damages adjustments—for interest and reduction to present value and probably attorney fees if any recoverable—need not be the same as *A* could have claimed.

24. *E.g.*, Phoenix Prof'l Hockey Club, Inc. v. Hirmer, 502 P.2d 164 (Ariz. 1972); Weinrot & Son, Inc. v. Jackson, 708 P.2d 682 (Cal. 1985) (statute did not permit the action of employer for (a) lost profits or (b) out of pocket expenses incurred because of employee's injury). Statutes may permit certain employer recoveries.

25. This roughly describes the charter in *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927), a so-called bare-boat charter that, unlike other charters and unlike leases of land, gives the plaintiff no property interest. If *B* had a property interest in the vessel (or leased land property), his claim arguably could be seen as a property damage claim, not a pure economic loss claim. That not being the case here, a transferred loss analysis is one way to resolve the claim.

However, if *B*'s claim is for net lost profits on the carriage of cargo, his claim is for a loss that *A* did not suffer. Recall that *A* suffered only a loss of rental value for the two week period. Unless *B* is losing money, the net profits on carriage of cargo will exceed the rental value, perhaps by large sums. To determine whether the case is one for a single, transferred loss, we must know exactly what loss *B* is claiming. If *B*'s loss is different from the loss that could be claimed by *A*, *B*'s claim is not for a transferred loss but a separate one in a string of potential losses. *B* should be permitted to claim only the lost rental value, not the loss of profits. However, I see no reason to say that ordinary damages adjustments—such as interest, reduction to present value, and the addition of attorney fees where permitted—must work out to the same sums that *A* could claim if the core claim for loss is identical.

3. Claims decided under rules for specific torts rather than negligence analysis. The economic loss rule should not apply to bar claims brought under the rules of specific torts that are shaped to deal with the specific kind of claim the plaintiff presents. Instead, the plaintiff's claim should stand or fall under the rules for those specific torts. Frequently the claims will fall because those torts require more than negligence as a basis for liability. But not always. The point is that the case should be determined by the rules for those torts, not by an overarching economic loss rule for strangers. I suggest a few possibilities.

The stranger economic loss rule cannot foreclose claims for statutory torts like trademark infringement, copyright violation, or wrongful death, even when the underlying wrong is best characterized as negligent rather than intentional.

We can be pretty sure that common law libel and slander claims are not barred by the economic loss rule, even though nowadays the plaintiff may be required to prove negligence in order to recover and even though recovery may be based on economic losses. Perhaps courts would agree with some participants in this conference that libel is not an economic tort.[26] Maybe this is true enough, because libel always theoretically harms reputation even if no loss can be proved.[27] Even without such an explanation, however, defamation law addresses reputational injury, economic or not, and the claim should stand or fall on the rules of defamation. Perhaps claims for invasion of the right of publicity, if such claims could ever be based on negligence alone, should be analyzed similarly.

Negligent misstatements about the plaintiff, or about a third person, can cause harm even if they are not defamatory. But if the statements are not defamatory of the plaintiff, no action for libel or slander will lie even if harm is done and even if the statements defame someone else.[28] That is the law of

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26. David A. Anderson, *Rethinking Defamation*, 48 ARIZ. L. REV. 1047 (2006).

27. The devil, as usual, is in the details. In slander that is not slander per se and in libel per quod where the per quod rule is applied, the plaintiff may be required to prove pecuniary loss before she can recover for any reputational harm that is conceived of as existing apart from any estimate of pecuniary loss. If that is combined with the rule followed in some jurisdictions even as to private persons suing for defamation that the plaintiff must prove negligence or more, it would be an economic tort based on negligence in some cases.

28. Kirch v. Liberty Media Corp., 449 F.3d 388, 398 (2d Cir. 2006).

defamation. The effect of the economic loss rule is to channel the claim into the law of defamation which is aimed at covering reputational harm: A plaintiff who knows that the economic loss rule will bar her claim in negligence must try to recover under the defamation rules or not at all. It honors the rules of defamation.[29] This is an instance of the first effect listed above—claims should stand or fall under the rules of specific nominate torts.

Conversion of a stranger's tangible property, either by bailee or stranger, is another tort that may not entail physical harm of any kind. It does require intent to exercise dominion over the tangible good, but given that intent, the defendant may be liable even if he reasonably believes he is acting rightly and in accord with the rights of the plaintiff.[30] Still, the conversion of tangible goods does require that the defendant exercise dominion of the goods and, in that sense, is comparable to the seizure of a person, which in turn is traditionally treated similarly to physical harm torts. While no actual physical damage is required, physical seizure seems easily equivalent and easily sufficient to justify recovery unaffected by the economic loss rule.

Conversion of or trespass to intangibles, not possible in earlier law, are now sometimes accepted as torts. Negligent interference with intangibles that causes economic harm can easily be imagined. A defendant might negligently reveal a trade secret or negligently interfere with the plaintiff's email or computer data by wholly electronic, non-physical means.[31] In some of these cases, conversion is not an appropriate claim because other claims, such as those based on trade secret law, better address the issues.[32] It is a very good idea to deny claims for conversion that are best dealt with by other legal rules, whether the economic loss rule applies or not. So far as the economic loss rule reflects a channeling of the case to the "right" set of rules for analysis, though, it suggests caution about adopting a conversion theory for harms to intangibles where other torts deal more specifically with the facts.

II. PARTIES IN A CONTRACTUAL OR OTHER RELATIONSHIP

In contrast to the stranger cases, many suits involve parties who have a definite relationship that can and usually does color their rights and duties. The relationship might be one arising out of an undertaking of a tort duty, as in the case of lawyers and their clients. In many instances, though, the relationship is

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29. *See* Travis M. Wheeler, Note, *Negligent Injury to Reputation: Defamation Priority and the Economic Loss Rule*, 48 ARIZ. L. REV. 1103 (2006) (developing this idea under the label of "defamation priority").

30. A bailee may be at greater risk for liability without moral fault if, for example, he "returns" bailed goods to the wrong person. *See* Rensch v. Riddle's Diamonds of Rapid City, Inc., 393 N.W.2d 269 (N.D. 1986). But even strangers may honestly and reasonably exercise dominion over property that counts as a conversion. *E.g.*, Wiseman v. Schaffer, 768 P.2d 800 (Idaho 1989).

31. *See* 1 DOBBS ON TORTS, *supra* note 2, § 60. The cases usually involve intentional, even vicious acts of electronic destruction. Such acts do not invoke the economic loss rules, but negligent interference is possible.

32. Thus the Uniform Trade Secret Act provides that it displaces all such claims as "conversion." 14 UNIF. TRADE SECRET ACT § 7 U.L.A. 651 (2006).

contractual in nature (although privity is not always present). How these relationship cases should be treated is a difficult matter with some uncertainties, but we can say that they are not all treated alike.

A. The Core Case of Contractual Limits

The core case for the contractual economic loss rule involves parties who are in a contractual relationship that governs their rights and duties with respect to the claim now being asserted by the plaintiff. The contractual economic loss rule applies to bar a tort claim based on negligence in such a case.

To take a simple example, suppose the defendant contracts to provide so many pounds of flour on October 1. The defendant's negligent mismanagement of his own enterprise leads to the loss of the flour or inability to acquire it. Consequently, he does not provide the flour. The plaintiff has a breach of contract claim, but not a negligence claim.[33] Negligent breach of contract is still breach of contract and the contract controls. Thus, the plaintiff's claim is for contract damages, not tort damages.[34]

To permit the tort claim would be to deny the validity of the contract. So if the contract is valid, its terms, not the terms of tort rules, will control the plaintiff's rights and the defendant's duties. It is not hard to understand the rule in this core case: It merely honors the valid contract.[35] The rule takes into account the parties' reasonable expectations. There should be no debate about this rule. Any debate should focus instead on the question of whether the contract provisions were valid and binding and what they mean, not on the proposition that a valid contract controls as to those rights and duties it expressly or impliedly establishes.[36]

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33. *See* Springfield Hydroelectric Co. v. Copp, 779 A.2d 67 (Vt. 2001).

34. This is just another incarnation of the channeling effect. By denying recovery in negligence, the economic loss rule ensures that a plaintiff cannot use tort law to make an end run around a valid contract. The economic loss rule pushes claims out of negligence and into contract.

35. Courts have stated several purported rationales, but most of them appear to be indirect and elliptical ways of recognizing the parties' expectations. They sometimes say that the purpose of the contractual economic loss rule is to preserve the distinction between torts and contracts, but that seems only to be a truncated statement of the perception that where the contract deals with the subject matter, it should not be undermined by a tort claim that ignores the contract limitations. That observation would make the rationale comport with the idea of honoring the parties' reasonable expectations. But if any of these rationales means to imply that the parties' reasonable expectations under the contract are irrelevant, then the economic loss rule, far from supporting the parties' contractual autonomy, would be attacking it.

36. Where the claim involves commercial misrepresentation, an added rationale is that limitations of the judicial process counsel heavy reliance on the written contract, so that it will prevail over the asserted pre-contract representations. *See* All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 865–66 (7th Cir. 1999). This rationale supports an economic loss rule that is substantially similar to the parol evidence rule.

B. The Products/Warranty Cases

One of the most prominent patterns in applying the contractual economic rule involves the seller of tangible goods, usually accompanied by express and implied warranties. If a good proves unreasonably dangerous—for example, a commercial vehicle explodes and injures the buyer—the seller will be strictly liable in tort for all physical harms caused by the good. But what if the vehicle simply fails to meet the buyer's reasonable expectations because it breaks down, causing lost profits? Since *Seely v. White Motor Co.*, courts have held that disappointed consumer expectations based upon a product's performance, where at most there is physical damage to the good itself, do not give rise to tort claims.[37]

The seller may of course be liable on the warranty for stand-alone economic harm caused by breach. But the terms of the warranty and the contract statute of limitations may bar many such claims. The prevailing view is that the seller is not liable in tort for the stand-alone economic harm but only under the terms of the contract. If, for any reason, the breach of warranty claim cannot be maintained, the plaintiff is out of court.[38] A limited exception is recognized. A negligence claim can be asserted for physical harms inflicted by the product on persons or on *other* property. But the negligence claim cannot be maintained for physical harm to the product itself.[39]

This products-liability application of the contractual economic loss rule potentially takes courts away from the core case. In *Wausau Tile, Inc. v. County Concrete Corp.*, the court first stated that the economic loss rule "protects the parties' freedom to allocate economic risk by contract," then went on to say that the rule encourages "the purchaser, which is the party best situated to assess the risk of economic loss to assume, allocate, or insure against that risk."[40] However, the effect of this "encouragement" would be to bar the purchaser from pursuing a negligence claim whether the contract *actually* addressed the damages in question or not. This would mean that if the parties are in a contractual relationship, then the negligence claim is always lost, irrespective of the parties' intent as shown by their contract. If the buyer contracts for liability, the core-case rule eliminates the tort claim; if he does not contract, he should have done so, and the court will automatically eliminate the negligence claim. Under the "encouragement" approach, freedom of contract in *Wausau*'s first rationale becomes its opposite in

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37. 403 P.2d 145 (Cal. 1965).

38. Courts that focus the application of the economic loss rule on the narrow case of products liability sometimes say that the purpose of the rule is to make the UCC remedies exclusive. *See, e.g.*, Allmand Assocs. Inc. v. Hercules Inc., 960 F. Supp. 1216, 1223 (E.D. Mich 1997). This cannot support application of the rule in cases involving enterprises bargaining with other enterprises on any of the many matters that do not involve the sale of tangible goods covered by the UCC. Consequently, rationales like this appear to represent indirect ways of understanding the parties' reasonable expectations. For example, the parties expect the UCC remedies to apply when they bargain for the sale and purchase of goods; but that does not speak to the parties' expectations when they bargain for something else or when their contract specifies limitations on rights or remedies.

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

40. 593 N.W.2d 445, 451 (Wis. 1999).

the second—a duty to contract, with loss of all claims if the buyer does not accept the court's encouragement.

In sum, the most obvious justification for the rule limiting the plaintiff to contract rights is that the rule often tracks the parties' reasonable expectations. However, courts often do not analyze the warranties or other contract provisions to discern the contract's implications and the parties' expectations in each case. They have instead created a rule of law for the products situation, automatically excluding tort claims if the parties are in a contractual relationship like that of seller and buyer of goods.[41] That appears to be at odds with a rationale based on honoring the contract.

C. Compelling Parties to Contract?

The rule of law approach, which abandons any effort to determine the contract's meaning and the expectations it reasonably generates, suggests that courts may not in fact be moved by a desire to honor the contract. Some expansions of the contractual economic loss rule suggest the same.

Recall that the contractual economic loss rule bars negligence claims even for physical damage to the product itself, but that it does not bar negligence claims for physical damage to persons or to other property. Physical damage to other property is not stand-alone economic loss; it is property damage and recovery is appropriate as it is with any other property damage. However, some courts have taken an extremely narrow view of what counts as "other property" and a correspondingly broad view of the economic loss rule.

Consider *Palmetto Linen Services, Inc. v. U.N.X., Inc.*[42] Palmetto operated a commercial laundry and supplied clean linens to hotels and restaurants. One of the defendants sold Palmetto a computerized system for injecting chemicals into the wash. The system malfunctioned and destroyed $200,000 worth of linens belonging to Palmetto. Palmetto sued the sellers and argued the other-property exception to the economic loss rule.[43] After all, linens were not the product sold to the plaintiff. Though the *Palmetto* court acknowledged the other-property exception, it rejected its application "in the context of a commercial transaction between sophisticated parties" where the type of injury that occurred "was or should have been reasonably contemplated by the parties to the contract" and where "the failure of the product to perform as expected will necessarily cause damage to other property, rendering the other property damage inseparable from the defect in the product itself."[44]

The court's reasoning is conceptual or mechanical: If the injury was foreseeable as a type of harm that would occur when the product was defective, then the other property harm is "inseparable" from the product itself. But perhaps

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41. Direct privity does not matter here. The plaintiff who purchases from a dealer may be limited to the contract/warranty recovery against the manufacturer, even though they are in no contractual relationship otherwise. *Seely*, 403 P.2d 145.

42. 205 F.3d 126 (4th Cir. 2000).

43. *Id.* at 129.

44. *Id.* at 129–30.

it boils down to saying that the buyer must always provide contractually not only for liability in the case of product defects, but also for all foreseeable harms from the defect. This lends support to the compulsory contracting interpretation of *Seely* and *Wausau Tile*.

D. Further Expansion of the Economic Loss Rule

Another expansion of the economic loss rule beyond the core case applies it to non-parties. Sometimes that seems realistic. The buyer-plaintiff may not be in direct privity with the manufacturer, but both parties have knowingly embraced the deal that carries the manufacturer's warranties, so the economic loss rule applies to invoke contract law to resolve the contract disputes.[45] In a different setting, but along the same lines, a subcontractor whose only contract is with the general contractor, may be bound by the terms of the general contractor's own contracts with the landowner, on the ground that all the entities in a construction project knowingly accept the network of contracts. Under this reasoning, the economic loss rule would apply to foreclose any tort claims by the subcontractor against the project engineer or landowner, limiting him to whatever rights he had under the contracts.[46] The economic loss rule has also been invoked to bar a landowner from recovery against a subcontractor who provided defective work or materials under a contract with the general contractor.[47]

At least if the rationale is to honor the contract, the contractual economic loss rule, by its own terms, deals only with persons who are in a consensual relationship—not necessarily a formal contract—that is expected to determine their responsibilities. Consequently, the contractual economic loss rule should not bar tort relief to strangers whose rights against the defendant do not arise out of a consensual arrangement that is expected to limit tort rights.[48] However, the weaker stranger economic loss rule, that one usually owes no duty to protect others from stand-alone economic loss, may still protect non-contracting defendants.[49]

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45. *Seely*, 403 P.2d 145.

46. BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66, 74 (Colo. 2004); *see also* Digicorp, Inc. v. Ameritech Corp., 662 N.W.2d 652 (Wis. 2003) ("[T]he economic loss doctrine generally precludes recovery in tort for solely economic losses, regardless of whether privity of contract exists between the parties.").

47. Corporex Dev. & Constr. Mgmt., Inc. v. Shook, Inc., 835 N.E.2d 701 (Ohio 2005).

48. This was the holding of *Indemnity Insurance Co. of North America v. American Aviation, Inc.*, 891 So. 2d 532 (Fla. 2004), except that even if the products-liability plaintiff is regarded as a stranger without a contractual relationship with the manufacturer, the economic loss rule continues to apply in products cases.

49. *See Corporex*, 835 N.E.2d 701 (under the economic loss rule, landowner could not recover against subcontractor for defective performance on the ground that if the subcontractor's contract had limited his damages, tort liability would defeat the hypothetical contract limitation).

E. Limitations to the Contractual Economic Loss Rule?: Application to Negligently Performed Services

Some courts have said that the contractual economic loss rule does not apply to contracts for services.[50] This means that the purchaser of services would always have a good claim for stand-alone harm done by negligent services. Yet this rule also seems to ignore the intent of the parties as expressed in the contract. Suppose a service contract in which the service provider expressly limits liability for defective services. If that limitation is valid, a rule that permitted a negligence suit would surely subvert the contract and the parties' reasonable expectations under it. Even if such a limitation is not express, some limits may be clearly enough implied to show the parties' intent to exclude tort actions. If we wish to honor the contract and respect the parties' autonomy, we will have to examine the contract's meaning just as we do in other contract cases; a blanket rule of law will not do. It is no surprise, then, that other courts have invoked the economic loss rule in service contracts to bar tort claims against negligent service providers as well as against product suppliers.[51]

But a blanket application of the economic loss rule to bar negligence claims in service contract cases can't be right either, even as a description of the cases. That is because the cases uphold negligence-based liability for lawyers.[52] If negligent conduct is a breach of a fiduciary's duty, we would expect liability on that theory too. So if we want to exclude service contracts generally, we have to find a basis for distinguishing the obligations of lawyers and other "professionals" against whom negligence claims remain viable.

And bases for subjecting lawyers and perhaps some other professionals to negligence liability do indeed exist. When you retain someone for the express purpose of being on your side, he cannot rightly contract to be your adversary instead or to be on your side but free to be negligent. This suggests that contract limits on lawyer liability for negligence would be inappropriate. That is not the whole story, because lawyers can limit the scope of their representation by contract, but it is enough to justify holding lawyers and fiduciaries liable in negligence and foreclosing any broad self-exculpatory contract.

That line of reasoning does not apply to all services, so you can say that while professionals may not readily limit their liability to clients by contract, other service providers might well be allowed to do so. Yet, for non-professional service

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50. *E.g.*, Ins. Co. of N. Am. v. Cease Elec. Inc., 688 N.W.2d 462 (Wis. 2004); Cargill, Inc. v. Boag Cold Storage Warehouse, Inc., 71 F.3d 545 (6th Cir. 1995) (turkey processor permitted to sue cold storage warehouseman who negligently allowed thawing, which necessitated costly recall; the economic loss rule did not bar because that rule is based on sales of goods).

51. *E.g.*, All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 867 (7th Cir. 1999) ("[W]e cannot think of a reason why the fact that the 'product' warranted was a hybrid of a product and a service should affect the application of the doctrine."); *BRW, Inc.*, 99 P.3d 66; Trans-Gulf Corp. v. Performance Aircraft Servs, Inc., 82 S.W.3d 691 (Tex. App. 2002).

52. *See* Collins v. Reynard, 607 N.E.2d 1185 (Ill. 1992); Clark v. Rowe, 701 N.E.2d 624 (Mass. 1998).

providers it would be more in line with contractual autonomy to ask what the parties actually provided, expressly or impliedly, rather than to determine by a rule of law that none of them can be liable for negligence.

III. PARTIES IN CONTRACTUAL OR OTHER RELATIONSHIPS: MISREPRESENTATION AND THE INDEPENDENT TORT CONCEPT

Misrepresentation to induce a contract involves parties in a special relationship, not strangers. Some cases have taken the view that the economic loss rule bars tort claims for innocent misrepresentation, but does not bar claims for intentional or negligent misrepresentation.[53] A number of other cases, however, have barred both the claims for innocent and negligent representations, leaving the plaintiff to recover, if at all, on the contract[54] or for a tortious injury that was independent of the contract.[55]

A. Scienter or Intentional Fraud and the Economic Loss Rule

1. The "Broad" Approach

A number of courts have said without qualification that intentional or scienter fraud is actionable when that fraud induces the plaintiff to enter the contract.[56] This view is sometimes called the "broad" approach, and it fits with the traditional perception that fraud vitiates the contract, including its clauses limiting liability,[57] on the ground that the plaintiff would not have entered into the contract with its limited contractual remedies had the plaintiff not been defrauded. It also

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53. *E.g.*, Keller v. A.O. Smith Harvestore Prods., Inc., 819 P.2d 69 (Colo. 1991) (relying upon cases of actual fraud); Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, (Ill. 1982); *see also BRW, Inc*., 99 P.3d 66.

54. *E.g.*, Duquesne Light Co. v. Westinghouse Elec. Corp., 66 F.3d 604 (3d Cir. 1995); Apollo Group, Inc. v. Avnet, Inc., 58 F.3d 477 (9th Cir. 1995); Fennell v. Green, 77 P.3d 339, 344 (Utah Ct. App. 2003) (where the parties were not in a contractual relationship, but perhaps explicable as a case of no duty under ordinary rules); Van Lare v. Vogt, Inc., 683 N.W.2d 46 (Wis. 2004); Richey v. Patrick, 904 P.2d 798 (Wyo. 1995); *cf.* Richmond Metro. Auth. v. McDevitt Street Bovis, Inc., 507 S.E.2d 344 (Va. 1998) (breach of contract and cover-up not actionable as tort, only as breach of contract).

55. *E.g.*, D.S.A., Inc. v. Hillsboro Ind. Sch. Dist., 973 S.W.2d 662 (Tex. 1998) (claim for negligent misrepresentation in inducing contract can be maintained only if plaintiff has an independent injury).

56. *E.g.*, *Moorman Mfg. Co.*, 435 N.E.2d at 452 (stating that the economic loss rule was applied to bar claims for innocent misrepresentation but not for fraudulent or negligent misrepresentation); Formosa Plastics Corp. v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41 (Tex. 1998). According to the Florida Supreme Court,

> Fraudulent inducement is an independent tort in that it requires proof of facts separate and distinct from the breach of contract. It normally "occurs prior to the contract and the standard of truthful representation placed upon the defendant is not derived from the contract," i.e., "whether the defendant was truthful during the formation of the contract is unrelated to the events giving rise to the breach of the contract."

HTP, Ltd. v. Lineas Aereas Costarricenses, S.A, 685 So. 2d 1238, 1239 (Fla. 1996) (citations omitted).

57. 2 DOBBS ON TORTS, *supra* note 2, § 482.

fits with the economic loss rule, which by its terms does not foreclose claims for intentional torts. It is also supported by the fact that accurate and reliable information about material facts is essential if commercial transactions are to go forward. If information supplied by the seller cannot be relied upon, expensive investigations or lengthy contractual negotiations will be required.[58] The prospect of such costs may eliminate some commercial transactions, while driving up the costs of others.

2. The "Narrow" Approaches

Other courts, however, foreclose tort claims against the defendant who fraudulently induces the contract by representations about the character and quality of the goods or services sold.[59] Put the other way around, no tort action for intentional fraud will lie under this rule unless the fraud is "independent of" or "extraneous to" the contract promises or warranties.[60]

For example, a seller might fraudulently induce the plaintiff to purchase the seller's paint by knowingly misrepresenting that the paint adheres to all industrial surfaces, including the buyer's stainless steel product. If the contract entered into on the basis of this representation promises or warrants adhesive qualities of the paint, then the fraud and the contract provisions are not independent. On the contrary, the fraudulent representations concern exactly the same matters as the "risk and responsibility" that were "expressly or impliedly dealt with in the contract."[61]

In contrast, if a manufacturer contracts to sell its product to a wholesaler for resale, representing that the manufacturer will not flood the market by direct sales to retailers, the misrepresentation claim is entirely independent of the contract itself, which dealt only with the purchase of specified goods, not with the marketing scheme involved in the misrepresentation.[62]

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58. *See* All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 867 (7th Cir. 1999); Kaloti Enters., Inc. v. Kellogg Sales Co., 699 N.W.2d 205, 220 (Wis. 2005) ("[P]arties need a background of truth and fair dealing in commercial relationships." (quoting *Van Lare*, 683 N.W.2d at 53)).

59. *See* Tietsworth v. Harley-Davidson, Inc., 677 N.W.2d 233 (Wis. 2004).

60. *See* Werwinski v. Ford Motor Co., 286 F.3d 661 (3d Cir. 2002); Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 223 F.3d 873 (8th Cir. 1999); Robinson Helicopter Co., Inc., v. Dana Corp., 102 P.3d 268 (Cal. 2004); Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532 (Fla. 2004). The idea may be expressed in slightly different terms, so some authority says that the tort action is permitted for "fraud extraneous to the contract" but not for "fraud interwoven with the breach of contract." Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541, 545 (Mich. 1995). In *BRW, Inc. v. Dufficy & Sons, Inc.*, 99 P.3d 66, 74 (Colo. 2004), the court considered three factors: (1) whether the tort relief sought is the same as the contractual relief; (2) whether there is common law duty of care apart from the contract terms; and (3) whether the tort duty differs in any way from the contractual duty.

61. *See Marvin Lumber*, 223 F.3d 873.

62. *Kaloti*, 699 N.W.2d 205. Although illustrative of the "narrow" approach, *Kaloti* actually appears to subscribe to a rationale that respects the parties' actual agreements and expectations.

In providing that the plaintiff can sue only on the contract, the economic loss rule does not imply that the plaintiff will prevail on that claim. Even if the contract provides no warranty or promise that will support the plaintiff's claim, the very absence of a warranty suggests that the risk of economic loss may have been placed upon the plaintiff, who could be expected to demand protection if protection was indeed part of the deal. And if there is a warranty, but it limits recovery to the cost of repair, to apply the economic loss rule is to say that the warranty limitations reflect an allocation of risks that binds the plaintiff and limits the economic loss claim.[63] The cases do not merely limit the tort remedy to match the limits imposed by the contract. Instead, they treat the action as wholly one in contract and subject to the whole set of legal rules governing contract. So the plaintiff, having no tort action, is out of court if the contract statute of limitations has run.[64] By the same token, the claim for punitive damages that might have been supportable on grounds of fraud will be barred by the rule that punitive damages are not generally recoverable in contract.[65]

As broad as these holdings are, they are largely consistent with a view that applies the parol evidence rule to exclude evidence of fraud where the written contract deals with the same matter.[66] So far as the parties have implicitly or explicitly agreed that contract shall control the resolution of a particular risk or default, the economic loss rule is also consistent with the strong rationale that honors the parties' reasonable expectations under the contract.

B. Applications: When the Harm from Tort and Contract Breach Are Different

If the plaintiff asserts damages not materially different from the values guaranteed by the contract, a focus on damage, relief, or harms suggests that the only claim available should be in contract. The same focus would mean that if the plaintiff asserts compensatory damages caused by fraud and those damages are distinct from the values exchanged by contract, there is at least room for a claim based on intentional misrepresentation, if one has in fact been made.

In line with this distinction, the court in *Grynberg v. Questar Pipeline Co.*[67] limited the plaintiff to a contract claim where the defendant-buyer's alleged

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63. *See* N.Y. State Elec. & Gas Corp. v. Westinghouse Elec. Corp., 564 A.2d 919 (Pa. Super. 1989)

64. *See Marvin Lumber*, 223 F.3d 873; Grynberg v. Questar Pipeline Co., 70 P.3d 1 (Utah 2003).

65. *See* Richard Swaebe, Inc. v. Sears World Trade, Inc., 639 So. 2d 1120 (Fla. Dist. Ct. App. 1994) (barring punitive damages under the economic loss rule); *see* Tietsworth v. Harley-Davidson, Inc., 677 N.W.2d 233 (Wis. 2004) (recognizing that punitive damages would be unrecoverable where economic loss rule eliminated tort claim). Conversely, if the economic loss rule does not apply and the plaintiff can make out a tort claim, punitive damages are recoverable if evidence otherwise shows a basis for such damages. *See Robinson*, 102 P.3d 268. Finally, Judge Posner argues that in some instances we should really ask whether it makes sense to allow punitive damages in contract rather than try to force a claim into tort. *See* Posner, *supra* note 2, at 745–47.

66. *See* Pinnacle Peak Developers v. TRW Inv. Corp., 631 P.2d 540 (Ariz. Ct. App. 1980); 2 DOBBS ON TORTS, *supra* note 2, § 482.

67. *Grynberg*, 70 P.3d 1.

fraud was that it misrepresented the quality of the product it received under the contract and hence paid the plaintiff-seller too little. The damages for underpayment sought in the tort claim for intentional fraud were the same that would have been covered by a breach of contract claim, had the contract statute of limitations not run, so rejecting the tort claim did in fact honor the contract and the attendant legal rules.

The other side of the coin can be seen in *Robinson Helicopter Co., Inc., v. Dana Corp*.[68] This also involved a misrepresentation in performance rather than in inducement of the contract, but the misrepresentation caused a type of harm that was almost certainly a type not guaranteed by the contract provisions. The defendant sold the plaintiff special helicopter clutches to specification that had to meet government standards. Without notifying the plaintiff, the defendant changed the clutches. In fact, the defendant gave false certificates of compliance with the specifications. Had the plaintiff discovered the defect and refused to accept the clutches and then sued for production loss, the contract terms would almost certainly control. But that is not what happened. Instead, the plaintiff, knowing nothing of the defect, used the clutches in helicopters it made and sold to others. Customers complained and the government required the plaintiff to replace all the clutches—at great cost. These are the costs the plaintiff sued to recover on an intentional fraud theory, adding a claim for punitive damages. The California Supreme Court approved the plaintiff's claims in tort, including the punitive damages claim, saying that the defendant's conduct was separate and independent from the breach.[69]

C. Application: The Economic Loss Rule to Protect Scienter Fraud

Where the parties have *not* agreed to subject a given risk or dispute to the contract's terms, to apply the economic loss rule is not to honor the contract but rather to impose a contract limitation where none was intended by the parties. It may be difficult to discover the line between honoring the parties' expectations and ignoring them.

In *Digicorp, Inc. v. Ameritech Corp.*,[70] plaintiff Digicorp contracted as an authorized dealer for Ameritech to sell Ameritech's calling services through the

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68. *Robinson*, 102 P.3d 268.

69. At least part of the reason for finding the conduct "independent" seems to have been that the kind of damages suffered would be consequential damages rather than damages based on the difference between the value of the clutches as sold and as promised. "But for [the defendant's] affirmative misrepresentations by supplying the false certificates of conformance, [the plaintiff] would not have accepted delivery and used the nonconforming clutches over the course of several years, nor would it have incurred the cost of investigating the cause of the faulty clutches." *Id.* at 274.

70. 662 N.W.2d 652 (Wis. 2003). The court also held that the economic loss doctrine barred fraud claims of third persons in the chain of distribution, including the plaintiff's subcontractor. Distinguish such cases as *Tietsworth*, 677 N.W.2d 233, where the plaintiff allegedly received goods worth less than they would be worth if the seller's representations had been true. In a case like that, the purchaser might be barred from the fraud claim but still recover for breach of warranty, since the economic loss doctrine does not bar contract claims.

plaintiff's subcontractor, Bacher. The contract provided that Ameritech could terminate the contract with Digicorp if employees of Bacher, the plaintiff's subcontractor, forged customer signatures. A Bacher employee named Krinsky did forge hundreds of customer names to contracts. When Ameritech discovered the forgery, it exercised its contract right to terminate Digicorp's contract. That termination had the secondary effect of removing the subcontractor, Bacher, from the picture as well. Bacher and Digicorp then claimed that Ameritech had fraudulently induced the contract (including the termination clause). The fraudulent inducement claim was based on the assertion that Ameritech knew before signing the contract that Krinsky had in the past forged hundreds of customer signatures on accounts for calling Ameritech's service. The jury apparently found that Ameritech fraudulently represented that it had no such knowledge and awarded punitive damages.[71] In this state of affairs, it does not look as if the right-to-terminate clause would be understood by the parties as overriding previous representations. Nevertheless, the court said that since the alleged fraud dealt with the same risks and responsibilities that were also dealt with by the contract's termination provision, the economic loss rule applied to bar any tort claim by Digicorp or Bacher.[72]

Digicorp appears to be a far broader application of the economic loss rule than encountered in those economic loss cases that seem to mimic the effects of a balanced application of the parol evidence rule. Put differently, in other cases applying the economic loss rule to protect fraud, it looks as if the plaintiff must have waived the fraud claim by the act of approving contract limitations; but in *Digicorp,* it would seem that the later contract limitation was itself secured by the initial fraud. To apply the economic loss rule in that situation is a far more radical move than to apply it where the plaintiff is necessarily on notice that the issue is to be governed solely by contract.

D. Final Thoughts: Fraud and the Economic Loss Rule

Fraud—scienter or intentional misrepresentation—is an economic tort primarily invoked in bargaining transactions,[73] and has been recognized for centuries as a ground for recovery. To the extent that the economic loss rule forecloses a tort claim for scienter fraud, it seems to radically change the law as it

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71. The evidence recited by the court to support this apparent finding is sketchy. However, the court's decision seems to rest on the provisional assumption that Ameritech was in fact fraudulent.

72. *Digicorp*, however, is clouded by divisions on the court. In *Cerabio LLC v. Wright Medical Technology, Inc.*, 410 F.3d 981, 989 (7th Cir. 2005), the result of the division was described this way:

> [A] majority (three) of the justices overruled the broad exception . . . , but a separate, but different[,] three-member majority rejected the narrow *Huron Tool* exception. The most we can discern from *Digicorp,* therefore, is that the fraud in the inducement exception to the economic loss doctrine is more narrow than [provided by the broad exception] and that it does not apply when the fraud pertains to the character and quality of the goods that are the subject matter of the contract.

73. *See* 2 DOBBS ON TORTS, *supra* note 2, § 469.

has been traditionally applied for a very long time. And perhaps not only the law of fraud but also the law of mistake, because innocent mutual and basic mistakes, whether generated by misrepresentation or not, would have traditionally warranted rescission[74] and in contemporary law would warrant damages that are more or less equivalent to the costs of rescission.[75] A comprehensive accommodation of these long legal traditions might well counsel an economic loss rule that looks very much like the parol evidence rule and asks whether the later, formal contract explicitly or implicitly spells out the risk allocations in the particular case—a rule that requires some adjudication of the facts rather than a blanket answer for all cases.

CONCLUSION

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.

For two reasons, the law might gain in clarity and coherence if we place emphasis less on the economic loss rules and more on the important underlying purposes and policies. First, the policies that support denial of the stand-alone economic claim do not apply uniformly to all economic loss cases. Application of those policies requires adjudication in the actual cases, not a blanket rule. Second, as courts elaborate the rules and qualifications, it is all too easy to lose sight of the important points of policy and justice. For example, as between contracting parties, respect for the parties' reasonable expectations under their agreement surely should be central, and that respect may require interpretation of the contract, not merely a rule of law in all cases. In the case of non-contracting parties, courts should be concerned in some instances to impose pragmatic limits on liability or to channel the case into other torts for more appropriate analysis, but neither concern always applies, as it may not, for instance, in the case of transferred loss or in the case of the defendant who profits from his own negligence.

"More reason, less rule" lacks lawyerly analysis, but it might do as a bumper sticker for the economic loss cases. If we reject that proposition, we may need to reverse it to say we need, not one or two economic loss rules, but many rules and qualifications to account for and deal properly with the differences in policy and facts in the cases.

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74. *See id.* § 473.
75. *See id.* § 483.