THE ECONOMIC LOSS RULE AND PRIVATE ORDERING

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My objective in this Article is to provide some perspective on the economic loss rule, the proper statement of which has figured prominently in debates about the proposed Restatement on economic torts.[1] Part I describes the varieties of the economic loss rule and the Article's focus on the rule's application to third-party cases. Part II summarizes the history of liability for third-party economic loss. Part III describes the conceptual underpinnings of the rule, its application in third-party cases, and its treatment in the proposed Restatement. Part IV criticizes the private ordering claim underlying the rule, particularly in light of recent changes in contract law. Part V situates the debates about the rule in the unmaking of neoclassical law and contemporary political changes. Part VI concludes with a warning about the historical significance of the adoption of elements of the rule in the Restatement.

I. THE ECONOMIC LOSS RULE IN GENERAL

The most general statement of the economic loss rule is that a person who suffers only pecuniary loss through the failure of another person to exercise reasonable care[2] has no tort cause of action against that person. Because the rule applies to a diverse range of situations, there is not one economic loss rule, but several.

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1. The Restatement is part of the American Law Institute's third effort to restate the law of torts and has been denominated the *Restatement (Third) of Torts: Liability for Economic Loss* in Preliminary Draft No. 1 (2005) and the *Restatement (Third) of Torts: Economic Torts and Related Wrongs* in Preliminary Draft No. 2 (2006).

2. The rule also applies to harm caused by actions that would otherwise be tortious under rules of strict liability, notably products liability, but my discussion is confined to negligence cases.

First, there are the applications of the rule that are closest to traditional tort cases. In these cases, a person suffers economic harm either as a result of physical injury to another person or as a result of negligent conduct that merely threatens physical harm.

Second, there are the two-party cases, in which one party to a contract suffers economic harm because of the negligent performance of the contract by its contracting partner. A commonly litigated instance of the two-party cases—which may involve products liability law as well as breach of contract—is product-related economic loss, in which the breach of contract is due to a defective product.

Third, there are the three-party cases, in which a person is injured by negligent performance of a contract to which he is not a party.[3] In some cases, the third party has no contractual relationship with either of the contracting parties. The expectant beneficiary injured by the negligent drafting of a will, illustrates. In other cases, the third party has a contractual relationship with the non-negligent contracting party. Examples include a home buyer who suffers because of the defective termite inspection commissioned by the seller, or a contractor injured due to the negligence of the owner's architect. In this Article, I focus on these three-party cases.

The economic loss rule as applied in these cases states that the third party has a remedy only in contract law, not in tort law. Each of these cases originates in a contract entered into by the defendant and its contracting partner. The defendant and its partner have allocated the risks and benefits of performance in their contract, and the court upsets that allocation when it imposes liability on the defendant. Imposing such liability outside the contract is unfair to the defendant, who has ordered its affairs on the expectations created in the contract, and undermines the process of contracting. Although there are other justifications for the rule, the argument about private ordering is primary.

The logic of private ordering is, of course, the logic of contract law: individuals are the best judges of their own interests; individuals maximize those interests through contracts; the expectation and reliance interests created by contracts deserve protection; promoting private contracting produces a social benefit; contract law provides the framework through which the individual and social benefits are realized in practice. In economic loss cases, private ordering is advanced when courts recognize contract law as the primary structure for regulating relationships. Applying tort law, on the other hand, could upset the parties' private ordering. As a result, recovery is allowed only within the bounds of contract law; in particular, recovery by a third party is allowed only if the third party is able to establish that it is a third party beneficiary of the defendant's contract according to traditional contract law principles (or that it otherwise has a claim under the contracts that fulfills the parties' private ordering). Thus, the third party's non-contract cause of action, if any, must be recast within the contract framework.

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3. *See generally* JAY M. FEINMAN, PROFESSIONAL LIABILITY TO THIRD PARTIES (2d ed. 2006).

II. HISTORICAL BACKGROUND: THIRD-PARTY ECONOMIC LOSS

Until the 1950s, limiting doctrines such as privity and restrictive liability rules in misrepresentation and negligence made it virtually impossible for a third party to recover for negligently-inflicted economic loss.[4] The economic loss rule was not formally stated in this era only because it was not needed; the absence of general principles of liability for negligence precluded recovery.

During this period, leading three-party cases conclusively established the principle of non-liability. The United States Supreme Court's 1879 decision in *Savings Bank v. Ward* cited *Winterbottom v. Wright*[5] as justification for avoiding the "absurd consequences" of indeterminate liability that would ensue if a third-party action were allowed.[6] Accordingly, *Savings Bank* established the bar of privity in economic loss cases.[7] Over time, of course, courts reduced the effect of the privity rule in personal injury cases, particularly those involving manufactured products. In *Ultramares Corp. v. Touche*, Cardozo recognized that "[t]he assault upon the citadel of privity is proceeding in these days apace"[8] but refused to extend the foreseeability principle of *MacPherson v. Buick Motor Co.*[9] to economic losses caused by an accountant's neglect.[10] The central concern was indeterminate liability,[11] particularly in misrepresentation cases which concerned "the explosive power resident in words."[12]

The limited liability approach epitomized in *Ultramares Corp. v. Touche* reigned virtually unchallenged until the late 1950s. Beginning in the 1950s and accelerating from the 1960s through the 1980s, a tort-based, relational argument put pressure on the traditional doctrines and liability increased, although the increase of liability was not uniform. The sources of the challenges lay in general movements in tort and contract law, the most noteworthy of which was the rise of a general concept of negligence. In third-party cases, this development was driven to a large extent by the use of a new standard for determining whether a duty to exercise reasonable care exists on a particular set of facts—the balance of factors test—and an expanded doctrine of negligent misrepresentation.

The balance of factors test was formulated in *Biakanja v. Irving*, in which the would-be beneficiary of a will failed to receive the property which had been devised to her because of improper attestation under the supervision of the defendant notary public.[13] Under the logic of *Biakanja*,

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4. *Id.* ch. 2.
5. (1842) 152 Eng. Rep. 402 (Exch.).
6. Sav. Bank v. Ward, 100 U.S. 195, 203 (1879).
7. *Id.* at 200.
8. 174 N.E. 441, 445 (N.Y. 1931).
9. 111 N.E. 1050 (N.Y. 1916).
10. *Ultramares*, 174 N.E. at 448.
11. "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." *Id.* at 444.
12. *Id.* at 445.
13. 320 P.2d 16 (Cal. 1958).

> [t]he determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.[14]

Following *Biakanja*, the California Supreme Court applied the test in a series of cases involving negligence actions against lawyers by nonclients.[15] Those cases firmly established that although a third-party beneficiary action was also available, liability under the balance of factors test lay primarily in tort. The use of the test in this way was followed in many jurisdictions. The test also became widely adopted as a useful approach to other types of third-party economic loss cases, including actions against design professionals by nonprivity participants in the construction process, actions against accountants by the users of audit reports, and actions against real estate brokers for nondisclosure, among others.[16]

In the early 1960s, a growing body of scholarship challenged the application of the *Ultramares* rule in negligent misrepresentation cases, the Restatement (Second) of Torts section 552 was drafted, and several important decisions allowed actions for negligent misrepresentation in various types of situations.[17] Section 552 extended liability to professionals who negligently supplied information to known or intended recipients of the information. The Reporter's Note states that the rewording of the section was "to clarify [its] meaning,"[18] but the debate in the American Law Institute suggests it was intended to expand liability beyond the *Ultramares* rule,[19] and courts picked up on the suggestion to expand liability.[20]

Since the mid-1960s and accelerating in the last decade, those liability-expanding doctrines have come under attack from a strengthened emphasis on private ordering, leading to the formal statement and widespread expansion of the economic loss rule and a concomitant limitation of liability to injured third parties. Part of the attack has taken the form of specific doctrinal developments. For example, the *Ultramares* principle was reformulated as the near privity doctrine of

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14. *Id*. at 19.

15. *E.g.*, Goodman v. Kennedy, 556 P.2d 737 (Cal. 1976); Heyer v. Flaig, 449 P.2d 161 (Cal. 1969); Lucas v. Hamm, 364 P.2d 685 (Cal. 1961).

16. FEINMAN, supra note 3, § 2.3.

17. *E.g.*, M. Miller Co. v. Dames & Moore, 18 Cal. Rptr. 13 (Dist. Ct. App. 1962); Texas Tunneling Co. v. City of Chattanooga, 204 F. Supp. 821 (E.D. Tenn. 1962), *rev'd in part*, 329 F.2d 402 (6th Cir. 1964).

18. RESTATEMENT (SECOND) OF TORTS §552 reporter's note (1977).

19. *Continuation of Discussions of the Restatement of the Law, Second, Torts*, A.L.I. PROC. 384–86 (1965).

20. *See, e.g.*, Rusch Factors, Inc. v. Levin, 284 F. Supp. 85 (D.R.I. 1968); Rozny v. Marnul, 250 N.E.2d 656 (Ill. 1969).

Credit Alliance Corp. v. Arthur Andersen & Co.[21] and adopted by legislation in some states.[22] But the more important part of the attack has been a resurgent belief in the possibility and desirability of private ordering and the associated resurgence of contract law as trumping tort law.

III. THE ECONOMIC LOSS RULE, PRIVATE ORDERING, AND THE CONTRACT–TORT BOUNDARY

As expressed in the case law and the literature, the principal explanation for the rise of the economic loss rule and the related attempt to limit liability to third parties is a preference for private ordering over public regulation.[23] Social welfare is maximized, so the argument goes, when private parties are free to allocate risks and benefits among themselves, rather than when the state, particularly through its courts, allocates risks and benefits by imposing liability. More particularly, this shift represents a belief that there is a meaningful distinction between contract law and tort law, and that in cases of potential overlap, contract law is a superior system for regulating behavior and achieving socially optimal results.

A. Border Wars

A classic illustration is an article in which William Powers, Jr. discusses the larger "border wars" between contract law and tort law.[24] Powers first defines the "basic paradigms" of private law, each of which has a "prime directive" or central organizing principle:

> The tort or negligence paradigm reflects the basic norm that people should act reasonably under the circumstances. If people do not act reasonably, this norm demands that they should then compensate those whom they foreseeably injure. . . .
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> . . . [T]he property paradigm gives individuals entitlements to do as they please with their own property. . . .

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21. 483 N.E.2d 110, 118–19 (N.Y. 1985).

22. *E.g.*, KAN. STAT. ANN. § 1-402 (2005); LA. REV. STAT. ANN. § 37:91 (2000); N.J. STAT. ANN. § 2A:53A-25 (West 2006); WYO. STAT. ANN. § 33-3-201 (2006).

23. Other elements of the rationale for the economic loss rule include avoiding indeterminate liability, the difficulty in measuring fault, causation, and damages, the adequacy of other remedies in providing deterrence, and preserving the defendant's assets for the most deserving victims. *See, e.g.*, RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8 cmt. b (Preliminary Draft No. 2, 2006).

24. William Powers, Jr., *Border Wars*, 72 TEX. L. REV. 1209 (1994). Other participants in the *Texas Law Review* symposium shared Powers's conception of a contract-based structure. *See* Dennis Patterson, *Good Faith in Tort and Contract Law: A Comment*, 72 TEX. L. REV. 1291, 1292 (1994) ("Relative to contract law, tort is a 'gap-filler'—and one of a special, limited sort. Put simply, tort law should never subordinate consent, and making breach of the duty of good faith actionable in tort would do just that."); Robert H. Jerry II, *The Wrong Side of the Mountain: A Comment on Bad Faith's Unnatural History*, 72 TEX. L. REV. 1317, 1342 (1994) ("Because I agree with Professor Powers that tort law is not a co-equal paradigm with contract law, I conclude that tort law has infringed upon contract law's rightful territory.").

> The contract paradigm expresses the basic norm that individuals should be able to agree between and among themselves how to allocate resources. Contract law does not itself give entitlements or independently evaluate the reasonableness of each party's conduct; instead, it establishes a structure within which individuals can voluntarily bargain and reach their own agreements.[25]

Each paradigm assigns authority for development of the content of the law to a different institution. The contract and property paradigms assign responsibility to individuals through actions in the private market. Tort, on the other hand, assigns power to courts and juries. When the paradigms potentially overlap, conflicts between them can be resolved by a resort to their purposes, which are reflected in the structure of the common law:

> In fact, an examination of this Balkanized structure [of the three subjects] reveals that the paradigms of the different bodies of law are not really coequal. The negligence paradigm takes a back seat.
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> As we have seen, contract law embodies the ideology of autonomy and consent and assigns decisionmaking power to markets. Sometimes, however, the predicates for the application of contract law are not present, for example, when disputes arise between noncontracting strangers or when a party to a contract is mentally incompetent. Thus, we do not need to refer either to another body of law—such as tort law—or to some extradoctrinal normative system in order to keep contract law from devouring the entire legal world. Contract law, along with its accompanying prime directive of agreement and consent, sets its own limits. Tort law waits in the background to step in and resolve the disputes that occur when no contractual relationship is present. In other words, tort law fills in when, due to contract law's own rules about its applicability, we do not have the option of using contract law.[26]

B. The Restatement and Private Ordering in General

The proposed Restatement is still in its early stages and so has not adopted a definitive position on the economic loss rule. The Reporter's first draft included a capacious economic loss rule with a baseline of non-liability for economic torts, subject to specific exceptions.[27] Following discussion with the advisors and consultants, the Reporter[28] prepared a less ambitious statement of the

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25. Powers, *supra* note 24, at 1210–11 (footnote call number omitted). Powers also defines paradigms in property law and criminal law or legislative and administrative regulation. *Id.* at 1211–12.

26. *Id*. at 1224–25 (footnote call numbers omitted).

27. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 8 (Preliminary Draft No. 1, 2005).

28. Professor Mark Gergen of the University of Texas School of Law. For Professor Gergen's earlier views on overlaps among bodies of law, see Mark P. Gergen, *Tortious Interference: How It Is Engulfing Commercial Law, Why This Is Not Entirely Bad, and a Prudential Response,* 38 ARIZ. L. REV. 1175, 1218–30 (1996).

rule in the second draft, stating the rule as a truism: Liability for solely pecuniary harm could not be based on the rules stated in the Restatements governing physical harm but would be determined by the principles of the Economic Torts Restatement.[29] The spirit of the broader economic loss rule hovers over the current draft, however, with frequent references, in black letter and comments, to the normative priority of private ordering principles over public regulation and of contract law over tort law.

The draft Restatement's most general principle of liability for negligently inflicted economic loss, in section 9(2), states that an actor owes a duty of care when the actor "appears to invite another to rely on the actor to render a service or supply information."[30] The "appears to invite" concept mediates between the rules of tort liability for physical harm and the rules of contract liability. It is narrower than the tort rules, under which a duty of reasonable care arises "when an actor's conduct increases the risk of physical harm."[31] The Reporter gives the example of a parent who watches a street crossing to enable his child to go to school safely.[32] Other parents may come to rely on his watchfulness, creating a duty of reasonable care to prevent physical harm to their children, but the parent has not invited their reliance and so would not be liable for economic harm.[33] The concept is also related to contract principles, particularly promissory estoppel. "[O]ne way for an actor to manifest an intention to invite another to rely on the actor to perform a task is to make a promise."[34] Section 9(2) is broader than the contract doctrine, however, in that it does not require a promise for liability, only an invitation.

In a number of circumstances, the general principle of section 9(2) is explicitly subordinated to private ordering. First, the principle does not apply if an actor "effectively disclaims liability."[35] Second, when the invitation to rely comes in the course of performing a contract governed by an integrated document, the parol evidence rule trumps what might otherwise be a duty of care.[36] Third, there is no duty of care when "the actor's obligation to the plaintiff is resolved by another body of law,"[37] which includes contract law. "Resolved by" apparently does not mean "provides a remedy for," but rather "addresses the issue," which would result in no liability in many cases. Fourth, "a tort action usually is unnecessary" when "the plaintiff could obtain redress for the harm by contract from the actor or an intermediate party."[38] "Imposing liability in these circumstances would undermine

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29. RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8 (Preliminary Draft No. 2, 2006). The draft also expressly, if redundantly, authorizes courts to impose liability in situations in which the black letter of the Restatement itself would not. *Id.* § 9(4).

30. *Id.* § 9(2).

31. *Id.* § 9 cmt. b.

32. *Id.*

33. *Id.*

34. *Id*.

35. *Id.* § 9(2).

36. *Id.* § 9 cmt. b.

37. *Id.* § 9(3)(b).

38. *Id.* § 9(3)(c), 9(3)(c)(i).

an agreed allocation of risk" and would fail to "preserve[] the priority of contract law."[39]

C. Third Party Cases and Private Ordering

The more specific application of these principles in the third party cases demonstrates the same deference to private ordering. The position of Preliminary Draft No. 1 was extreme: A person is liable only if "the actor . . . knowingly invites the plaintiff to rely."[40] Section 13 of Preliminary Draft No. 2 states two principles for establishing a duty of care. The first principle, which is less restrictive than that of the previous draft, is that "an actor owes a duty of care to the other when the actor or the third person (with the actor's apparent acquiescence) appears to invite the other to rely on the actor to render a service, the other does so rely, and the actor is aware of the other's reliance."[41] As with section 9(2), this rule is narrower than tort law and resembles promissory estoppel. It likewise is preempted by a contract between the actor and the other or the actor and a third person.[42] The second principle is that an actor owes a duty of care "when the actor knows or should know [that] a primary objective of the undertaking is to benefit the other, imposing a duty of care to the other is in the interest of the third person, and the third person cannot redress the actor's negligence or the resulting harm without an undue burden."[43] As the comment notes, this is "similar to the contract doctrine of third party beneficiary."[44]

Consider as a specific example of the consequences of this approach what the Restatement describes as cases in which the defendant has harmed the plaintiff by "negligently supplying a third person with misinformation that induces the third person to act in a manner harmful to the plaintiff."[45] Here the Restatement points out that there is no basis for liability in either traditional negligent misrepresentation or under section 13(2) because the plaintiff has not relied on the statement, nor should there be liability otherwise because it does not fit the contractual paradigm of liability in section 13(3).[46]

The Restatement's illustration involves a case in which a drug testing laboratory inaccurately reports a positive result to an employer about an

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39. *Id.* § 9 cmt. e(i).

40. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. LOSS § 11(1)(a) (Preliminary Draft No. 1, 2005).

41. RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 13(2) (Preliminary Draft No. 2, 2006). Section 13 concerns liability for rendering a service; sections 11 and 12 address the related issue of liability for negligent misstatement.

42. *Id.* § 13(2)(a)–(b).

43. *Id.* § 13(3).

44. *Id.* § 13 cmt. a. Section 11(1)(b) of Preliminary Draft No. 1 stated a similar requirement, except that it only provided for liability where the actor had actual knowledge, not reason to know.

45. RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 13 cmt. f (Preliminary Draft No. 2, 2006).

46. *Id.*

employee.[47] The Restatement's basis for rejecting the claim is that there is no contract or contract-like obligation, and that is the only source of obligation here. Because the laboratory has not invited the employee to rely and because the testing is for the primary benefit of the employer, not the employee, there is no liability.[48]

The difficulty with this approach is that third party beneficiary law and its analogue in section 13(3) are intent-focused, but intent is not the whole story. Fundamental tort policies are implicated as well: compensating victims of harm; deterring wrongful conduct and providing incentives for reasonable conduct; placing losses on those who can best bear or distribute them; and fairness, under which is included redressing harm caused to innocent parties and imposing the burden of harm on the parties responsible for it. Because there is no personal injury or property damage, the tort policies may be weaker. Still, they are not absent from the analysis, as the economic loss rule (and to a lesser extent the Restatement) would have it. Indeed, these are not exclusively tort policies. At least since the legal realist revolution, contract law has been recognized to have a regulatory function beyond the simple enforcement of private bargains. Its core principle, the protection of reasonable expectations, entails a concept of reasonableness similar to the principle of reasonable care at the core of negligence law.

In the drug testing cases, the courts recognize this point better than does the Restatement. The courts are split on the resolution of claims against drug testing laboratories, but even courts that do not find liability generally recognize that tort rather than contract provides the better means of analysis.

In an early case, *Elliott v. Laboratory Specialists, Inc.*, the Louisiana Court of Appeals recognized the reasonableness of imposing a duty on a drug testing laboratory:

> To suggest that [the laboratory] does not owe [plaintiff] a duty to analyze his body fluid in a scientifically reasonable manner is an abuse of fundamental fairness and justice. . . . The risk of harm in our society to an individual because of a false-positive drug test is so significant that any individual wrongfully accused of drug usage by his employer is within the scope of protection under the law.[49]

In *Elliott*, the plaintiff-employee was released from his employment after the drug testing laboratory reported that plaintiff's urine sample tested positive for

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47. *Id.* § 13 illus. 21. *See generally* Amy Newnam & Jay M. Feinman, *Liability of a Laboratory for Negligent Employment or Pre-employment Drug Testing*, 30 RUTGERS L.J. 473 (1999).

48. Illustration 21 suggests that in the drug testing case, liability may be found on the basis of defamation. RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 13 illus. 21 (Preliminary Draft No. 2, 2006). But that hardly concludes the matter; it first depends on the jurisdiction adopting negligence as the standard for defamation (which many do), and it would not take care of a similar case in which a laboratory negligently reported that a health care employee had an infectious disease, for example.

49. 588 So. 2d 175, 176 (La. Ct. App. 1991).

THC, the active ingredient in marijuana.[50] Expert testimony at the trial showed that the laboratory's testing procedures were not "scientifically defensible, ethical, or proper," and that the chain of custody form was inadequate.[51] The appellate court affirmed the trial court judgment holding the laboratory liable for negligently testing plaintiff's sample, noting that the "issue of whether a duty is owed is largely based on the interaction between parties in society and the seriousness of certain consequences should sub-standard conduct occur."[52]

The Illinois Court of Appeals agreed with this reasoning in *Stinson v. Physicians Immediate Care, Ltd.*, stating: "There is a close relationship between a plaintiff and a defendant which [has] a contract with the plaintiff's employer if it is reasonably foreseeable that the plaintiff will be harmed if the defendant negligently reports test results to the employer."[53] The plaintiff alleged in his complaint that the defendant had breached a duty to act with care in collecting and handling the sample and in reporting the results of the test.[54] The appellate court reviewed the decisions of the Louisiana courts and agreed that the harm to the employee was foreseeable and that the laboratory owed the employee a duty to exercise reasonable care:

> Here, the injury, that the plaintiff would be terminated from his employment, is not only foreseeable, but also is a virtual certainty in the event of a positive drug test result. In addition, the likelihood of injury is great; the plaintiff allegedly lost his job and was hindered in his efforts to find other employment because of the false positive drug test report. The first two factors favor imposing a duty.[55]

The court then noted that public policy requires the imposition of a duty on the drug testing laboratory:

> The drug-testing laboratory is in the best position to guard against the injury, as it is solely responsible for the performance of the testing and the quality control procedures. In addition, the laboratory, which is paid to perform the tests, is better able to bear the burden financially than the individual wrongly maligned by a false positive report.[56]

Even courts that limit liability do so through a tort lens. In *SmithKline Beecham Corp. v. Doe*, the Supreme Court of Texas rejected the plaintiff's claims that (1) a laboratory has a duty to warn an employee that ingestion of certain substances (in this case poppy seeds) may cause a false positive and that (2) the laboratory has a duty to inquire whether an employee has ingested such substances.[57] When the employee tested positive for opiates during a pre-employment drug screen, she asserted that eating poppy seed muffins caused the

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50. *Id.* at 175.
51. *Id*. at 176.
52. *Id*.
53. 646 N.E.2d 930, 933 (Ill. App. Ct. 1995).
54. *Id.* at 931.
55. *Id*.
56. *Id*. at 934.
57. 903 S.W.2d 347, 351–52 (Tex. 1995).

result and that the laboratory was obligated to inform her of this possibility before performing the test.[58] The employee raised only a claim of failure to inform and did not allege negligent performance by the laboratory.[59] The court noted that no court of last resort has ruled on the duty to warn, and therefore it would rely upon general tort principles and upon a duty-risk balancing test.[60] This balancing test incorporated "the risk, foreseeability, and likelihood of injury weighed against the social utility of the actor's conduct, the magnitude of the burden of guarding against the injury, and the consequences of placing the burden on the defendant."[61]

IV. PRIVATE ORDERING AND THE LIMITS OF CONTRACT LAW

The private ordering claim that underlies the economic loss rule and resonates through the Restatement initially rests on empirical assumptions: that parties generally specify performance terms and allocate risks during the contracting process and that they observe the fruits of their planning during performance, rather than departing from the requirements of contractually specified performance. In an ideal contracting situation, the parties' contracts represent the culmination of a planning process in which the parties have specified the terms of their performance and the allocation of the risks of the construction process. Presumably, each party has achieved an acceptable balance between its responsibilities and risks and the responsibilities and risks of the other parties. In such a situation, the court should be reluctant to upset the balance by imposing liability other than the liability that would result under the terms of the contract.

In many real contracting situations, however, we know that parties often do not meet these requirements. They frequently fail to specify performance terms and allocate risks during the contracting process. To the extent they have planned, they often do not really observe the fruits of their planning in practice, by departing from the stated requirements of the contractually specified performance.

Notwithstanding practical shortcomings, the private ordering claim arguably is still justified because it reflects confidence in a body of contract law that is sensitive to these concerns. Contract law is sufficiently robust to discern and honor private ordering even when that private ordering is less than complete. In doctrinal terms, this means, among other things, that formation doctrine is sufficiently sensitive to ascertain when a contract has been made; interpretation doctrine is sufficiently sensitive to determine accurately the meaning of the terms of that contract; the parol evidence rule appropriately balances written and oral agreements; third party beneficiary doctrine determines when third parties appropriately have rights arising from other people's contracts; and promissory estoppel is well-developed enough to pick up the pieces when reliance is induced but there are gaps in other doctrines.

Such confidence may be misplaced. In fact, we are in the midst of an historical shift, in which contract law is becoming increasingly *less* sensitive to the

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58. *Id.* at 348.
59. *Id.*
60. *Id.* at 351.
61. *Id*. at 353 (quoting Greater Houston Transp. Co. v. Phillips, 801 S.W.2d 523, 525 (Tex. 1990)).

complexities of private ordering.[62] Two major developments in neoclassical contract law from the 1920s through the 1970s were the contextualization of previously abstract doctrine and the recognition of the inevitability of regulating market transactions. During this period, contract law became more attentive to the real-world situations and contexts of contracting parties and more sensitive to the complexities of private ordering in exactly the way the economic loss rule requires. But lately we have seen a challenge to these developments, arguing that the law has departed from the core principles governing contract law. According to this challenge, courts should strictly enforce the contracts people make, not reading beyond the four corners of a document when enforcing a contract, and certainly not evaluating the bargains for contextual fairness. The solution is to revert to a simple model of contract based on an ideal market.[63]

As a result, contract law today increasingly emphasizes abstraction over contextualization. Following this trend means paying less attention to the factual details of a particular case and to the complexities of real-world contracting. Under this "classical revival," formality reigns at two levels.[64] First, the contract doctrine itself becomes more formal; ostensibly clear, rigid rules are favored over flexible standards. Second, the substance of the rules favors formality in contracting practices. Written contracts (including standard form contracts) are favored over oral contracts, the interpretation of contracts relies primarily on plain meaning, and parties have great freedom to define the terms of their relationships without examination or intervention by the law. It is difficult to square this increasingly abstract and formal body of contract law with a sensitivity to actual private ordering.

This transformation in contract law is widespread, and I have discussed it more fully elsewhere.[65] Simply to give a flavor for the changes, here are some examples.

First, the most common kind of contract today involves a standard form containing many terms, which are poorly understood if read at all. A business that enters into many such deals drafts the contract and presents it to the other party on a take-it-or-leave-it basis. The law always has had difficulty accommodating adhesion contracts to the paradigm of bargained contracts, but it is increasingly deferential to them, treating standard form contracts, in Professor Charles Knapp's phrase, as "sacred cows" rather than "dangerous animals, likely to do harm unless confined and tamed."[66]

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62. *See* Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law*, 28 SEATTLE U. L. REV. 1 (2004).

63. The inevitable hyperbolic quote from Professor Richard Epstein: "For all its minor differences, and with a little refurbishing at the edges, we could do as well with the Roman law of contract as we do with any modern system dedicated to the principle of freedom of contract, as our system too often is not." RICHARD A. EPSTEIN, SIMPLE RULES FOR A COMPLEX WORLD 327 (1995).

64. Feinman, *Un-Making Law*, *supra* note 62.

65. *Id.* at 14–29.

66. Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 FORDHAM L. REV. 761, 789 (2002).

Second, from the 1920s through the 1970s, as contract law became more flexible, courts became more inclined to find a contract even when the parties' behavior fell short of the paradigm of bargaining resulting in a formal written contract. The recent trend, on the other hand, favors formal, written contracts and disfavors imposing liability in other circumstances; under this approach, a court should find a contract only when the formalities of contracting have been observed. The most striking manifestation of this shift is the decline of promissory estoppel, the doctrine that a promise can be enforceable even if it fails to meet the traditional standards for forming a contract.

Third, because the paradigmatic contract is the complete written contract, evidence of alternative interpretations or varying terms is excluded. As a doctrinal matter, this vision is realized by reverting to a classical Willistonian view, focusing on the four corners of the document itself as the touchstone of interpretation and as the basis of the parol evidence rule. Courts also have expanded the cases to which the parol evidence rule applies. Traditionally, the rule never barred introduction of parol evidence to interpret an agreement or to bar evidence of modification of a contract. Recent cases have departed from these tenets as well, relying again on the face of the written agreement as conclusive evidence of its meaning.[67]

Fourth, a basic tenet of neoclassical law is that contract law is regulatory as well as facilitative. Recently, however, many courts have become less willing to exercise an overt regulatory role. The most prominent example involves the now-routine enforcement of pre-dispute, mandatory arbitration clauses. Traditionally, courts considered arbitration provisions to be particularly egregious elements of adhesion contracts, and examined them to determine whether the consumer had actually assented to the arbitration provision, proof of which often required a separate expression of assent. Some state courts still engage in this inquiry, but the expansion of consumer arbitration received a major endorsement by the United States Supreme Court in a series of cases beginning in the 1980s. In a dozen cases since, the Court has approved arbitration in different settings, bringing a wide range of issues within the federal arbitration policy. The Court's expansion extends beyond the types of relationships in which arbitration clauses are enforceable to issues that arise about the conduct of arbitration.[68]

V. BROADER CONTEXTS: LAW AND POLITICS

There is a broader context to this development, because this shift in contract law is part of a broader classical revival across the common law, which may be resulting in the un-making of neoclassical law.[69] In contract law, the classical revival aims to reinstate the principle that courts should simply enforce the contracts people make, through formal rules of formation and interpretation, and should not impose terms or evaluate the fairness of bargains. In tort, the

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67. Feinman, *Un-Making Law*, *supra* note 62, at 22–26.

68. *Id*. at 26–29.

69. *See generally* JAY M. FEINMAN, UN-MAKING LAW: THE CONSERVATIVE CAMPAIGN TO ROLL BACK THE COMMON LAW (2004). The phrase "un-making" was used originally in Stephen D. Sugarman, *Judges as Tort Law Un-Makers: Recent California Experience with "New" Torts*, 49 DEPAUL L. REV. 455 (1999).

revival seeks to restore corrective justice based on fault as the prime objective by rolling back the generalization of liability for negligence, narrowing products liability, and reducing the scope of compensatory and punitive damages. In property, the revival focuses on expanding the law of takings to limit the ability of the government to regulate property owners in pursuit of the common good. All the individual changes fit within a broader structure in which, as exemplified by Powers,[70] the boundaries among contract, tort, and property are sharply defined, the market-focused subjects (contract and property) are primary, and a revived formalist method is prescribed for judicial decision.[71]

There is a still broader context. The unmaking of the common law is consistent with changes proposed and adopted to reshape American government, law, and society.

As Ronald Reagan proclaimed in his first inaugural address: "Government is not the solution to our problem; government is the problem."[72] In this vision, government is the problem because it interferes with individual freedom, particularly the individual freedom to pursue self-interest through the market, the social institution that promotes the best results.

If government is the problem, then the solution is to reduce the reach of government. Many government programs can be reduced or eliminated altogether; others will be cut by shifting responsibility from government to the market. Direct public regulation of environmental harm, public health, and product safety will be diminished. Publicly-supported retirement will be replaced by private investment accounts instead of Social Security. Public support of education will be replaced by voucher-funded school choice. Public welfare support for the poor and needy will be supplanted by voluntary, faith-based initiatives. Tax cuts will starve government across the board.

A vision of the common law is central to this ideology, and the ideology is central to contemporary changes in the common law. The ideal of individual freedom and limited government and the classical revival conceptions of contract, tort, and property law reinforce each other.

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70. *See generally* Powers, *supra* note 24.

71. At the Dan B. Dobbs Conference on Economic Tort Law, where this paper was first presented, Judge Richard Posner criticized my approach as "Quixotic," pointing out the contradiction between criticizing the Restatement for favoring contract at the expense of tort while asserting that tort was also subject to conservative influences. While the charge is slightly off-target—Don Quixote attacked figures that his imagination transmogrified, while my targets are more accurately described—it does present an interesting question of legal discourse. Certainly there is nothing inherently conservative or liberal, or liability-contracting or liability-expanding, in either contract or tort law; nevertheless, even as tort law becomes more conservative, the language and concepts of tort today still may be more amenable to expansion than the parallel constructions of contract law.

72. President Ronald Reagan, First Inaugural Address (Jan. 20, 1981), *available at* http://www.reaganfoundation.org/reagan/speeches/first.asp.

VI. CONCLUSION

The conclusion to be drawn from all of this is that the choices we make are situated in contemporary and historical contexts. The economic loss rule is not just the borderline between contract and tort doctrine, its application in third-party cases is not just about the scope of liability for negligence, and the drug-testing cases are not just about drug testing.

Today when scholars discuss the founding of the American Law Institute and the drafting of the First Restatements, we note how those events are situated in the context of the attacks on classical legal thought, legal realism and the responses to it, the influence of progressivism on the law, and other political and social movements of the time.[73] Fifty or a hundred years hence, when the history of the common law and the ALI at the beginning of the twenty-first century are written, the debates we have about approaches to the Restatement and particular issues of doctrine will be seen in broader contexts. If we choose to favor private ordering in general and adopt specific contract-oriented rules for cases such as drug testing, that choice may also be seen as a reflection of the ideological and political tenor of these conservative times.[74]

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73. *E.g.*, JOHN HENRY SCHLEGEL, AMERICAN LEGAL REALISM AND EMPIRICAL SOCIAL SCIENCE 212–13 (1995); N.E.H. Hull, *Restatement and Reform: A New Perspective on the Origins of the American Law Institute*, 8 LAW & HIST. REV. 55 (1990); G. Edward White, *The American Law Institute and the Triumph of Modernist Jurisprudence*, 15 LAW & HIST. REV. 1 (1997).

74. The materials for the Dan B. Dobbs Conference on Economic Tort Law offered an irresistible illustration. Professor Oscar Gray's paper mentioned remarks of Restatement Reporter, Mark Gergen, "at a meeting for the ALI Members Conservative Group." The reference was to a meeting of the Members *Consultative* Group, but his spell checker must have engaged in a Freudian slip.