Constructing a New Action for Negligent Infliction of Economic Loss: Building on Cardozo and Coase

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CONSTRUCTING A NEW ACTION FOR NEGLIGENT INFLICTION OF ECONOMIC LOSS: BUILDING ON CARDOZO AND COASE

Michael D. Lieder*

Abstract: This Article proposes the creation of a new tort of negligent infliction of economic loss, a hybrid of negligence, negligent representation, and breach of contract. An action in this new tort would permit an injured party to recover for economic loss caused by a person with whom the party is not in contractual privity. This Article focuses on the infliction of economic loss by negligent construction, where courts have applied various doctrines and arrived at six distinct and inconsistent approaches to liability issues.

This Article provides a solution applicable to litigation for negligent construction. Any action should protect an injured party's reliance rather than expectation interests consistent with the economic risks and benefits associated with such an action. This Article structures in Restatement-like format a new action to protect the injured party's reliance on the tortfeasor, without exposing the tortfeasor to unacceptable risks. Finally, this Article suggests how to recast the elements of the proposed tort into more general terms for application to any dispute involving the negligent infliction of economic loss.

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I. INTRODUCTION

During the past thirty years, courts and commentators have repeatedly addressed whether an architect, contractor or developer should be liable for a plaintiff’s economic loss arising from a defect or delay. The term “economic loss” generally connotes all losses except those from personal injury or damage to property other than the allegedly defective property. Economic loss includes diminution in the value of the allegedly defective property, the costs of repair and replacement, loss of use, and consequent loss of profits and goodwill. Barrett, *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C.L. Rev. 891, 892 n.1 (1989).

The boundary between damage to the defective property and damage to other property is often problematic. If a defect in the pipes installed in a house at the time of the initial construction
in the construction of an improvement, when the parties are not in privity of contract and the plaintiff has suffered no injury to person or property other than the allegedly defective improvement. They have arrived at a bewildering array of solutions, none of which is satisfactory.

This issue generally arises in two settings. First, a contractor or other party involved in the construction of an improvement sues another builder, most often the architect or supervising engineer, for economic loss arising during the construction project. Second, after the completion of construction, an owner or tenant, or occasionally a party with no direct interest in the property, sues one of the builders.

In either setting, the plaintiff often sues in contract and tort. The plaintiff alleges that the builder's contractual duties, especially its implied warranties, run to the plaintiff despite the absence of privity. Causing injury to the walls of the house, the injury may be classified either as an economic loss (pipes and walls are part of the same property—the house) or property damage (pipes and walls are separate). This Article does not address that issue.

2. When a defect in construction results in personal injury or significant damage to property other than the defective property itself, the injured party may sue for negligence, even if the alleged tortfeasor and injured party are not in privity of contract. See, e.g., Schipper v. Levitt & Sons, 44 N.J. 70, 207 A.2d 314, 320-24 (1965) (tenants of original house purchaser may sue builder for negligence in installing water heating system that produced excessively hot water that scalded tenants' infant son). If the defect that caused the injury is subject to an express or implied warranty, the injured party may also sue for breach. See, e.g., 207 A.2d at 324-28. Under either the tort or contract claim, the injured party may recover all consequential economic loss in addition to the damages directly arising from the personal injury or property damage. This Article does not address "parasitic" economic loss.

3. Part III of this Article addresses various judicial solutions. Commentators disagree whether plaintiffs should have relief, and if so, under what theories. See, Barrett, supra note 1, at 932-33 (property owners suffering only economic loss from construction defects should be denied recovery under a negligence theory; contract law should supply the only remedy); Grubb, A Case for Recognising Economic Loss in Defective Building Cases, 43 CAMBRIDGE L.J. 111 (1984) (property owners suffering only economic loss from construction defects should be permitted to sue nonprivity builders for negligence); Schwartz, Economic Loss in American Tort Law: The Examples of J'Aire and of Products Liability, 23 SAN DIEGO L. REV. 37 (1986) (although a general tort theory concerning the recovery of economic loss may be impossible, contract law, not tort law, should have governed the claim of a commercial tenant against a general contractor hired by the property owner to renovate the tenant's space); Wright & Nicholas, The Collision of Tort and Contract in the Construction Industry, 21 U. RICH. L. REV. 457 (1987) (a builder, such as a contractor, subcontractor or architect, should not have a negligence claim against another builder when the claimant suffered only economic loss; contract law should supply the only remedy); Note, Architectural Malpractice: A Contract-Based Approach, 92 HARV. L. REV. 1075 (1979) (although tort suits against nonprivity builders should be permitted, contract duties should determine the builders' reasonable standard of conduct).

4. This Article refers to architects, contractors, and subcontractors collectively as "builders" and to a builder who is not in privity of contract with a plaintiff as a "nonprivity builder."

5. For clarity of reference and to avoid using only the masculine gender, this Article refers to builders with neuter pronouns, original purchasers of an improvement with masculine pronouns, and subsequent purchasers with feminine pronouns.
The plaintiff also claims that the builder breached a duty not to act negligently or engage in negligent misrepresentations so as to cause economic loss. The builder typically responds that its duty not to cause economic harm is contractual only and that its contractual duty does not extend beyond the party with which it contracted. The "economic loss" rule, a doctrine which states that negligence law applies only to injuries to person or property, not to purely pecuniary loss, precludes a negligence or negligent misrepresentation claim. Therefore, the builder concludes, it has no duty to the plaintiff. 

In some cases, if no claim exists against the nonprivity builder, the claimant retains a viable claim against the party with whom it contracted. In many other cases, however, if the claimant cannot sue the nonprivity builder, it will have no claim at all, or at least no economically worthwhile claim. The statute of limitations may have expired on the contract claim but not the tort claim, the claimant may not have received a warranty broad enough to support a claim, or the contracting party may be insolvent.

According to its proponents, the economic loss rule provides two primary benefits outweighing its deleterious impact on injured parties: the prevention of disproportionate liability, and the protection of

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6. See New Mea Constr. Corp. v. Harper, 203 N.J. Super. 486, 497 A.2d 534, 540 (1985) ("[T]here is no need here to invent an independent tort cause of action against [the individual owner of the corporate contractor] in order to permit the owners to recover against the defaulting promisor contractor."). The claimant may nevertheless elect to sue a nonprivity builder in tort for several reasons: to bring in as many defendants as possible, the hope being that the claim against one of them will stick or that the number of contributors will lead to a larger settlement; to recover the greater damages that may be available in tort, including punitive damages; or to avoid imposing a strain on a continuing relationship with the contracting party. See Wright & Nicholas, supra note 3, at 457-58; see also Schwartz, supra note 3, at 41.

7. This is especially likely in states that have adopted the discovery rule for tort, but not contract, claims. Compare Hansen v. A.H. Robins, Inc., 113 Wis. 2d 550, 335 N.W.2d 578, 583 (1983) (discovery rule adopted for all tort actions not governed by legislatively created discovery rule) with State v. Holland Plastics Co., 111 Wis. 2d 497, 331 N.W.2d 320, 325 (1983) (in contract actions, statute of limitations begins to run from date of breach, regardless whether the injured party knows of the breach at that time).

8. See Barrett, supra note 1, at 932-33; infra notes 202-17 and accompanying text (discussing contract claims by subsequent owners).


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parties’ freedom to allocate risks by contract.\(^\text{11}\) In support of the former, the more important, courts frequently quote from Justice Cardozo’s decision in *Ultramares Corp. v. Touche*,\(^\text{12}\) which denied a lender’s claim that the defendant’s accountants had negligently audited financial statements on which the lender had relied.\(^\text{13}\) Justice Cardozo stated, “[i]f liability for negligence exists, a thoughtless slip or blunder . . . may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.”\(^\text{14}\)

As the use of Justice Cardozo’s decision from a nonconstruction dispute indicates, the issue whether an injured party should recover in tort for negligently inflicted economic loss arises in many contexts outside the construction setting. This Article proposes the adoption of a new tort, a hybrid of negligence, negligent misrepresentation, and contract actions, dubbed the “negligent infliction of economic loss.” It works effectively in construction-defect cases to provide relief to injured parties without exposing nonprivity builders to indeterminate risks. It should logically work just as well in any other circumstance of negligently inflicted economic loss. Economic loss caused by negligent construction apparently raises similar issues as other types of negligently inflicted economic loss.\(^\text{15}\)

The argument is developed in four parts. Part II discusses the development of the doctrines which courts have applied to the construction cases. These doctrines are sometimes at odds, and unsurprisingly, courts have applied them in many ways. Part III identifies six distinct, inconsistent approaches adopted by various jurisdictions.

Part IV contains the bulk of the Article. After determining that any action should protect the injured party’s reliance interest,

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13. 174 N.E. at 444–48. Several other Cardozo opinions discussed in this Article also shape the debate on economic loss claims against nonprivity builders.
14. Id. at 444 (emphasis added).
15. The action’s application to non-construction disputes is considered only illustratively in this Article. Several authors have discussed the possibility or desirability of permitting parties to recover for negligently caused economic loss, without concentrating on issues associated with defects or delay in the construction of improvements. See, e.g., Abel, *Should Tort Law Protect Property Against Accidental Loss?*, 23 SAN DIEGO L. REV. 79 (1986) (advocating denial of all recoveries for accidental loss); Dente, *Negligence Liability to All Foreseeable Parties for Pure Economic Harm: The Final Assault upon the Citadel*, 21 WAKE FOREST L. REV. 587 (1986) (if trends continue, lack of privity will no longer bar negligence actions for economic loss); Rabin, *supra* note 10, at 1534 (primary reason for denial of economic loss has been concern for liability disproportionate to the egregiousness of the act); Note, *Purely Economic Loss: A Standard for Recovery*, 73 IOWA L. REV. 1181 (1988) (advocating recovery for negligently inflicted economic loss if the plaintiff and harm were foreseeable).
microeconomic analysis, in particular the Coase theorem, is applied to show that Cardozo correctly identified indeterminacy as the major problem posed by an action to recover for negligently inflicted economic loss. The proposed action is structured to protect injured parties' reliance on the nonprivity builder without exposing the builder to claims by an indeterminate class of possible plaintiffs seeking indeterminate types and amounts of damages for losses caused over an indeterminate period of time. Finally, Part V recasts the tort into more general terms and illustrates its application to non-construction disputes.

II. THE DEVELOPMENT OF THE GOVERNING DOCTRINES

Until the second half of the twentieth century, no jurisdiction would have recognized a claim against a nonprivity builder to recover purely economic loss caused by an alleged delay or defect in the construction of an improvement. Several different defenses—lack of privity, economic loss, caveat emptor, and “completed and accepted”—blocked recovery.

More recently, however, the privity defense has declined in importance, and the caveat emptor and “completed and accepted” defenses have all but disappeared. Only the economic loss doctrine remains vital, having gained strength as a means of preventing the Uniform Commercial Code from becoming superfluous in products liability litigation. Meanwhile, the post-1950 expansion of two actions, implied warranty and negligent misrepresentation, has provided additional bases for recovery for plaintiffs suffering economic loss from construction defects.

16. The Coase theorem derives from a thirty-year old article, Coase, The Problem of Social Cost, 3 J. LAW & ECON. 1 (1960), which largely fueled the law and economics movement.
17. See infra notes 20–28 and 42–45 and accompanying text.
18. See infra notes 29–41 and 65–89 and accompanying text.
19. See infra notes 47–64 and accompanying text. This Article only briefly discusses these developments; other authors have addressed them in greater detail. See, e.g., Barrett, supra note 1, at 897–919 (discusses builder's defenses to claim for economic loss caused by defective construction); Roberts, The Case of the Unwary Home Buyer: The Housing Merchant Did It, 52 CORNELL L.Q. 835, 837–62 (1967) (discusses the rise of implied warranty claims in the home construction context).
A. The Builder's Defenses

1. Lack of Privity

The privity defense to negligence actions reaches back to 1842. The English Court of Exchequer held in Winterbottom v. Wright\textsuperscript{20} that a mail coach driver had no claim against the defendant, who had contracted with the Postmaster General to maintain the coaches, because allowing a party not in privity to maintain an action would lead to "the most absurd and outrageous consequences, to which I can see no limit."\textsuperscript{21} For the remainder of the nineteenth century, both English and American courts followed Winterbottom in barring negligence claims of parties not in privity with the defendant.\textsuperscript{22}

The erosion of the privity defense to negligence actions began with Justice Cardozo's decision in MacPherson v. Buick Motor Co.,\textsuperscript{23} permitting a plaintiff who had suffered personal injury to bring a negligence claim against the manufacturer of a defective car wheel.\textsuperscript{24} The privity defense also increasingly proved unavailing when alleged negligence resulted in injury to tangible property.\textsuperscript{25} By the early 1960s lack of privity generally did not bar negligence or strict liability actions arising from personal injuries or damage to tangible property.\textsuperscript{26}

During the last twenty years, most states also have abrogated the privity defense to claims of negligent construction resulting in purely

\begin{itemize}
  \item \textsuperscript{20} 152 Eng. Rep. 402 (1842).
  \item \textsuperscript{21} Id. at 405.
  \item \textsuperscript{22} See Barrett, \textit{supra} note 1, at 901-04; Dente, \textit{supra} note 15, at 587-88; Rabin, \textit{supra} note 10, at 1529-31. Courts may have misinterpreted the decision. The Winterbottom court may have intended to condemn a broad third-party beneficiary theory or may have intended to state "that not every duty assumed by contract will sustain an action sounding in tort." Barrett, \textit{supra} note 1, at 901 (quoting Council of Co-Owners Atlantis Condominium, Inc. v. Whiting-Turner Contracting Co., 308 Md. 18, 32, 517 A.2d 336, 343 (1986)).
  \item \textsuperscript{23} 217 N.Y. 382, 111 N.E. 1050 (1916).
  \item \textsuperscript{24} Barrett, \textit{supra} note 1, at 904-05.
  \item \textsuperscript{25} The Restatement of Torts did not expressly identify the nature of the interests protected against unreasonable risk of harm. Its illustrations, however, made clear that harm to the property of another with whom the actor was not in contractual privity could subject the actor to liability. \textit{See, e.g.}, Restatement of Torts § 302 illustrations 4, 22, § 303 illustration 2 (1934).
  \item \textsuperscript{26} The Restatement (Second) of Torts expressly rejects any privity requirement for strict liability actions. \textit{See} Restatement (Second) of Torts § 402A (1964) (a seller of a product is subject to liability to a user or consumer who suffers personal injury or injury to property even though the injured party has not bought the product from or entered into any contractual relation with the seller). The Restatement (Second) does not expressly reject the privity defense for negligence actions. Nevertheless, it continually refers to negligent acts as occurring when the actor should know that his conduct involves an unreasonable risk of invading another's interest, without limiting the other to contracting parties, see, \textit{e.g.}, Restatement (Second) of Torts (1984) §§ 289, 291, and permits consideration in certain circumstances of the unreasonable risk of harm posed to third parties. \textit{Id.} §§ 294, 295. Clearly, therefore, the Restatement (Second) does not require contractual privity for a negligence action either.
\end{itemize}
economic loss.27 Lack of privity remains, however, a viable defense to construction defect suits in at least five states.28

2. Economic Loss Doctrine

The extent to which courts prior to 1950 adopted the economic loss doctrine, preventing plaintiffs from suing under nonintentional tort theories for injuries causing purely economic loss, is unclear. Some scholars believed that harm to person or property generally was necessary for a negligence action;29 but in most or all of the cited decisions denying recovery in negligence when the only harm was pecuniary, the parties also had not contracted, making it difficult to pinpoint the determinative factor.30 The Restatement did not address the issue


28. The effect of lack of privity, however, varies slightly among those five jurisdictions. See Morse/Diesel, Inc. v. Trinity Indus., 859 F.2d 242, 247 (2d Cir. 1988) (under New York law, except for accountants, "professionals are not liable either in tort or contract absent privity" for the plaintiff's purely economic loss); Public Service Enter. Group v. Philadelphia Elec. Co., 722 F. Supp. 184, 193–95 (D.N.J. 1989) (under Pennsylvania law, a plaintiff may recover because of negligently caused economic harm only if in contractual privity with the defendant; this case involves management of a nuclear power plant rather than its construction); Wells v. Clowers Constr. Co., 476 So. 2d 105, 106 (Ala. 1985) (per curiam) (an action for damages allegedly arising from the negligent construction of a house, if brought by a party not in privity with the builder, is barred under the doctrine of caveat emptor); Village of Cross Keys v. United States Gypsum Co., 315 Md. 741, 556 A.2d 1126, 1131 (1989) (when negligence creates a risk of economic loss only, an intimate nexus between the parties, such as privity, is required to impose tort liability); Floor Craft Floor Covering v. Parma Community Gen. Hosp. Ass'n, 54 Ohio St. 3d 1, 560 N.E.2d 206, 212 (1990) (in the absence of privity, a contractor has no tort action against an architect for economic loss caused by the architect's allegedly negligent plans and specifications).

29. For example, in the first edition of his handbook, Dean Prosser stated:

In other situations, difficult to distinguish in principle, there has been some reluctance to find such liability to a stranger [to a contract] even for misfeasance—notably in the case of a building contractor who turns over a defective building to the owner, or one who repairs a chattel and leaves it in a dangerous condition. The fear of burdening industry with a crushing responsibility has played a prominent part in these decisions. Particularly where the harm is to a pecuniary interest of the plaintiff, rather than to his person or tangible property—as in the case of misrepresentation inducing him to buy—the tendency has been to restrict liability within very narrow limits.

W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 33, at 207–08 (1941) (emphasis added) (footnotes omitted). This is the closest Dean Prosser comes to recognizing the economic loss rule in the handbook. It is impossible to ascertain from the quotation how much the "tendency" to restrict liability results from lack of privity and how much from the lack of harm to the plaintiff's person or tangible property. Moreover, Prosser does not state that no liability exists, only that it is restricted "within very narrow limits." Id. at 208.

30. See, e.g., Stevenson v. East Ohio Gas Co., 47 Ohio L. Abs. 586, 73 N.E.2d 200, 203 (Ohio App. 1946) ("If one who by his negligence is legally responsible for an explosion or a
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directly, defining a negligent act as one which posed "an unreasonable risk to another," without specifying the interests imperiled by the risk. The Restatement only implied that purely economic loss was not recoverable in negligence actions. It did so in several ways: first, none of its illustrations of negligent acts involved instances of purely economic loss; second, it contained a separate section for negligent misrepresentations causing only economic loss, which arguably would have been unnecessary if a plaintiff could recover economic loss in an ordinary negligence action; and third, it provided an action for intentional interference with contractual relationships but none for negligent interference.

Regardless of the views of scholars and Restatement authors, very few decisions prior to 1950 stated that injured parties could not recover in negligence for purely economic loss. In fact, the approaches taken by many courts suggested that they did not recognize the economic loss rule. Their holdings that a plaintiff could not sue in tort for any type of injury, including purely economic loss, unless in contractual privity with the defendant, implied that when privity existed, the plaintiff possessed a negligence claim. Moreover, courts sometimes imposed a tort duty on a defendant who had performed contractual duties poorly, resulting in only economic loss, stating that the duty arose at least in part independently of the contract. Finally, even

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31. RESTATEMENT OF TORTS §§ 302, 303 (1934).
32. Some involved injury to persons, others injury to property. See, e.g., id. §§ 302, 303, illustrations.
33. Id. § 552 (1938). Negligent misrepresentations are discussed in detail below. See infra notes 47–56 and accompanying text.
34. RESTATEMENT OF TORTS § 766 (1939). The comment to § 766 is clear: "The essential thing is the purpose to cause the result. If the actor does not have this purpose, his conduct does not subject him to liability under this rule even if it has the unintended effect of deterring the third person from dealing with the other." Id. comment d.
35. See, e.g., Brunelle v. Nashua Bldg. & Loan Ass’n, 95 N.H. 391, 64 A.2d 315 (1949) (rejects defendant’s argument that no tort action is available when parties are in contractual privity and permits plaintiffs to sue in tort as well as contract when defendant negligently performed its contractual undertaking to convey good title).
36. Justice Cardozo was among them. In Glanzer v. Shepard, 233 N.Y. 236, 135 N.E. 275 (1922), which is discussed in greater detail below, see infra text accompanying notes 48–51, he wrote that public weighers could be liable for negligently failing to weigh beans accurately:

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nominally contractual claims against builders actually were based on the implied duty of the builder to use the skill and care of ordinarily skilled persons in the business. The courts read this tort duty into the contracts.

Although the economic loss rule may not have as clear a heritage as its advocates believe, it was largely adopted in section 766C of the Restatement (Second) of Torts. That section provides that an actor is not liable for purely pecuniary harm caused by the actor's negligent interference with a third party's entry into or performance of a contract with the plaintiff or "with [the plaintiff's] performance of his contract or making the performance more expensive or burdensome." If followed by the courts, this provision would block all, or virtually all, claims by one builder against another, because the plaintiff almost always claims that the defendant's negligence made it more expensive for the plaintiff to perform its existing contractual duties. Section 766C, however, has had little impact in construction cases. Moreover, the section does not block a claim by a subsequent purchaser because the negligent construction generally will not interfere with a third party's entry into or performance of a contract with the subsequent purchaser or make the subsequent purchaser's performance of an existing contract more expensive.

In such circumstances, assumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed. We do not need to state the duty in terms of contract or of privity. Growing out of a contract, it has none the less an origin not exclusively contractual. Given the contract and the relation, the duty is imposed by law.

37. The builder frequently sued for money withheld by the owner because of an alleged defect, and the owner asserted the defect as an affirmative contractual defense and/or counterclaim. See, e.g., Chapel v. Clark, 117 Mich. 638, 76 N.W. 62 (1898); White v. Pallay, 119 Or. 97, 247 P. 316 (1926); Pierson v. Tyndall, 28 S.W. 232 (Tex. Civ. App. 1894).


39. Cf Redarowicz v. Ohlendorf, 92 Ill. 2d 171, 441 N.E.2d 324, 332 (1982) (Ryan, C.J., dissenting) (the extension of the implied warranty of habitability to subsequent purchasers is a fiction that actually converts what was originally conceived "as a contract action into an action in tort in the nature of strict liability").


41. Few courts applying the economic loss rule in construction cases have relied on § 766C. But see Local Joint Executive Bd. of Las Vegas, Culinary Workers' Union, Local # 226 v. Stern, 98 Nev. 409, 651 P.2d 637, 638 (1982).
3. **Other Doctrines Blocking Recovery**

Two other doctrines protected builders: caveat emptor and the "completed and accepted" defense.\(^{42}\) The doctrine of caveat emptor, or buyer beware, barred purchasers of new homes from suing sellers for defects in the property, regardless of whether the defects resulted in personal injury, damage to other property, or only economic loss.\(^{43}\) The "completed and accepted" defense worked much the same way to block third party claims: the completion of the work and its acceptance by the owner terminated the builder's liability to everyone but that owner, for personal injury as well as economic loss.\(^{44}\) As the twentieth century progressed, however, "these defenses became riddled with exceptions and have been rejected outright in most jurisdictions."\(^{45}\)

Through the first half of the twentieth century, therefore, at least four defenses protected a nonprivity builder against a claim to recover economic loss caused by an alleged construction defect. As three of those defenses decreased in importance, the economic loss doctrine increased, primarily, at first, in products liability litigation. Before discussing the products liability suits, however, it is necessary to sketch the development of two actions permitting recovery for purely economic loss: negligent misrepresentation and implied warranty.\(^{46}\)

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\(^{42}\) These doctrines would have had no impact on a lawsuit between two builders on a project.

\(^{43}\) See Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults upon the Rule*, 14 VAND. L. REV. 541, 542–43 (1961) (through World War II, courts uniformly held that, under the doctrine of caveat emptor, no warranties of quality or fitness for a known purpose are implied in the sale of real estate).

\(^{44}\) Barrett, *supra* note 1, at 904. The concept of contractual privity was crucial to this defense. The general rule was that:

> The contractor is not liable [for negligence resulting in injury or damage to a third person after the completion of the work and its acceptance by the owner], on the theory that no privity of contract exists between the contractor and such third person, and that no duty is owed by the contractor in performing the contract to one other than the contratee .... The responsibility for maintaining the completed structure and protecting third persons against danger therefrom, or for use of it in a defective condition, or for failing to give notice or warning of danger to be apprehended from its existence, is, after the acceptance, shifted to the owner.

Annotation, *Negligence of Building or Construction Contractor as Ground of Liability upon His Part for Injury or Damage to Third Person Occurring After Completion and Acceptance of the Work*, 13 A.L.R.2d 191, 201–03 (1950).


\(^{46}\) These actions were not available in construction cases until the latter half of the twentieth century. The lack of privity would have blocked a contractor's negligent misrepresentation claim.
B. Actions Available to Plaintiffs

1. Negligent Misrepresentation

The action for negligent misrepresentation developed largely out of several decisions of the New York Court of Appeals, culminating in the 1931 decision in *Ultramares*. In deciding against the plaintiffs, Justice Cardozo distinguished several prior decisions, including his own opinion in *Glanzer v. Shepard*. In that case, a bean seller requested defendants, public weighers, to weigh his beans and provide a copy of the certificate to the plaintiff, the buyer. The weighers’ certificate stated that it was ordered by the seller for the use of the buyer. The certificate, however, turned out to be incorrect, and the buyer, relying on it, overpaid.

Cardozo stated that the transmission of the certificate to Glanzer "was not merely one possibility among many, but the 'end and aim of the transaction,' as certain and immediate and deliberately willed as if a husband were to order a gown to be delivered to his wife . . . ." The relationship was akin to contractual privity. The relationship in *Ultramares* between the accountants who prepared the audited financial statements and an unknown lender was different, according to Cardozo. Whereas in *Glanzer*, the weigher's service "was primarily for the information of a third person . . . and only incidentally for that of the formal promisee," in *Ultramares* the accountants' service was primarily for the audited company "and only incidentally or collaterally for the use of those to whom [that company] might exhibit it thereafter."

The *Restatement* elaborated on the distinction drawn by Cardozo between the facts in *Ultramares* and *Glanzer*. Liability attached to one who "in the course of his business or profession" negligently supplied information "for the guidance of others in their business transactions" if the harm was suffered "by the person or one of the class of persons for whose guidance the information was supplied" because of "his justifiable reliance upon it in a transaction in which it was intended to influence his conduct" or in a "substantially identical" transaction.

The *Restatement* did not expressly provide that liability would extend against an architect. See supra notes 23–28 and accompanying text. Nor did courts recognize implied warranty claims for faulty construction. See infra notes 60–64 and accompanying text.

47. See supra text accompanying notes 12–14.
49. 135 N.E. at 275.
51. *Id.* at 446.
52. *Restatement of Torts* § 552 (1938).
to purely economic harm, but illustration 1 makes clear that it would.\footnote{Id., illustration 1. In that illustration, Y Bank makes a loan in reliance on a negligently prepared audit of A performed by B & Company, a firm of public accountants, which in turn believed that A would obtain the loan from X Bank instead of Y Bank. Because of the neglect, Y Bank suffers the loss of the loaned funds. Even though Y Bank has suffered only economic loss, B & Company may be liable, depending on whether it undertook the audit on condition that it be used to obtain the credit from X Bank only. In the Restatement (Second) of Torts, that illustration reappears in altered form as illustrations 5 through 7 to § 552.}

The Restatement (Second) expands the claim marginally\footnote{Liability extends to one who supplies information in any “transaction in which he has a pecuniary interest,” not just in the course of his business or profession. RESTATEMENT (SECOND) OF TORTS § 552(1) (1976). At least one court has used this provision to hold that a property owner may be liable to a subcontractor for plans negligently prepared by the owner’s architect. Gilbane Bldg. Co. v. Nemours Found., 606 F. Supp. 995, 1001–02 (D. Del. 1985). Persons under a public duty to give information also may be liable under specified conditions. RESTATEMENT (SECOND) OF TORTS § 552(3) (1976).} and, more important, defines the damages recoverable. The plaintiff may recover any pecuniary loss suffered in reliance on the misrepresentations including the difference between the value received and the purchase price, but not the benefit of the plaintiff’s bargain with the defendant.\footnote{See infra notes 132–41 and accompanying text. The comments to § 766C suggest that § 552 should control over § 766C. RESTATÉMENT (SECOND) OF TORTS § 766C comment e (1977).}

The plans and specifications prepared by architects and engineers contain representations relied upon by other builders in the course of construction. A court following section 552, therefore, may hold an architect or engineer liable for the economic loss suffered by another builder in reliance on the plans, despite the application of the economic loss rule to negligent performance claims.\footnote{See generally 2 S. WILLISTON, WILLISTON ON SALES §§ 15–19, 15–20 (A. Squillante & J. Fonesca, 4th ed. 1974).}

2. Implied Warranty

Claims based on implied warranties date back at least to 1815.\footnote{UNIF. SALES ACT § 14 (1906) (act superseded by Article 2 of UCC).} The action became sufficiently well established that under the Uniform Sales Act, adopted in 1906, a seller of goods impliedly warranted that they were reasonably fit for a particular purpose made known by the buyer when the buyer relied on the seller’s skill or judgment, and a dealer in goods bought by description warranted their merchantability.\footnote{See B. CLARK & C. SMITH, THE LAW OF PRODUCT WARRANTIES §§ 1.01, 1.02 (1984).} Implied warranties have attached to the sale of goods by merchants ever since.\footnote{See generally 2 S. WILLISTON, WILLISTON ON SALES §§ 15–19, 15–20 (A. Squillante & J. Fonesca, 4th ed. 1974).}
While merchants impliedly warranted the quality of their goods throughout the first half of the twentieth century, sellers of newly constructed improvements often did not. 60 A builder who contracted with a consumer to construct a house impliedly warranted its quality, but caveat emptor protected a builder-vendor who sold a completed house. Courts reasoned that if the house had not been started prior to purchase, the buyer could not perform a pre-purchase inspection and was entitled to protection. If the house had been completed before purchase, however, the opportunity to inspect obviated the need for an implied warranty. 61

After the Korean War, several jurisdictions began to eat away at the distinction, holding that when the plaintiff purchased a house in the process of construction, the builder-vendor impliedly warranted its quality. From that point, it was an easy jump to hold that any seller of a new house gave an implied warranty, whether or not it was purchased prior to the completion of construction. 62 Now all or virtually all states provide that an implied warranty accompanies the first sale of a new house. 63

This warranty, however, does not help a subsequent purchaser of a house, or any purchaser of commercial property, unless the warranty protects more than new home purchasers. To the extent that courts do extend implied warranties to protect those not in privity with builders, they evade the restrictions of the economic loss rule. 64

C. The Economic Loss Doctrine in the Sale of Products

As privity and other defenses declined, the economic loss doctrine rose to the fore in the 1960s largely to preserve a role for contractual

60. Professor Roberts ridiculed the distinction, pointing out that the purchaser of a two dollar fountain pen could recover the cost of the pen from the seller if it did not work, while a couple who had poured their entire savings into the purchase of a house could not recover from the developer when the ceiling collapsed. Roberts, supra note 19, at 835–36.

61. Id. at 837–43. Paradoxically, one court recently held that builder-vendors give implied warranties of habitability, while builders who are not vendors give a lesser warranty. See Carolina Winds Owners' Ass'n v. Joe Harden Builder, 297 S.C. 74, 374 S.E.2d 897, 899–901 (S.C. Ct. App. 1988), overruled in part, Kennedy v. Columbia Lumber & Mfg. Co., 299 S.C. 335, 384 S.E.2d 730, 736 (1989) (rejects the Court of Appeals' position that a nonvendor builder gives no warranty, but states in dictum that a builder-vendor gives an implied warranty of habitability while the nonvendor builder gives only an implied warranty of workmanlike service).


64. See infra notes 117–21 and accompanying text (discussing extensions of warranty protections).
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risk allocations and the Uniform Commercial Code's (UCC) implied warranty provisions. Under the UCC, a merchant impliedly warrants the merchantability of the goods it sells,\(^65\) and if the seller knows the particular purpose for which the purchaser intends to use a product, its fitness for that purpose.\(^66\) If the product does not perform up to the warranty, the seller is liable for direct, incidental and reasonably foreseeable consequential damages, regardless of whether the breach results in personal injury, property damage or only economic loss.\(^67\)

If an injured purchaser can also sue the seller for negligence, the implied warranty may still have a unique role, because a plaintiff need not prove lack of due care to show breach of warranty.\(^68\) The uniqueness largely disappears, however, if the plaintiff also has a strict liability claim under Restatement (Second) of Torts section 402A, because the basic elements of implied warranty and strict liability actions are virtually identical.\(^69\) Indeed, strict liability doctrine evolved in part to provide consumers the protection of implied warranties without the defenses which sometimes defeated implied warranty claims.\(^70\)

For purposes of this Article, the most important of these defenses was lack of privity.\(^71\) The UCC originally provided that the warranty ran from the seller of goods to the buyer, members of the buyer’s family and household and the buyer’s guests.\(^72\) It took no position whether a consumer could sue a nonprivity manufacturer for breach of warranty.\(^73\) As discussed above, by the early 1960s, lack of privity provided little defense against a negligence claim,\(^74\) and the Restatement...
ment (Second) of Torts expressly provided that an injured consumer could bring a strict liability claim directly against the manufacturer.\textsuperscript{75} Many states subsequently also abolished the privity requirement for implied warranties connected with the sale of goods, refusing to allow manufacturers to insulate themselves from liability through layers of distributors and retailers.\textsuperscript{76} Even with the easing of the privity restriction, however, plaintiffs could not sue more remote parties in contract than in tort.

Given the similarity between the elements of strict liability and implied warranty claims and the fewer defenses which a seller could raise to the former, if all types of injury could be prosecuted in tort, the UCC's implied warranty provisions and the parties' ability to allocate risks by contract might become no more than an historical artifact. Courts refused to roll back an injured party's right to sue in negligence and strict liability as well as under the UCC when the defective product allegedly caused injury to the plaintiff's person or property; tort law traditionally applied to those types of injury. Many drew the line, however, when the product caused only economic loss.\textsuperscript{77}

Two decisions from 1965 took polar positions. The New Jersey Supreme Court, in \textit{Santor v. A. \& M. Karagheusian, Inc.},\textsuperscript{78} rejected the argument that the economic loss rule precluded tort actions. It held that a consumer could sue a carpet manufacturer in strict liability to recover the cost of defective carpet.\textsuperscript{79} Four months later, however, the California Supreme Court, expressly rejecting the reasoning in \textit{Santor}, held in \textit{Seely v. White Motor Co.}\textsuperscript{80} that the purchaser of a truck which

\textsuperscript{75. Re}\textsuperscript{statement (Second) of Torts § 402A (1963).}

\textsuperscript{76. See Coburn v. Lenox Homes, 173 Conn. 567, 378 A.2d 599, 601 (1977); Brown v. Fowler, 279 N.W.2d 907, 910 (S.D. 1979); see infra notes 356-61 and accompanying text (discussing erosion of UCC's privity defense to an implied warranty action).}

\textsuperscript{77. See Feinman, The Jurisprudence of Classification, 41 STAN. L. REV. 661, 665-67; Schwartz, supra note 3, at 51-53.}

\textsuperscript{78. 44 N.J. 52, 207 A.2d 305 (1965).}

\textsuperscript{79. 207 A.2d at 309. The court explained that making all intermediate sellers parties to a series of contract claims would be inefficient (this factor has disappeared to the extent that the vertical privity requirement for breach of warranty suits has been eliminated), that consumers lack the competence and opportunity to inspect products for defects, that the manufacturer is in a better position to bear or spread the cost of repair or replacement, and that any distinction between damage to the product itself and damage to other property is purely arbitrary. \textit{Id.} at 310-12.}

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overturned due to defective brakes had only a warranty remedy. Recovery of the cost of repairs, the purchase price and lost profits in tort would undermine the risk allocation negotiations of the parties and/or the scheme of warranty remedies established in the UCC.

The courts of several other jurisdictions have staked out intermediate positions, focusing on the risk of harm. They believe that under Seely the ability to bring a tort claim depends on a mere fortuity. For example, if a defective toaster burns, damaging only the toaster, a plaintiff may sue only in contract; if the fire spreads to the table on which the toaster rests, a plaintiff may sue in tort. In response, these courts hold that if the loss takes place in a manner that poses an unreasonable risk of harm to persons or other property, the plaintiff may sue in negligence or strict liability, even if the damage happens to be confined to the defective product itself.

Most jurisdictions have adopted the position staked out in Seely. In 1986, the United States Supreme Court strengthened this trend when it concluded in East River Steamship Corp. v. Transamerica Delaval, Inc., an admiralty case, that the economic loss rule precluded the plaintiff's tort claims for repair costs and lost profits caused by several allegedly defective turbine engines. The Court criticized the intermediate position as "too indeterminate to enable manufacturers easily to structure their business behavior." It then rejected the Santor approach, at least in the context of two commercial parties, for several reasons, including the desirability of permitting a manufacturer to disclaim warranties or limit remedies in exchange for a reduction in the purchase price, and in part because of the risk, a la Justice Cardozo, that a tort duty would expose manufacturers to liability in

81. 403 P.2d at 149–52, 45 Cal. Rptr. at 21–24.
82. See id.
84. Even the New Jersey Supreme Court has retreated from its position in Santor, at least in the context of a commercial purchaser. Spring Motors Distrib. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660, 672 (1985). When both parties are commercial, the court explained, they have comparable bargaining power, the purchaser may have even more knowledge of its risk than does the manufacturer, and allowing a tort suit would undermine the UCC. 489 A.2d at 671.
85. 476 U.S. 858 (1986).
86. Id. at 871. The decision barred the plaintiff in East River from any relief. The applicable statute of limitations and possibly also a prior settlement agreement barred any contract claim. Id. at 861, 875.
87. Id. at 870.
an indefinite amount to an indefinite range of plaintiffs.\textsuperscript{88} Since this decision, several courts which had not addressed the issue or had followed the Santor or intermediate positions have adopted the majority approach.\textsuperscript{89}

Many of the same issues recur in suits against a nonprivity builder alleging that a defect or delay in construction has resulted in purely economic loss. Not surprisingly, the conflicting theories have produced a wide and inconsistent range of solutions.

III. A BABEL OF VOICES

Courts have focused primarily on three actions in deciding whether an injured party may sue for a purely economic loss arising from a defect or delay in construction: negligence, breach of implied warranty, and negligent misrepresentation.\textsuperscript{90} The availability and nature

\textsuperscript{88.} Id. at 872–74.

\textsuperscript{90.} Plaintiffs also occasionally, and generally unsuccessfully, sue as third-party beneficiaries of a contract or under strict liability in tort. Typically, a contractor is regarded as merely an incidental beneficiary of a contract between an architect and an owner, and therefore unable to sue as a third party beneficiary. \textit{See} A.L. Moyer, Inc. v. Graham, 285 So. 2d 397, 402–03 (Fla. 1973), \textit{overruled on other grounds} by Abstract Corp. v. Fernandez Co., 458 So. 2d 766 (Fla. 1984). A provision in the form contract between an architect and owner issued by the American Institute of Architects, the most commonly used form Architect-Owner Agreement, makes that status clear. \textit{See infra} note 262 and accompanying text. \textit{But see} Prichard Bros. v. Grady Co., 407 N.W.2d 423, 427–28 (Minn. Ct. App. 1987) (without explanation, treats general contractor as third-party beneficiary of owner-architect contract, but concludes that architect did not breach that agreement), \textit{rev'd}, 428 N.W.2d 391 (Minn. 1988) (en banc).

A subsequent purchaser’s right to sue as a third-party beneficiary of the contract between the defendant builder and the original purchaser is dubious, because the subsequent purchaser’s identity was unknown at the time of contracting and the contracting parties therefore did not intend the contract to benefit her. \textit{See} Coburn v. Lenox Homes, 173 Conn. 567, 378 A.2d 599, 601 (1977). In rare circumstances, however, such as when the builder contracts with a landlord to renovate the premises of an existing tenant, a third-party beneficiary claim may be viable. \textit{See} Schwartz, \textit{supra} note 3, at 42–44; \textit{infra} note 98. \textit{See also} Keel v. Titan Constr. Corp., 639 P.2d 1228, 1231 (Okl. 1982) (owner is third-party beneficiary of contract between general contractor and architect concerning house to be built for owner).

Judicial unwillingness to use strict liability theory is somewhat surprising because of the practical and theoretical similarities between strict liability and implied warranty actions, especially when privity of contract is no longer required for recovery based on an implied warranty concerning goods. \textit{See supra} notes 71–76 and accompanying text. Nevertheless, the
of these actions vary substantially among the states. Nevertheless, states can be grouped into six major categories based on the type(s) of relief available: negligence but not warranty; warranty but not negligence; intermediate negligence (whether or not a warranty action is also available); negligent misrepresentation available in instances when negligence is not; both warranty and negligence; and neither negligence nor warranty.

This part of the Article focuses on the decisions of one jurisdiction within each category. The discussion concerns only whether the non-privity builder owes a tort or contractual duty to the injured party.91

A. Negligence but Not Warranty: California

Probably the two most frequently cited decisions concerning a non-privity builder’s duty not to negligently cause purely economic loss come out of California. One of these involved a suit by a contractor against an architect, the other a suit by a commercial tenant against a contractor.

In United States v. Rogers & Rogers,92 a general contractor claimed that the architect had breached its duty to supervise a project by allowing a subcontractor to use defective concrete. As is typical on large construction projects, the architect and contractor were not in privity of contract; each had contracted directly with the owner, the United States. When the problem was discovered, the architect issued a stop order, and the subsequent corrective measures and delay allegedly caused the plaintiff substantial loss.93

Applying a six-factor test used by California courts to determine whether a defendant has a duty to a noncontractual party to avoid the negligent infliction of economic loss,94 the United States district court

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91. Courts have barely considered the other elements of a claim: breach of duty, causation and damages. Only the failure to analyze damage issues has been critical. See infra notes 289–94 and accompanying text (identifying recoverable damages under proposed action).
93. Id. at 133–34.
94. The test, first enunciated in Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958), considers (1) the extent to which the transaction is intended to affect the plaintiff, (2) the foreseeability of harm to the plaintiff, (3) the degree of certainty that the plaintiff has suffered injury, (4) the closeness of the connection between the defendant’s conduct and the injury suffered, (5) the moral blame attached to the defendant’s conduct, and (6) the policy of preventing future harm. 320 P.2d at 19.
rejected the architect's motion for summary judgment and held that the architect had a tort duty to the contractor:

Considerations of reason and policy impel the conclusion that the position and authority of a supervising architect are such that he ought to labor under a duty to the prime contractor to supervise the project with due care under the circumstances, even though his sole contractual relationship is with the owner, here the United States. Altogether too much control over the contractor necessarily rests in the hands of the supervising architect for him not to be placed under a duty imposed by law to perform without negligence his functions as they affect the contractor. The power of the architect to stop the work alone is tantamount to a power of economic life or death over the contractor. It is only just that such authority, exercised in such a relationship, carry commensurate legal responsibility. 

About twenty years after Rogers & Rogers, the California Supreme Court held in J'Aire Corp. v. Gregory that a general contractor had a tort duty to the tenant of a commercial building to complete renovations within a reasonable time, even though the contractor contracted with the landlord, not the tenant. The tenant alleged that, because of the unreasonable delay in completing the job, it had lost business and profits. The court focused on the foreseeability of harm to the plaintiff, the second factor in its six-factor test. It distinguished two prior decisions (not in the construction setting) because the risk of injury in those cases had been much less foreseeable to the defendants, and held that here, where the tenant was known, the contrac-
tor could have foreseen that its negligence would result in economic harm. Subsequently, a California court of appeals permitted a subsequent purchaser who had suffered only economic loss to pursue a negligence claim against a builder.

Although California has led the way in providing relief against non-privity builders in negligence, it has not looked favorably on claims based on breach of implied warranty. An implied warranty of fitness for the buyer's use accompanies the first sale of improved property in California, but subsequent purchasers may not recover for breach of the implied warranty: privity is required.

A plurality of jurisdictions apparently follow California's approach of permitting a plaintiff to sue a nonprivity builder for purely economic loss in negligence but not for breach of implied warranty. Most of the states which conclude that a nonprivity builder has a duty to avoid the negligent infliction of economic loss, however, do not use the six-factor test. Some focus virtually exclusively on the foreseeability of the harm, others on the nature of the duties set forth in the contract, and still others on the violation of building codes or industry standards.

101. 598 P.2d at 65.
103. 203 Cal. Rptr. at 808–09.
104. This author has not attempted a comprehensive count of all jurisdictions.
107. See, e.g., Donnelly Constr. Co. v. Ober/Gillette, 139 Ariz. 184, 677 P.2d 1292, 1295–96 (1984) (duty and liability are imposed when the plaintiff and the risk are foreseeable to a reasonable person); Waldor Pump & Equip. Co. v. Orr-Schelen-Mayeron & Assoc., 386 N.W.2d 375, 377 (Minn. Ct. App. 1986) (professional may be liable in negligence if it fails to use reasonable skill and judgment and a third party foreseeably and detrimentally relies upon its services); A.E. Inv. Corp. v. Link Builders, 62 Wis. 2d 479, 214 N.W.2d 764, 766 (1974) (a defendant has a duty if his act or omission foreseeably may cause harm to another, even if the identity of the other and the nature of the harm are unknown).
108. See, e.g., Bagwell Coatings, Inc. v. Middle South Energy, 797 F.2d 1298, 1310 (3d Cir. 1986) (under Mississippi law, an architect or engineer may be liable in tort to a third party for purely economic loss only if it breaches its duty to the principal or employer); Seattle W. Indus. v. David A. Mowat Co., 110 Wash. 2d 1, 10, 750 P.2d 245, 251 (1988) (the engineer’s duty of care to third parties “extends at least as far as the duties assumed by him in the contract with the owner,” plus any other duties assumed by affirmative conduct).
109. See Burran v. Dambold, 422 F.2d 133, 135 (10th Cir. 1970) (under New Mexico law, a builder may be liable for negligence per se if it violates the building code, proximately causing economic loss to a party whom the code is designed to protect); Kennedy v. Columbia Lumber & Mfg. Co., 299 S.C. 335, 384 S.E.2d 730, 738 (1989) (a builder may be liable in tort if it violates an
B. Implied Warranty but Not Negligence: Illinois

Probably the second most common approach when a construction defect causes only economic loss permits a suit only for breach of an implied warranty. One of the leading decisions setting out this position is the Illinois Supreme Court's Redarowicz v. Ohlendorf.\(^{110}\)

In Redarowicz, the second owner of a house sued the builder-vendor in negligence and for breach of implied warranty to recover economic loss arising from the builder's allegedly poor workmanship.\(^{111}\) In a prior decision, the Illinois Supreme Court had held that the owner of a storage tank had no negligence claim against the manufacturer when the tank deteriorated prematurely; under the economic loss rule, the owner's sole remedy was contractual.\(^{112}\) The court in Redarowicz saw no reason to treat a disappointed owner of a house differently than the disappointed owner of a storage tank.\(^{113}\) The Illinois Supreme Court subsequently held that these decisions blocked a negligence action between builders as well.\(^{114}\)

The homeowner in Redarowicz had a remedy, however. The implied warranty of habitability, which the builder-vendor had given to the original purchaser, also ran to the plaintiff as a subsequent purchaser, despite the absence of privity between them. The implied warranty existed independently of a contractual relationship, because of the homeowner's necessary reliance on the builder's expertise.\(^{115}\)

\(^{109}\) Washington Law Review

\(^{110}\) 92 Ill. 2d 171, 441 N.E.2d 324 (1982).

\(^{111}\) 441 N.E.2d at 326. The plaintiff also sued for fraud and as a third party beneficiary. Id. The supreme court upheld the dismissal of the fraud claim for failure to allege intent to defraud. Id. at 331. It permitted the homeowner to proceed on its third-party beneficiary theory, based on a unique set of facts. Id. at 328. The city in which the house was located had agreed to forego prosecution of the builder in exchange for the builder's agreement to make necessary repairs to the house. Id. The homeowner sued as the beneficiary of that agreement. Id. at 327–28.

\(^{112}\) 91 Ill. 2d 69, 435 N.E.2d 443, 448–53 (1982).

\(^{113}\) 441 N.E.2d at 327.


\(^{115}\) 441 N.E.2d at 330. The court stated:

While the warranty of habitability has roots in the execution of the contract for sale, we emphasize that it exists independently. Privity of contract is not required. Like the initial purchaser, the subsequent purchaser has little opportunity to inspect the construction methods used in building the home. Like the initial purchaser, the subsequent purchaser is usually not knowledgeable in construction practices and must, to a substantial degree, rely upon the expertise of the person who built the home. If construction of a new house is

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A subsequent purchaser may prefer an implied warranty claim to a negligence claim in one respect: she does not have to prove lack of due care. Even in those states, like Illinois, that permit subsequent house purchasers to sue builders for defects causing economic loss, however, other injured parties will find an implied warranty action inadequate or unavailable. Most states that have addressed the issue, including Illinois, hold that implied warranties do not protect purchasers of commercial property or purchasers for investment purposes. In several states, implied warranties protect only against defective, its repair costs should be borne by the responsible builder-vendor who created the latent defect. The compelling public policies underlying the implied warranty of habitability should not be frustrated because of the short intervening ownership of the first purchaser; in these circumstances the implied warranty of habitability survives a change of hands in the ownership.

Id. at 330 (citations omitted).

116. In at least some states, however, that benefit may be chimerical. In New Hampshire, for example, the implied warranty is of "workmanlike quality." Lempke v. Dagenais, 130 N.H. 782, 547 A.2d 290, 291 (1988). It is unclear how the duty to use "workmanlike quality" differs from the duty not to build negligently.

The New Hampshire Supreme Court has struggled with the construction cases. Only two years before its decision in Lempke, the court had decided that a subsequent purchaser did not benefit from the implied warranty of workmanlike quality. Ellis v. Robert C. Morris, Inc., 128 N.H. 358, 513 A.2d 951 (1986), overruled by Lempke v. Dagenais, 130 N.H. 782, 547 A.2d 290 (1988). Two years later, only Justice Souter dissented from the reversal. 547 A.2d at 298.

The New Hampshire Supreme Court is not the only state supreme court to somersault on extending the implied warranty to subsequent purchasers. In Keyes v. Guy Bailey Homes, 439 So. 2d 670 (Miss. 1983), the Mississippi Supreme Court rejected its own reasoning in three recent cases and also held that an implied warranty of habitability extended to subsequent purchasers. Id. at 671.

117. The states are approximately evenly split on the issue. Compare Barnes v. Mac Brown & Co., 342 N.E.2d 619, 620 (Ind. 1976) (implied warranty of habitability runs to subsequent purchaser because the mobility of our society and the complexity of construction technology make the privity requirement outmodeled) and Aronsohn v. Mandara, 98 N.J. 92, 484 A.2d 675, 678–79 (1984) (subsequent purchaser benefits from an implied warranty because it is assigned by the original purchaser unless the contract between the builder and the original purchaser had a nonassignability clause or the original purchaser intended to retain the warranty rights) with Coburn v. Lenox Homes, 173 Conn. 567, 378 A.2d 599, 601–02 (1977) (although privity is not required for implied product warranties, it should be for house warranties because the builder is not insulated by intermediaries from the purchaser, the builder does not solicit buyers through mass marketing, and houses are generally long-term investments that builders should not foresee changing ownership rapidly) and Stuart v. Coldwell Banker Commercial Group, 109 Wash. 2d 406, 415–16, 745 P.2d 1284, 1289 (1987) (court has been reluctant to extend the implied warranty of habitability in general). See generally Mallor, Extension of the Implied Warranty of Habitability to Purchasers of Used Homes, 20 AM. BUS. L.J. 361 (1982).


119. Chubb Group of Ins. Cos. v. C.F. Murphy & Assocs., 656 S.W.2d 766, 782 (Mo. Ct. App. 1983); see, e.g., Frickel v. Sunnyside Enters., 106 Wash. 2d 714, 719–20, 725 P.2d 422, 425–26 (1986) (plaintiffs have no implied warranty claim because, among other reasons, they were investors in the apartment complex, dispelling the notion of unequal bargaining positions). There are dissenters, however, see Tusch Enters. v. Coffin, 113 Idaho 37, 740 P.2d 1022, 1031 (1987) (implied warranty of habitability protects subsequent purchaser of three duplexes for
defects adversely affecting the habitability of the property, not ordinary defects. Finally, a builder who has been harmed by another builder during the construction process has no implied warranty claim.

C. Negligence Based on Risk of Physical Injury: Washington

In trying to balance the desire to compensate a party who has suffered economic loss against the policies underlying the economic loss rule, some courts have adopted intermediate approaches similar to those used in products liability litigation. In these jurisdictions, a defendant has a duty to avoid negligent infliction of economic loss if the negligence poses a risk of serious personal injury, even though no personal injury actually occurs.

The Washington Supreme Court first applied risk of loss analysis to construction disputes in Stuart v. Coldwell Banker Commercial Group, Inc., which involved allegations by a condominium homeowners’ association that the developer-builder’s construction defects resulted in rotten wood in decks and patios. Eleven years before, the same court in Berg v. General Motors Corp. had adopted a Santor-like approach when it permitted a commercial fisher to recover profits lost because his boat was laid up for repairs to its negligently built motor. The court in Stuart attempted to distinguish Berg, but in reality severely limited or overruled it, by stating that factors such as

investment purposes), and many states have not addressed the issue at all. The policy justifications for implied warranties, such as the typical home purchaser’s lack of knowledge of construction and the consequent disparity in bargaining power with the builder, often apply to sales of commercial real estate, but not as strongly or as uniformly. See Powell & Mallor, supra note 63, at 331–34 (arguing in favor of extension of implied warranties to sales of commercial real estate).

120. See Aronsohn v. Mandara, 98 N.J. 92, 484 A.2d 675, 681–82 (1984) (implied warranty of habitability extends only to suitability for living purposes, and plaintiffs have not shown that the allegedly defective patio was a vital living element in the house); Stuart v. Coldwell Banker Commercial Group, 109 Wash. 2d at 413–14, 745 P.2d at 1289 (builder-vendor warrants only that the foundation supporting a house is firm and secure and that the house is structurally safe).

121. Cf. Peck & Hoch, Liability of Engineers for Structural Design Errors: State of the Art Considerations in Defining the Standard of Care, 30 Vill. L. Rev. 403, 425 (1985) (courts reluctant to extend implied warranty action against design engineers except in residential construction setting). The Arizona Supreme Court, however, apparently is willing to recognize an implied warranty claim by one builder against another. See infra note 145 and accompanying text.

122. See supra text accompanying note 83.


124. Id. at 411–12, 745 P.2d at 1287.

125. 87 Wash. 2d 584, 555 P.2d 818 (1976).

126. See supra notes 78–79 and accompanying text.

127. 87 Wash. 2d at 591–94, 555 P.2d at 822–23.
“the nature of the defect, the type of risk, and the manner in which the injury arose” determine the availability of tort relief in economic loss cases.\textsuperscript{128} The Stuart court held that the association could pursue only a contract claim, because the nature of the defect was that the decks and walkways were not of the quality desired, the risk of personal injury did not appear great, and the injury stemmed from deterioration rather than an accident.\textsuperscript{129}

Several other courts have also focused on the risk of harm, although they have characterized the risk necessary to support a negligence duty differently.\textsuperscript{130} Although some subsequent purchasers who suffer only economic loss may have negligence claims in these states, few, if any, builders have claims against other builders under any risk of loss test.\textsuperscript{131}

\section*{D. Negligent Misrepresentation: Georgia}

General contractors and subcontractors file most negligent misrepresentation claims, generally against architects or engineers based on allegedly negligently prepared plans and specifications. Not surprisingly given the Restatement (Second)'s recognition of a negligent misrepresentation action,\textsuperscript{132} courts that permit negligence claims against nonprivity builders to recover economic loss also permit negligent misrepresentation claims to recover similar loss.\textsuperscript{133} Courts that either deny negligence actions entirely or impose a risk of harm analysis, however, divide on whether the economic loss rule affects negligent misrepresentation claims in the same manner as negligent performance claims.\textsuperscript{134}

\begin{footnotes}
\item[128] 109 Wash. 2d at 419–21, 745 P.2d at 1291–92.
\item[129] Id. at 421, 745 P.2d at 1292.
\item[130] See Council of Co-Owners Atlantis Condominium v. Whiting-Turner Contracting Co., 308 Md. 18, 517 A.2d 336, 345 n.5 (1986) (plaintiff may recover for purely pecuniary loss only if the negligence created a clear danger of death or personal injury); Chubb Group of Ins. Cos. v. C.F. Murphy & Assoc., 656 S.W.2d 766, 775 (Mo. Ct. App. 1983) (architects and contractors owe a duty to third parties who will foreseeably suffer injury, if the negligently built structure is "essentially and imminently dangerous to the safety of others . . . ") (quoting Begley v. Adaber Realty & Inv. Co., 358 S.W.2d 785 (Mo. 1962)).
\item[131] Because all risk of loss tests require that the defect pose a substantial risk of personal injury to the injured party, even though only economic loss actually occurred, a builder suffering only economic loss would have to show that the defect causing the loss actually created a substantial risk of personal injury to it during the construction process.
\item[132] See supra notes 54–55 and accompanying text.
\item[134] Compare AAA Excavating v. Francis Constr., 678 S.W.2d 889, 893 (Mo. Ct. App. 1984) (permitting negligent misrepresentation claim for allegedly negligent soil sampling and soil compaction tests) with Widett v. United States Fidelity & Guar. Co., 815 F.2d 885, 886–87 (2d
\end{footnotes}
A decision from a federal district court applying Georgia law dramatizes the distinction between negligent performance and misrepresentation claims.\(^{135}\) A general contractor alleged that it had suffered economic loss because the project engineer had negligently prepared its drawings of bridges for an interstate highway and negligently delayed its review of shop drawings submitted by the contractor. The court granted the engineer's motion for summary judgment on the negligence claim for delay in reviewing the drawings, based on the economic loss doctrine.\(^{136}\) Relying on a prior decision of the Georgia Supreme Court,\(^{137}\) however, the court denied the motion for summary judgment on the claim based on the negligently prepared drawings. The economic loss doctrine does not apply to negligent misrepresentation claims in Georgia.\(^{138}\)

In contrast, the Maryland Supreme Court has stated that it uses the same standards to determine whether a duty exists in negligence and negligent misrepresentation cases.\(^{139}\) An intimate nexus between the parties, such as contractual privity, is required, or the negligence must create a risk of death or severe personal injury.\(^{140}\) In dictum, however, the court recently has indicated that a manufacturer may have an intimate nexus with an architect that had read and allegedly relied on the manufacturer's description of its wall system in a commercial publication.\(^{141}\) The court did not mention any facts suggesting that the reliance created a risk of personal injury, and the relationship between advertiser and subscriber fell far short of contractual privity. This suggests that in Maryland as well, plaintiff builders may bring negligent misrepresentation claims even when they cannot bring negligence claims.

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\(^{136}\) Id. at 907.


\(^{141}\) Village of Cross Keys v. United States Gypsum Co., 556 A.2d at 1134.
E. Both Warranty and Negligence: Arizona

Several states are plaintiffs' paradises; they permit suits against non-privity builders for economic loss under both negligence and implied warranty theories, although in some instances with peculiar twists. Arizona is one such state.

The Arizona Supreme Court addressed suits among builders in its 1984 decision Donnelly Constr. Co. v. Oberg/Hunt/Gilleland. Donnelly, a general contractor, alleged that it detrimentally relied on the defective site plans and specifications prepared by Oberg/Hunt/Gilleland, an architectural firm, in readying its bid and performing its work. The Arizona Supreme Court permitted Donnelly to proceed under three different theories: negligence, negligent misrepresentation, and breach of implied warranty that the architects had prepared the plans and specifications in a reasonable, non-negligent manner.

About one month earlier, the Arizona Supreme Court had extended the implied warranty of habitability to subsequent house purchasers. Still later in 1984, however, the Arizona Court of Appeals held that a subsequent purchaser has no negligence claim against a builder-vendor. The court did not try to distinguish Donnelly. The result is that, in Arizona, builders have a panoply of actions available, while subsequent owners may sue for breach of implied warranty only. Other states, by contrast, allow builders to sue for negligence and subsequent owners to sue both for negligence and breach of implied warranty.

143. 677 P.2d at 1295–96.
144. Id. at 1296–97.
145. Id. at 1297. Donnelly may be the only reported decision from any jurisdiction that concludes that a builder impliedly warrants the quality of its work to another builder.
148. In 1988, however, the same court denied a tort action to the subsequent purchaser. It distinguished Donnelly stating, "Donnelly did not involve a claim of negligent construction nor a claim of implied warranty of workmanlike performance and habitability." Colberg v. Rellinger, 160 Ariz. 42, 770 P.2d 346, 351 (1988). This explanation leaves much to be desired. Donnelly did involve a claimed breach of implied warranty. 677 P.2d at 1294. Possibly, the appellate court intended to distinguish negligent preparation of architectural plans as in Donnelly from negligent construction, on the basis that the former involves a negligent misrepresentation. If so, that distinction is left completely undeveloped.
149. See, e.g., Bagwell Coatings, Inc. v. Middle South Energy, 797 F.2d 1298, 1310 (5th Cir. 1986) (under Mississippi law, an architect or engineer may be liable in negligence to a subcontractor suffering purely economic loss); Keyes v. Guy Bailey Homes, 439 So. 2d 670, 672–73 (Miss. 1983) (subsequent owner may sue a builder-vendor for negligence or breach of implied warranty).
F. Neither Negligence Nor Warranty: New York

The approach adopted by the fewest states denies relief under both negligence and warranty theories. Although its highest court has not addressed all of the issues discussed in this Article, New York apparently follows this approach, with an important exception.

In *Widett v. United States Fidelity & Guaranty Co.*, a grading subcontractor sued a project architect, claiming that the architect had negligently misrepresented the elevations of the site, causing the subcontractor to incur additional cost in fulfilling its contract. The subcontractor contended that the New York Court of Appeals had relaxed the privity requirement for negligent misrepresentation suits. Based on four state court opinions, the Second Circuit held, however, that the relaxed requirement does not extend to suits against architects.151

Although a builder apparently has no negligent misrepresentation claim absent privity, it may have a negligent supervision claim. One year after its decision in *Widett*, the Second Circuit in *Morse/Diesel, Inc. v. Trinity Industries* dismissed economic loss claims filed by two subcontractors on a hotel construction project against three other subcontractors. It stated in dicta, however, that the plaintiffs could have advanced claims absent privity if the defendants had the duty to manage, supervise and inspect the construction, because the supervisory duties would have inured to the benefit of the plaintiffs as well as the owner of the project.153 Under appropriate facts, therefore, a builder presumably can advance a negligent supervision claim in New York.154

Subsequent purchasers of improvements apparently face greater obstacles. The rule requiring privity to sue for economic loss precludes negligence claims.155 New York's highest court only recently created an implied warranty of habitability for the benefit of homeowners,156 and has not yet addressed its extension to subsequent purchasers. In reaching its conclusion that the original purchasers benefited from an implied warranty, however, the court cited with

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150. 815 F.2d 885 (2d Cir. 1987).
151. Id. at 887.
152. 859 F.2d 242 (2d Cir. 1988).
153. Id. at 247-48. The defendants in *Morse/Diesel* did not have general supervisory powers, however, requiring dismissal. Id. at 248-49.
154. New York apparently is the only state which treats at least one type of negligent performance claim more favorably than a negligent misrepresentation claim.
155. See supra notes 150-51 and accompanying text.
approval lower court decisions distinguishing “between contracts for
the sale of completed houses and contracts for the construction and
sale of a new home, [and] holding that an implied warranty of good
and skillful construction exists only as to the latter.”157 The distinc-
tion is justified, because “[w]hen a buyer signs a contract prior to con-
struction of a house, inspection of premises is an impossibility . . . .”158
A subsequent purchaser, obviously, can inspect a house prior to
purchase. The implied warranty, therefore, probably will not extend
to subsequent purchasers.159

IV. NEGLIGENT INFILCTION OF ECONOMIC LOSS BY
BUILDERS

As shown above, judicial dispositions of economic loss claims
against nonprivity builders, taken collectively, verge on incoherence.
This part of the Article suggests a replacement for the present intellec-
tual chaos by developing the elements of a tort of negligent infliction
of economic loss applicable to both types of construction cases. This
tort would treat negligent performance and negligent misrepresenta-
tion claims identically.160 The elements of the tort will be developed
and explained in several steps. Subsection A posits that any action
against a nonprivity builder to recover economic loss should protect
the injured party's reliance on the builder, not that party's expecta-
tions. Subsection B develops the argument that builders should have a
duty to subsequent purchasers as long as liability is limited to a deter-
mine amount for a determinate time to a determinate class: subse-
quent purchasers generally will lack an adequate remedy otherwise,
and microeconomic analysis suggests that imposing a duty on builders
actually fosters economic efficiency. A similar analysis is pursued in

157. 526 N.E.2d at 269 (citations omitted).
158. Id. New York's implied warranty law continues to be restricted to a scope that other
jurisdictions transcended in the 1950s and 1960s. See supra notes 60–63 and accompanying text.
159. Missouri courts first enunciated and then silently backed away from a position that
denied any remedy in tort or contract. In Crowder v. Vandendeale, 564 S.W.2d 879 (Mo. 1978),
overruled on other grounds by Sharp Bros. Contracting Co. v. American Hoist & Derrick Co.,
703 S.W.2d 901 (Mo. 1986), for example, the Missouri Supreme Court held that a subsequent
purchaser had no contract claim against a builder because of the absence of privity, and no
negligence claim because of the inappropriateness of tort remedies without personal injury or
property damage. Id. at 882–84. Five years later, however, the Missouri Court of Appeals
permitted a claim when a structure is “essentially and imminently dangerous to the safety of
others,” even though the plaintiffs suffered only economic loss. Chubb Group of Ins. Cos. v.
C.F. Murphy & Assocs., 656 S.W.2d 766, 775 (Mo. Ct. App. 1983) (quoting Begley v. Adaber
Realty & Inv. Co., 358 S.W.2d 785, 791 (Mo. 1962)).
160. States may choose to provide additional protection through implied warranties. See
infra text accompanying note 316.
Subsection C for suits among builders. Based on the considerations identified in the previous three sections, Subsection D sets out the elements of the tort and shows that this action meets the essential needs of plaintiffs while avoiding the risks of indeterminacy. Finally, the proposed action is briefly defended against two types of attack in Subsection E.

A. Plaintiff's Reliance Interest

Courts and commentators disagree about the interests plaintiffs seek to protect when they claim that a nonprivity builder's negligence caused them economic loss. Advocates of the economic loss rule often define "economic loss" in terms of the plaintiff's expectations.161 For example, one author states that "economic loss" is "the loss of an expectancy interest created by contract, often described as the 'benefit of the bargain.'"162 Courts imposing a duty to avoid the negligent infliction of economic loss often do not identify the interest to be protected at all, but speak in general terms of foreseeable harm.163 When an interest is identified, it generally is the plaintiff's reliance on the defendant.164 Courts have less difficulty with related claims. Implied warranties protect the purchaser's reliance,165 and the Restatement (Second) of


162. Barrett, supra note 1, at 895.


One court addressed the protected interest in a related context. In Conklin v. Hurley, 428 So. 2d 654 (Fla. 1983), the court refused to extend an implied warranty of fitness to purchasers of residential lots, the only pre-purchase improvement of which had been a sea wall that collapsed post-purchase. The court ruled in favor of the defendant developer partly because of the nature of the damages claimed. For example, one plaintiff had purchased a lot for $28,000, sold it with the damaged wall for $31,500, and sought $6,500 in damages based on the asking price for similar lots with an undamaged wall. The court stated, "Protection against this kind of loss, based merely upon an expectancy, was not intended by this Court when it adopted" the implied warranty. Id. at 659.

165. See, e.g., Redarowicz v. Ohlendorf, 92 Ill. 2d 171, 441 N.E.2d 324, 330 (1982) (The subsequent purchaser, like the initial purchaser "is usually not knowledgeable in construction practices and must, to a substantial degree, rely upon the expertise of the person who built the home. If construction of a new house is defective, its repair costs should be borne by the responsible builder-vendor who created the latent defect.").
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*Torts* gives a claim to one who justifiably relies on a negligent misrepresentation.\(^{166}\) By and large, therefore, opponents of relief contend that proponents protect expectations, while proponents, to the extent that they consider the issue, believe that they protect the plaintiff's reliance. The disagreement reflects a collision not only between contract and tort law, but also between conceptions of normal human interactions.

Contract law traditionally protected parties' expectations. Entering into a contract entitled the promisee to performance of the promise, including, if the promisee had struck a favorable bargain, the benefit of that bargain. Even if the promisee had taken no action in reliance on the contract and the promisor had not realized any benefit from it, the parties had a full complement of rights and obligations.\(^{167}\) By contrast, if a contract had not been entered into, but one party to the contractual negotiations acted in reliance on the other's promise, that party had no remedy.\(^{168}\)

This protection of the parties' expectations grows out of the idea that they autonomously exercise powers of free choice in deciding to enter the contract.\(^{169}\) A promisee may treat a contractual promise as equivalent to having the action performed, unless the reason for non-performance falls within one of the excuses acceptable under traditional contract law.\(^{170}\) The promisor otherwise bears responsibility for deciding not to or failing to perform. This is not unfair to the promisor, who freely elects to enter the transaction. Nor is the refusal to

\(^{166}\) Restatement (Second) of Torts § 552(1) (1976).

\(^{167}\) The classic case of *Lucy v. Zehmer*, 196 Va. 493, 84 S.E.2d 516 (1954) provides a dramatic example. The court concluded that the Zehmers contracted to sell their farm to Lucy over drinks at a local restaurant. Before Lucy left, Zehmer told him that it was all a joke, and that they had no agreement. Even though Lucy had not relied on the contract before this notification, the court held that it was enforceable. 84 S.E.2d at 522.

\(^{168}\) See, e.g., *James Baird Co. v. Gimbel Bros.*, 64 F.2d 344, 345–46 (2d Cir. 1933) (L. Hand, J.) (material supplier who quoted a price for linoleum to a general contractor, who in turn submitted a lump sum bid to the owner based on that price quotation, could withdraw the quotation prior to its acceptance by the general contractor, even though the contractor had relied upon it in submitting its bid). See generally Metzger & Phillips, Promissory Estoppel and Reliance on Illusory Promises, 44 Sw. L.J. 841, 849–51, 853–54, 856–57 (1990) (discussing unenforceability of reliance on a gratuitous, indefinite, or illusory promise under traditional contract doctrine).

\(^{169}\) See P. Atiyah, The Rise and Fall of Freedom of Contract 40–41 (1979). Atiyah describes the rise of contractual theory: "In short, what was new in contractual theory was not the idea of a relationship involving mutual rights and duties, but the idea that the relationship was created by, and depended on, the free choice of the individuals involved in it." *Id.* at 41.

\(^{170}\) For discussion of the various grounds on which parties may be excused from contractual obligations, see E. Farnsworth, Contracts chs. 4, 5, 6, 9 (2d ed. 1990).
enforce a non-contractual promise unfair to the promisee, who freely assumes the risk of relying upon it.\textsuperscript{171}

The conception of humans as autonomous actors that undergirds traditional contract law is waning. For many reasons, including the increasing dependence of individuals on huge business and governmental units\textsuperscript{172} and the growing number and influence of academics and other professionals, many of whose jobs involve the identification of various influences on human actions,\textsuperscript{173} an individual (or entity) now generally is perceived not as autonomous, but as pushed and pulled by a large number of often unrecognized forces.\textsuperscript{174} Put another way, persons are continuously influenced by, and must continuously rely on, others, whether or not they even know them.

Not surprisingly, the concept of reliance traditionally associated with tort law has assumed increasing importance in commercial and consumer litigation. Scholars have argued that contracts should be enforced not to prevent frustrated expectations, but primarily because of reliance upon them.\textsuperscript{175} More important to litigation results, reliance-based actions increasingly intrude into realms previously governed almost exclusively by contract law.

Misrepresentation claims provide one example. Scienter is no longer a prerequisite for a misrepresentation action. This Article has already discussed the development of the negligent misrepresentation action,\textsuperscript{176} and some courts also recognize strict liability misrepresentation claims, especially in transactions involving the sale, lease or exchange of property.\textsuperscript{177}

The rise of promissory estoppel provides a more celebrated example.\textsuperscript{178} Originally, it may have evolved as a means of enforcing gratui-

\textsuperscript{171} See P. Atiyah, supra note 169, at 761. Obviously, the protection of expectations may have alternative justifications, including economic efficiency. See R. Posner, Economic Analysis of Law 79–85 (3d ed. 1986).


\textsuperscript{174} See P. Atiyah, supra note 169, at 743. The forces may be internal, as in Freud’s theories of behavior, or external, as in Marx’s theories of social change.

\textsuperscript{175} See id. at 4–6. This perception reaches far beyond legal scholars. Many of the author’s first-year students initially wish to explain liability in cases decided under traditional contract doctrine by the promisee’s adverse reliance.

\textsuperscript{176} See supra notes 47–56 and accompanying text.

\textsuperscript{177} See, e.g., Ollerman v. O’Rourke Co., 94 Wis. 2d 17, 288 N.W.2d 95, 99 (1980). Claims for strict liability misrepresentation are recognized at Restatement (Second) of Torts § 552C (1976).

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tous promises, especially charitable subscriptions, on which the
promisee relied.179 Neither Restatement of Contracts, however, limits
promissory estoppel to gratuitous promises, and promissory estoppel
now applies to a wide range of commercial disputes.180 Reasonable
reliance makes promises enforceable not only when there is no consid-
eration, but also when they are indefinite, illusory,181 or fall within the
Statute of Frauds.182

Whether an action for negligent infliction of economic loss protects
expectations or reliance has more than theoretical importance. It may
affect whether a particular plaintiff has a claim and the damages recov-
erable, as demonstrated by the following hypotheticals.

The original owner of a five-year old office building worth
$11,000,000 is in dire straits, and a real estate developer agrees to
purchase it for $10,000,000. The contract contains an inspection con-
tingency. The inspector discovers that the original builder negligently
constructed the foundation, which will cost $2,000,000 to repair. The
owner refuses to reduce the purchase price and the developer with-
draws based on its contingency. The developer then sues the builder,
claiming $1,000,000 in lost profits.

Second, based on plans and specifications prepared by an architect,
a contractor agrees to construct an office building for $8,000,000,
anticipating $500,000 in profits. Before the contractor incurs any
costs or enters any contracts with subcontractors, the owner discovers
that the plans and specifications are defective. The owner, having lost
confidence in the architect, decides not to build. The contractor sues
the architect, claiming $500,000 in lost profits.

If courts protect the purchaser’s and contractor’s expectations, they
will have claims; if only their reliance interests are protected, they will
not. The interest to be protected determines the existence of a claim.

In almost all reported decisions concerning negligent infliction of
economic loss by builders, however, the plaintiff has partly or com-
pletely performed its contractual obligations before discovery of the

179. See Ricketts v. Scothorn, 57 Neb. 51, 77 N.W. 365 (1898); Allegheny College v.
National Chautauqua County Bank, 246 N.Y. 369, 159 N.E. 173, 174–75 (1927) (Cardozo, J.)
dictum).

(subcontractor estopped from withdrawing bid when general contractor used that bid in
preparing its own bid, which was accepted by the owner); Hoffman v. Red Owl Stores, 26 Wis.
2d 683, 133 N.W.2d 267 (1965) (grocery store chain estopped from denying its promises that led
potential franchisees to sell their existing facilities at a loss and move to another town).


182. See R. S. Bennett & Co. v. Economy Mechanical Indus., 606 F.2d 182, 186–88 (7th Cir.
1979).
defect. The plaintiff therefore has a claim regardless of whether the court protects its expectations or reliance.

The identity of the interest to be protected may affect more frequently the amount of damages recoverable. Change the second hypothetical, so that the contractor has incurred $25,000 in costs before the owner discovers that the plans are defective. In promissory estoppel cases, courts generally have permitted the promisee to recover on the promise, either to protect its expectations or its "hidden" reliance costs,\textsuperscript{183} despite scholarly and occasional judicial contentions that the promisee typically should recover only its damages in reliance on the promise.\textsuperscript{184} The same two damage theories—recovery limited to reliance damages or recovery based on the injured party's expectations—may apply to claims of negligent infliction of economic loss. The theory adopted will make a substantial difference. In the hypothetical, for example, the difference would be between a $500,000 and a $25,000 recovery.\textsuperscript{185}

The most important factor in deciding between the expectation and reliance interests is that the factual situation giving rise to a claim is inconsistent with liability under the view of human interactions supporting traditional contract doctrine.\textsuperscript{186} Consider first a subsequent purchaser's claim. The builder's liability, if any, does not arise from a voluntarily entered business relationship. A subsequent purchaser generally can discover prior to closing who constructed an improvement, and therefore arguably voluntarily elects to enter into a relationship with that builder.\textsuperscript{187} The builder does not voluntarily enter into a relationship with the subsequent purchaser, however; it does not know

\textsuperscript{183} See Walters v. Marathon Oil Co., 642 F.2d 1098, 1100-01 (7th Cir. 1981) (permitting recovery of lost profits); \textsc{Restatement (Second) of Contracts} § 90 (1981) (promise should be enforced, although remedy may be limited as justice requires); Wangerin, \textit{Damages for Reliance Across the Spectrum of Law: Of Blind Men and Legal Elephants}, 72 \textsc{Iowa L. Rev.} 47, 49, 89-94 (1986) (although scholars believe that the \textsc{Restatements} enunciated a flexible remedy in promissory estoppel cases, courts generally have awarded damages based on expectations).


\textsuperscript{185} For reasons developed subsequently, the plaintiff's recovery should be limited to $25,000. See \textit{infra} notes 289-94 and accompanying text (discussing damages).

\textsuperscript{186} Unfortunately, the broad theoretical conflict in the economic loss cases makes identification of a metatheoretical measuring stick to decide between the two interests impossible. \textit{Cf.} T. \textsc{Kuhn}, \textit{The Structure of Scientific Revolutions} 92-110, 198-99 (2d ed. 1970) (scientists have no metatheoretical measuring stick to judge between competing paradigms).

\textsuperscript{187} Probably very few subsequent purchasers, especially of residential properties, actually know the identity of the property's builders.
at the time of construction who will subsequently purchase the building.

Even if the builder and subsequent purchaser are deemed to have voluntarily entered a non-contractual business relationship, the latter does not have any justifiable expectations of profit from it. Profits are realized from contractual relationships. A subsequent purchaser may expect gain from her purchase contract with her seller, her eventual contract for the sale of the property, her contracts with employees working on the property, and her contracts to acquire and sell goods and services. Unexpected building repair costs will diminish those expected profits, because when entering some or all of those contracts, the subsequent purchaser depended on the building having been constructed in a reasonable manner. The subsequent purchaser’s reliance on the adequacy of the services previously provided by the builder to the original purchaser, rather than the builder’s autonomous act of entering a relationship with the subsequent purchaser, is the source of liability.

The analysis is similar for disputes based on allegedly faulty plans and specifications. Generally, the architect enters into a contract with the owner and prepares the plans and specifications, which the owner uses to solicit bids from potential general contractors.\[188^\] Whether or not the architect assists the owner in selecting the contractor,\[189^\] the architect does not know the identity of the general contractor at the time that the plans are prepared. The architect has no more voluntarily entered into a relationship with the general contractor than has the builder voluntarily entered into a relationship with the subsequent purchaser. The general contractor has no more expectations of profits from its reliance on the adequacy of those plans than the subsequent owner has from its reliance on the adequacy of the builder’s original construction.

At first blush, a builder claiming that an architect negligently performed its supervisory duties may seem more deserving of having its expectations protected. The architect knows the identity of the contractor when performing those duties, and “[t]he power of the architect to stop the work alone is tantamount to a power of economic life

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\[189^\] The architect “shall assist the Owner in obtaining bids or negotiated proposals and assist in awarding and preparing contracts for construction.” American Institute of Architects, Standard Form of Agreement Between Owner and Architect, A.I.A. Doc. B141 § 2.5.1. (1987) [hereinafter Architect-Owner Agreement].
or death over the contractor. But the architect does not know the identity of the contractor when it assumes the contractual obligation to supervise construction, and the contractor's expectations of profits arise from the spread between the contract price with the owner and the amounts it agrees to pay to its employees, subcontractors and material suppliers. The contractor's reliance on the architect's supervision is essentially no different than its reliance on the architect's plans and specifications.

The arguments for protection of the reliance interest receive additional support from the rationales underlying negligent misrepresentation and implied warranty actions. Both originate in adverse reliance. To recover for a negligent misrepresentation, an injured party must suffer loss in "justifiable reliance" on the information, and may recover the difference between the value received and the purchase price and any other pecuniary loss suffered in reliance on the misrepresentation, but not the benefit of his bargain.

The purposes and elements of a negligent misrepresentation action are especially significant because of the difficulty in distinguishing the action from a negligent performance action. An architect's failure to adhere to professional standards of care while preparing plans and specifications may result either from negligent design work or negligent depiction of the designs on paper. Either cause of the negligent misrepresentation can be characterized as negligent performance of the architectural services. Indeed, many courts have analyzed cases involving negligent plans in terms of negligence rather than negligent

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191. Without detrimental reliance, a builder should have no claim. For example, although the Florida Supreme Court had earlier stated that an architect could be liable to another builder for its negligent plans or supervision, A.R. Moyer, Inc. v. Graham, 285 So. 2d 397, 402 (Fla. 1973), overruled on other grounds by Abstract Corp. v. Fernandez Co., 458 So. 2d 766 (Fla. 1984), the Florida Court of Appeals in 1989 refused to hold that a roofing consultant had a duty to a roofing subcontractor. E.C. Goldman, Inc. v. A/R/C Assocs., 543 So. 2d 1268, 1270-72 (Fla. Dist. Ct. App. 1989). After the subcontractor had completed its work, the owner engaged the consultant to advise it whether the work merited payment. Unlike in Moyer, the roofing subcontractor did not rely on the consultant. Indeed, the subcontractor did not even know that the consultant would have any role until after it had completed its work.


193. Id. § 552B.

194. See Village of Cross Keys v. United States Gypsum Co., 315 Md. 741, 556 A.2d 1126, 1132 (1989) (a negligent misrepresentation claim is stated if the duty allegedly breached involves "due care in obtaining and communicating information upon which [the other] party may reasonably be expected to rely . . ." regardless of the reason that the information was erroneous) (quoting United States v. Neustadt, 366 U.S. 696, 706 (1961)).
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misrepresentation. Conversely, a negligent construction claim can be recharacterized as a breach of an implied representation, negligently made, that the property is fit.

Similarly, courts extend implied warranties to original and subsequent purchasers of new houses in recognition of property owners' reliance on the builders who construct improvements. The original purchaser "must rely in great part upon the expertise of the builder who holds himself out as competent to construct the consumer's home." The same applies to subsequent purchasers. "[L]ike an initial buyer, the subsequent purchaser has little opportunity to inspect and little experience and knowledge about construction."

For these reasons, any action against a nonprivity builder to recover economic loss arising from defects or delay in construction should protect the injured party's reliance on the builder, not its expectations arising from contracts with others. The next two sections address whether and under what conditions courts should protect the injured party's reliance.

B. Suits by Nonbuilders Against Nonprivity Builders

This section analyzes claims by a subsequent purchaser against a nonprivity builder for negligent infliction of economic loss. It begins with the prospect that the subsequent purchaser generally will have no viable claims against any other party if the builder's negligence causes her economic loss. Next, microeconomic analysis is utilized to show that imposing a duty on builders to a subsequent purchaser actually will foster efficient decisionmaking, so long as the action can be structured to avoid three primary risks: an indeterminate class of plaintiffs, an indeterminate period of liability, and an indeterminate amount of damages, the very same risks identified by Justice


196. Negligent construction frequently results in implied warranty claims. See supra notes 110–21 and accompanying text (discussing implied warranty claims arising from defective residential construction). Such claims are the contractual analogues to negligent or innocent misrepresentation claims.


199. Claims by tenants or by parties with no ownership or possessory interest in an improvement are also briefly discussed, see infra notes 245–47 (tenant) and 248 (person with no ownership or possessory interest) and accompanying text. To simplify the analysis, however, the discussion focuses on the subsequent purchaser.
Cardozo in *Ultramares*. Courts, therefore, should recognize an action fashioned to avoid those risks.

### I. Alternatives to Direct Action Against Builder

Creating a new action directly against a builder may be unwarranted if subsequent purchasers or other nonbuilders who suffer economic loss because of construction defects generally have adequate remedies against others. Without a direct action against a builder, however, these injured parties generally lack any effective remedy.

Two potential problems facing an injured party arise relatively infrequently and require little discussion. The most logical candidate for a subsequent purchaser to sue, other than a builder, is the seller, but that person may be insolvent. Moreover, the statute of limitations may have expired on any contract claims.

More importantly, a subsequent purchaser and other nonbuilders generally have no protection, contractual or otherwise, if they cannot sue a builder for negligent construction. Proponents of the economic loss rule point to three sources of contractual protection for a subsequent purchaser: the seller, a professional inspector, and a third party insurer. Each is discussed below.

**Seller.** A subsequent purchaser generally has no claim in contract or tort against the seller for any defects latent and unknown to the seller at the time of the subsequent owner's purchase. No jurisdiction has imposed implied warranties of habitability on owners who did not build or develop the improvement. Because the original purchaser did not construct the allegedly defective structure, it is not liable for any negligence in that construction. Negligent misrepresentation is unavailable if the original purchaser had no reason to be aware of the defect.

The Restatement (Second) of Torts section 552C suggests a possible theory of liability if the seller innocently—that is, neither fraudulently nor negligently—misrepresents material facts. Most jurisdictions,
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however, will probably not find a seller liable under section 552C if the misrepresentation occurs by silence. In those jurisdictions, for example, an innocent failure to mention an unknown defect in a septic system will not create liability, while an affirmative statement, such as that the septic system is fine, may be tortious if untrue.204

Only express warranty remains. No legal obstacle prevents a buyer from obtaining an express warranty. Nevertheless, very rarely, if ever, will a property owner warrant to a purchaser that improvements are free of all defects. Form contracts used by brokers typically provide that the property is sold "as is" or that the seller warrants that he has no notice or knowledge of any defect.205 Attorneys generally use similar language, and almost never negotiate a warranty that improvements are free of defects.206 Obviously, a warranty stating that a seller has neither notice nor knowledge of any defect does not provide a

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204. For example, the generally pro-consumer Wisconsin Supreme Court declined to decide whether purchasers of a residential lot had a claim against the developer for negligent misrepresentation in failing to disclose the existence of an underground well. Ollerman v. O'Rourke Co., 94 Wis. 2d 17, 288 N.W.2d 95, 112 (1980). The allegations in Ollerman favored liability more than the typical sale from original purchaser to subsequent purchaser in two respects: the seller was in the business of selling lots, and he allegedly knew or should have known of the well. The court nevertheless decided that it needed a full factual record before imposing a duty to speak.

205. See, e.g., Legal News (Toledo, Ohio), Real Estate Purchase Agreement, Form No. 37, § 3 (revised 5-25-89) ("Purchaser . . . acknowledges inspection of said premises and knows the condition thereof, and is purchasing the premises . . . in an 'as is' condition, based on said personal inspection and not in reliance upon any statements or representations of Seller or their agent.").

206. The standard residential offer to purchase form approved by the Wisconsin Department of Regulation and Licensing provides:

Seller warrants and represents to Buyer that Seller has no notice or knowledge of any:

. . .

(c) underground storage tanks or any structural, mechanical, or other defects of material significance affecting the property, including but not limited to inadequacy for normal residential use of mechanical systems, waste disposal systems and well, unsafe well water according to state standards, and the presence of any dangerous or toxic materials or conditions affecting the property.

WB-11 Residential Offer to Purchase, approved by Wisconsin Department of Regulation and Licensing, ll. 82, 86-89, (3-1-88) (mandatory use date).

207. The many contracts for the sale of improved real estate by a nonbuilder included in the seminal collection of forms for business transactions, J. RABKIN & M. JOHNSON, CURRENT LEGAL FORMS WITH TAX ANALYSIS (1990), do not contain one warranty as to the structural soundness of the improvements. The majority of the contracts, both residential and commercial, provide for the sale to be "as is." See, e.g., 8A J. RABKIN & M. JOHNSON, form 21.13, § 22; form 21.15, § 8; form 21.18, §§ 7, 16; form 21.30, § 16. Two contain warranties that the seller has no knowledge of any defect. Id. form 21.14, § 5(d); form 21.28, § 13. Others contain representations that the property will not be in worse condition, ordinary wear and tear excepted, than when inspected by the purchaser or on the date of contracting. Id. form 21.32A, § 10(d);
claim to the purchaser unless the seller actually did possess such notice or knowledge.

Sellers' unwillingness to warrant against defects is hardly surprising. After selling property, sellers do not want a continuing risk of a claim. Given the well established practices and the aversion of sellers to warranting against defects, such a warranty probably would be prohibitively expensive.

**Professional inspector.** Increasingly persons interested in purchasing residential and commercial property make their obligations to close contingent on inspection of the property by a professional inspector.\(^{208}\) Inspectors' services, although valuable, do not eliminate the advantage of having a direct action against builders.

As a preliminary matter, courts appear unlikely to make professional inspections a prerequisite to a negligence claim. Implied warranties protect purchasers only against latent defects that a reasonable inspection performed by the purchaser prior to purchase would not have disclosed.\(^{209}\) Several courts have rejected arguments that a defect was not latent if a professional inspector could have discovered it.\(^{210}\) Such an approach expresses an unwillingness to hold purchasers to a standard that would require the additional monetary expenditure associated with inspection.

Even if all purchasers used professional inspectors, however, inspections would not adequately substitute for an action against builders for two reasons. First, the exercise of due care will not reveal all latent defects, especially those not disclosed by a visual inspection.\(^{211}\)

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\(^{208}\) See Rosenthal, *Should Your Client Get a Professional Home Inspection?*, PRAC. REAL EST. LAW. 79, 79–80 (Nov. 1986) (concerning residential transactions). In the author's experience, commercial purchasers make their obligations to close contingent on inspections more often than home purchasers.


\(^{211}\) According to one commentator:

Inspectors have a number of important practical limitations. They are visual in nature and, therefore, many possible defects cannot be recognized. Few, if any, tests are performed. In addition, the inspector observes only whether or not an item or system is functioning at the time of the inspection; no prediction is made about the future.
second, contracts proffered by inspectors to potential purchasers frequently contain disclaimers and may limit inspectors' liability to the amount of the fee for their services. It is unclear whether inspectors treat these provisions as negotiable and whether courts will uphold them.

- Insurance. Finally, proponents of the economic loss rule argue that subsequent owners do not require an action against builders because it is possible to insure them against loss. Typical "all risk" property insurance policies, however, exclude losses resulting from defective design or faulty workmanship in the construction of the insured property from coverage. Most property owners are unacquainted with this exclusion. Without actual knowledge, property owners will not purchase supplemental insurance to cover defective design and faulty workmanship.

Homeowner's warranty policies present an alternative to "all risk" insurance. Although these policies protect the subsequent purchaser against latent defects better than all risk policies, they are not a complete substitute for an action to recover economic loss arising from construction defects. Some warranty policies provide coverage for as

Rosenthal, *supra* note 208, at 86.

212. *Id.* at 87.

213. The author's experience in Wisconsin serves as the basis for this assertion.


215. *See infra* text accompanying note 227 (social engineering through liability rules is impossible when the party bearing the risk does not know of that risk).

Builders' liability insurance policies also may not cover them against an owner's economic loss claim caused by the builder's own negligence. Whether a policy covers a particular claim may involve several issues beyond the scope of this Article, including the definition of "economic loss" under the policy (which may be different than the definition used in this Article), the extent to which another builder was responsible for the defect, and whether the structure was completed before the defect manifested itself. *See W.E. O'Neil Constr. Co. v. National Union Fire Ins. Co., 721 F. Supp. 984, 992-96 (N.D. Ill. 1989)*. The argument that subsequent purchasers can insure themselves against loss, however, applies with greater force to builders. They also presumably can purchase coverage; they should have greater knowledge than owners of the extent of their coverage and, therefore, are more likely to obtain adequate protection; and insurers should be willing to provide coverage, given their provision of economic loss coverage to service providers, such as lawyers and accountants.

216. Today, about ten percent of homeowners own such policies. *See Should Your Next Home Carry a Warranty?, 55 CONSUMER REP. 74 (1990).*
little as one year. In addition, warranties on existing houses typically
do not cover structural defects, roof problems, or termite damage;
their coverage is limited to defects in heating, water and electric sys-
tems. Moreover, the policies are expensive. One of the largest issuers
pays out less than one-third of premiums collected on repairs. These
warranty policies also do not protect commercial properties.

Few subsequent purchasers, therefore, will have an adequate rem-
edy if a builder's negligence results in economic loss unless they have a
tort action against the builder. Arguably, however, no remedy is
appropriate, i.e., subsequent purchasers should bear the risk of eco-
nomic loss. That issue is explored below.

2. Economic Efficiency and Indeterminacy

The Coase theorem provides a starting point in analyzing
whether and under what conditions builders should be liable for the
economic loss of subsequent purchasers. The Coase theorem is an
analytical proposition which, for purposes of this article, can be sum-
marized as follows: if two persons, A and B, can bargain freely for
ownership of an alienable reciprocal entitlement (E), both A and B
are profit maximizers, transaction costs (C) must be borne by A and
B, and C is less than the difference between X and Y, where X is the
value of E to A and Y is the value of E to B, then the initial assign-
ment of E does not affect the resulting allocation of resources. The
assignment has no effect because A and B will reach a bargain under
which the one who values E more will retain or acquire it, as the case
may be. That outcome will be socially efficient. If transaction costs
exceed the difference between X and Y, however, the transaction will

217. Id.
218. See supra note 16.
219. The summary below is abstracted from Hovenkamp, Marginal Utility and the Coase
220. "An 'alienable reciprocal entitlement' is a transferable relationship expressed in the
common law dichotomies of 'liability/no-liability' or 'right/duty,' that exhausts all possibilities
with respect to its domain." Id. at 793. For example, assigning a builder a duty of care to a
subsequent purchaser means that she will have a claim against the builder if it fails to use the
appropriate level of care; assigning the risk to the subsequent purchaser means that she will have
none. "To say that the reciprocal entitlement is alienable means merely" that the party lacking
the entitlement may purchase it from the other. Id.
221. "This means that for any alienable reciprocal entitlement [E] held by B, A will purchase
[it] at price X if [its] profitability to A [exceeds] X," but not if its "profitability to A is less than
X." Conversely, B "will sell [E] to [A] at price Y if [its] profitability . . . to [B] is less than Y," but
not if its profitability to B exceeds Y. Id. No other factors but profitability enter into the
decisionmaking of A and B.
222. Transaction costs include the cost of gathering information. Id.
not occur, and assignment of E to the person who values it less will produce a socially inefficient result.223

Many adherents to the "law and economics" movement advocate assignment of legal entitlements to encourage socially efficient transactions, which largely entails assignment of liability so as to reduce transaction costs.224 Aside from the normative assumption that economic efficiency should be encouraged, devising rules on this basis rests on the assumptions that human behavior is rational and corresponds to the theorem to some extent.225

For at least four reasons, however, even though entitlements may be assignable, people may not assign them so as to maximize profits or utilities. First, people frequently pursue goals other than or in addition to profit maximization.226 Second, people who do not know the liability rules will not negotiate over rights.227 Third, the prohibitive cost of gathering information and engaging in negotiations may stymie even a person who is aware of the liability rules and the possibility of bargaining over rights.228 Finally, even if information is readily available, many are unable to make use of it because of competing demands on their time.229 It is likely that these constraints affect consumers more than businesses.230

Notwithstanding the discrepancies between Coase Theorem analysis and actual human behavior, fostering efficient decisionmaking and reducing transaction costs remain desirable goals, absent countervailing policy considerations. A direct action by a subsequent purchaser against a builder may provide the purchaser with the only effective legal recourse when a purely economic loss is suffered and may thus prevent the negligent builder from otherwise escaping liability. If analysis showed that such an action would foster economically inefficient results, courts would have to weigh the non-economic benefits of compensating the injured party and holding the negligent party responsible231 against the economic values to be promoted. As shown

223. Id. at 793–94.
225. See Latin, supra note 224, at 678; Minda, supra note 224, at 608-11.
226. See Hovenkamp, supra note 219, at 806-07.
228. See Latin, supra note 224, at 678, 682–83.
229. Id. at 683–84, 686–88.
230. See Hovenkamp, supra note 219, at 797; Latin, supra note 224, at 693–96; Comment, supra note 227, at 405 n.48.
231. Obviously, the imposition of a negligence duty on a builder also may foster economic efficiency by providing an incentive to act with an appropriate level of care.
below, however, an action against a builder for negligent infliction of economic loss operates to encourage economic efficiency, provided the builder's liability is made reasonably determinate.

Coase theorem analysis generally has focused on only two parties. At least three are necessarily involved, however, when a subsequent purchaser suffers economic loss from a construction defect: the builder, the original purchaser and the subsequent purchaser. This section first analyzes the relationship between the builder and the original purchaser; the subsequent purchaser is then brought into the calculus under several different scenarios.

**Builder-Original Purchaser Relationship.** Applying the Coase theorem and assuming no transaction costs, whether or not a builder has a duty of care to the original purchaser is irrelevant to determining the degree of care the builder will use while constructing an improvement. Suppose a builder and a landowner agree that the cost of an additional increment of work will be $800, that if the work is not performed the chance of economic loss increases by 10% (if the owner exercises ordinary care), and that if loss occurs, it probably will be in the amount of $10,000. Finally, suppose the parties also agree that the homeowner will own the property indefinitely and nobody else will even use it, eliminating all risk of economic loss to others.

Under these circumstances, it is rational for the builder to insist on performing and charging the owner for the additional work. Under Judge Hand's formula, which is generally used by economists in analyzing negligence issues, the builder would be negligent if he or she did not use extra care, because the additional probability of an accident (10%) multiplied by the probable loss if an accident occurs ($10,000) exceeds the cost of the action ($800). On the other hand, if the expected cost is $1200, the builder should decide not to use the extra level of care.

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232. Often far more than three parties are involved. More than one builder may have violated a duty of care, and several parties may have owned the property before the party who suffers the loss. For simplicity's sake, this Article generally considers only three parties.

233. Professor Schwartz engaged in a similar analysis several years ago in critiquing the California Supreme Court's decision in *J'Aire*. Schwartz, *supra* note 3, at 42–50. This Article, however, applies the analysis to disputes outside the scope of Schwartz's article and reaches different conclusions.

234. The owner may be able to reduce the risk of loss or the amount of damages if loss occurs by exercising an extraordinary degree of care. As a simplifying assumption, this Article ignores that possibility in all of the following hypotheticals.

235. See United States v. Carroll Towing Co., 159 F.2d 169, 173 (2d Cir. 1947) (liability depends upon whether the burden of adequate precautions is less than the product of the probability of harm and the magnitude of the injury).
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The outcome will be the same even if the builder does not have a legal duty to the homeowner. If the cost is $800, the homeowner will pay the builder to do the work; if $1200, no “bribe” will be forthcoming. Under either liability model, if the cost is $800, the price to the owner will be between $800 and $1,000, with the actual price depending on the bargaining ability of each.

In reality, few builders and original purchasers will bargain over the level of care, especially with respect to home construction. Many homes are constructed by developers without the buyer even viewing the structure until after it is complete. The care with which the builder performed much of the work will be hidden. The purchaser’s primary sensitivity will be to price and to the quality of the visible features. The builder alone will determine the level of care appropriate to hidden features.

Many purchasers who contract for construction of an improvement are also unlikely to negotiate over the level of care. A purchaser may not know whether the builder has a legal duty of care. Even if he knows a builder lacks such a duty, the purchaser still cannot bargain to impose a particular level of care unless the purchaser has sufficient knowledge of building industry standards. Few home and commercial purchasers probably possess such knowledge—or have access to it at a reasonable cost—because of the high cost of acquiring it through self-education or expert opinion.

Original purchasers who hire both an architect and a general contractor are probably in the best position to bargain over the use of extra increments of care. Consulting both builders allows a homeowner to acquire a second opinion on the level of care each proposes to use. If the builders disagree, however, the original purchaser must decide which, if either, is correct. An informed assessment may require expensive self-education or yet another professional opinion.

Placing a duty of care on the builder should produce equally efficient or more efficient decisions at lower transaction costs. Although informed bargaining with the original purchaser over the level of care remains unlikely, the builder probably knows it faces liability if neg-

236. In all states, the builder actually has a duty of care to the original purchaser. This hypothetical highlights a reason that the builder should have that duty.


238. The builder and original purchaser may negotiate, but probably over price. To the extent that a builder continually uses less care than appropriate, it may obtain additional business
ligent. The builder is also likely to have a strong incentive to evaluate the costs and benefits associated with a given level of care, and to have access to information concerning these costs and benefits, with the exception of the original purchaser's special damages if a problem occurs.

Although courts have not engaged in this type of microeconomic analysis, they agree on the desirability of imposing on builders at least a duty of care to original purchasers. Indeed, as already noted, most states now provide additional protection to original purchasers of houses in the form of implied warranties.

Builder-Original Purchaser-Subsequent Purchaser Relationship with Calculable, Approximately Equal Risks. Under the Coase theorem, the existence or lack of a duty of care that runs from builders to subsequent purchasers does not affect the degree of care that will be used, assuming no transaction costs and roughly equal risks for the original purchaser and subsequent purchaser. Further assume that the original purchaser and builder anticipate that the original purchaser will sell the property, that the cost of the extra care is the same $800, and that the amount of economic loss, if any, will be $10,000, even if the loss occurs while the subsequent purchaser owns the property. They also agree on the same 10% possibility of loss, of which three-fifths falls on the original purchaser and two-fifths on the subsequent purchaser.

If the builder's duty runs both to the original and subsequent purchasers, while the original purchaser owes no duty, in tort or contract, to the subsequent purchaser for building defects latent at the time of her purchase, a rational builder will insist on performing the work, for which it will charge at least $800, in order to save the $1,000 average potential liability. But if the builder's duty runs only to the original purchaser, while the original purchaser still has no duty to the subsequent purchaser, a rational builder will not employ an extra level of care: the cost would be $800, while the average savings would in the short run, but its increased liability should more than offset any gain, eventually resulting in the failure of its business. To the extent that a builder continually uses more care than appropriate, its prices will probably exceed industry norms, with the same eventual result—failure of the business. The market's slow self-corrective mechanism in weeding out builders who price their services inappropriately, however, does not help the subsequent purchaser who paid market value for a home constructed by an unknown builder who used below standard care.

239. See supra notes 37–39 and accompanying text.

240. See supra note 63 and accompanying text.

241. See supra notes 202–07 and accompanying text (explaining why an original purchaser typically will have no contractual or tort duty to a subsequent purchaser).

242. Except as assumed contractually.
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only be $600.\textsuperscript{243} The rational original purchaser, however, will pay the builder to use the extra care. That care will save the original purchaser an average of $600 directly,\textsuperscript{244} and he will anticipate that, if the subsequent purchaser analyzes the risks at the time of sale as the original purchaser does when contracting with the builder, the subsequent purchaser will pay him approximately $400 for the extra level of care. Thus, use of the extra care will benefit the original purchaser in the average amount of $1,000.

Now assume that the third party is a tenant to whom the original purchaser anticipates leasing the property sometime after the building is completed, rather than a subsequent purchaser.\textsuperscript{245} In most states, an original purchaser has an implied warranty duty to a residential tenant, and in a few states to a commercial tenant, to remedy defects affecting habitability unless the tenant contractually assumes the duty of repair.\textsuperscript{246} Assume further the same cost of extra care, division of risk between the original purchaser and tenant, and probable amount of economic loss if any loss occurs, as in the previous hypothetical illustrations.

Once again, whether or not the builder has a duty to the tenant does not alter the level of care. If the builder has a duty to both the original purchaser and the tenant, the builder should insist on performing the work and charging at least its cost, $800. If the builder is not directly liable to the tenant, the original purchaser will pay for the exercise of care. He will expect to receive $600 of benefit before the lease is assumed, and $400 of escaped liability, on average, to the tenant.\textsuperscript{247}

\textsuperscript{243} The builder's unwillingness to adopt the socially efficient level of care should not be surprising; analogous facts result in the "tragedy of the commons," familiar to environmental law students. If an individual company does not pay for many of the costs of its pollution, such as cleanup, increased health care, and loss of aesthetic and recreational values, it may decide to discharge an extra increment of pollution when, if it paid for all those social costs, additional discharge would be inefficient. See Hardin, The Tragedy of the Commons, 162 SCIENCE 1243, 1244-45 (1968).

\textsuperscript{244} Because the builder's duty runs only to the original purchaser, the risk to the subsequent purchaser cannot be included in determining whether the builder is negligent. The original purchaser, therefore, cannot hold the builder responsible for the loss, and the extra care results in a $600 benefit to him.

\textsuperscript{245} This hypothetical is similar to the facts in J'Aire, see supra notes 96-101 and accompanying text, except that the plaintiff in that case was a tenant at the time the renovation contract was entered. The difference in timing should not affect the analysis, except that the 60-40 division of the risk which this Article uses in the hypothetical would be difficult to justify.


\textsuperscript{247} If the builder and original purchaser anticipate that the builder will have to indemnify the original purchaser against any claim of the tenant, the analysis will be the same as when the
Although this analysis may work in the ideal world of the economist, it cannot predict outcomes in the real world. Even if the original purchaser contracts for the improvements, he is less likely to decide to purchase extra care by what he expects to receive from, or avoid liability to, a subsequent purchaser, than by his desire to insulate himself from direct loss. The original purchaser cannot pay the builder to use extra care if the improvement has been constructed prior to purchase. Like most lawyers, the original purchaser probably will not know whether the builder has a duty to the subsequent purchaser—knowledge critical to evaluating his chance of exacting a premium from the subsequent purchaser for the extra care. Moreover, he probably will have little knowledge of the level of care appropriate for builders, little incentive to bargain with the subsequent purchaser over the premium to be paid for a given level of care, and little desire to make decisions based on the probable actions of an unknown purchaser at an unknown time in the future. Given these obstacles, a subsequent purchaser will almost certainly not initiate any bargaining to bring about the appropriate level of care. Making the builder liable to both purchasers would thus be more likely to produce the desired level of care.

Builder-Original Purchaser-Subsequent Purchaser Relationship with Calculable, Disproportionate Risks. Opponents of a duty from a builder to a subsequent purchaser may object to drawing any conclusions from the prior hypotheticals, believing that the efficiencies may disappear when the original purchaser’s risk is much less than the subsequent purchaser’s. The larger the percentage of risk attributed to the subsequent purchaser, however, the greater the benefits associated with a direct duty of care from the builder to the subsequent purchaser.

Once again, given the assumptions of the Coase theorem and assuming no transaction costs, whether or not the builder will be deemed to have a duty to the subsequent purchaser will not affect the level of care employed. To illustrate, assume that an additional level of care will cost $800 and the risks of loss are $100 for the original purchaser and $900 for the subsequent purchaser. The substitution of $100 for $600 and $900 for $400 in the analysis above produces identical results. If the builder lacks a duty to the subsequent purchaser, however, the original purchaser will be far more reluctant under the assumed $100-$900 division of risks than under the $600-$400 division to pay the builder to use extra care. This reluctance will stem partly from the

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builder has a duty to both the original purchaser and subsequent purchaser but the original purchaser has none to the subsequent purchaser.

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large proportion of the increased price that the original purchaser will not recover if the subsequent purchaser perceives the risks differently. But this reluctance may also stem in part from the reason for the disproportionate risk.

The builder’s exposure to the original purchaser may fall far short of its exposure to third parties for three reasons. First, a subsequent purchaser may experience greater loss than the original purchaser because of a different or more intensive use of the property. Such a subsequent purchaser is more likely to pay the premium than the other purchasers discussed below. Second, a series of purchasers may own the property longer than the original purchaser, making it more likely that a defect will become apparent during their ownership. The original purchaser will find it difficult to collect the premium from the person who buys from him. That subsequent purchaser will pay the full premium only if she expects to be able to pass it on to the person who buys from her; the same consideration will affect each owner in the chain of title. Third, if the builder has a duty to persons without ownership or possessory interests in the property, such as employees of the owner who lose wages during the period in which a defect is being repaired, the total loss to these persons may substantially exceed the original purchaser’s. To the extent that persons without ownership or leasehold interests bear the risk, the original purchaser’s ability to collect the premium virtually disappears. Simply placing a duty on the builder to all others to whom the risks are calculable is far more efficient.

Builder-Original Purchaser-Subsequent Purchaser Relationship with Indeterminate Risks. The above analysis establishes that an action exposing builders to calculable liability to persons other than the original purchaser, even if it means substantial exposure over a long period of time to a large class, is more efficient than a system in which the builder’s only exposure is to the original purchaser. Justice Cardozo

248. Thus far a subsequent purchaser has been treated as being a single person. In fact, a property will often have multiple owners, and persons without an ownership, or even a possessory, interest in an improvement may suffer economic loss from a construction defect. To account for these possibilities “subsequent purchaser” refers in this paragraph to the individual who purchases from the original purchaser, and “third parties” include the “subsequent purchaser” and any others suffering economic loss.

249. These three scenarios pose the three risks identified by Justice Cardozo in Ultramares: damages, time, and parties. Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931). As discussed below, however, Cardozo warned of indeterminate risks and this hypothetical assumes that the risks are calculable. Id.
warned, however, of liability "in an indeterminate amount for an indeterminate time to an indeterminate class." 250

Indeterminacy is crucial. A builder, like any other person deciding what level of care is appropriate to a task at hand, must anticipate the conclusions of the judicial factfinder in the eventuality that harm occurs. Assume that a builder has a duty to original and subsequent purchasers. The builder determines that failure to use an extra level of care will cause a 6% increase in the chance of economic loss in the probable amount of $10,000 to the original owner, and a 4% increase in the chance of economic loss in the same amount to the subsequent purchaser. 251 It decides against spending $1200 on extra care. An accident causing only economic loss occurs after the original purchaser has sold the property. Instead of $10,000 in economic loss, however, the subsequent purchaser experiences a loss of $40,000. With the wisdom of hindsight, the factfinder deems that the builder should have anticipated a loss in this amount. The builder is held liable. 252

If, as many courts hold, builders have a duty to act with due care to avoid imposing economic loss on all foreseeable injured parties 253 and, if builders are liable for consequential damages, 254 any risk evaluation will be highly speculative, particularly for commercial properties. A builder usually cannot predict how a building might be used five or ten years in the future. Neither can the builder be expected in most cases to foresee the impact that a given defect might have on that use, or the various ramifications upon employees or individuals doing business with the owner or tenant. Thus, a builder will generally have little basis for anticipating who may suffer economic loss, or for estimating the amount of that loss. 255

250. 174 N.E. at 444 (emphasis added).
251. See supra notes 241-44 and accompanying text (analyzing similar hypothetical facts).
252. See Calfee & Craswell, Some Effects of Uncertainty on Compliance with Legal Standards, 70 VA. L. REV. 965, 968-69, 976 (1984) (uncertainties about courts' and juries' interpretations of legal standards and of evidence concerning compliance with those standards will alter the incentives for rational profit maximizers to comply with those standards). Of course, juries probably use the Hand formula for determining negligence no more than do the builders and original purchasers of the world.
253. See supra note 107 and accompanying text.
255. The builder and original purchaser may disagree about the risk of economic loss and the probable amount of the loss which the original purchaser will experience if a defect develops while he owns the property. The builder and original purchaser will know, however, much more
Many builders are likely to take disproportionate precautions against this. Recent psychological and economic studies "suggest that people tend to regard their current or anticipated income as an important reference point for determining the utility of income . . . . [T]he utility cost of a sudden substantial reduction in income is much greater than the utility gain of a sudden increase in income of the same magnitude."256 Although some authors have suggested that this attitude is limited to consumers, builders, who frequently work in small, closely-held corporations and family businesses,257 probably manifest the same tendencies.258 Accordingly, they are likely to charge high prices to protect themselves from open-ended liability. Many original purchasers, who may enjoy only a small percentage of the benefit from the additional measure of care used, would probably resist paying such inflated prices. Indeterminate liability therefore threatens to impede socially desirable construction.259

Even if construction occurs because the purchaser acquiesces in the builder's expensive precautionary measures, the degree of care attending it may be unreasonable under the circumstances. Alternatively, a builder may acquire information allowing it to adapt its level of care to the circumstances. But information acquisition entails costs. Presumably the builder has at hand, or can gather relatively easily, information concerning the cost of additional care, the likelihood of economic loss if additional care is not used and the probable amount of that loss to the original purchaser. Reliable information about the impact on unknown parties, however, will be far more expensive to obtain.

The analysis in this subsection suggests that extending the builder's duty beyond the original purchaser fosters economic efficiency only where the builder can identify and calculate the risks with reasonable accuracy and at a reasonable cost. The problem of course consists in

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256. Hovenkamp, supra note 219, at 800; see Comment, supra note 227, at 397 ("Prospect theory postulates loss aversion: losses loom larger than the corresponding gains. In other words, there is less utility or pleasure in winning $100 than there is disutility or displeasure in losing $100.").

257. Barrett, supra note 1, at 933–34.

258. See Hovenkamp, supra note 219, at 806–07 (ranchers did not engage in the type of profit-maximizing bargaining hypothesized by the Coase theorem because they were neighbors as much as businesspersons).

259. The analysis does not change even if the builder does not engage in formal risk-benefit analysis. So long as the builder perceives that it must exercise care at a price that the original purchaser considers inappropriate in order to protect itself against liability to third parties, the indeterminate risk may block entry into a contract.
drawing lines in such a way that liability is not indeterminate as to parties, period of exposure or damages. These issues are addressed in subsection D, below.

C. Suits Between Builders

Normally an action between builders involves a claim by the general contractor, or a subcontractor, against the project architect or engineer.\textsuperscript{260} Permitting an action against the architect protects an injured party less than permitting a subsequent purchaser to sue a builder does; it also poses less risk of indeterminate liability. The limited benefit might not justify a new action. A remedy for plaintiff builders, however, can ride the coattails of an action for subsequent purchasers.

1. Need for Direct Action Against Architect

A subsequent purchaser generally has no viable claim when it suffers only economic loss from a defect still latent at the time of purchase, unless it can sue the builder for negligence. In contrast, under the widely used American Institute of Architects (A.I.A.) contracts,\textsuperscript{261} although the general contractor cannot directly sue the architect for breach of contract,\textsuperscript{262} it has a claim against the owner for

\textsuperscript{260} For sake of brevity, this Article considers only claims by a contractor against an architect or engineer, and refer only to the architect in discussing those claims. Occasionally a builder sues a person other than the architect. \textit{See} Morse/Diesel, Inc. v. Trinity Indus., 859 F.2d 242 (2d Cir. 1988) (steel subcontractors sued concrete subcontractors on a project alleging failure to perform work so as properly to coordinate schedule); Gilbane Bldg. Co. v. Nemours Found., 606 F. Supp. 995 (D. Del. 1985) (claim by subcontractors against project owner for allegedly providing incomplete and inaccurate plans and specifications and for various allegedly negligent acts in supervising the construction); E.C. Goldman, Inc. v. A/R/C Assocs., 543 So. 2d 1268 (Fla. Ct. App. 1989) (claim by roofing subcontractor against consultant hired by owner to determine whether roof was satisfactory); Hawthorne v. Kober Constr. Co., 196 Mont. 519, 640 P.2d 467 (1982) (claim by one subcontractor against another based on defendant's late delivery of steel); Alvord & Swift v. Stewart M. Muller Constr. Co., 46 N.Y.2d 276, 385 N.E.2d 1238, 413 N.Y.S.2d 309 (1978) (claim by subcontractor against owner for interference with contractual relations after the owner allegedly became dissatisfied with the general contractor's performance).


The basic A.I.A. forms were rewritten in 1987, Comment, \textit{Flirting with Disaster: The A.I.A. Owner-Architect Agreement Shifts the Risk of Loss to Owners}, 36 Loy. L. Rev. 409 (1990), and few reported decisions construe the new provisions. Accordingly, the liability analysis below has little caselaw support.

\textsuperscript{262} American Institute of Architects, General Conditions of the Contract for Construction, A.I.A. Doc. A201 (1987) [hereinafter \textit{Owner-Contractor Agreement}], which is incorporated into all of the A.I.A. standard agreements for construction services between the owner and
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breach of contract if the plans and specifications prepared by the architect or the architect’s supervision of the project are deficient.

Each subcontractor has the same rights against the general contractor as the general contractor has against the owner. If an architect’s plans or supervision result in loss, the subcontractor may bring claim against the general contractor for breach of contract, and the general contractor may then seek relief from the owner.

If an owner becomes liable to a general contractor because of an architect’s deficient plans or supervision, the owner is likely to seek relief against the architect. The A.I.A. documents do not deal with the architect’s standard of care or an owner’s right to indemnification from the architect, with the result that common law principles should prevail. Under the common law, to the extent that the owner becomes liable to the general contractor because of the architect’s negligence, the architect should be liable to the owner.

general contractor, provides, “[t]he Contract Documents shall not be construed to create a contractual relationship of any kind (1) between the Architect and Contractor . . . .” Id. § 1.1.2.

265. The claim would not be resolved in the courts. If a contractor believes that it is entitled to an adjustment in the contract price, because of “an error or omission by the Architect” or for any other reason, it must file a claim which is referred to the architect. Id. § 4.3.2. If the matter is not resolved by the architect satisfactorily to the parties, the contractor’s sole recourse is to arbitration. Id. § 4.5.

266. The owner is responsible for providing any of the architect’s drawings necessary for the contractor’s work to the contractor. Id. § 2.2.5. The Owner-Contractor Agreement does not expressly permit a claim for an adjustment in contract price based on an error in the drawings, but the general provision permitting claims based on architect errors or admissions should suffice to permit an adjustment for a defect in the drawings. See id. § 4.3.2; see also Mayor of Columbus v. Clark-Dietz & Assoc.-Eng’rs, 550 F. Supp. 610, 625 (N.D. Miss. 1982) (without referring to specific contractual language, court held that general contractor may sue owner for breach of contract to recover expenses incurred because of defects in the plans and specifications prepared by the architect), appeal dismissed, 702 F.2d 67 (5th Cir. 1983). The contractor, however, must “carefully study” the contract documents, compare them to actual field conditions, and report any error or inconsistency to the architect. Owner-Contractor Agreement, supra note 262, §§ 3.2.1, 3.2.2. Failure to fulfill these obligations may expose the contractor to liability to the owner or architect for work performed pursuant to the erroneous plans, id. § 3.2.1; presumably, failure to fulfill these obligations will also prevent the contractor from claiming an adjustment to the contract price.

267. The architect has various specified supervisory powers over the work. Owner-Contractor Agreement, supra note 262, § 4.2. In exercising these powers, the architect acts as the owner’s representative. Id. § 4.2.1.


269. The only requirement is that the architect perform its services “as expeditiously as is consistent with professional skill and care and the orderly progress of the work.” Architect-Owner Agreement, supra note 189, § 1.1.2.

269. See County of Los Angeles v. Superior Court, 155 Cal. App. 3d 798, 802–03, 202 Cal. Rptr. 444, 447 (1984) (when owner’s liability to contractor arose only because owner provided contractor with architect’s defective plans, architect may be liable to indemnify owner even
Unlike typical contractual provisions that operate to block recovery by a subsequent purchaser, the A.I.A. documents, therefore, generally provide a contractual remedy to general contractors and subcontractors. A contractor harmed by an architect’s negligence also does not confront the statute of limitations problem which plagues the subsequent purchaser. Presumably, the builder will know whether it has suffered harm by the time the project is complete; it need not wait for a defect to become manifest.\textsuperscript{269}

Two gaps in the contractual protections for contractors nevertheless may exist. First, non-A.I.A. documents may not provide for the same contractual remedies. Second, the owner, or in the case of subcontractor loss, the general contractor, may be insolvent.

A tort action for builders, therefore, has far less importance than an action for subsequent purchasers. Nevertheless it is not completely superfluous: it may fill gaps in the contractual protection available to builders. That possible role justifies examination of the efficiencies of this potential avenue for recovery.

2. Economic Efficiency and Indeterminacy

As in actions by subsequent purchasers against builders, where actions by builders against project architects generate economically inefficient decisions, the cost of such actions may outweigh their benefits. Many of the same considerations apply to both types of actions. Using the Coase theorem, and assuming no transaction costs, the initial assignment of liability does not affect the level of care used. For example, assume that an extra increment of care will cost the architect $800. If that level of care is not used, the risk of loss to the owner is $100; to other builders, $900. If a duty of care runs from the architect to the owner and builders, the architect will use the extra care. If the architect’s duty runs only to the owner, the owner has a duty to the builder and the architect need not indemnify the owner against his liability to the builders, then the owner will pay the architect to use the care, saving $100 on average directly and $900 on average in liability to the builders. If the owner, like the architect, has no duty to the builders, the owner will still pay the architect to use the care, expect-

\textsuperscript{269} The A.I.A. form contracts do create a time deadline for the contractor. If something occurs which the contractor believes justifies an increase in the contract sum, the contractor must give written notice within 21 days after the occurrence. Owner-Contractor Agreement. \textit{supra} note 262, § 4.3.3.
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ing to recover $900 through discounted prices which the builders will charge for their services.²⁷⁰

Architects, owners and contractors have different motivations in and knowledge of the construction process. To encourage efficient decisionmaking, liability should be assigned to the party most likely to hold down the transaction costs associated with reaching an agreement under which the architect will use a socially efficient level of care. Assuming calculable costs and risks, the architect should be the party bearing a duty of care. Granted, assigning an architect a duty of care to other builders is a closer call than assigning a builder a duty of care to subsequent purchasers, because the difference between the architect’s and other builders’ knowledge of the costs of the architect’s performance and the risks associated with a given level of care are presumably much less than the difference in knowledge of a builder and owner. Yet, unless an architect has no peculiar expertise, a difference must exist.

Indeterminate exposure, however, can render a builder’s action against an architect inefficient. The architect, like any other builder, will increase its charges for services to account for its potential liability.²⁷¹ If the architect and other affected builders perceive the exposure identically, the indeterminacy will arguably have no effect; the architect’s increase in fees to account for its liability will equal the amount by which the various contractors will decrease their charges because of their new potential claims. But such offsets certainly would not occur. Studies suggest that architects would perceive their potential liability to be large, while contractors would view new opportunities to sue architects relatively pessimistically.²⁷² Moreover, even if builders reach approximately the same assessments internally, they would probably use different figures in their negotiations with the owner—with architects systematically padding their exposure and contractors systematically deflating their benefit. As a result, the cost of construction would likely increase.

The issue then is the extent of the uncertainties. Two of the risks identified by Justice Cardozo in Ultramares are irrelevant. The architect should know all the types of work that the project requires by the time it completes the plans and specifications, even if it does not know

²⁷⁰. See supra text accompanying notes 248–49 (analyzing builder-original purchaser-subsequent purchaser relationship using same numbers).
²⁷¹. See supra notes 256–59 and accompanying text. The architect is also one of the builders who may be liable to subsequent purchasers, and will be doubly motivated to increase its charges for services to account for its potential liability.
²⁷². See supra note 256 and accompanying text.
the identity of the contractor and subcontractors. The architect therefore need not worry about suits by indeterminate builders. Any contractor or subcontractor should know of claims that it may have against the architect by the time the project is complete; consequently, the architect need not fear that a construction defect will give rise to claims at indeterminate times.

Potential exposure, however, will be indeterminate if the architect is liable for all the damages to other builders that its negligent plans or supervision proximately causes. Certain costs, such as costs for reconstruction work, are roughly ascertainable in advance, determining costs arising from delays caused by defective plans or supervision may be more difficult, and damages arising from contractual bonuses, obligations of the contractor to other projects, or other special damages may be all but impossible for the architect to estimate in advance.

Limiting damages recoverable by builders renders an action reasonably determinate, enabling architects to calculate the risks associated with a particular level of care. The action, if so limited, will not encourage economic inefficiencies.

D. Elements of the Action

The analysis above has identified the key elements of an action for negligent infliction of economic loss in the construction context: such an action should protect the injured party’s reliance on the builder’s services; it should restrict the parties who can sue to a limited group of persons whose reliance the builder could particularly foresee; and it

273. See supra note 269 and accompanying text.

274. See Mayor of Columbus v. Clark-Dietz & Assoc.-Engrs, 550 F. Supp. 610, 627 (N.D. Miss. 1982) (holding city and engineer jointly and severally liable to contractor for all the damages proximately caused by its negligence), appeal denied, 702 F.2d 67 (5th Cir. 1983).

275. Architects’ estimates, however, may not jibe with judicial determinations of the damages. Courts sometimes use the “total cost method” of calculating damages, which consists of “subtracting the bid on the project or the estimated cost of completion from the actual total cost.” Seattle W. Indus. v. David A. Mowat Co., 110 Wash. 2d 1, 6, 750 P.2d 245, 249 (1988). This method may yield inflated recoveries if the initial bid was unreasonably low or factors unrelated to the architect’s alleged negligence contributed to the contractor’s cost overrun. Id.

276. See Milton J. Womack, Inc. v. House of Representatives, 509 So. 2d 62, 68 (La. Ct. App. 1987) (general contractor entitled to recover from architect the $100,000 bonus for early completion when the architect’s inadequate plans prevented the contractor from completing the project in time to earn the bonus); Seattle W. Indus. v. David A. Mowat Co., 110 Wash. 2d at 5, 750 P.2d at 248-49 (subcontractor entitled to recover from engineer on one project when discrepancies in the engineer’s drawings caused the subcontractor to do additional work on that project, thereby causing delays and additional costs to the subcontractor on another unrelated project). In neither case did the court state whether the architect or engineer knew or had reason to know of the bonus or other project at the time that it performed the allegedly negligent acts.
should limit the builder’s exposure to a reasonable, defined period of time, and the recoverable damages to those reasonably foreseeable by the builder.

The action for negligent misrepresentation set forth in Restatement (Second) of Torts section 552 encompasses many of these objectives. The language of that section suggests a model for the action.

1. The Builder’s Duty

The first task is to define the builder’s duty. The following would be a suitable definition:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, fails to exercise reasonable care or competence in designing, planning, constructing or supervising the construction of an improvement (a “builder”) is subject to liability for economic loss caused to any person identified in paragraph (2) below who justifiably relies on the due care or timeliness with which the builder has performed its services, the accuracy of its designs, plans or other representations, or the quality of its work on the improvement.

(2) The liability stated in paragraph (1) is limited to loss suffered by:
   (a) any person (i) whom the builder knows has or acquires an ownership or possessory interest in the improvement prior to or during the course of the builder’s work, or (ii) if no person satisfies clause (i), who first acquires an ownership or possessory interest in the improvement after the services have been completed;
   (b) any person who has been assigned the rights of any person identified in subparagraph (a) or who otherwise acquires an ownership or possessory interest in the improvement; or
   (c) any of a limited group of persons whom the builder has particular reason to know will particularly rely on those services, including but not limited to any other builders who are or will be engaged in the construction of the same improvement, even if, at the time that the builder provides those services, it does not know the identity of any or all of those other persons, provided that the injured party suffers the loss in connection with the construction of that improvement.

The project of identifying a duty applicable only to builders may be criticized as ad hoc and therefore creating undue complexity.277 There

277. See Barrett, supra note 1, at 939 (limiting recovery to fee owners of an improvement to eliminate open-ended liability is hardly less arbitrary than the distinctions drawn by a bright-line economic loss rule).
are several responses to this criticism. First, the common law has developed many rules that vary depending on the particular type of property or actors involved, such as distinct rules concerning invasions of interests in chattels, land and water,\textsuperscript{278} that are similarly ad hoc. Second, although the proposed action may create an additional distinction in the law, it also eliminates one: negligent performances and negligent misrepresentations are treated identically, at least in claims against builders.\textsuperscript{279} Third, an action applying to all instances of negligently inflicted economic loss, not just those related to construction, is formulated in Part V below. The narrower action against builders, however, does not depend on the viability of the more comprehensive action;\textsuperscript{280} rather, it suggests that the more general action also has merit.

Switching from the overall objection to the particular provisions, paragraph (1) limits liability to one who negligently performs or misrepresents “in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest.” This language, taken from the \textit{Restatement (Second) of Torts} section 552(1), shields an individual who constructs an improvement for his own use but eventually sells it.\textsuperscript{281}

Paragraph (1) differs from section 552 in one fundamental respect: it extends the same duties to those engaged in design, planning, construction and supervision of improvements, thereby treating negligent misrepresentations and negligent performances identically.\textsuperscript{282} Distinctions between negligent misrepresentation and negligent performance

\begin{itemize}
\item \textsuperscript{278} \textit{See} \textit{Restatement (Second) of Torts} §§ 157–66 (1965) (trespass to land), §§ 216–22 (1965) (trespass to chattels), §§ 850–57 (1979) (interference with use of watercourses and lakes).
\item \textsuperscript{279} \textit{See} supra notes 132–41 and accompanying text (discussing differential treatment by some jurisdictions of negligent misrepresentation and negligent performance claims).
\item \textsuperscript{280} \textit{Cf.} Schwartz, \textit{supra} note 3, at 38 (negligent infliction of economic loss may vary in different types of circumstances, precluding a single solution).
\item \textsuperscript{281} \textit{Cf.} Howe v. Bishop, 446 So. 2d 11, 13 (Ala. 1984) (defendant not liable in negligence in part because, when he acted as his own general contractor in constructing apartments, he intended to own them indefinitely); Hopkins v. Hartman, 101 Ill. App. 3d 260, 427 N.E.2d 1337, 1339 (1981) (defendant not liable for breach of implied warranty in part because that warranty attaches to houses built for sale in the manner of merchandise, and not to structures built for the builder’s own use).
\item \textsuperscript{282} Treating the two types of negligence identically does not depart from judicial decisions as radically as from the \textit{Restatement}. Although some jurisdictions have followed the \textit{Restatement’s} position that persons may have a duty to avoid negligent misrepresentations causing only economic loss but not a duty to avoid negligent performances causing identical loss, \textit{see} supra notes 132–41 and accompanying text, others have imposed a duty on builders to avoid negligent performances causing economic loss, \textit{see} supra notes 92–109 and accompanying text, or treated negligently prepared plans like any other type of negligent performance. \textit{See} supra note 195 and accompanying text.
\end{itemize}
claims are unjustified. As noted, negligent misrepresentation claims generally can be recast as negligent performance claims, and negligent performance claims as negligent misrepresentation claims. More important, as this section shows, the same limitations can make both types of claim reasonably determinate.

Finally, paragraph (1) premises liability on justifiable reliance on the builder's services, representations or product. Not every person who detrimentally relies on a builder, however, should have a claim; this would create the problem of indeterminate parties.

Paragraph (2) addresses this issue by limiting the classes of potential plaintiffs. Subparagraphs (a) and (b) give claims to persons with an ownership or possessory interest in the improvement. The builder should foresee that these persons may suffer economic loss when it performs a negligent act or makes a negligent misrepresentation. Any owner may suffer from diminution in market value or incur the cost of repairing or replacing the defectively constructed improvement, and any possessor may lose use of the property until repairs are completed. Moreover, although the ownership or possessory interests may be unified at one time and carved into many pieces at another, those interests cannot total more than the whole at any time.

A builder has no duty under subparagraphs (a) and (b) to any other person who experiences only economic loss, no matter how severe. The builder cannot anticipate the nature and amount of others' losses, or the total number of persons who might suffer loss.

Although failing to arrive at a unified theoretical justification, courts apparently have drawn similar lines between persons with and without claims. For varying reasons they have permitted tenants to sue builders for economic loss caused by a property defect, but have

283. See J'Aire Corp. v. Gregory, 24 Cal. App. 3d 799, 805, 157 Cal. Rptr. 407, 411 (1979) (sufficient nexus between contractor engaged by landlord and tenant in whose premises contractor was performing work for contractor to be liable for negligent delay); Chubb Group of Ins. Cos. v. C.F. Murphy & Assocs., 656 S.W.2d 766, 776-77 (Mo. Ct. App. 1983) (distinguishes between tenants injured by roof collapse and others who merely may have lost expected business); A.E. Inv. Corp. v. Link Builders, 62 Wis. 2d 479, 214 N.W.2d 764, 767 (1974) (foreseeable that future tenant of commercial building would be harmed by failure to account properly for subsoil conditions in designing building). Chubb arose out of the collapse of the roof of the Kemper Arena in Kansas City. Plaintiffs, who alleged that they were tenants of the center, sued the builders for their loss of use. The trial court threw out the negligence claim on a motion to dismiss, but the appellate court reversed, stating:

Liability must be premised instead on whether the injury to plaintiffs was foreseeable and within the policy considerations of avoiding both unlimited liability and the overburdening of those who assume contractual responsibilities . . . .

The answer to that question turns on the nature of plaintiffs' injury. Defendants characterize it as a mere loss of a business expectation at best, or alternatively, a loss of a
uniformly rejected the economic loss claims of more remote parties, including employees who worked at a hotel damaged by fire, users of a bridge over the Mississippi River which had to be closed for seven months for repairs, and businesses which saw the tourist industry decline after the accident at Three Mile Island.

Subparagraph (c) provides for claims by members of a limited group "whom the builder has particular reason to know will particularly rely" on its services. Other builders on a project, who are specifically identified as falling within the general category, may be the only persons who qualify. Because the general language may be unnecessary in construction cases, discussion of it is deferred until Part V.

The final phrase in subparagraph (c) limits the injured party's claim to reliance on the defendant's actions or representations to the particular improvement on which the defendant acted negligently. A contractor, for example, cannot sue an architect when the contractor's attempt to use information provided by the architect on a different project results in economic loss.

2. Damages

Merely limiting the persons to whom a builder has a duty is insufficient. If subsequent owners, tenants or other builders could sue a builder for all economic loss caused by the builder's negligence, the builder could not reasonably estimate its exposure. An injured party's recovery should be limited to those damages incurred in reliance on void oral contract. If so, extending liability would no doubt expose defendants to almost unlimited liability to all businesses damaged in any collateral manner by the collapse of the arena's roof . . . .

Plaintiffs, however, characterize their injury as a loss of rights to which they were entitled by a lease, a recognized property interest. If that were so, their loss would not only be far more foreseeable by defendants, who were alleged to have been aware that the arena would be used for entertainment purposes, but extending liability would not expose defendants to unlimited liability to all establishments which may have suffered some loss of business as a result of the collapse of the roof.

656 S.W.2d at 776.


287. See supra note 269 and accompanying text (claim by builder against project architect does not pose problem of indeterminate parties).

288. See infra notes 344–51 and accompanying text.
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the builder's performance or representation which were roughly calculable at the time of that performance or representation.

Contract law, supplemented by Restatement (Second) of Torts section 552B, provides most of the necessary restrictions:

(1) Subject to paragraph (2), the damages recoverable are those necessary to compensate the injured party for the economic loss which he has incurred in reliance on the builder's negligent misrepresentation or performance with respect to an improvement, including:

(a) the cost of repair or replacement of any defect in the improvement, unless such repair or replacement is economically wasteful, in which case the diminution in the fair market value of the injured party's interest in that improvement;

(b) if the improvement can be repaired or replaced at reasonable cost, any diminution in the fair market rental value of that improvement during the period it is unusable or of diminished usefulness;

(c) any additional costs which the injured party incurs in performing services which he was under contractual obligation to perform with respect to the improvement; and

(d) any other out-of-pocket economic loss suffered incidental to the injured party's reliance on the builder's services, including reliance on the timely performance of those services.

(2) The damages recoverable do not include:

(a) the "benefit of the injured party's bargain," i.e., the difference between the amount which the injured party paid or agreed to pay for an ownership or possessory interest in the improvement and its then-fair market value, or between the amount which the injured party received or agreed to receive for services in connection with the improvement and the then-fair market value of those services;

(b) any profits which the injured party expected to realize by services to be performed in connection with the construction of another improvement or in its business enterprise conducted at the site of the improvement; and

(c) any opportunities to acquire interests in other properties or to perform work in connection with the construction of other improvements lost because of the injured party's reliance on the builder's performance or representation.

(3) Notwithstanding paragraph (2), the injured party may recover the benefit of its bargain, lost profits and lost opportunity costs to the extent that the builder had reason to know of that bargain, expected profit, or opportunity before committing the negligent performance or misrepresentation.
Under this formulation, whether a defect becomes manifest while the original purchaser still owns and possesses an improvement, or after it has changed hands and uses many times, will have little impact on a builder’s exposure. The identity of the owner or possessor does not affect the diminution in market value caused by a defect, the cost of repairing or replacing it,\(^{289}\) or any consequent loss of rental value.\(^{290}\) The identity of the owner or possessor and the nature of the use of the improvement will affect the amount of the bargain, profits and opportunities lost because of the defect\(^{291}\)—but those are unrecoverable under paragraph (2) except to the extent the builder has reason to know of them when it commits the tort.\(^{292}\)

Except when a builder has reason to know, the only damages recoverable by an owner or possessor of an improvement are the incidental damages under subparagraph (1)(d). A builder can anticipate that any owner or possessor may incur incidental damages not identified in paragraph (2), such as the cost of arranging for repair or for alternative facilities during the repairs, but the amount of the damages may be inestimable. Nevertheless, these damages, which will probably be relatively minor in comparison with other damages, should be recoverable because they represent out-of-pocket costs borne by the injured party in reliance on the builder’s actions or words.\(^{293}\)

The same principle of estimability underlies the formulation of the damages standards for actions between builders. As discussed above, an architect or engineer can anticipate most of the additional costs which its negligence may cause to other builders engaged on a project, but not the profits to be realized from contract terms of which the architect has no reason to know.\(^{294}\) An injured builder therefore cannot recover those unforeseeable damages, just as a subsequent owner cannot recover damages based on expectations which a defendant builder has no reason to foresee. Incidental damages also are treated the same as in actions by nonbuilders, even though the defendant may

\(^{289}\) Paragraph (1)(a) limits recovery to the cost of repair or replacement, or if that is excessive, the diminution in fair market value caused by the defect. That is a normal measure of damages for defects in improvements. E. Farnsworth, supra note 170, § 12.13.

\(^{290}\) See Note, Economic Loss in Products Liability Jurisprudence, 66 COLUM. L. REV. 917, 957 (1966) (amount of direct economic loss suffered because of defective product is unaffected by the identity of the injured party).

\(^{291}\) See id. at 955–56 (amount of consequential economic loss caused by defective product may be affected by the identity of the plaintiff).

\(^{292}\) Foreseeability limits the recovery of consequential economic loss in the same manner as for a breach of contract. See U.C.C. § 2-715(2) (1987).

\(^{293}\) See U.C.C. §§ 2-710, 2-715(1) (1987) (a non-breaching party may recover its reasonable incidental damages).

\(^{294}\) See supra notes 274–76 and accompanying text.
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have difficulty anticipating the amount—presumably relatively small—of those costs.

With the exception of relatively minor incidental damages, therefore, this proposal eliminates the risk that imposition of liability on a nonprivity builder will create liability in an "indeterminate amount." It accomplishes this goal by limiting damages to those incurred in reliance on the negligent actions or representations, and roughly calculable by the builder at the time of the alleged negligence.

3. Time

The final member of Cardozo’s triad of risks is "indeterminate time." This risk has taken on greater importance since his 1931 opinion in *Ultramares* because many courts now hold that tort actions do not accrue until the injured party discovers or reasonably should have discovered the facts giving rise to a claim.295 A builder will find calculation of its ultimate exposure very difficult if the statute of limitations on a negligence action does not begin to run until a defect becomes manifest five, ten or more years after construction.296 Although this problem would plague builders to some extent even if privity remained a requirement, extension of an action to subsequent purchasers greatly exacerbates it.

States have adopted two means to limit the temporal risk. The first is statutory. During the 1960s and 1970s, over forty states adopted applicable statutes of repose which cut off claims not filed within a specified time from the date of the allegedly wrongful action, regardless of the date of discovery.297 These statutes generally applied to any


296. A decision from Indiana, Essex v. Ryan, 446 N.E.2d 368 (Ind. Ct. App. 1983), highlights the problem. In 1955, a homeowner, Davis, engaged the defendant surveyor, Ryan, to survey his lot. *Id.* at 369. In reliance on the erroneous survey, Davis constructed an addition, most of which unbeknownst to Davis encroached on a neighbor’s lot. Davis sold to an intermediate party, who sold to the plaintiffs in 1962. In 1976, 21 years after the survey, the adjoining lot owners discovered the encroachment and brought a quiet title action. The Essexes incurred damages in excess of $10,000 in connection with the suit and its settlement, and after its conclusion, sued Ryan. While the suit was pending, the Essexes obtained from Davis an assignment of his rights against Ryan. *Id.* at 369.

The Indiana appellate court held that the Essexes had no direct negligence claim against Ryan, not because it was time-barred, but because, even if Indiana would adopt the tort of negligent misrepresentation, it would apply only if the parties were "in privity . . . or . . . [the defendant] had actual knowledge that the plaintiff would rely on the information given." *Id.* at 372. They could, however, proceed with their contract claim derived from the assignment. *Id.* at 374-75. Ryan, therefore, faced liability on his decades-old performance.

claims arising from the negligent design or construction of improvements to real property, and cut off claims not filed within as few as four or as many as twenty years. 298

Many courts declared the statutes unconstitutional, primarily on equal protection grounds, because, without reasonable justification, they granted only a narrow spectrum of defendants immunity from suit. 299 Statutes of repose, however, contribute substantially to making builders' exposure roughly calculable. 300 Redrafting unconstitutional statutes of repose to deal with all claims of negligent infliction of economic loss may obviate the constitutional objection. 301

Courts created the other temporal limitation. A builder is not negligent, and does not breach an implied warranty, if a reasonable length of time passes before an improvement develops a defect. 302 The expected efficient life of a component or treatment of the property primarily determines reasonableness. 303

These limitations—statutes of repose and reasonableness premised on expected efficient life—together eliminate most of the indeterminate time problem. Combined with the elements above, they reduce the risks posed by an action for negligent infliction of economic loss to an acceptable level, at least in the construction setting. With these risks limited, the action will not be inefficient (indeed, it probably will encourage greater efficiency) and will give legal recourse to individuals who might otherwise have none.

298. Id. at 824.
299. Id. at 825–31 (declaring Wyoming statute of repose unconstitutional and identifying decisions of other jurisdictions which upheld or rejected statutes of repose); Note, Actions Arising Out of Improvements to Real Property: Special Statutes of Limitations, 57 N.D.L. REV. 43, 57–63 (1981) (jurisdictions considering statutes of repose applicable to construction-related actions have divided almost equally on their constitutionality, with equal protection challenges being the primary basis for overturning the statutes).
300. See Epstein, The Temporal Dimension in Tort Law, 53 U. Chi. L. REV. 1175, 1206–12 (1986) (statutes of repose for claims against builders control adjudication errors caused by passage of time and provide more definite liability rules for builders and owners, and any reduction of rights of the injured party may be countered in part through insurance, inspections and provisions for occupier liability).
301. See infra text accompanying note 354.
302. Compare Shiebels v. Estes Homes, 161 Ariz. 403, 778 P.2d 1299, 1301–02 (1989) (a builder's implied warranty against termite damage does not extend beyond the five-year effective period for soil treatment, and against floor cracks does not extend to a crack which developed ten years after construction, when the cost of repair was only $600) with Wagner Constr. Co. v. Noonan, 403 N.E. 2d 1144, 1148 (Ind. Ct. App. 1980) (a builder breaches its implied warranty when a septic system proves defective within five years) and Moxley v. Laramie Builders, 600 P.2d 733, 735 (Wyo. 1979) (although an implied warranty expires after a house has manifested no defect within a reasonable time, it still exists when electrical wiring proves defective within two years after a house is constructed).
303. See Shiebels v. Estes Homes, 778 P.2d at 1302.
Negligent Infliction of Economic Loss

Before advocating this new action, however, this Article will address two other objections: that the proposed action will interfere with the parties' freedom to contract, and that it will not adequately protect injured parties.

E. Objections to the Action

1. Freedom to Contract

Opponents of noncontractual liability for economic loss argue that a negligence action will interfere with parties' ability to contract in four ways. First, the specter of liability will cause a builder to charge more for services than the owner will pay, or to insist on performing work which the owner does not want done. In either case, an otherwise desirable improvement may not be built.\(^{304}\) As shown in Subsections B and C above, however, contractual impasse should not occur so long as the potential liability is estimable, and as demonstrated in Subsection D, the proposed action makes a builder's exposure estimable.

Opponents of noncontractual liability also assert that the possibility of a tort action will impede parties from allocating risks and from building inexpensive structures and will provide an unwarranted windfall to parties which do not contract with the builder.\(^{305}\) I analyze these three related arguments in the context of a suit by an owner against a builder, but similar analysis applies to suits between builders.

The first of these arguments is correct in part. A negligence claim may undermine the agreement between the original purchaser and a builder if that purchaser can recover in tort but not in contract or if he can recover more under a tort claim than under a contract claim. The proposed tort action ordinarily will not expand the builder's liability to the original purchaser\(^{306}\) or permit recovery of greater damages, however, unless the contract contains disclaimers or limitations on liability and those provisions do not apply to the tort claim. Otherwise, the builder will be liable under either action if it acts negligently.\(^{307}\)

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\(^{304}\) See supra notes 256-59 and accompanying text.

\(^{305}\) See Barrett, supra note 1, at 937-38, 941 (raising each of these arguments). All three arguments assume that original and subsequent purchasers bargain over levels of care, which this author doubts happens frequently. See supra notes 226-29 and accompanying text. To rebut the arguments on their terms, however, this author must make the same assumption to some extent.

\(^{306}\) Indeed, if an implied warranty protects the original purchaser, he can recover for breach of that warranty even when he cannot prove negligence. See supra text accompanying notes 116, 240.

\(^{307}\) Virtually every court reads into construction contracts an obligation to use the skill and care reasonably expected of builders in that industry. See supra notes 38-39 and accompanying text (discussing the standard of care and skill read into contracts during the first half of the
and the damages available under the proposed action will equal contractual damages when the parties are in contractual privity.\footnote{308}

To prevent circumvention of the parties' agreement, courts should enforce provisions disclaiming or limiting tort as well as contract remedies. Case law indicates that they will: their willingness to honor clear disclaimers of implied warranties\footnote{309} suggests that they also will enforce clear disclaimers of negligence liability for economic loss. Similarly, if the parties agree to a term of eight months to complete an improvement, a court should not decide that four months was reasonable and make the builder liable in tort for taking longer.

Briefly summarized then, when parties are in privity of contract and the plaintiff has suffered only economic loss, the contract should be the primary source of the builder's obligations and the plaintiff's rights. That can be assured by adherence to the following principle: when the plaintiff and defendant are in privity of contract, the contract controls with respect to any issue which it addresses, unless that provision is unenforceable for any reason.

Given the primacy of the contract between the contracting parties, the existence of a negligence action will not prevent a builder and the original purchaser from allocating risks between them. For example, the original purchaser may agree to limit his right to sue in return for a reduction in price. The builder will obviously pay less for the limitation because of any subsequent owner's continuing right to sue than it will if she possesses no action.\footnote{310} If the builder desires protection from twentieth century. Negligent construction, therefore, will result in contractual as well as tort liability.

\footnote{308} Aside from the possibility of punitive damages, tort damages often exceed contractual damages because of the ease of recovery of consequential damages. Not so with the proposed action. Contract law provides the basis for the consequential damages provisions. \textit{See supra} notes 291–92. If the original purchaser is entitled to consequential damages under the proposed action, he will recover them under contract law as well.

\footnote{309} \textit{See} Tyus v. Resta, 328 Pa. Super. 11, 476 A.2d 427, 432 (1984). \textit{Cf.} Tusch Enters. v. Coffin, 113 Idaho 37, 740 P.2d 1022, 1030–31 (1987) (a generalized disclaimer not mentioning implied warranties is ineffective because a "disclaimer must be clear and unambiguous and such disclaimers are strictly construed against the builder-vendor").

\footnote{310} Under the UCC, a purchaser's disclaimer of, or limitation on, contractual liability also binds any subsequent purchaser or user. U.C.C. § 2-318 comment 1 (1987). \textit{But see} Patty Precision Prods. Co. v. Brown & Sharpe Mfg. Co., 846 F.2d 1247, 1253 (10th Cir. 1988) (warranty limitations in contract between manufacturer and original purchaser are ineffective against subsequent purchaser to whom the limitations were not communicated, because, with respect to that purchaser, they were not in writing or conspicuous). By contrast, a seller cannot disclaim strict products liability under \textit{Restatement} § 402A. \textit{See Restatement (Second) of Torts} § 402A (1964). This Article takes an intermediate position with respect to the proposed action. A builder may disclaim liability to the original purchaser, but that disclaimer does not bind a subsequent purchaser.
tort claims by subsequent purchasers, it can pay the original purchaser to insert a limitation clause protecting the builder in any contract which he subsequently enters to sell the property or to record a limitation on the right to sue in the property's chain of title. Alternatively, it can negotiate a similar clause directly with each subsequent owner. The costs to the builder should differ little if at all from the costs to purchasers absent a direct tort action. The original purchaser would have to negotiate an agreement with the builder permitting subsequent purchasers to sue in tort, or subsequent purchasers could obtain this right directly from the builder.

Second, some suggest a direct tort action might prevent parties from building a cheaper structure. The owner and architect determine the design and budget for the structure, and these affect its quality at least as much or more than the contractor's workmanship. The contractor, the argument goes, should not be liable merely for following instructions.\footnote{See Barrett, supra note 1, at 937-38.}

This argument is fallacious in one respect, and will, if adopted, result in certain inefficiencies. The legal system should discourage an owner and a builder from discounting or excluding risk to subsequent purchasers and therefore deciding to build a structure that is unreasonably unsafe, when the risk to the subsequent purchaser is considered.\footnote{See supra note 243 (exclusion of subsequent purchaser from calculation of level of care analogous to “tragedy of the commons”).} Such an improvement may be cheaper in the short term but will ultimately cost society more.

Presumably advocates of the economic loss rule are concerned about inhibiting the construction of reasonably cheap but safe structures, that is, structures for which the cost of an increase in the level of care would exceed the decreased risk of loss to both original and subsequent purchasers. The proposed action would not interfere with the construction of this type of improvement. Even if a builder has a tort duty to subsequent purchasers, it will not use extra care when it believes that the cost of the extra care would exceed the benefit. Of course, the builder may fear that the judicial factfinder might perceive the risks and benefits differently and impose liability even though the builder acted reasonably.\footnote{See Barrett, supra note 1, at 937-38 (fearing that courts would impose a uniform standard of care for a new $1.5 million mansion and a used wooden bungalow built for temporary use).} The proposed action controls against this
possibility as much as possible, and there is no evidence that courts and juries do not recognize that different standards of care may be appropriate for different types of structures.

Finally, the existence of the tort action is said to provide a windfall to the subsequent purchaser. That owner may have paid less for the improvement because of the below standard level of care. Once a defect develops, however, she may sue the builder for damages arising from the very same risks for which she has already obtained a discounted purchase price.\(^\text{314}\)

This argument once again is flawed. If a builder uses a non-negligent reduced standard of care, the original purchaser should receive a reduction in the construction price, and pass on part of it to the subsequent purchaser. Because the construction is not negligent, the subsequent purchaser has no viable claim against either the builder or the original purchaser, and therefore does not receive a windfall. If, however, the builder reduces the level of care to a negligent level, the original purchaser should receive a price reduction less than the total cost savings, because the builder should demand a premium for the enhanced tort risk. No windfall occurs: the subsequent purchaser receives part of the original purchaser's price reduction, and the builder covers its risks.

All three arguments fail provided two conditions are met. First, the builder must know that an action for negligent infliction of economic loss exists. Second, the risks must be calculable when the allegedly negligent action takes place.

2. Adequacy of the Protection for Injured Parties

Advocates of the present implied warranty and negligence remedies may advance another objection, namely that the proposed action does not provide adequate relief to injured parties. This objection has surface appeal. Some scholars have justified the award of expectation damages in breach of contract and promissory estoppel cases on the basis of the difficulty in recognizing and valuing reliance losses.\(^\text{315}\) The proposed action not only does not protect expectations, it does not permit recovery for certain reliance damages, such as lost opportunity costs, unless the tortfeasor had reason to foresee them before committing the tort. Hence the injured party is not completely compensated.

\(^{314}\) Id. at 938.

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In response, two points should be made. First, some compensation is better than none. Without the limitations built into the proposed action, the injured party should not recover at all. The absence of limitations would make any action, whether in contract or tort, inefficient.

Second, the proposed action and implied warranty actions are not mutually exclusive: implied warranty actions could be available to whatever extent states wish to accord certain classes of plaintiffs, such as homeowners, greater rights against builders than the proposed action provides. Some courts already permit homeowners to sue both for negligence and breach of implied warranty.316

Neither of the above objections justifies a refusal to implement the proposed action. The proposal provides a means of relief to people who might otherwise have no remedy, while possibly encouraging, and certainly not inhibiting, economically efficient decisions. It should therefore be adopted.

V. NEGLIGENT INFLICTION OF ECONOMIC LOSS IN NON-CONSTRUCTION CASES

Although the action developed in Part IV applies only to construction cases, the construction cases do not appear to have unique qualities. Construction cases may be divided into three broad categories: claims by builders against other builders, which may be characterized as claims arising from a negligently performed or communicated service of which the injured party is a direct or indirect consumer; claims by non-builders with an interest in an improvement against builders, which may be called claims arising from a negligently constructed product; and claims brought by non-builders without an interest in an improvement against its builders, which can be called “stranger” cases.317

Non-construction cases fall into three similar groups: claims arising from negligently manufactured goods;318 claims arising from a negligently performed or communicated service of which the injured party is a direct or indirect customer;319 and “stranger” cases.320 The simi-

316. See supra notes 142–49 and accompanying text. This author does not analyze the advisability and elements of an implied warranty action in addition to the proposed tort action.
317. See supra notes 284–86 and accompanying text (discussing several stranger cases).
318. See infra notes 355–61 and accompanying text.
319. See infra notes 362–76 and accompanying text.
320. See infra notes 321–42 and accompanying text. The following hypothetical may clarify the oft-blurry line between an indirect consumer of a service and a stranger. Assume that a chemical manufacturer engages a trucking company to deliver volatile chemicals to a customer.
larity suggests that the action proposed in Part IV, if recast into more general terms, will apply equally well to non-construction cases.

Before reformulating the proposed tort, this Article will consider the most recent judicial attempt to construct a generalized theory, in People Express Airlines v. Consolidated Rail Corp.\textsuperscript{321} This Article will explain why that theory is deficient, and why the proposed action is superior. Finally, the Article will discuss the application of the proposed tort, first to disputes over the quality of goods, and then to disputes over the quality of services. The analysis, unlike in Part IV, is illustrative only, not comprehensive.

A. People Express

A fire began in the freight yard of defendant Consolidated Rail Corporation (Conrail) after gas escaped from a tank car punctured during a “coupling” operation. The municipal authorities, in consultation with Conrail, evacuated the area within a one-mile radius of the fire to lessen the risk if the tank car exploded. The evacuation area included a terminal of the Newark International Airport housing People Express’ business operations. Although the feared explosion never occurred, People Express employees could not use the terminal for twelve hours. The airline sued Conrail for negligence, seeking to recover the amount of its fixed operating costs allocable to the period of evacuation and lost profits. The trial court applied the economic loss doctrine and granted summary judgment to Conrail. People Express appealed.\textsuperscript{322}

The New Jersey Supreme Court attempted to strike a compromise by fashioning a tort of negligent infliction of economic loss. The court reasoned that ordinary principles of foreseeability would create “hopelessly unpredictable” claims.\textsuperscript{323} A per se rule against recovery, however, would frustrate the purposes of tort law to compensate wronged persons for their injuries and to hold liable the responsible parties.\textsuperscript{324}

The New Jersey Supreme Court held that a defendant has a duty of due care to avoid inflicting economic loss “to particular plaintiffs or

\textsuperscript{321} 100 N.J. 246, 495 A.2d 107 (1985).
\textsuperscript{322} 495 A.2d at 108–09. People Express also sued the manufacturer of the gas and the owner of the tank car. \textit{id.}
\textsuperscript{323} \textit{id.} at 116.
\textsuperscript{324} \textit{id.} at 111.
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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." An identifiable class of plaintiffs is not merely a foreseeable class. Many members of the general public can be expected to suffer economic loss when an accident such as the one in People Express occurs; it is the exact nature of their injuries which will be fortuitous and unpredictable. Rather, "[a]n identifiable class of 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."

In People Express the court's proximate cause and damage analysis ran together. A defendant cannot proximately cause economic loss that is "only generally foreseeable," but may proximately cause economic loss that it is "in a position particularly to foresee." It is liable only for those damages it proximately causes, that is, those that "are reasonably to be anticipated in view of defendant's capacity to have foreseen . . . the risk" to the plaintiff or class of plaintiffs. Those damages may include lost profits.

The New Jersey Supreme Court held that Conrail could have foreseen People Express' economic loss in the event of a gas leak because of the proximity of its offices to the freight yard, defendants' knowledge of the volatility of the gas, the obvious impact of a shutdown on the airline's operations, and the apparent existence of an emergency response plan which called for the nearby area to be evacuated in the event of a leak.

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325. Id. at 116.
326. Cf. supra note 320 (explaining distinction between claims by indirect customers and strangers).
327. People Express, 495 A.2d at 116.
328. Id. at 116–17.
329. Id. at 118.
330. Id.
331. Id. For a decision with such potentially far-reaching implications, People Express has been cited relatively infrequently by courts of other jurisdictions. Quoting extensively from the decision, the Alaska Supreme Court adopted the People Express analysis in Mattingly v. Sheldon Jackson College, 743 P.2d 356, 359–61 (Alaska 1987). In that case, the college's alleged negligence resulted in physical injury to three of Mattingly's employees. The appellate court upheld the dismissal of Mattingly's claim to recover damages for negligent interference with his relationship with his employees, id. at 361, but reversed the dismissal of his claim for negligently caused economic loss under which he sought damages based on lost profits and increases in expenses. Id. Applying the People Express test, the court concluded that Mattingly was a particularized foreseeable plaintiff to whom the college owed a duty of care. Id. Two other courts, however, subsequently have rejected Mattingly's extension of the People Express analysis to employer claims arising from injuries to employees. See Edward F. Heimbrock Co. v. Marine
Much of the New Jersey Supreme Court's analysis coincides with the analysis in Part IV of this Article. The result, however, is diametrically opposed. The court sought to avoid formulating a rule in which the potential plaintiffs, and presumably the damages, would be "hopelessly unpredictable and not realistically foreseeable." Yet its conclusion, permitting a "stranger" like People Express to sue, placed an impossible burden on Conrail to assess the risks associated with its actions. Except possibly for the impact of a shutdown on the airline's operations, the other factors mentioned by the court as causing People Express to fall within an identifiable class of plaintiffs—the type of entity, the certainty of the injured party's presence, and the approximate number in the class—probably applied equally to every other business operating within the evacuated zone, possibly numbering in the hundreds. To assess the risks associated with a given level of care, Conrail would have had to know the fixed operating costs and profits of each. The cost of obtaining that information for each freight yard in the country in which cars carrying hazardous substances are coupled or uncoupled would add substantially to the cost of rail transportation.

The People Express court's holding suggests that other "stranger" cases have been wrongly decided. In Dundee Cement Co. v. Chemical Laboratories for example, the Seventh Circuit held that the owner of a cement plant had no claim against the driver and owner of a tanker truck which overturned, blocking the only access to the plant for more than five hours. Allowing recovery in such a case would open defendants to "crushing, virtually open-ended liability." Applying the New Jersey court's factors, however, the plant owner almost certainly should have prevailed. Aside from the fortuity of the place of the accident (the New Jersey court did not consider the fortuity that the tank was punctured in the Newark freight yard instead of elsewhere), the class of plaintiffs was presumably small, the particular plaintiff was a business enterprise, its plant and access road had a cer-

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332. People Express, 495 A.2d at 116.
333. Even that factor probably applies to most or all businesses. All would have fixed operating costs allocable to the period of shutdown, and an unanticipated, sudden twelve-hour shutdown would affect the profits of most businesses.
334. Businesses frequently cluster near air and rail centers.
335. 712 F.2d 1166 (7th Cir. 1983).
336. Id.
337. Id. at 1171.
tain location, and the type of economic operations disrupted would presumably be ascertainable in advance.\(^{338}\)

Aikens v. Baltimore & Ohio Railroad Co.\(^{339}\) provides another illustration of the problems with People Express. In Aikens the employees of a plant damaged by a train derailment sued the railroad for lost wages.\(^{340}\) The appellate court affirmed the dismissal of the complaint on the pleadings, because the railroad had no knowledge of the contracts between the plant and its employees and thus had no way to foresee harm to the plaintiffs' interests. Permitting the claim "would create an undue burden upon industrial freedom of action," posing "a danger to our economic system."\(^{341}\) Although in Aikens the class of plaintiffs would have consisted of individuals instead of businesses (as in People Express), it was predictable that the plaintiffs in Aikens would suffer loss if the plant were forced to close; and the railroad could have easily ascertained the number of employees and potential lost wages in advance much more accurately than in a context like People Express, involving lost profits and fixed operating costs.\(^{342}\) If anything, the argument for the plaintiffs in Aikens was stronger, applying the People Express formula, than it was for People Express.

These projected outcomes show that the People Express formula undercuts the court's goal of limiting plaintiffs and damages to those predictable and reasonably foreseeable to the alleged tortfeasor. The formula is flawed in two fundamental, related respects. First, it does not limit liability to those who particularly rely on the defendant's performance or the product of that performance, nor does it limit damages to reliance damages. Second, it does not permit reasonable estimation of the risks before a person embarks on an action. Those shortcomings could be eliminated with a modified approach.

B. Elements of the Action

I. The Defendant's Duty

Persons have a duty to avoid the negligent infliction of economic loss under the following conditions:

\(^{338}\) See supra note 327 and accompanying text (identifying factors in deciding whether a party is within an identifiable class of plaintiffs).


\(^{340}\) 501 A.2d at 278.

\(^{341}\) Id. at 279.

\(^{342}\) See supra text accompanying notes 322-31 (one of the factors in People Express for an "identifiable class" was the type of economic expectations disrupted, which, in that case, were lost profits and fixed operating costs).
(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, acts negligently or makes a negligent misrepresentation (the "defendant") is subject to liability for economic loss caused to any person identified in paragraph (2) below who has justifiably relied on the due care with which that action was performed, the accuracy of that representation, or if the action results in the generation or alteration of a tangible product, the quality or timeliness of the work on that product.

(2) The liability stated in paragraph (1) is limited to loss suffered by:

(a) any person (i) for whose benefit the defendant takes the action, (ii) to whom the defendant makes the representation, or (iii) whom the defendant knows has or acquires an ownership or possessory interest in that product;

(b) any person who is assigned or otherwise acquires the rights of any person identified in paragraph (a) with respect to the defendant's action or representation or the ownership or possession of the product; or

(c) any of a limited group of persons whom the defendant knows or has a particular reason to know will particularly rely on either the due care with which the action has been or will be performed or on the accuracy of the representation, or on the quality of or timeliness of the work on that product, even if, at the time of the defendant's actions or representations, the defendant did not know the identity of any or all of those persons, provided that the injured party suffers the loss in connection with the event or transaction for which the defendant performed the action, made the representation or worked on the product, or a substantially similar transaction.

Although they are expressed in more general terms, the elements of the duty are virtually identical to those applicable only to builders. The comments above concerning builders' duties apply equally here, and need not be repeated. The earlier comments, however, do not discuss the use of the word "particular" to modify "reason to know" and "particularly" to modify "reliance" in subparagraph (c)'s descriptions of the group of persons to whom a duty of care is owed, because, as discussed above, the particularity requirements are probably unnecessary for the tort applicable to builders.

In one sense, each person relies on others countless times every day, such as when driving, purchasing goods at a store, or dealing with co-employees and clients, even if that person does not know their identities or has not contemplated how their actions, if performed negli-

343. See supra notes 281–88 and accompanying text.
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gently, may result in harm. If this type of reliance triggers liability, the proposed tort will not limit the class of plaintiffs any more successfully than the *People Express* formula. In this sense of "reliance," the airline company in *People Express* and the employees in *Aikens* relied on the railroad not to act so negligently as to cause their facilities to be closed. Likewise the owner of the cement plant in *Dundee* relied on motorists not to overturn their vehicles so as to block access to the highway.

The words "particular" and "particularly" emphasize that this type of reliance will not support liability. Instead, the injured party must have relied on the specific defendant against whom action is brought; the general reliance placed on any individual whose negligence might result in harm is insufficient. Particular reliance, however, does not necessarily require knowledge of the defendant's identity. Although often, as in disputes between builders, the injured party knows the identity of the person upon whom it relies, sometimes the injured party may be relying on status. For example, a subsequent purchaser may particularly rely on the builders of the improvements on her property, even though she may not know their individual identities.

Moreover, the putative tortfeasor must know or have particular reason to know of the injured party's particular reliance. For example, an accountant's knowledge that potential lenders and investors frequently rely on financial statements in making lending and investment decisions is not particularized knowledge that such use will be made of the particular statements that it prepares. To be liable to a lender or investor, the accountant must know that the company for whom the statements are prepared intends to use them in connection with its efforts to obtain financing or investment of the type actually loaned or invested. Particular reason to know, however, does not necessarily require knowledge of the intentions of another party. It may arise from the relationship of the injured party to the alleged tortfeasor's

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345. See supra notes 172–74 and accompanying text (discussing interdependence and interreliance of members of society).
346. See supra text accompanying notes 321–34.
347. See supra text accompanying notes 339–42.
348. See supra text accompanying notes 335–38.
349. Compare RESTATEMENT (SECOND) OF TORTS § 552 illustrations 6 & 7 (1976) (accountants who prepared audited financial statements have a duty to a lender bank when the audited company had informed the accountants that it expected to use the statements in connection with the negotiation of a bank loan, even though the accountants did not know the identity of the bank) with id. illustration 10 (accountants who prepared audited financial statements have no duty to a lender bank when the accountants had not been informed that the audited company intended to use the statements in connection with the procurement of a loan, even though the accountants knew that financial statements often are used for that purpose).
activities. A builder has particular reason to know that any subsequent purchaser of an improvement will rely on the quality of construction even though the builder does not know how long the original purchaser intends to own the property.350

Whenever a legal standard contains broad concepts, such as both particularity requirements, judicial decisions must elaborate the meanings of those concepts. The interpretations of the particularity requirements should limit the possible plaintiffs, in order to facilitate efforts of a potential tortfeasor to assess the risks associated with the particular level of care which it employs in any action.351

Under the particular reliance and particular reason to know standards, People Express was wrongly, and Dundee and Aikens correctly, decided. In none of the cases was liability warranted: the plaintiff did not particularly rely on the defendant, and had plaintiff done so, the defendant would have had no reason to know of that reliance. The same “no duty” conclusion should prevail in most if not all disputes in which a “stranger” has allegedly negligently caused economic loss.

2. Other Elements: Damages, Temporal Limitations, and Precedence of Contractual Terms

The other elements analyzed with respect to the tort of negligent infliction of economic loss by builders—damages, temporal limitations, and precedence of contractual terms—need not be analyzed again here in detail. The same considerations apply as in the prior sections. For example, an injured party may not recover the benefit of a lost bargain, lost profits or lost opportunity costs, unless the tortfeasor knew or had reason to know of them before committing the tortious act.352 An injured party has no negligence action to the extent

350. Arguably, the only particularity requirement should be the actor's particular knowledge or reason to know, permitting the injured party to recover even if he only generally relied on the actor. If the only goal is to allow an actor to estimate the risks associated with a given level of care, the actor's particular knowledge or reason to know may suffice, even though the injured party lacked particularized reliance. This author has rejected that position for two reasons. First, this author doubts that this modification would make the risks roughly calculable in practice, because it could lead to what is essentially a strict foreseeability test. Given the People Express facts, a court could conclude that Conrail had particular reason to know that People Express and every other business within the zone of danger was generally relying on it. Second, existing doctrines which protect against economic loss caused by detrimental reliance, such as promissory estoppel and negligent misrepresentation, require more than generalized reliance.

351. Although formulated more generally than Restatement (Second) of Torts § 552 to accommodate reliance on actions as well as representations, the proposed tort incorporates similar standards concerning the nature and knowledge of the reliance sufficient to make a party liable. See Restatement (Second) of Torts § 552 (1976).

352. See supra text accompanying notes 291–92.
that tort liability or damages would conflict with the terms of a contract which the injured party entered with the defendant.\textsuperscript{353}

The existence of a general tort of negligent infliction of economic loss may provide a peripheral benefit to builders. It may permit the drafting of statutes of repose that will pass constitutional muster in those states which rejected earlier statutes as benefiting too narrow a class.\textsuperscript{354} A statute of repose applicable to all actions for negligent infliction of economic loss should be constitutional in any state. Of course, this will not help a builder whose alleged negligence results in personal injury or property damage many years after completion of construction, but will at least provide protection against economic loss suits.

Apparently, therefore, the principles developed in Part IV can govern non-construction disputes as well. The proof, however, will come only when the action is applied to the facts of numerous disputes.

C. Application of the Action

1. Negligently Manufactured Goods

The proposed action will not help parties claiming economic loss because of negligently manufactured goods. Adoption of the Uniform Commercial Code by the legislatures of every state except Louisiana preempts any common law action.

The conclusion that contractual terms should control when parties are in privity of contract is even stronger when the contract concerns the sale of goods, because the UCC supplies terms not addressed by the parties.\textsuperscript{355} The UCC, therefore, supplants any common law action to recover economic loss between parties in privity of contract.

The proposed tort should have no greater role when the parties are not in privity, for the same reason that parties suffering only economic loss should have no negligence or product liability claim.\textsuperscript{356} Courts have advanced two theories to explain why the UCC should preclude inconsistent tort actions when allegedly defective goods cause only economic loss: the superiority of its policy judgments, and statutory priority over the common law. As Professor Schwartz has demonstrated, however, the elements of a breach of warranty action under the UCC differ little from those of a strict liability action under Restatement (Second) of Torts section 402A, and the differences, taken

\textsuperscript{353} See supra text accompanying note 309.
\textsuperscript{354} See supra notes 299–301 and accompanying text.
\textsuperscript{355} See, e.g., U.C.C. §§ 2-305 to 2-325 (1987).
\textsuperscript{356} See supra notes 65–89 and accompanying text.
collectively, do not clearly favor the UCC. Instead, "[t]he UCC has pertinence in the first place precisely because it has been enacted into law by the legislatures of almost every state; and under elemental jurisprudence, legislation takes precedence over the common law." Some states have elected to abrogate the privity requirement for implied warranty actions partly or completely. In those jurisdictions, an action for negligent infliction of economic loss would provide an alternative, and at times inconsistent, remedy. Other states have kept the original text of the UCC, which provides that a seller's warranties protect only members of the buyer's household and guests who might reasonably be expected to use, consume or be affected by the goods against personal injury. To allow the tort action to operate would frustrate any legislative decision not to extend the statutory warranties. In all jurisdictions, therefore, the UCC should control.

The tort of negligent infliction of economic loss, therefore, has no application when allegedly negligently made goods cause purely economic harm. The UCC occupies the field. In suits not governed by a comprehensive legislative scheme, however, such as claims of economic loss arising from negligently performed services, courts may apply the proposed tort.

2. Negligently Performed Services

During the last three decades, courts have increasingly concluded that professionals, including accountants, surveyors, termite inspectors, attorneys, notaries public and stockbrokers have a duty to

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357. See Schwartz, supra note 3, at 56–70. Because the UCC should preempt the proposed action, comparing their relative merits is pointless.

358. Id. at 70; see Spring Motors Distrib. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660, 671 (1985) ("[C]ourts should pause before extending judicial doctrines that might dislocate the legislative structure.").


360. It provided:

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty.

U.C.C. § 2-318 (1962) (amended 1966). The section expressed no opinion whether warranties extended to remote persons in the distribution chain. Id. comment 3. As amended, § 2-318 contains three alternative formulations, of which the original version is alternative A. Id. § 2-318 (1987).


avoid the negligent infliction of economic loss upon parties with whom they have not contracted. Two decisions imposing tort liability on professionals demonstrate the important differences between analysis using the proposed tort and more traditional, legal theories.

Problems sometimes arise because courts do not focus on the injured party's reliance. In *Lucas v. Hamm*, for example, the California Supreme Court held that disappointed legatees could sue an attorney whose improper drafting of a will frustrated the intended gift, both in negligence and as third party beneficiaries of the contract between the testator and the attorney. The allegations, however, did not reflect that the plaintiffs relied on the gift in any way; they alleged only that they received $75,000 less than they would have if the attorney had drafted the documents properly. Without detrimental reliance, the intended legatees should not have had a negligence claim. They did, however, have a valid claim as third-party beneficiaries of the contract. In general, contract law should govern the rights of disappointed legatees.

Of course, not all claims against attorneys can be decided under third-party beneficiary doctrine. If an attorney negligently gives erroneous advice, with particular reason to know that a non-client will particularly rely on it, and that reliance causes economic loss, that person should have a negligence claim against the attorney. The attorney-client relationship should not preclude the action of a non-client who can satisfy all the requirements of the proposed action any more than the relationship of trust between any other type of professional, including an architect, and its client.

A more common problem is judicial willingness to base liability on a notion of foreseeable harm that is not appropriately circumscribed, as courts frequently do in construction cases. Several decisions imposing a duty on accountants demonstrate this tendency.

365. 15 Cal. Rptr. at 823–25, 364 P.2d at 687-89. The California Supreme Court nevertheless sustained the demurrer to plaintiffs' claims entered by the trial court. When agreeing to perform services, an attorney promises to use the skill, prudence and diligence of lawyers of ordinary skill and capacity, but does not guarantee results. The gifts to plaintiffs failed because they violated the rule against perpetuities. The supreme court concluded that this provision was sufficiently complicated that, as a matter of law, plaintiffs could not show negligence or breach of contract. 15 Cal. Rptr. at 825, 364 P.2d at 689-91.
366. 15 Cal. Rptr. at 823, 364 P.2d at 687.
367. See Schwartz, supra note 3, at 42.
368. See, e.g., Vanguard Prod. Inc. v. Martin, 894 F.2d 375, 378 (10th Cir. 1990) (reversing summary judgment for defendant attorney who knew that buyer would rely on its title opinion, even though the seller was the attorney's client).
369. See supra note 107 and accompanying text.
The leading decision, *H. Rosenblum, Inc. v. Adler*, like *People Express*, comes from the New Jersey Supreme Court. In *Rosenblum*, plaintiffs, who had acquired stock in a publicly traded corporation as part of a merger transaction, sued the accountants who had audited the corporation's financial statements for negligence and fraud, after it was discovered that the corporation had manipulated its books and actually was bankrupt. The trial court granted the accountants' motion for summary judgment on the negligence claim, and the plaintiffs appealed.

Although the accountants had prepared the audit report before the merger discussions began, disputed testimony suggested that a representative of the accountants attended those discussions and permitted the report to be used. This fact could have made the accountants liable under the guidelines created by Justice Cardozo in *Glanzer* and *Ultramares*, and certainly under the slightly more liberal rules of the *Restatement (Second) of Torts* section 552.

Disdaining this limited approach, the court stated that an auditor who does not limit the recipients of an opinion "has a duty to all those whom that auditor should reasonably foresee as recipients from the company of the statements for its proper business purposes, provided that the recipients rely on the statements pursuant to those business purposes." Without the *Restatement's* provision that the duty extends only to the members of a limited group to whom the accountant intends to supply the information or knows that the recipient intends to supply it, or the proposed tort's provision limiting the duty to those whom the accountant has "particular reason to know will particularly rely" on the information, the accountant cannot assess with any accuracy the risks associated with a particular level of care. Nevertheless, other jurisdictions have followed *Rosenblum*'s open-ended lead.

371. One author, who believed that *Rosenblum* might lead many courts to adopt the principle of "negligence liability for pure economic harm to all reasonably foreseeable parties," discussed this decision in great detail. Dente, *supra* note 15, at 596-99.
372. 461 A.2d at 140-41.
373. *Id.* at 154.
374. *Id.* at 145. *See supra* notes 47-55 and accompanying text (discussing *Restatement's* development out of *Glanzer* and *Ultramares*).
375. 461 A.2d at 153.

Other courts have gone in the opposite direction, imposing requirements beyond those in the *Restatement* or this article. *See, e.g.*, *Toro Co. v. Krouse, Kern & Co.*, 827 F.2d 155, 160-61 (7th
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These jurisdictions thus expose accountants, and other professionals to whom the foreseeable harm standard applies, to indeterminate liability running to indeterminate parties. Use of the tort proposed in this Article would avoid infliction of these risks and their attendant costs on professionals and other providers of services.

VI. CONCLUSION

This Article has explicated the elements of a new action applicable to all types of tortfeasors, the tort of negligent infliction of economic loss. The new tort appears both administratively workable and equitable in its operation. This Article, however, provides only the analytical foundation; further analysis is needed to reach a final conclusion about the merits of such an action.

Regardless of the fate of the general action, courts should adopt the proposed action for negligent infliction of economic loss by builders. It avoids the problems associated with tort actions to recover for negligently inflicted economic loss identified by Justice Cardozo sixty years ago, and reaffirmed today through microeconomic analysis. It thus promises to provide relief to injured parties without placing an undue burden on builders, and intellectual coherence to an area of the law in serious need of reformulation.

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Cir. 1987) (under Indiana law, accounting firm may be liable to a lender for negligence in its financial reports concerning the potential borrower only if, in addition to the Restatement requirements, accountants engaged in some conduct “linking them to that [lender] which evinces the accountant’s understanding of that [lender’s] reliance”) (quoting Credit Alliance Corp. v. Arthur Andersen & Co., 65 N.Y.2d 536, 483 N.E.2d 110, 118 (1985)).

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