RESPECTING BOUNDARIES AND THE ECONOMIC LOSS RULE IN TORT

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I. INTRODUCTION

By 1985, the New Jersey Supreme Court had assumed the mantle of progressivism in enunciating new tort doctrine that had long been worn by the California Supreme Court.[1] In a succession of notable cases in the early years of the decade, including *Beshada v. Johns-Manville Products Corp.*,[2] *O'Brien v. Muskin Corp.*,[3] *H. Rosenblum, Inc. v. Adler*,[4] and *Kelly v. Gwinnell*,[5] the court systematically broke down pre-existing barriers to recovery in tort under both negligence and strict liability principles. As a consequence, close observers of tort law developments took notice when the court proceeded even further in this direction in *People Express Airlines, Inc. v. Consolidated Rail Corp.*,[6] posing a direct challenge to the near-universal unwillingness of the courts to recognize a duty to compensate victims for pure economic loss in accidental harm cases.

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1. On the preceding generation of California Supreme Court cases, see Gary T. Schwartz, *The Vitality of Negligence and the Ethics of Strict Liability*, 15 GA. L. REV. 963, 963–77 (1981).

2. 447 A.2d 539 (N.J. 1982) (ruling that an asbestos manufacturer could be held responsible *ex post* for risks associated with the product that were unknown at the time the product was marketed).

3. 463 A.2d 298 (N.J. 1983) (holding that in the case of a non-essential product a jury could engage in generic risk-utility analysis even if no feasible safer alternative to the product existed).

4. 461 A.2d 138 (N.J. 1983) (deciding that an accountant could be held liable to any person, including both known and unknown investors, who might foreseeably rely on the negligent misstatements in an audit report).

5. 476 A.2d 1219 (N.J. 1984) (establishing social host liability for serving liquor to an intoxicated third-party who subsequently drives negligently and injures someone).

6. 495 A.2d 107 (N.J. 1985).

In fact, *Rosenblum*, which similarly addressed claims to recovery for stand-alone economic loss,[7] could have been taken to foreshadow *People Express*. Nonetheless, despite the potentially far-reaching foreseeability analysis in the *Rosenblum* treatment of auditor's liability for negligent misrepresentation to third parties, *People Express* came as something of a bombshell. Here was a case, unlike *Rosenblum*, in which the plaintiff, a "stranger," bore no relationship, direct or indirect, to the defendant: The plaintiff in *People Express* simply had the misfortune of conducting airline operations in an airport terminal that was closed down when defendant's toxic spill in an adjoining railroad yard threatened the health and safety of everyone in the area. Bushels of precedents from other jurisdictions stood in the way of allowing economic loss recovery by the "indirect" victim of a dangerous condition created by an unrelated defendant.[8] Undaunted, the New Jersey Supreme Court enunciated a principle of "particular foreseeability" under which People Express, doing business as a next-door neighbor of the railroad yard, stated a claim for recovery.[9]

Twenty years later, the bold thrust of the New Jersey court in limiting the no-duty domain of negligently inflicted economic loss is largely a historical artifact. With a striking degree of unanimity, the highest courts in other states have failed to follow *People Express*; it stands as a lonely outpost.[10] Similarly, in the neighboring territory of an auditor's liability for third-party economic loss, the expansive, foreseeability-based duty approach in *Rosenblum* has been treated as an outlier.[11] What is commonly referred to as "the economic loss rule"—the longstanding no-duty barrier to recovery of pure economic loss—appears to exhibit more vitality than ever.

In this Article, I will briefly comment on three aspects of the rule, in an effort to dig beneath the surface and explore its foundations: first, the array of circumstances in which the no-duty rule comes into play, which turn out to be varied; second, the set of justifications offered for the rule, which turn out to differ

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7. 461 A.2d at 143.

8. *See* DAN B. DOBBS, THE LAW OF TORTS § 452, at 1283–84 (2000).

9. *People Express*, 495 A.2d at 116–18. The court held that

> a defendant owes a duty of care to take reasonable measures to avoid the risk of causing economic damages, aside from physical injury, to particular plaintiffs or plaintiffs comprising an identifiable class with respect to whom defendant knows or has reason to know are likely to suffer such damages from its conduct.

Id. While disavowing liability to "simply a foreseeable class of plaintiffs," the court could go no further in defining what constitutes an "identifiable class" than to state that "plaintiffs must be particularly foreseeable in terms of the type of persons or entities comprising the class, the certainty or predictability of their presence, the approximate numbers of those in the class, as well as the type of economic expectations disrupted." *Id.*

10. DOBBS, supra note 8, § 452, at 1285 (stating that only "[t]wo or three cases have proposed a general modification of the rule against recovery for negligently inflicted economic harm," the "most important" of which was *People Express*).

11. *Id* § 480, at 1373 & n.23 (citing only two states that have adopted a reasonable foreseeability test other than New Jersey, and indicating that New Jersey subsequently rejected *Rosenblum* by statute).

in persuasiveness; and third, the extent to which the rule shares some common roots with related areas of accident law (such as personal injury).

More broadly, I want to emphasize that the constraints imposed by the economic loss rule do not, as I see it, reflect any single normative principle. Correspondingly, the cases do not comprise a single generic category guided by a unified set of underlying policy considerations, any more than limitations on recovery for emotional harm—ranging from direct emotional distress, to bystander emotional distress and loss of consortium—can be explained by reference to a single rationale.[12] In both areas, attempts to generate a single rationale for what the courts are doing run the risk of oversimplifying the policy concerns at stake.

With these basic premises in mind, I want to offer an overview of the field based on three scenarios of negligently inflicted economic loss. I will begin by addressing the scenario in which tort is invoked as an alternative remedy in the context of disappointed contractual expectations. Next, I will consider the scenario in which a defendant creates a dangerous condition or causes physical harm, resulting in economic loss to a stranger. Finally, I will turn to a scenario in which there is either a negligent misrepresentation, or more broadly negligent performance of an obligation, that results in third-party economic loss. This latter category is a hybrid of sorts, falling between the realm of harm arising out of contractual expectations and that of economic loss entirely distinct from any contractual expectations.[13]

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12. Consider, for example, that the claim for direct emotional distress has traditionally raised fears about opening the floodgates of litigation, and consequently has been constrained by zone of danger type limitations. *See, e.g.*, Falzone v. Busch, 214 A.2d 12 (N.J. 1965). By contrast, consortium claims raise no floodgates of litigation concerns, since they are collateral to related physical injury cases. As a consequence, the consortium limitations are cast in terms of close family relationship and reflect underlying concerns such as disproportionate recovery for a single claim of negligence rather than a fear of a multiplicity of serial claims. *See, e.g.*, Borer v. Am. Airlines, Inc., 563 P.2d 858, 862–63 (Cal. 1977).

13. In his contribution to this symposium, Professor Jay Feinman sketches out a similar breakdown, but his paper exclusively addresses the third of these scenarios. Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813 (2006). Professor Mark Gergen's contribution is also predominantly aimed at the third scenario. Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749 (2006). Professor Anita Bernstein's contribution provides a "taxonomy of claims" that covers all three of the scenarios—in fact, ranges beyond these scenarios—in a descriptive account that is far more detailed about subcategories of cases than my discussion in this paper. Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773 (2006). In an earlier article, I addressed primarily the second of these scenarios and grounded my discussion largely in a historical account of the comparative treatment of widespread economic loss. Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513 (1985).

With regard to conflating the categories, in his introduction to this symposium Judge Richard Posner begins with an illustrative fact situation that he says, "will be the vehicle for discussing the 'economic loss' doctrine." *See* Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735, 736 (2006) (citing East River

II. SCENARIOS OF NEGLIGENTLY INFLICTED ECONOMIC LOSS

A. Tort as an Alternative Remedy in the Context of Disappointed Economic Expectations

If the New Jersey Supreme Court stood out for its proactive stance in tort cases during the 1980s (and beyond), it had a firm foundation on which to build. Beginning around 1960, the California Supreme Court reshaped tort doctrine in unprecedented fashion, ranging from the abolition of immunities to the establishment of new, expansive duties of care.[14] Nowhere was this more evident than in the area of products liability, where under the guiding hand of Justice Roger Traynor the court enunciated principles of strict liability for injuries from defective products, in a bold effort to move beyond responsibility based on negligence.[15]

From the outset, Justice Traynor viewed this new departure not just as a rejection of negligence, but as an assertion of the hegemony of tort over contract, which might have served as an alternative route to strict liability premised on warranty.[16] In this context, Traynor's landmark opinion in *Seely v. White Motor Co.*[17] appears on the surface to be going against the grain. But only on the surface. In *Seely*, the plaintiff's truck bounced violently. Over the course of almost a year, the retailer who had sold the truck to the plaintiff could not remedy the problem, even with guidance from the manufacturer. All the while, the plaintiff lost profits from the truck's downtime. Although he did recover against the manufacturer on a breach of express warranty theory for failure to repair the defects, his claim in tort for lost profits was rejected.

Justice Traynor's opinion reasserted that strict liability in tort governed claims for personal injury and property damage. But claims for commercial loss, standing alone, were relegated to warranty and the Uniform Commercial Code. Traynor's rationale—which has been highly influential in the states and was later

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S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986)). But *East River* is a case involving tort invoked as an alternative remedy in the context of disappointed economic expectations; by contrast, Posner's illustration—a victim of lost profits suffered during the period when plaintiff's building is closed because of defendant's negligence on an adjoining site—is a case involving what I refer to as economic loss imposed on a stranger. Courts invoke the economic loss rule in these two situations for reasons that are entirely unrelated.

14. Schwartz, *supra* note 1, at 964–77.

15. *See* Gary T. Schwartz, *Foreword: Understanding Products Liability*, 67 CAL. L. REV. 435 (1979) (discussing how the California Supreme Court was at the forefront of products liability doctrine). The leading case was *Greenman v. Yuba Power Products, Inc.*, 377 P.2d 897 (Cal. 1963), building on the foundation of Justice Traynor's landmark concurring opinion in *Escola v. Coca Cola Bottling Co. of Fresno*, 150 P.2d 436, 440 (Cal. 1944).

Interestingly, the New Jersey Supreme Court had taken a similar step beyond liability based on negligence even earlier than *Greenman* in *Henningsen v. Bloomfield Motors, Inc.*, but chose to do so through the vehicle of warranty law. 161 A.2d 69 (N.J. 1960).

16. In *Greenman*, Justice Traynor explicitly rejected the warranty route to strict liability for defective products. 377 P.2d at 900.

17. 403 P.2d 145 (Cal. 1965).

adopted by the U.S. Supreme Court in the often-noted *East River Steamship Corp. v. Transamerica Delaval Inc.*[18]—was straightforward. Public policy demanded that a narrow defense—assumed risk—should be the limit on recovery in cases of personal injury; in other words, consumers should only be granted the option of bargaining away their rights to recover for personal harm from a defective product when they were fully cognizant of the risks that might come to fruition. In contrast, there was no equivalent concern about consumers taking products "as is" (i.e., recognizing a broad right to disclaim liability for defects) in a commercial setting where bargaining over price in return for the risk of out-of-pocket loss promoted autonomous market behavior.[19]

In short, private ordering had to take a backseat to tort when personal injury (or property damage) was involved—a proposition already enunciated in a freshly-minted line of cases eviscerating exculpatory clauses in hospital consent forms, residential rental leases, and a variety of other settings.[20] But there was no persuasive reason to extend this tort override to "as is" provisions involving purely commercial risk-taking. The economic loss rule served as the perfect instrument for effectuating this limitation on the domain of tort.

B. Tort as a Potential Remedy When Defendant Creates a Dangerous Condition or Causes Physical Harm Resulting in Economic Loss to a Stranger

Interestingly, the second area in which the economic loss rule has its firmest grounding has nothing at all to do with encroachments on the domain of contract. This is the *People Express* scenario, involving endangering activity that causes economic loss to strangers. But as I indicated at the outset, *People Express* has been studiously ignored by other courts. By contrast, consider a more recent case, decided by the New York Court of Appeals in the shadow of 9/11, *532 Madison Avenue Gourmet Foods, Inc. v. Finlandia Center, Inc.*[21] *532 Madison* consolidated claims by property owners in midtown Manhattan for construction-related economic loss caused by street closures that blocked access to their stores and businesses. There seems to be little doubt that at least some of the plaintiffs would have been "particularly foreseeable" within the terms of *People Express*. But the New York court dismissed all claims, explicitly declining to follow *People Express*.[22] Instead, the Court relied on its own earlier precedents, some of which rested on a privity of contract limitation, asserting the necessity "to avoid exposing defendants to unlimited liability to an indeterminate class of persons conceivably injured by any negligence in a defendant's act."[23]

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18. 476 U.S. 858 (1986).

19. The somewhat more troublesome question was which regime, tort or contract, should govern stand-alone property damage. But logic dictated that property damage be addressed under the tort regime. If warranty applied there would be no recovery by a "bystander," one with no contractual relationship to the manufacturer of the defective product—for example, the owner of a parked vehicle whose car was totaled by Seely's bouncing truck.

20. *See, e.g.*, Tunkl v. Regents of Univ. of Cal., 383 P.2d 441 (Cal. 1963).

21. 750 N.E.2d 1097 (N.Y. 2001).

22. *Id.* at 1103.

23. *Id.* at 1101.

Resort to the economic loss rule here may sometimes be expressed in terms of a partially resurrected privity of contract limitation. But, in fact, the cases that fall within this scenario have nothing to do with respecting contractual bargaining rights in the *Seely* sense, considered just above; indeed, there is no contractual relationship to respect here. Instead, as the concern about "unlimited liability to an indeterminate class" suggests, the appropriate metaphorical image in these cases can be referred to as the "ripple-effect" concern.[24]

It is commonplace to observe that we live in a highly interdependent society. Nonetheless, that is the starting point in explaining the uncompromising no-duty approach in this category of cases. The street closures in *532 Madison* might well have affected not just neighboring stores and businesses, but also hot dog vendors, taxis, theater performances, and an untold host of other commercial activities dependent on the free flow of traffic in the immediate area for their livelihood. "Particular foreseeability" seems an inapt way of sorting the merits of these claims. In fact, one can argue that from a horizontal equity perspective, those who are least particularly foreseeable are just those who are least likely to have business interruption insurance that would assist in covering the losses experienced.[25]

But it is critical to note that the concern over ripple effects is not synonymous with a crushing liability concern. Consider in this regard the application of the no-duty rule in a sub-category of cases in which plaintiff's employee is physically injured by defendant's negligent act, and the employer consequently seeks to recover economic loss for replacement services. Courts routinely deny recovery in such cases.[26] There is no potential crushing liability in these cases. Rather, the ripple-effect concern is grounded in the exceedingly fine and elaborate network of interdependencies—one being the employment relationship—that characterize modern life.

Another rationale sometimes offered for invoking the economic loss rule, in this cluster of cases, is that in many instances of economic loss falling under this scenario there are no net social costs.[27] Take the leading case of *Rickards v. Sun Oil Co.*, in which the defendant's barge negligently destroyed a bridge that was the only means of access to the plaintiffs' retail businesses.[28] The court invoked the

24. *Id.* at 1102–03 ("[T]o extend a duty to defendant FMC would, 'like the rippling of the waters, [go] far beyond the zone of danger of the explosion,' to everyone who suffered purely economic loss." (quoting Beck v FMC Corp., 385 N.Y.S.2d 956, 958 (App. Div. 1976) (alteration in original))).

25. This proposition carries over with even greater force to major disasters, such as 9/11 or Hurricane Katrina; a strong case can be made for treating these disasters as the place for government intervention such as loans, loan guarantees, tax breaks—perhaps even no-fault compensation for physical injuries and death, as in 9/11. *See generally* Robert L. Rabin & Suzanne A. Bratis, *Financial Compensation for Catastrophic Loss in the United States*, *in* FINANCIAL COMPENSATION FOR VICTIMS OF CATASTROPHES: A COMPARATIVE APPROACH, 303 (Michael Faure & Ton Hartlief eds., 2005).

26. *See, e.g.*, I.J. Weinrot & Son, Inc. v. Jackson, 708 P.2d 682 (Cal. 1985); Phoenix Prof'l Hockey Club, Inc. v. Hirmer, 502 P.2d 164 (Ariz. 1972).

27. *See* Posner, *supra* note 13, at 736–37.

28. 41 A.2d 267, 268 (N.J. 1945).

economic loss rule and denied recovery. In an article approvingly noted by Judge Posner, Professor William Bishop pointed out that as long as excess capacity exists elsewhere, the disappointed customers in *Rickards* will simply find other vendors; private costs occur (to the plaintiff) but they are in the nature of transfer payments from the plaintiffs to others who provide substitute services; no social costs arise and hence no reason suffices to grant recovery.[29]

There are serious problems with this rationale. To begin with, no court, to my knowledge, has ever indicated that upon a showing of no excess capacity, a plaintiff *would* recover—in other words, that in the judicial mind anything turns on the showing of excess capacity. Nor would an aggrieved hockey club recover on a showing that its goalie was one of a kind. Something is clearly amiss here.

The crux of the matter is that whatever the argument for taking cognizance of economic considerations in articulating negligence doctrine, accident law has always taken account of distributive, interpersonal fairness, and moral considerations along with economic reasoning.[30] With particular regard to the "no-social-cost" argument, the negligent will-drafting cases, considered in the following section, are germane.[31] An attorney negligently drafts a will and as a consequence a bequest that was meant to go to *A* instead goes to *B*. *A*, of course, cannot get the testator to correct the error because he is deceased; nor does he have any contractual privity with the errant attorney. Despite negligence on the attorney's part and economic loss suffered by *A*, Bishop's analysis would dictate no recovery, because there is no net economic loss in this situation. *A*'s loss is *B*'s gain—just as, in *Rickards*, the lucky retail establishments on the accessible side of the bridge realize the gains that would have gone to the unfortunate vendors cut off from their prospective customers.

Yet in the negligent drafting case recovery is allowed.[32] Fairness and deterrence considerations both cut in favor of recovery, and these are the salient features for a court, not an assessment of social utility cut loose from the nexus of the parties to the litigation. What distinguishes *Rickards* is that the ripple-effects

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29. William Bishop, *Economic Loss in Tort*, 2 O.J.L.S. 1 (1982). Posner refers to this rationale as "the first strut of the economic-loss doctrine." *See* Posner, *supra* note 13, at 741.

30. This is too broad a topic to address in this paper. But consider the rights-based claims for respect of individual autonomy that characterize the classic nonfeasance/misfeasance theme underlying the traditional no-duty to rescue cases. *See generally* MARC A. FRANKLIN, ROBERT L. RABIN, & MICHAEL D. GREEN, TORT LAW AND ALTERNATIVES: CASES AND MATERIALS 133–75 (8th ed. 2006).

31. *See, e.g.*, Biakanja v. Irving, 320 P.2d 16 (Cal. 1958); *see infra* note 53 and accompanying text for discussion.

32. *Biakanja*, 320 P.2d at 19; *see generally* DOBBS, *supra* note 8, § 488, at 1397 ("[M]ost courts today reject the blanket privity rule. . . . [and] extend[] [the lawyer's professional duty] to those the lawyer was retained to benefit, such as the beneficiary of the will . . . .").

concern, which is dominant there as well as in the entire *532 Madison* line of cases, is not present in the negligent drafting cases.[33]

In sum, just as in the products liability scenario, the economic loss rule dominates the terrain in this second configuration, featuring physical harm or endangerment leading to indirect economic loss to a "stranger." But the rule has very different underpinnings. Tort poses no threat to the dominion of contract in these cases. Instead, tort is threatened by the implications of its own doctrinal substratum; namely the oft-invoked concept of foreseeability. In physical endangerment cases, as in bystander emotional distress cases, foreseeability proves too much. A veritable army of drivers trapped for hours in a highway tunnel because of a traffic-paralyzing accident caused by a defendant may suffer enormous economic loss, just as a random set of eyewitnesses may suffer enormous emotional distress from viewing the aftermath of a gruesome auto accident.[34] All of these losses may well be "foreseeable." In the emotional distress category, definable characteristics—close familial relationship, proximity to the accident scene—can be taken as guideposts for establishing generic characteristics of those most likely to suffer serious harm.[35] Neither "particular foreseeability," nor some other stand-in, seems a good candidate for sorting in the endangerment/ripple-effects cases. Hence the strong authority of the economic loss rule as an absolute barrier to recovery.

C. Third-Party Effects of Negligent Misrepresentation or Negligent Performance of an Obligation

In this category of cases, the economic loss rule is far more problematic and subject to qualification than in the areas discussed above. For purposes of brevity, I will survey the foundational considerations in invoking the no-duty rule here by discussing two familiar scenarios.[36] The first is a classic instance of negligent misrepresentation: Lack of due diligence in conducting an audit of the financial health of a client, leading to economic loss to those relying on the audit. The second is a set of circumstances that has been much discussed in the recent literature (and litigated, as well): the failure to hire (or retain, as the case may be)

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33. And note that the ripple-effects concern *is* present as an alternative explanation when recovery is denied in the excess retail capacity and irreplaceable goalie cases discussed above, when the no-social-costs argument fails.

34. The tunnel illustration was used by Judge Kaufman in *Kinsman Transit Co. v. City of Buffalo* to demonstrate the unsatisfactory nature of a foreseeability test as a guideline in defining the scope of duty in these cases. 388 F.2d 821, 825 n.8 (2d Cir. 1968).

35. *See* Dillon v. Legg, 441 P.2d 912 (Cal. 1968). *See generally* Rabin, *supra* note 13, at 1522.

36. I agree with Professor Gergen's observation that the variations in circumstances under which negligent performance of an obligation arise are near-infinite, and any effort to offer an all-encompassing explanation is bound to trail off into conclusions about the need to "balance" a number of quite general considerations (his list is "institutional considerations, social considerations, legal culture, judicial philosophy, and judicial temperament")—*see* Gergen, *supra* note 13, at 751—a not very satisfying resolution.

an employee based on a false positive in a negligently conducted test for drug or alcohol abuse by a professional testing organization.[37]

1. Negligent Misrepresentation

The baseline commitment to a no-duty approach in the long line of accountant-negligence cases—the leading example of negligent misrepresentation resulting in economic loss—was set in the landmark opinion of Judge Cardozo in *Ultramares Corp. v. Touche*.[38] Later cases are closely akin to the facts in that early decision. The plaintiff, a lender, claimed reliance on financial statements prepared by the defendant for a client company in making a loan to that company; the financial statements were inaccurate in representing the financial well-being of the client; the client soon after declared bankruptcy; and the plaintiff suffered the economic consequences of the loan default. Just as in the preceding category of physical endangerment cases, Judge Cardozo anchored dismissal of the claim in a concern about unbounded liability; indeed, the opinion provides the initial invocation of the language, altered only to match the circumstances, intoned in cases such as *532 Madison*, discussed above. As Judge Cardozo put it, "[i]f 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."[39]

With the passage of time, a more refined view of an auditor's responsibility developed—one that highlighted a critical distinction from the physical endangerment cases; namely, the third-party nexus in the claim for negligent misrepresentation in financial statements. And concomitantly, a cleavage developed, turning on how much of a "relationship" with the third person was required to override the no-duty approach—rather than casting no-duty in the absolute terms that it maintains in physical endangerment scenarios.

The conflicting positions are nicely spelled out in *Nycal Corp. v. KPMG Peat Marwick LLP*,[40] an *Ultramares*-type case brought for economic loss resulting from a large-block stock purchase rather than a lending agreement.[41] As the *Nycal* court indicates, the near-privity approach taken by Judge Cardozo has in fact been refined in its home state to recognize a duty in a limited set of situations where the plaintiff relies on the auditor's report, and in addition has some direct contact—a

37. In this symposium, Judge Posner, as well as Professors Feinman, Gergen, and Bernstein, contribute to the dialogue on the negligent testing cases. *See* Posner, *supra* note 13, at 742–43; Feinman, *supra* note 13, at 820–23; Gergen, *supra* note 13, at 770–71; Bernstein, *supra* note 13, at 811 n.201.

38. 174 N.E. 441 (N.Y. 1931).

39. *Id.* at 444.

40. 688 N.E.2d 1368 (Mass. 1998).

41. For a detailed discussion of the principal positions, see generally Jay M. Feinman, *Liability of Accountants for Negligent Auditing: Doctrine, Policy, and Ideology*, 31 FLA. ST. U. L. REV. 17 (2003).

"link"—with the defendant before entering into the purchase or lending agreement with the third-party.[42]

Clearly, this "link" requirement directly addresses each aspect of Cardozo's concern about liability "in an indeterminate amount for an indeterminate time to an indeterminate class." And of course, as *Nycal* spells out, a link, or direct contact requirement, is diametrically opposed to the general foreseeability approach taken in the New Jersey *Rosenblum* case mentioned at the outset (which, as I have indicated, like *People Express*, has not been persuasive elsewhere).[43]

But the *Nycal* court seeks a middle ground—and it is not difficult to find. Section 552 of the Restatement (Second) of Torts, discussing negligent misrepresentation, offers what appears to be the majority approach: requiring justifiable reliance and limiting recovery to "a limited group of persons for whose benefit and guidance [the defendant] intends to supply the information…in a transaction that he intends the information to influence or knows that the recipient so intends."[44] Note that this middle-ground approach appears to require no actual course of conduct between the auditor and the plaintiff experiencing economic loss, as would be necessary in New York.[45]

What explains the more qualified character of the economic loss rule in this class of cases compared to the physical endangerment cases, despite the figurative storm clouds of massive numbers of claims that darken both horizons? Two considerations seem to loom large, both of which resonate with more general features of tort law. On the one hand, there is an active/passive theme associated with the plaintiff's conduct that bolsters the case for no-duty in the negligent misrepresentation scenario. In its strong form, in the realm of tort generally, the "active" strand plays out in the classic assumed-risk defense, which traditionally barred recovery to victims of harm who proceeded in the face of known risk.[46] Although it would be far too condemnatory to place duped lenders and stock

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42. Credit Alliance Corp. v. Arthur Andersen & Co., 483 N.E.2d 110 (N.Y. 1985).

43. *See supra* text accompanying notes 7–11.

44. RESTATEMENT (SECOND) OF TORTS § 552 (1977).

45. Professor Gergen's test of "invited reliance," *see* Gergen, *supra* note 13, at 752–60, seems quite close to the Restatement position, although he queries the requirement that the reliance be "justifiable" in all cases. Gergen draws on Stephen R. Perry, *Protected Interests and Undertakings in the Law of Negligence*, 42 U. TORONTO L.J. 247 (1992), in proposing the invited reliance standard. As he recognizes, the concept of invited reliance is not a sure touchstone to liability. Even when it is present, the cases involving denial of negligence claims against financial news services for inaccurate information to subscribers demonstrate that liability can be denied where reliance appears to be "invited." See references in Gergen, *supra* note 13, at 759 n.37. (Once again, it should be noted, in these cases the crushing liability concern seems to be dominant.) And Gergen proceeds to discuss a wide variety of cases, such as the negligently drafted will claims, where liability is imposed and invited reliance is simply not a relevant consideration. Gergen, *supra* note 13, at 760–63.

46. *See* DOBBS, *supra* note 8, § 211 (discussing the doctrine of assumed risk and the traditional situations in which it applied).

purchasers in this category, there is more than a trace of related caveat-emptor thinking that lurks in *Ultramares* and its extended progeny.[47] By contrast to these active market participants, the plaintiffs in the physical endangerment cases are the quintessential innocent victims: "strangers" who just happen to be in the wrong place at the wrong time. In this regard, the case for no-duty in the negligent audit scenario is reinforced.

On the other hand, a second consideration, alluded to above, cuts in the opposite direction. At odds with the physical endangerment cases, there is a transactional character to the negligent misrepresentation cases that casts a shadow presence of a special relationship. How pronounced the shadow is depends, of course, on a fact-intensive inquiry into the grounds for reliance by the plaintiff, as the Restatement (Second) view anticipates.[48] Viewed from a wider tort perspective, the presence of a special relationship has played a dominant role in eroding no-duty limitations in physical injury cases as well, ranging from third-party obligations owed to those at risk to obligations of affirmative action.[49]

In the end, then, the economic loss rule's strength is diluted in the prototypical professional negligent misrepresentation case of the negligent audit, as the limits of fiduciary obligation become blurred (and correspondingly, widespread loss concerns are diminished in scope).

2. Negligent Performance of an Obligation

When one moves beyond the confines of claims of professional obligation based on negligent misrepresentations to third-parties to more broadly-conceived third-party configurations, the strictures of no-duty are often relaxed still more. To be concrete, I will once again draw on a paradigm case: the question of whether the economic loss rule—and hence a no-duty approach—should be extended to the situation in which an employee or prospective employee is the victim of a negligently performed test for drug or alcohol abuse. The plaintiff is either fired as a consequence of the false positive report, or loses a position that was contingent on a "clean" report.[50]

At the outset, it is far too facile, in my view, to attach any weight to the lack of contractual privity in these cases, despite the collateral professional service agreement between the tester and the employer (which superficially distinguishes the case from the physical endangerment scenario). The self-evident point, at the

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47. *See, e.g.*, Gergen, *supra* note 13, at 756–57 (discussion of justifiable reliance).

48. In fact, a general foreseeability test of duty, an invited reliance test, and a linked conduct test—the alternative approaches discussed earlier—*all* turn on such an inquiry. But as indicated, each test has its own distinct conception of what constitutes a sufficient transactional character, reflecting differing degrees of tolerance for unpredictability over the parameters of potential liability.

49. *See* Tarasoff v. Regents of the Univ. of Cal., 551 P.2d 334 (Cal. 1976) (third-party obligations to those at risk); RESTATEMENT (SECOND) OF TORTS § 314A (duty of affirmative action-related obligations).

50. *See, e.g.*, Duncan v. Afton, Inc., 991 P.2d 739 (Wyo. 1999).

threshold, is that the *plaintiff* isn't a contracting party, and as a consequence has no alternative pathway to recourse against the negligent service provider.

But the critical point is that in fact the case for making promotion of private ordering a salient consideration in the negligent drug-testing cases cuts precisely in the opposite direction; in other words, in favor of recognizing the tort obligation of the service provider. It is the service provider and the employer—those in contractual privity—who can take account of the risk of inadvertent error in conducting the testing and provide for loss allocation in negotiation of the service agreement.[51]

Moreover, and of equally critical importance, ripple-effect and widespread-loss considerations are entirely foreign to this situation, which distinguishes it not just from the physical endangerment cases but also from the negligent misrepresentation/auditing line of decisions just considered. Thus, the incentives to promoting optimal care, which cut in favor of a liability rule here, are not counterbalanced in any way by concerns about crushing liability.[52]

A variant on the negligent testing cases is the scenario mentioned earlier in which an intended legatee is deprived of her bequest by the defendant attorney's negligent drafting of a will. In my view, this scenario puts the argument for departing from the economic loss rule in sharpest relief.[53] It is possible, of course, to view this configuration as tantamount to a third-party beneficiary contract.[54] But this is simply engaging in formalistic thinking. The professional service contract was an agreement between the now-deceased testator, whose intention was to leave his estate to plaintiff, and the defense attorney who negligently drafted the will. The plaintiff's case sounds in tort—there was no course of conduct between the plaintiff and the defendant; indeed, the plaintiff may not even have known of the testator's intentions (or the defendant lawyer's existence, for that matter), until

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51. Professor Gergen suggests as a countervailing consideration the judicial incapacity to assess negligence in these cases. *See* Gergen, *supra* note 13 at 768–71. This is, of course, an empirical question, but I see nothing special about judicial competence (or rather the lack thereof) in this particular category of cases requiring evaluation of technology-based conduct, as distinguished from the universe of tort cases in which courts are required to assess technology-based conduct that results in physical harm.

52. Note that the drug testing cases are another scenario in which taking seriously the "no-net-social-costs" argument would lead to a perverse outcome from a tort perspective. If deterrence, compensation, and fairness arguments all support liability, why should it be relevant that there are arguably no net social costs when a substitute employee is available?

53. *See* Biakanja v. Irving, 320 P.2d 16 (Cal. 1958).

54. *See* Posner, *supra* note 13, at 741–42. He posits third-party beneficiary as "a superior approach":

> If the intended legatees are third-party beneficiaries, the lawyer will be exposed to greater liability and as a result will presumably charge a higher price for preparing the will. The testator will then decide whether the increase in the price is worth incurring in order to reduce the risk that the wrong legatee will inherit.

Id. at 742.

I fail to see how the incentives play out any differently by casting the claim in tort, as has traditionally been done.

the estate was settled. It is the goals of tort—deterrence of negligent conduct, interpersonal considerations of fairness, and compensation—that support liability in this most compelling of scenarios for departure from the economic loss rule.[55]

Nonetheless, if the economic loss rule has reduced force in this sub-category of cases, as I suggested earlier, it is not entirely stripped of vitality. Consider, for example, the scenario in *Randi W. v. Muroc Joint Unified School District*, involving a claim of sexual abuse of a student by an administrator who was hired after allegedly negligent misrepresentations in letters of reference from past employer school districts, ignoring prior sexual improprieties.[56] The court recognized a duty of the referring school districts, but very explicitly rejected in dictum the extension of this duty to claims based solely on economic loss.

Thus, if the defendant reference-writer's negligent misrepresentations about *A*'s work habits led another school district to hire administrator *A*, whose lack of diligence subsequently cost teacher *B* a promotion to a higher paying job, *B* would have no claim for her economic loss—even though student *C* would have a claim for her physical injuries if a misrepresentation about *A*'s student relations led to hiring *A*, who was a sexual predator. Clearly, a version of the economic loss rule is being invoked here in giving priority to the free flow of communications in reference letters over *B*'s disappointed economic expectations (even though no such priority is recognized in the case of physical harm).

It would undoubtedly be more aesthetically satisfying to have an economic loss rule that could be invoked without micro-scrutiny of competing policy considerations that arguably lead to different results in the drug testing and reference letter economic-harm scenarios, to stay with a single pair of illustrative cases. But bright-line rules grounded in single-dimension justifications would lead to undesirable policy outcomes.

III. CONCLUDING THOUGHTS

The economic loss area has continuing vitality because it casts a shadow on the conventional goals of tort law in redressing personal harm—raising the question of whether those goals should be given lesser regard, or none at all, when the loss suffered might generically be viewed as either less compelling than physical harm or better redressed under a different regime. Thus, the economic loss rule highlights the tension between tort and contract in cases arising out of disappointed commercial expectations. From another vantage point, the rule tests the enduring tort concern over the prospect of crushing liability, or near-endless ripple effects, from conduct severing the connection between an ongoing business enterprise and its network of commercial relationships. In still other cases, it tests the limits of fiduciary obligations to those not within the narrow confines of

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55. A variant on these cases, involving a claim of physical harm, is the situation in which a physician hired by a prospective employer negligently conducts a pre-employment physical exam of plaintiff and fails to inform about signs of trouble. In *Reed v. Bojarski*, the court held that the physician owed a duty to the prospective employee, even though no traditional special relationship existed. 764 A.2d 433 (N.J. 2001). *Reed* represents the minority view, but to me it seems the better view.

56. 929 P.2d 582, 584 (Cal. 1997).

contractual privity. And finally, the rule tests our tolerance for departing from hard-and-fast rules in cases where interest-balancing might lead to more satisfying policy outcomes. These are age-old concerns that show no evidence of fading with the passage of time, as I have attempted to spell out through surveying the principal byways of the economic loss rule in this Article.