Doctrinal Classification and Economic Negligence

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This Article discusses the nature of doctrinal classification and some of the problems arising in third-party cases due to the distinction between contract and tort. It suggests that the cases can best be understood by recognizing an emerging field of law known as "economic negligence." Economic negligence concerns the liability of a contracting party to a third person for negligent performance of a contract. Economic negligence cases include actions against attorneys, accountants, real estate brokers, manufacturers, title abstracters, surveyors, appraisers, design professionals, builders, and other professionals and businesses. Recognizing economic negligence as a field of law facilitates generalization across cases and leads to the identification of themes, arguments, principles, and subclassifications that improve analysis of case law.

INTRODUCTION

Most law review articles that address legal doctrine describe a problem with a rule or set of rules and suggest how the problem should be resolved. This Article is different. It examines a problem at a much more general level—that of the classification of legal doctrine. The doctrinal structure of contract and tort law is inadequate to deal with a large group of cases in which two parties have a contract, the breach or negligent performance of which causes economic harm to a third party.

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This Article argues that the solution to this problem is changing the structure through which we approach the problem, rather than focusing on changes in particular rules. What is needed is a new field of law: economic negligence.

Part I of this Article discusses the nature of doctrinal classification. What do we expect doctrinal categories to do for us as lawyers, judges, and scholars? How are they supposed to do this? Why do they sometimes fail to do what they are supposed to do? This part illustrates the failure of doctrinal classification in contract and tort law in general and in some issues involving the liability of a contracting party to a third party in particular. Part II describes a response to this failure in the creation of the new field of law known as economic negligence. Part III concludes by explaining how the recognition of this field of law addresses the problems that arise from the traditional classification.

I. DOCTRINAL CLASSIFICATION

Classification is a sorting process. Through classification, criteria are used to sort objects among categories. Shrimp are classified as medium, large, or jumbo according to their size; beef is graded as good, choice, or prime according to fat marbling, color, and texture; buildings are described as Byzantine, Baroque, or Rococo according to their style; applicants are admitted to a law school, rejected, or placed on a waiting list according to their undergraduate records and LSAT scores.

In law, the objects classified are the situations that present disputes which are potentially subject to legal resolution. The categories are doctrinal classes and subclasses, and the criteria for sorting are the essential facts of the situations.[1] A fact situation that presents a consensual transaction between commercial parties in which one party suffers pecuniary loss when the other party fails to perform its part of the bargain ordinarily will be classified as a contracts case. A situation involving the accidental infliction of personal injury between two strangers will be classified as a tort case. At a lower level, a contracts case in which there is evidence that the parties did not actually conclude an agreement will be classified as a formation case, while a case in which the parties dispute whether a performance conforms to the contractual requirements will be classified as an interpretation case.

Classification is more than an attempt to bring a degree of order to a disorderly world. Each classification is created and implemented to achieve certain purposes. Shrimp is classified by size to enable

1. On classification in law, see Jay M. Feinman, *The Jurisprudence of Classification*, 41 STAN. L. REV. 661 (1989).

purchasers to estimate how many shrimp will be in a pound; beef is graded by fat marbling, color, and texture to allow purchasers to compare price and predict palatability; buildings are described as belonging to schools of architecture to make explicit the similarities and differences in their design; prospective law students are grouped by academic predictors so that schools can admit students who are most likely to succeed academically.

The classification of legal doctrine also serves certain purposes. The first purpose is instrumental—to achieve certain ends through the classification process. Different principles, policies, and interests underlie the various doctrinal categories. Cases that differ in fundamental ways should be treated under these distinct principles, policies, and interests. Sorting cases into doctrinal categories by identifying criteria is an effective and efficient way to assure that those cases are treated properly.

The rules of contract law, for example, are designed to encourage consensual transactions, distinguish between transactions in which the parties have assumed responsibility and those in which they have not, ensure that parties adhere to minimum standards of commercial decency when they transact, etc. Tort doctrine, on the other hand, aims to deter conduct that creates an unreasonable risk of physical harm to persons, compensate physically injured victims of wrongdoing or carelessness, distribute the losses of accidents to those parties who can best bear them, and so on. The criteria used to allocate cases between contract and tort law (for example, whether the interaction arises from a consensual transaction or an accident, or whether the harm suffered is solely pecuniary or involves personal injury) ensure that the proper policies are brought to bear in particular cases.

The second purpose of doctrinal classification is analytic; in addition to providing a convenient means of serving policy goals, classification creates and maintains a rational doctrinal structure. A doctrinal structure that is relatively rigorous, consistent, and rational supports the law's claim to legitimacy.[2] Contract and tort law as distinct categories facilitate a legal system which is relatively nonarbitrary, objective, principled, and just.

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2. Such a structure is also aesthetically pleasing.

This description of classification as a systematic activity is highly idealized, and many real classification systems—including doctrinal classification—often do not work in this way. Classification is often accomplished through the recognition of abstracted and idealized models or exemplars of the categories.[3] These models or exemplars contain the stylized facts of a situation and the rules, principles, and policies that are applicable to the situation. A judge does not conclude that a dispute is a contracts case by a deductive process of comparing the facts of the particular case with a set of criteria for a contracts case; rather, the judge immediately recognizes the case as a contracts case, and implicit in that recognition is an understanding of the content and objectives of contract law. This paradigmatic approach to classification challenges the claim of a doctrinal classification scheme to objectivity and rationality, but doctrinal classification is beset with problems even at its most systematic.

A. Problems with Classification

The integrity of the classification boundary between contract law and tort law has been one of the great issues in private law during the past several decades. In the academy, the impetus for controversy was the publication of Grant Gilmore's *The Death of Contract*.[4] The extraordinary critical reaction that the book engendered[5] highlighted the significance of the classification issue that it raised. The debate between Gilmore and his critics was about doctrinal classification. In Gilmore's view, contract law as an independent doctrinal category rested on the classical bargain model. Because the classical model had declined in acceptance, he concluded that contract was no longer a viable, independent discipline. Instead, it was being reabsorbed into tort law. To his critics, though, the development of contract law from its classical form to neoclassical contract law showed the continued vitality of a field that was fundamentally, necessarily distinct from tort.

The issue of the classification of contract and tort has exclusively been confined to the academy; the courts have explored the boundary territory as well. Gilmore noted that products liability was the first

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3. *See* Feinman, *supra* note 1, at 696-700.

4. GRANT GILMORE, THE DEATH OF CONTRACT (1974).

5. *See, e.g.*, Gary Milhollin, *More on the Death of Contract*, 24 CATH. U. L. REV. 29 (1974) (book review); Jeffrey O'Connell, *The Interlocking Death and Rebirth of Contract and Tort*, 75 MICH. L. REV. 659 (1977); Richard E. Speidel, *On the Reported Death and Continued Vitality of Contract*, 27 STAN. L. REV. 1161 (1975) (book review); Robert W. Gordon, Book Review, 1974 WIS. L. REV. 1216; Curtis Reitz, Book Review, 123 U. PA. L. REV. 697 (1974-75).

major area of incursion of tort doctrines into contractual settings; although early efforts focused on the hybrid doctrine of implied warranty,[6] tort law all but preempted the field with the widespread adoption of the Restatement (Second) of Torts § 402A. More recently, a major issue has been the availability of a tort cause of action and tort remedies in cases involving contracts of insurance,[7] employment,[8] bank relationships with their borrowers[9] and depositors,[10] and franchises,[11] among others. Often litigated under the rubric of "bad faith," the possibility of tortious breach of contract even extended into ordinary commercial contracts.[12] Meanwhile, contracting parties' duties of honesty and disclosure have expanded through the tort doctrine of misrepresentation.[13]

The action along the boundary has not all taken the form of incursions by tort concepts into contract law. Both scholars[14] and judges[15] have made significant efforts to reestablish the primacy of contract and to limit the applicability of tort to situations in which the contracting process fails or is inappropriate.

The debate about the boundary between contract and tort illustrates the defects from which classification schemes can suffer. Classification schemes can fail to achieve their instrumental and analytic objectives for three reasons. First, the criteria by which objects are sorted into classes

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6. *E.g.*, Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69 (N.J. 1960).

7. The well-known California line of cases includes Communale v. Traders & General Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

8. *E.g.*, Gates v. Life of Mont. Ins. Co., 668 P.2d 213 (Mont. 1983).

9. *E.g.*, Quality Automotive Co. v. Signet Bank/Maryland, 775 F. Supp. 849 (D. Md. 1991).

10. *E.g.*, First Nat'l Bank in Libby v. Twombly, 689 P.2d 1226 (Mont. 1984).

11. *E.g.*, Dunfee v. Baskin-Robbins, Inc., 720 P.2d 1148 (Mont. 1986).

12. *E.g.*, Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 36 Cal. 3d 252, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984); DCR Inc. v. Peak Alarm Co., 663 P.2d 433 (Utah 1983).

13. *E.g.*, Johnson v. Healy, 405 A.2d 54 (Conn. 1978); Weintraub v. Krobatsch, 317 A.2d 68 (N.J. 1974).

14. *E.g.*, William K. Jones, *Economic Losses Caused by Construction Deficiencies: The Competing Regimes of Contract and Tort*, 59 U. CIN. L. REV. 1052 (1991); Gary T. Schwartz, *Economic Loss in American Tort Law: The Example of* J'Aire *and of Products Liability*, 23 SAN DIEGO L. REV. 37 (1986).

15. *E.g.*, East River S.S. Co. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986); Foley v. Interactive Data Corp., 47 Cal. 3d 654, 765 P.2d 353, 254 Cal. Rptr. 211 (1988).

may not be strongly associated with the ultimate purposes for which the sorting is done. Within a considerable range, undergraduate academic performance is a weak predictor of success at the typical law school. Second, categories and the criteria used to establish them may overlap, making it difficult to clearly assign an object to one category or another. Rococo architecture is a developed, extreme form of Baroque architecture, and some European cathedrals exhibit qualities of both styles so that they cannot properly be described as one or the other. Third, and contrarily, the process of classification itself encourages the accentuation of differences between items, creating a framing bias, rather than a more nuanced understanding of their nature. Sorting law school applicants according to their numerical credentials makes it easy to understate their personal qualities that may be relevant to an admissions decision; describing two buildings as belonging to different architectural styles accentuates the differences between them rather than the similarities.

These problems arise with doctrinal classification as well. The fact that an insurance relationship arises from agreement places it within the realm of contract law, but ordinary contract principles are inadequate to address the expectations of the insured when the insurer rejects an advantageous settlement offer; instead, the tort principle of bad faith is imported to provide an appropriate remedy.[16] The difficulty here is the lack of a strong association between the criterion for classification (agreement) and the principle that contract law aims to further (protection of reasonable expectations).

The overlap between categories arises frequently in contract and tort law. The sale of a defective product gives rise to liability for breach of warranty in contract and for strict product liability in tort.[17] An erroneous statement of intention can give rise to liability for breach of promise and for misrepresentation.[18] Difficulties arise in these cases when the characterization as either tort or contract makes a difference in the outcome of the case due to a different liability rule, damage formula, required formality (such as the Statute of Frauds), or collateral effect (such as a statute of limitations).[19]

Framing bias results from the overemphasis of the differences between doctrinal categories. In wrongful discharge cases, for instance, some courts take a purely contracts approach and fail to provide a remedy for an employee unless the court can construct an express or implied

16. *See* sources cited *supra* note 7.
17. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 98, at 694 (5th ed. 1984).
18. *Id.* § 105, at 734-35.
19. *Id.* § 92, at 664-67.

contract right rebutting the presumption of employment at will.[20] Other courts create a tort remedy and focus on the wrongfulness of the employer's conduct, understating the terms on which the parties agreed to perform, including the lack of any understanding limiting the employer's power to discharge.[21]

B. Classification Problems in Third-Party Settings

The problems of association, overlap, and framing bias occur in pockets of cases involving typical two-party contractual settings. They arise even more frequently in situations in which the performance of a contract between two parties affects a third person and in situations in which multiple parties have contracts that contemplate interlocking performances. This section illustrates the difficulties by discussing two areas in which third-party cases arise.[22] The construction process presents some of the most complex settings in which classification problems arise. Product-related economic loss, or the liability of a manufacturer of a product to a remote purchaser, is a much-discussed area of conflict between the law of contract and the law of tort.

1. Construction

Each participant in a construction project structures its role on the job through contracts with a limited number of other participants. In the classic form of organization, for example, the owner hires an architect to design the building and to supervise its construction. The owner contracts separately with a general contractor to build the building in accordance with the architect's design and under the architect's supervision. Much of the actual work is done by specialist subcontractors who are hired by the general contractor. Each party can look to its contracting partner(s) for a remedy in case it suffers economic harm. For example, the owner could pursue the general contractor for defects

20. *Compare* Carter v. Kaskaskia Community Action Agency, 322 N.E.2d 574 (Ill. App. Ct. 1974) (employee entitled to damages because employer failed to follow procedures set forth in employment manual), *with* Hogge v. Champion Labs, 546 N.E.2d 1025 (Ill. App. Ct. 1989) (manual expressly stated it did not constitute a contract or exclusive statement of reasons for discharge).

21. *E.g.*, Monge v. Beebe Rubber Co., 316 A.2d 549 (N.H. 1974).

22. For other examples, see Part III, *infra*.

or delay in the work, even if a subcontractor was actually at fault, and the general could in turn pursue the subcontractor. In practice, however, an injured party's action against its contracting partner may be unattractive or unavailing.[23] Therefore, the construction process often generates claims against third parties with whom the plaintiffs do not have a contract.[24]

The disputes among performing parties arise when one party has been delayed or its work made more costly by another party's failure to perform properly. The largest group of these disputes involves claims against architects or engineers for negligent design or preparation of the plans and specifications or negligent supervision of the construction process, so this issue serves as an example of the classification problems in the construction area.[25]

The classification problem was resolved easily under the traditional law because the absence of a contractual relationship between the design professional and a third party—the lack of contractual privity—was a clear bar to any form of action. Without privity, the design professional obviously owed no contractual duty to the third party and, under the rule of *Winterbottom v. Wright*,[26] also owed no tort duty. The traditional rule was very durable, lasting for more than thirty years before it was generally rejected.[27]

The two cases that were most important in removing the privity barrier to third party actions against design professionals and thereby confusing the classification issue were *United States for the Use of Los Angeles Testing Laboratory v. Rogers & Rogers*[28] and *A.R. Moyer, Inc. v. Graham*.[29] In *Rogers & Rogers*, concrete work used in the project with

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23. For example, the contracting partner may be insolvent; the injured party may wish to preserve good relations with its partner; the injured party and the contracting partner may settle the dispute in an amount that is less than the extent of its entire loss; or the action against the contracting partner may be limited in amount or barred altogether, either by a provision in the contract or by the operation of a rule of law.

24. Persons who ultimately benefit from the construction process often do not enter into contracts concerning the process itself, yet they may be injured by the inadequate or untimely performance of the contracting parties. By far the largest group of third-party cases of this type involves actions by a purchaser or subsequent purchaser of residential property against the builder of the property or another participant in the construction process. There are also cases in which an owner who participates in the construction process sues a subcontractor, and cases in which a tenant sues the builder who was retained by the owner to build or renovate the leased property.

25. Another large group of cases involves actions by co-prime contractors against each other. In addition, subcontractors sometimes sue each other or the owner.

26. 152 Eng. Rep. 402 (Ex. 1842).

27. *E.g.*, Peyronnin Constr. Co., Inc. v. Weiss, 208 N.E.2d 489 (Ind. Ct. App. 1965).

28. 161 F. Supp. 132 (S.D. Cal. 1958).

29. 285 So. 2d 397 (Fla. 1973).

the approval of the architect was inadequate, requiring the contractor to compensate for the defects. The contractor alleged that the architect negligently interpreted tests on the concrete, approved the work, and then stopped the work. The federal court noted California's then-recent abandonment of the privity doctrine in actions for economic loss resulting from negligent performance of a contractual duty in favor of the balance of factors test for negligence.[30] The court did not analyze each of the factors in detail, but it focused on a particular aspect of the situation as decisive:

> 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 . . . . 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.[31]

After the Florida Supreme Court in *Moyer* adopted the rule of *Rogers & Rogers*, a definite trend emerged in favor of negligence liability in design professional cases.[32] The *Moyer* court dismissed the common law rule that an architect is not liable to a party with whom it is not in privity, stating that "[p]rivity is a theoretical device of the common law that recognizes limitation of liability commensurate with compensation for contractual acceptance of risk. The sharpness of its contours blurs when brought into contact with modern concepts of tort liability."[33]

Following *Rogers & Rogers*, and especially *Moyer*, a number of jurisdictions adopted the position that a third party engaged in the construction process had a cause of action for negligent performance by an architect. Some courts used the control rationale of *Rogers & Rogers*

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30. *Rogers & Rogers*, 161 F. Supp. at 135 (citing Biakanja v. Irving, 49 Cal. 2d 647, 651, 320 P.2d 16, 19 (1958)).

31. *Id.* at 135-36.

32. In a recent case involving the liability of a subcontractor to purchasers of condominium units, the Florida Supreme Court limited *Moyer* "strictly to its facts." Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1248 n.9 (Fla. 1993).

33. *Moyer*, 285 So. 2d, at 399.

and *Moyer*.[34] Others used more general negligence analysis, applying the basic principle that liability attaches for foreseeable risks,[35] sometimes also emphasizing the professional status of the architect and the malpractice liability that attaches to that status.[36]

The most significant challenge to placing design professional cases in the negligence category has been the application of the economic loss rule. In this context, the economic loss rule distinguishes purely pecuniary losses from losses due to personal injury or property damage losses as the criterion that governs the classification of cases. Economic losses are losses due to disappointed expectations, and should therefore be governed by contract law; only losses due to personal injury or property damage, which generally are not the subject of prior bargaining and which invoke public safety concerns, are within the realm of tort law. Accordingly, actions against design professionals for economic losses are barred in jurisdictions which enforce the economic loss rule.[37]

The attitude of the courts that have refused to impose negligence liability in economic loss cases is summed up in *Blake Construction Co. v. Alley*:[38]

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34. *E.g.*, E.C. Ernst, Inc. v. Manhattan Constr. Co. of Tex., 551 F.2d 1026 (5th Cir. 1977); Shoffner Indus. v. W.B. Lloyd Constr. Co., 257 S.E.2d 50, (N.C. Ct. App.), *rev. denied*, 259 S.E.2d 301 (N.C. 1979). *Shoffner Industries* is representative of those cases that use several rationales in support of negligence liability, including the architect's control over the contractor, the foreseeability of an unreasonable risk of harm, and the reliance caused by the interdependence of the performing parties.

35. *E.g.*, Donnelly Constr. Co. v. Oberg/Hunt/Gilleland, 677 P.2d 1292 (Ariz. 1984) (contractor was foreseeable victim of foreseeable risk of architect's error); Farrell Constr. Co. v. Jefferson Parish, 693 F. Supp. 490 (E.D. La. 1988) (architect/engineer owed duty of care to contractor even though contractor was not third party beneficiary); Davidson & Jones, Inc. v. New Hanover County, 255 S.E.2d 580 (N.C. Ct. App.), *rev. denied*, 259 S.E.2d 911 (N.C. 1979) (foreseeable harm yields duty of care); Calandro Dev't, Inc. v. R.M. Butler Constructors, Inc., 249 So. 2d 254 (La. Ct. App. 1971) (architect liable to contractor's surety).

36. *E.g., Donnelly Constr. Co.*, 677 P.2d 1292; *Davidson & Jones, Inc.*, 255 S.E.2d 580.

The negligence of the design professional that results in an erroneous statement can form the basis of an action for negligent misrepresentation, as well as for negligent performance in an ordinary negligence action. In these cases, the courts typically use the RESTATEMENT (SECOND) OF TORTS § 552 formulation of the standard for negligent misrepresentation as the basis for liability in appropriate cases.

37. *E.g.*, Sandarac Ass'n v. W.E. Frizzell Architects, Inc., 609 So. 2d 1349 (Fla. Dist. Ct. App. 1992), *approved in* Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244 (Fla. 1993); Fence Rail Dev't Corp. v. Nelson & Associates, 528 N.E.2d 344 (Ill. App. Ct.), *appeal denied*, 535 N.E.2d 401 (Ill. 1988); Floor Craft Floor Covering, Inc. v. Parma Community Gen. Hosp. Ass'n, 560 N.E.2d 206 (Ohio 1990); Blake Constr. Co. v. Alley, 353 S.E.2d 724 (Va. 1987).

38. *Blake Constr. Co.*, 353 S.E. 2d 724.

> The parties involved in a construction project resort to contracts and contract law to protect their economic expectations. Their respective rights and duties are defined by the various contracts they enter. Protection against economic losses caused by another's failure properly to perform is but one provision the contractor may require in striking his bargain. Any duty on the architect in this regard is purely a creature of contract.[39]

There follows from this analysis a general attack on the *Rogers & Rogers* and *Moyer* control rationale:

> So long as the contracting parties have freedom to contract as they wish, with respect to the architect's power and role, these will vary considerably and no rule of general applicability may logically be stated which is founded simply upon the status of the defendant as "an architect" or upon what one believes to be the customary relationship between the work, the architect, the owner, and the contractor; particularly a general rule should not be founded upon a presumption that the architect has power over the contractor's performance, in general or in any particular of the work.[40]

As the conflict between *Rogers & Rogers* and *Moyer* on the one hand and *Blake Construction Co. v. Alley* on the other makes clear, the architect liability cases embody the problems of doctrinal classification. When an architect improperly designs or supervises a contractor's work, the resulting dispute has the attributes of both a contract case (a relationship founded on agreement) and a tort case (negligently-inflicted harm). The courts are faced with a dilemma: The two doctrines that could apply to the case yield inconsistent results, but it is unsatisfactory to treat the case exclusively either in contract or in tort. The contract approach slights the concern for the harm that the architect's carelessness can inflict on the contractor, while the tort approach gives too little weight to the allocation of risks and benefits in the parties' agreement.

2. *Manufactured Products*

Product-related economic loss cases also present problems for the contract-tort boundary. Most of the cases arise from a series of sales in which the parties are all sequential links in a chain for the production and distribution of goods from manufacturer to ultimate purchaser. Typically, the user of a product who purchased it from an intermediate

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39. *Id.* at 727.
40. Bernard Johnson, Inc. v. Continental Constructors, 630 S.W.2d 365, 371-72 (Tex. Ct. App. 1982).

distributor brings an action against the original manufacturer or a manufacturer of a component part. In many of the cases some of the harm takes the form of physical damage to the product or other property of the user, so it is necessary first to determine if the injury involves purely economic loss or some form of physical harm. The presence of an extensive statutory scheme that regulates many of the transactions in this area—the Uniform Commercial Code—complicates the analysis.

Two leading New Jersey cases illustrate the classification problems in this area of law: *Santor v. A & M Karagheusian, Inc.*,[41] and *Spring Motors Distributors, Inc. v. Ford Motor Co.*[42] *Santor v. A & M Karagheusian, Inc.*, the first major third party products case, involved a consumer who purchased carpet that developed unusual "lines" running through it. When the retail dealer from whom Santor purchased the carpet moved out of state, Santor contacted Karagheusian, the manufacturer, in a fruitless attempt to have the defect remedied. The trial court found that the manufacturer had breached an implied warranty of merchantability that existed even in the absence of privity. Although the Supreme Court of New Jersey agreed that the warranty action would lie, it stated that "the manufacturer's liability may be cast in simpler form" under the doctrine of strict liability in tort.[43]

Tracing the development of the liability of manufacturers to nonprivity consumers, the *Santor* court found no reason to distinguish between personal injury and economic loss in product cases. In both cases, the court emphasized, the manufacturer is the key actor who puts the product on the market and who guarantees its quality.[44] Providing a direct action by the consumer avoids a chain of actions against intermediate sellers and avoids the occasional inability of the consumer to recover against a retailer (as would likely have happened in *Santor*, since the dealer had moved from New Jersey to Maine).[45] Implied warranty is a legal fiction that accomplishes what strict liability accomplishes more directly; in both cases, the basis of the action is the presence of the product on the market, not any representations that accompany it.

The New Jersey Supreme Court moved away from its position in *Santor* in *Spring Motors Distributors Inc. v. Ford Motor Co.*[46] In

41. 207 A.2d 305 (N.J. 1965).
42. 489 A.2d 660 (N.J. 1985).
43. *Santor*, 207 A.2d at 311.
44. *Id.* at 309.
45. *Id.* at 307.
46. For a complete discussion of the case, see Patricia A. Brown & Jay M. Feinman, *Economic Loss, Commercial Practices, and Legal Process:* Spring Motors Distributors, Inc. v. Ford Motor Co., 22 RUTGERS L. J. 301 (1991).

Spring Motors the commercial purchaser of a fleet of trucks encountered repeated and irremediable difficulties with the trucks' transmissions. The purchaser brought an action against the dealer, the manufacturer of the trucks, and the manufacturer of the transmissions. The purchaser initially pleaded breach of express and implied warranties under the Uniform Commercial Code, negligence, and strict liability, but it was forced to proceed only on the tort claims because the statute of limitations had run on the contract claims.[47]

The *Spring Motors* court reformulated the approach that it had fashioned in *Santor*. The court defined a model of contract in which commercial parties of equal bargaining power bargained with respect to the risks that they could effectively bear.[48] This area of bargaining is governed by the Uniform Commercial Code "which constitutes a comprehensive system for determining the rights and duties of buyers and sellers with respect to contracts for the sale of goods."[49] Tort law is appropriately invoked only when the preconditions of contract—comparable bargaining power and the ability to bear or distribute risks—do not exist.[50] Personal injury to a consumer caused by a manufactured product is a prime example of an instance in which the preconditions of contract do not exist, which is why strict liability is imposed in that area. The court distinguished *Santor* without reconsidering it by stating that *Spring Motors* involved a commercial purchaser, contrasted to the consumer purchaser in the earlier case.[51] Nevertheless, the privity barrier could be surmounted in warranty. In dictum, the court stated that it would allow a nonprivity purchaser to recover against a manufacturer of the finished item or a component part.[52] However, that step was taken in contract law, not tort.

Santor and *Spring Motors* present a sharp contrast between the tort and contract approaches to products cases and illustrate the problems of the existing classification. The problems become even more acute in cases in which the nature of the injury is seen as a key to determining the appropriate classification. In the paradigm case of a remote

47. Spring Motors Distributors Inc. v. Ford Motor Co., 489 A.2d 660, 664 (N.J. 1985).
48. *Id.* at 666.
49. *Id.* at 665.
50. *Id.* at 670.
51. *Id.*
52. *Id.* at 676-77.

commercial purchaser who suffers only economic loss because of the inadequacy of the product, the great majority of jurisdictions follow *Spring Motors* and hold that no tort action is available.[53] This approach to the paradigm case presents the economic loss rule in its pure form: when the harm caused by a product takes only the form of economic loss, the injury is not compensable in tort law. Quite frequently, however, the defect in the product does more than simply diminish its value; the defect may also cause, in ascending order of seriousness, physical damage to the product itself, physical damage to other property of the purchaser, or personal injury to the purchaser or others.

Personal injury caused by a defective product is always recoverable in tort.[54] Physical damage to other property of the purchaser is also generally recoverable in either negligence or strict products liability under the theory that the interest in the security of one's physical property is an interest traditionally protected by tort law.[55] For example, when an ingredient supplied to a feed manufacturer to be mixed into calf feed adulterates the feed, causing injury and death to the calves of the buyer of the feed, the ingredient manufacturer is liable only in contract to the feed manufacturer but is liable in tort to the owner of the calves.[56] Cases in which the only damage that occurs is to the product sold itself are more controversial. There are two polar positions and two intermediate positions.[57]

One large group of cases holds that damage to the product is simply a form of economic loss which is covered by the economic loss rule, so no tort liability is available.[58] As the United States Supreme Court stated, "[t]he tort concern with safety is reduced when an injury is only to the product itself. . . . Such damage means simply that the product has

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53. *E.g.*, State *ex rel*+. Smith v. Tyonek Timber, Inc., 680 P.2d 1148 (Alaska 1984) ; Anthony v. Kelsey-Hayes Co., 25 Cal. App. 3d 442, 102 Cal. Rptr 113 (1972); GAF Corp. v. Zack Co., 445 So. 2d 350 (Fla. Dist. Ct. App. 1984); Marcil v. John Deere Indus. Equip. Co., 403 N.E.2d 430 (Mass. App. Ct. 1980); Hapka v. Paquin Farms, 458 N.W.2d 683 (Minn. 1990).

54. *See* RESTATEMENT (SECOND) OF TORTS § 402A (1965).

55. *E.g.*, Pisano v. American Leasing, 146 Cal. App. 3d, 194 Cal. Rptr.77 (1983); United Air Lines, Inc. v. CEI Indus. of Ill., Inc., 499 N.E.2d 558 (Ill. App. Ct. 1986); *John Deere Indus. Equip. Co.*, 403 N.E.2d 430 (Mass. App. Ct. 1980); Lloyd F. Smith Co. v. Den-tal-ez, Inc., 491 N.W.2d 11 (Minn. 1992).

56. Starks Feed Co. v. Consolidated Badger Coop., Inc., 592 F. Supp. 1255 (N.D. Ill. 1984).

57. *See* Jay M. Zitter, Annotation, *Strict products liability: recovery for damage to product alone*, 72 A.L.R.4th 12.

58. *E.g.*, Wellcraft Marine v. Zarzour, 577 So. 2d 414 (Ala. 1990); Long v. Jim Letts Oldsmobile, Inc., 217 S.E.2d 602 (Ga. Ct. App. 1975); Board of Educ. of Chicago v. A, C & S, Inc., 546 N.E.2d 580 (Ill. 1989).

not met the consumer's expectations, or, in other words, that the customer has received 'insufficient product value.'"[59] Accordingly, warranty law under the U.C.C. is the proper vehicle for defective product actions; warranty law gives the purchaser the benefit of its bargain while limiting the manufacturer's liability to foreseeable losses.

At the other end of the spectrum, some courts have suggested that any injury to the product is recoverable in tort. In *John R. Dudley Construction, Inc. v. Drott Manufacturing Co.*,[60] for example:

> [The court found] no logical reason why, under the circumstances of the accident as alleged, the law should allow recovery for injuries to plaintiff's property beyond the limits of the crane (assuming there had been some) and disallow damages for the parts of the crane damaged or destroyed when it collapsed. In either case the damages could be said to have resulted from the same tortious conduct by appellants in supplying a crane that was dangerously susceptible to collapse because of the defective bolts.[61]

In between these two polar positions, other jurisdictions use two more complex methods to draw the line between contract and tort in cases of injury to the product.[62] One group of cases focuses on the means by which the harm occurs. If the harm to the product occurs in a manner that could have caused personal injury or damage to other property, then the interests protected by tort law are implicated, even if the only injury that actually does occur is to the product itself. The most common formulations of this approach are that the harm be caused in an accident[63] or be "sudden and calamitous."[64]

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59. East River S.S. Co. v. Transamerica Delaval, Inc., 476 U.S. 858, 871-72 (1986), (citing JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 406 (2d ed. 1980)).

60. 412 N.Y.S.2d 512 (N.Y. App. Div. 1979).

61. *Id.* at 514. *See also* Spence v. Three Rivers Building & Masonry Supply, Inc., 90 N.W.2d 873 (Mich. 1958); Cova v. Harley Davidson Motor Co., 182 N.W.2d 800, 807 (Mich. Ct. App. 1970).

62. *See* Touchet Valley Grain Growers, Inc. v. Opp & Seibold, 831 P.2d 724, 733-34 (Wash. 1992).

63. Clevenger & Wright Co. v. A.O. Smith Harvestore Prods., Inc, 625 S.W.2d 906, 909 (Mo. Ct. App. 1981); Russell v. Ford Motor Co., 575 P.2d 1383, 1384 (Or. 1978).

64. Cloud v. Kit Mfg. Co., 563 P.2d 248, 251 (Alaska 1977); Vulcan Materials Co. v. Driltech, Inc., 306 S.E.2d 253 (Ga. 1983); Capitol Fuels, Inc. v. Clark Equip. Co., 382 S.E.2d 311 (W. Va. 1989). *But see* Northern Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324, 328 (Alaska 1981) (sudden and calamitous phrase has no "magical quality").

The rule in a second group of cases directs courts to conduct in each case an individualized examination of the application of tort and contract policies to determine the proper classification of the case. This approach originated in the Third Circuit opinion in *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*[65] Under this rule, no simple test or formula can determine whether contract or tort policies are involved in a particular case.

> In cases such as the present one where only the defective product is damaged, the majority approach is to identify whether a particular injury amounts to economic loss or physical damage. In drawing this distinction, the items for which damages are sought, such as repair costs, are not determinative. Rather, the line between tort and contract must be drawn by analyzing interrelated factors such as the nature of the defect, the type of risk, and the manner in which the injury arose. These factors bear directly on whether the safety-insurance policy of tort law or the expectation-bargain protection policy of warranty law is most applicable to a particular claim.[66]

II. ECONOMIC NEGLIGENCE AS A NEW CLASSIFICATION

Third-party cases involving economic loss present significant problems for the classification of contract and tort law. As the design professional and products cases demonstrate, the classification problem was not so acute when privity was required for a cause of action. The law was relatively stable, and there were very few cases brought by third parties and therefore very little difficulty with the law. Beginning in the 1950s and accelerating in the 1970s, though, courts recognized the injustice of the privity requirement's complete bar to a remedy in these cases and began to expand liability.[67] The expansion of liability has made apparent the problems of association, overlap, and framing bias that are immanent in the contract-tort classification.

These problems can be best addressed by reorganizing the doctrinal structure, rather than by manipulating the doctrinal content of the traditional structure. All these third-party economic loss cases have common characteristics and raise common issues. To better understand this expanding body of case law, it is appropriate to view the cases as

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65. 652 F.2d 1165 (3rd Cir. 1981) (applying Pa. law); *see also* Jame v. Bell Helicopter Co., 715 F.2d 166 (5th Cir. 1983); Ales-Peratis Foods Int'l, Inc., v. American Can Co., 164 Cal. App. 3d 277, 209 Cal. Rptr. 917 (1985).

A more recent Third Circuit opinion suggested that the Pennsylvania courts would depart from the *Pennsylvania Glass Sand* rule in light of the Supreme Court's opinion in *East River*. Aloe Coal Co. v. Clark Equip. Co., 816 F.2d 110 (3d Cir. 1987). The suggestion was adopted in Rem Coal Co. v. Clark Equip. Co., 563 A.2d 128 (Pa. Super. Ct. 1989). *But see Capitol Fuels, Inc.*, 382 S.E.2d 311 (declining to follow *East River*).

66. *Pennsylvania Glass Sand,* 652 F.2d at 1173.

67. *See* part II, *infra.*

belonging to a distinctive doctrinal category with its own themes, issues, and problems that is usefully conceived to be independent of both contract and tort, as more general fields, and of the particular factual categories from which the cases arise. This category is known as "economic negligence".[68]

Economic negligence cases have four distinctive characteristics that render them appropriate for consolidation into a single field for purposes of analysis. These characteristics become the identifying criteria for inclusion of a case in the field. First, every economic negligence case arises out of a contractual setting. At a minimum, the defendant enters into a contract with a second party, the performance of which affects a third person (the plaintiff). Often, the second party solicits the defendant's performance in part to confer a benefit on the plaintiff. For example, a testator who retains an attorney to draft a will through which the testator wishes to devise property to a beneficiary illustrates.

Many cases involve more complex contractual relationships. In some cases, the defendant and the plaintiff each have a contract with the second party. In others, a chain of contracts exists: a product manufacturer sells its goods to a retailer who in turn sells them to the ultimate purchaser. In still others, the separate contracts can be formed in the context of a single transaction. For example, a home seller contracts

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68. *See generally* Jay M. Feinman, ECONOMIC NEGLIGENCE: LIABILITY OF PROFESSIONALS AND BUSINESSES TO THIRD PARTIES FOR ECONOMIC LOSS (1995). The term was first used in BRUCE FELDTHUSEN, ECONOMIC NEGLIGENCE: THE RECOVERY OF PURE ECONOMIC LOSS 8-14 (2d ed. 1988), a monograph primarily focusing on law in the Commonwealth. There has been considerably more literature on aspects of the subject in the Commonwealth than in the United States. *See, e.g.*, Patrick S. Atiyah, *Negligence and Economic Loss*, 83 L.Q. REV. 248 (1967); PETER CANE, TORT LAW AND ECONOMIC INTERESTS ch. 9 (1991); THE LAW OF TORT: POLICIES AND TRENDS IN LIABILITY FOR DAMAGE TO PROPERTY AND ECONOMIC LOSS (Michael Furmston ed., 1986); J.A. Smillie, *Negligence and Economic Loss*, 32 U. TORONTO L. REV. 231 (1982); Jane Stapleton, *Duty of Care and Economic Loss: A Wider Agenda*, 107 L.Q. REV. 249 (1991).

For general discussion of issues relating to economic negligence in American law, see, e.g., Leon Green, *The Duty to Give Accurate Information*, 12 UCLA L. REV. 464 (1965); Fleming James, Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43 (1972); Michael D. Lieder, *Constructing a New Action for Negligent Infliction of Economic Loss: Building on Cardozo and Coase*, 66 WASH. L. REV. 937 (1991); Walter Probert, *Negligence and Economic Damage: The California-Florida Nexus*, 33 U. FLA. L. REV. 485 (1981); William L. Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231 (1966); Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513 (1985).

with a termite inspector to provide a certification that the home is free of infestation because the seller's contract with the buyer requires such a certification. In the most complex contractual settings, the defendant, the second party, and the plaintiff have contracts that effectively require interlocking performances. A subcontractor on a building project may formally contract only with the general contractor, but its performance will affect and be affected by the actions of the owner, architect, and other subcontractors.

Second, the harm to the plaintiff occurs because the defendant acts carelessly (or, in a nontechnical sense, negligently) with respect to some element of its contractual performance. The defendant's failure to exercise care in the performance of its contract (e.g., drafting a will, designing a building, inspecting a home) causes injury to the plaintiff's economic interests. Frequently, the defendant's performance culminates in a communication upon which the plaintiff relies, and the communication is erroneous due to the defendant's failure to exercise care in making the investigation upon which the communication depends, as can be the case with an accountant's audit report, an attorney's opinion, and a building inspector's certificate.

Third, these cases involve pecuniary loss, not physical injury. Under the traditional view, personal injury is considered to be qualitatively different than economic loss because it often has catastrophic consequences for the victim and because monetary compensation is unable to wholly remedy injury of this kind.[69] As noted above, some economic negligence cases involve property damage, which occupies a middle ground between purely pecuniary loss and personal injury. The defects in a negligently constructed building or a defective product often manifest themselves as physical injury to property: a cracked foundation or a collapsed vehicle, for instance. The defects also may cause injury to other property, as where tainted feed kills the animals who eat it. As an initial classification criterion, cases of property damage of this sort are enough like economic loss cases to fall within the law of economic negligence.

Fourth, because the plaintiff's loss is not bounded by either physical causation or a direct contractual relationship with the defendant, economic negligence cases have the potential of creating indeterminate liability on the defendant.[70] The economic consequences of a negligent act can ripple much farther than the physical consequences, particularly where the negligent act is the communication of information. Driving

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69. *See* FELDTHUSEN, *supra* note 68, at 8-14.
70. *See id.* at 96-125.

through a red light is likely to cause harm only to people who are in the intersection at the time; even manufacturing a defective product is likely to cause personal injury only to a single user of the product and perhaps others in proximity at the time of use. The consequences to the injured parties may be catastrophic, but they ordinarily do not extend to a large group of people or to anyone far removed from the negligent act. Economic harm is much less confined; many lenders or investors can rely on an accountant's audit report, and a purchaser of property may rely on a survey prepared for a prior owner years earlier.

The threat of indeterminate liability refers both to indeterminacy of the number of potential plaintiffs (the potential users of the audit report) and to the size of their claims (the property purchaser whose loss depends on the increase in value of the property since the time of survey). Not all economic negligence cases feature these concerns to the same extent, and indeterminacy is involved in some physical damage cases,[71] but the distinction is sufficient to suggest the desirability of treating economic negligence as a distinctive area of law.

These four features characterize the construction cases and products cases described in Part I, and they also arise in many other settings. The following cases illustrate the range of settings that give rise to economic negligence cases:

—A lender or trade creditor who advances funds to a company in reliance on the company's audited financial statements sues the accountant who performed the audit when the company turns out to be insolvent and unable to repay the funds.[72]

—A putative beneficiary of a will who is denied a bequest because of an error in the drafting or execution of the will sues the attorney who prepared the will and supervised its execution.[73]

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71. *See* Rabin, *supra* note 68.

72. *E.g.*, Credit Alliance Corp. v. Arthur Andersen & Co., 483 N.E.2d 110 (N.Y. 1985); Raritan River Steel Co. v. Cherry, Bekaert & Holland, 367 S.E.2d 609 (N.C. 1988).

73. *E.g.*, Hale v. Groce, 744 P.2d 1289 (Or. 1987); Guy v. Liederbach, 459 A.2d 744 (Pa. 1983); *see also* Jay M. Feinman, *Attorney Liability to Nonclients*, 30 TORT & INS. L.J. (forthcoming 1996).

—A home buyer who relies on a termite inspection report ordered by the seller sues the inspector when the house turns out to have undisclosed termite infestation.[74]

—The successor in title to a landowner sues a surveyor[75] or title abstractor[76] whose errors in performing its contract with the original landowner caused the successor's interest in the property to be less valuable.

—An employee who was dismissed for failing a drug test sues the testing laboratory for negligently administering the test.[77]

—A home buyer who relies on statements concerning the condition of the property relayed from the seller through the seller's real estate broker sues the broker when the statements are revealed to be erroneous.[78]

III. ADVANTAGES OF RECLASSIFICATION

The conscious definition of a new field of law is an exercise in problem-solving designed to facilitate the application of legal principles and policies. A group of cases presents issues that cannot be satisfactorily resolved through the existing doctrinal structure. When lawyers and judges apply existing rules or principles to address the issues, the results appear to be inadequate or inconsistent. These problems can be solved—or at least lessened—by reconceptualizing the cases at a relatively general level; that is, by incorporating them within a new field of law or a new doctrinal structure.[79]

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74. *E.g.*, Allred v. Dobbs, 223 S.E.2d 265 (Ga. Ct. App. 1976); Barrie v. V.P. Exterminators, 625 So. 2d 1007 (La. 1993); *see also* Jay M. Feinman, *Economic Negligence in Residential Real Estate Transactions*, 25 REAL ESTATE L.J. (forthcoming 1996).

75. *E.g.*, Rozny v. Marnul, 250 N.E.2d 656 (Ill. 1969); Cook Consultants v. Larson, 700 S.W.2d 231 (Tex. Ct. App. 1985), *writ refused nre*, (Tex. 1986); *see also* Feinman, *supra* note 74.

76. *E.g.*, First Am. Title Ins. Co. v. First Title Service Co. of the Florida Keys, 457 So. 2d 467 (Fla. 1984); Williams v. Polgar, 215 N.W.2d 149 (Mich. 1974); *see also* Feinman, *supra* note 74.

77. *E.g.*, Lewis v. Aluminum Co. of America, 588 So. 2d 167 (La. Ct. App.), *writ denied*, 592 So. 2d 411 (La. 1992); SmithKline Beecham Corp. v. Doc, 903 S.W.2d 347 (Tex. 1995).

78. *E.g.*, Tennant v. Lawton, 615 P.2d 1305 (Wash. Ct. App. 1980); Hagar v. Mobley, 638 P.2d 127 Wyo. 1981); *see also* Feinman, *supra* note 74.

79. This experience is much like the situation in Thomas Kuhn's classic description of scientific inquiry. See THOMAS KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS (2d ed. 1970), and commentary, especially David Hollinger, *T.S. Kuhn's Theory of Science and its Implications for History*, 78 AM. HIST. REV. 370 (1973). Scientists proceeding under a prevailing theory may encounter observations or experimental results which cannot easily be explained by the theory. One response is

The reconceptualization of third-party economic loss cases into the field of economic negligence serves this problem-solving purpose by facilitating generalization across cases and groups of cases. Generalization is the core of the common law process in which lawyers, judges, and scholars decide that cases are similar or different in material respects and generalize about the similarities and differences. The new doctrinal classification makes more readily apparent the ways in which different third party cases do or do not resemble each other. This recognition leads to the identification of themes, arguments, principles, and subclassifications that improve the understanding of the cases.

This Part suggests some of the different types of generalizations that result from the reclassification of economic negligence.[80] Because economic negligence is a new field, this is only an exploration. It indicates some of the kinds of generalizations that the reclassification makes possible, but it does not exhaust the list of possibilities or explore all of their applications.

The first type of generalization consists of certain themes that represent the fundamental policies with which the courts grapple in this area of law. Second, the themes give rise to broad policy arguments about the appropriate treatment of the cases. Third, some factual issues recur in the cases, leading to various subclassification of factually similar cases arising in different settings. Finally, some principles or rules of thumb for the decision of cases arise.

A. The Central Themes in Economic Negligence

A few issues or themes recur in the hundreds of economic negligence cases that exhibit the characteristics described in Part II. These themes provide an important perspective on the historical development of the law and on the policy conflicts that arise throughout the cases. The three central themes in the law of economic negligence are:

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to maintain the fundamental attributes of the theory and to introduce complexities that account for the new evidence, much the way Ptolemaic astronomers introduced the concept of epicycles to account for the irregularity of planetary behavior. Ultimately, though, the contradictions and inconsistencies accumulate to such an extent that they can be resolved only by substituting a new general theory. The new theory not only provides an explanation of the data, but it also provides a structure of inquiry for scientists working in the field.

80. *See generally* Feinman, *supra* note 68.

(1) The application of fundamental tort policies, which has led to the decline of privity as a prerequisite to liability;

(2) The protection of private ordering through contract; and

(3) The threat of indeterminate liability.

Each of these themes is discussed in many cases and figures importantly in the selection of liability rules. The themes express the issues that are involved in economic negligence cases as they arise in varied fact settings, and they provide a basis for constructing arguments that can be used to address those issues. The following sections briefly explain these three themes.

1. The Application of Tort Policies

Courts and legislatures prescribe rules of tort liability to serve certain fundamental policies. The most important of the basic tort policies are compensating victims of harm, deterring wrongful conduct and providing incentives for reasonable conduct, placing losses on those who can best bear or distribute them, and fairness—under which is included redressing harm caused to innocent parties and imposing the burden of harm on the parties responsible for it.[81] The first major theme in the law of economic negligence is the courts' desire to serve these policies in cases of economic injury to third parties. Serving these policies has led to an increase in liability to third parties, at the expense of the doctrine of privity, and has made apparent the inadequacy of the traditional doctrinal classifications in this area.

The New Jersey Supreme Court in *H. Rosenblum, Inc. v. Adler* stated the general proposition that tort policies are of primary importance: "[u]nless some policy considerations warrant otherwise, privity should not be, and is not, a salutary predicate to prevent recovery. Generally, within the outer limits fixed by the court as a matter of law, the reasonably foreseeable consequences of the negligent act define the duty and should be actionable."[82]

In other words, the ordinary principles of tort law—here summarized as liability for "the reasonably foreseeable consequences of the negligent act"—govern; liability is limited to parties in privity only when the court determines that those principles dictate that result.[83]

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81. PROSSER & KEETON, *supra* note 17, § 4. In serving these policies, lawmakers also must be concerned with the courts' ability to conveniently and capably administer the resulting doctrine. *Id.*

82. 461 A.2d 138, 145 (N.J. 1983).

83. In its opinion, the court further detailed and applied the policies of tort law. *Id.* at 150-52.

Rusch Factors, Inc. v. Levin,[84] one of the first cases to expand the liability of accountants in negligent misrepresentation beyond privity, makes the same point about the application of tort policies and provides a convenient summary of those policies.

> Why should an innocent reliant party be forced to carry the weighty burden of an accountant's professional malpractice?[85] Isn't the risk of loss more easily distributed and fairly spread by imposing it on the accounting profession, which can pass the cost of insuring against the risk onto its customers, who can in turn pass the cost onto the entire consuming public?[86] Finally, wouldn't a rule of foreseeability elevate the cautionary techniques of the accounting profession?[87] For these reasons it appears to this Court that the decision in *Ultramares* constitutes an unwarranted inroad upon the principle that "the risk reasonably to be perceived defines the duty to be obeyed."[88]

The balance of factors test for the determination of a negligence duty, first adopted in will beneficiary cases and subsequently applied to a myriad of third party situations, defines in more detail guidelines for the application of the tort policies.

> The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.[89]

All of these statements of the doctrine are motivated by a primary concern for the application of tort policies to third party situations. The courts have attempted to bring economic negligence, or at least some parts of it, within the mainstream of tort law. Although liability rules and results may differ among economic negligence situations and between economic negligence cases and cases of physical injury, the thrust of the doctrine is to ensure that the objectives of compensation, deterrence, loss distribution, and fairness are served.

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84. 284 F. Supp. 85 (D.R.I. 1968).
85. This invokes the compensation and fairness policies.
86. This invokes the loss distribution policy.
87. This invokes the deterrence policy.
88. *Rusch Factors, Inc.*, 284 F. Supp. at 91 (quoting Palsgraf v. Long Island R.R., 162 N.E. 99, 100 (N.Y. 1928)).
89. Biakanja v. Irving, 49 Cal.2d 647, 651, 320 P.2d 16, 19 (1958).

Courts have recognized that the decline of privity and the application of tort policies was a necessary step in economic negligence cases, but taking the step presents new problems. The application of tort policies threatens to undermine the process of private ordering in many settings and to expose parties to the threat of indeterminate liability. Those concerns are embodied in the other major themes of economic negligence.

2. *The Protection of Private Ordering*

The second major theme in the law of economic negligence is the desire to protect the private ordering process which takes place when parties enter into contracts. Every economic negligence case originates in a contract entered into by the defendant and its contracting partner. In the simplest case, the defendant and its partner have allocated the risks and benefits of performance in their contract. The court upsets that allocation when it imposes liability on the defendant in favor of a non-contracting third person. Imposing such liability outside the contract is unfair to the defendant, who has ordered its affairs on the expectations created in the contract, and undermines the process of contracting.

Many economic negligence cases involve more elaborate private ordering. The defendant and the plaintiff each may enter into a contract with the other party, as where an accountant and a lender each contract with a company. Or, multiple parties are involved in a set of interlocking relationships created by several contracts. In the classic construction project, the owner contracts separately with the architect and the general contractor, the general contractor retains subcontractors, the subcontractors contract with suppliers, and so on, with each contract specifying some of the duties owed to one's contracting partner and perhaps to other participants in the project as well. In settings such as these, all the parties have planned their interlocking relationships, and imposing liability beyond the obligations assumed in the contracts disrupts that planning.[90]

The logic of private ordering is, of course, the logic of contract law: Individuals are the best judges of their own interests; contracts provide a means through which they can enter into transactions that maximize those interests; the expectation and reliance interests created by contracts deserve to be protected; promoting private contracting produces a social benefit; contract law provides the framework through which the individual and social benefits are realized in practice. In economic

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90. *See, e.g.*, Mandal v. Hoffman Constr. Co., 527 P.2d 387, 390 (Or. 1974); Blake Constr. Co. v. Alley, 353 S.E.2d 724 (Va. 1987).

negligence cases, private ordering is furthered by recognizing the primacy of contract law as the appropriate structure for regulating relationships, whereas the application of tort law could upset the parties' private ordering. This position is most strongly expressed in the economic loss rule, under which contract law is exclusively applied to govern economic negligence cases.[91] As a result, recovery by a third party is allowed only if the third party is able to establish that it is a third party beneficiary of the defendant's contract according to traditional contract law principles.

3. The Threat of Indeterminate Liability

The threat of imposing liability of an uncertain scope on a defendant has been one of the central concerns of the law of economic negligence since its origins.[92] The concern received its authoritative expression in Cardozo's maxim in *Ultramares Corp. v. Touche*:[93] "If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class."[94]

The problem of indeterminate liability is not, in essence, a problem of magnitude. The damages to which the defendant may be subject in an economic loss case may be enormous, just as they can be in a physical injury case, but the potential size of the damages raises no problem that is distinctive to the economic negligence area. Instead, the problem of indeterminacy is a problem of uncertainty caused by the spreading out or rippling down of the harm caused by the defendant's negligence. In many cases the damages are very large, but it is only because the damages also are unpredictable that they are problematic.

Two types of indeterminacy arise in third party cases: uncertainty as to the number of plaintiffs who can bring a claim and uncertainty as to

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91. Product-related economic loss cases applying the economic loss rule provide especially rich discussions. *See, e.g.*, East River S.S. Co. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986); Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Spring Motors Distrib., Inc. v. Ford Motor Co., 489 A.2d 660 (N.J. 1985).

92. *See, e.g.*, Stapleton, *supra* note 67, at 253-56.

93. 174 N.E. 441 (N.Y. 1931).

94. *Id.* at 444.

the size of each claim. These are determined by the related factors of the class of plaintiffs who are permitted to recover, the class of transactions for which they may recover, and the time in which compensable harm may occur. There are many ways of defining these factors. For example, the class of plaintiffs could be defined to include only those persons who are in actual privity, those who are in a relationship of near privity, those whom the defendant knows will rely, or those whose reliance is unknown but reasonably foreseeable. Similarly, the transactions could be defined to include those for which the defendant specifically furnishes its performance, transactions of a similar nature, or any foreseeable transaction. The limits of compensable harm could be defined to include only harm which results from a relatively immediate use of the defendant's performance, or it could extend to a use which is many steps removed and years later. Obviously, as one moves further up each scale, the indeterminacy of the liability expands.

There are two features of economic negligence situations that make the threat of indeterminate liability particularly acute. First, the consequences of a negligent act which causes economic loss can extend very far, unlike the consequences of a negligent act causing physical injury. Although the consequences of a physical accident can be catastrophic, they tend to be limited in space and time to the immediate victims.[95] The economic consequences of a negligent act, on the other hand, can extend along chains of causation to many persons far removed in time and contact from the defendant. By definition, plaintiffs in third party cases are at least one step removed from the defendant, and they are often farther removed—the ultimate purchaser of a manufactured product, a subsequent purchaser of property that has been negligently constructed or surveyed, or the supplier to a subcontractor who relies on an architect's specifications.

Second, many economic negligence cases arise from the making of a statement or the communication of information. The rippling of consequences is particularly likely to occur with information, which can be passed quickly and costlessly from person to person (and often to many persons at once) in ways over which the defendant who produced the information has no control.[96] Once an accountant's audit report is

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95. Economic loss which flows to persons other than the immediate victim of the accident, such as the loss suffered by members of the victim's family, do raise indeterminacy problems, so they are usually dealt with under special duty rules. *See, e.g.*, FOWLER V. HARPER, ET AL., 3 THE LAW OF TORTS § 18.4 (2d ed. 1986).

96. There is a further distinctive problem with information in that it is difficult for the creator of the information to recapture the benefits of its use by the many parties to

issued, it can be disseminated widely and relied on by members of the general public.[97]

The threat of indeterminate liability is often asserted as an independent reason for limiting the scope of liability in economic negligence cases. However, indeterminacy is not a concern in and of itself, but because it affects the application of the fundamental tort policies and the protection of private ordering.

The defendant is unable to calculate the costs and benefits of its behavior when the amount of its potential liability is uncertain, so the threat of liability in an indeterminate amount is likely to undermine the parties' ability to achieve a contractual allocation of costs and benefits and to produce either too little or too much of an incentive for the defendant to regulate its conduct. Similarly, when the defendant cannot reasonably accurately calculate its potential loss, it cannot either insure against the loss or distribute it appropriately to its customers. Moreover, in many situations the plaintiff is in a better position to reduce the likelihood or extent of the loss because it knows better than the defendant the facts relevant to its particular situation that will determine the scope of loss. Finally, indeterminate liability can impose an unfair burden on the defendant because the defendant is not in a position to prevent or prepare for the unknowable loss.

B. Arguments

The central themes of economic negligence can be restated to form two general arguments about the doctrinal classification and liability rules that are appropriate to the cases. Courts and lawyers make these arguments in many different kinds of cases. One argument emphasizes the contractual origins of the relationships that give rise to the cases and asserts that liability on the contract is the exclusive means of recovery; this argument is most clearly embodied in the economic loss rule. The second argument builds on the extracontractual elements of the parties's relationships and stresses responsibilities that arise beyond their

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whom it ultimately may be communicated. *See* Greycas, Inc. v. Proud, 826 F.2d 1560, 1564-65 (7th Cir. 1987).

97. The distinctive character of information cases is a principal reason that the law of negligent misrepresentation has featured so prominently in the law of economic negligence, as a supplement to or substitute for the general law of negligence.

contracts; this argument is more open to the possibility of liability to third parties, as third party beneficiaries or in tort.

1. The Contractual Argument

The contractual argument is based on a conception of the contracting process and of the legal system's relationship to the process.[98] Every economic negligence case arises from a contractual setting, either a simple contract the performance of which affects a third person or a network of intertwined contracts that structure a complex interaction among multiple parties. The parties allocate the costs, benefits, and risks of their interaction through this contracting process. Sometimes the allocation is explicit and detailed; at others, it is implicit and by default. In every case, however, the parties actually or potentially have control of the structure and content of their relationship.

The law's role in this process is to support the parties' private ordering by using contract law to interpret and enforce their contracts. In defining obligations and allocating risks and benefits, the parties create expectations. The function of the law is to fulfill those expectations by enforcing the contracts as the parties have made them. It is inappropriate for the courts to impose liability outside the contracts, as through tort law. Tort law is better suited to the redress of accidental physical harm than to the regulation of the kind of consensual economic relationships present in most economic negligence cases. When the courts impose liability, it upsets the parties' own allocation of rights and duties, diminishes their ability to regulate their own affairs, introduces inefficiencies into the process, and raises the threat of indeterminate liability.

The contractual argument is made throughout the law of economic negligence, but it is particularly well-suited to situations involving experienced parties engaged in extensive contracting, as in cases arising from the construction industry, sales of product to commercial purchasers, or financial transactions involving sophisticated parties. Although the power to engage effectively in private ordering through contract is often hypothesized, it is most effectively realized in areas such as these. In the construction area, for example, participants typically do use extensive contracts to form their relationships. Both at the level of the trade groups which promulgate form contracts and the individual

98. For expressions of this view, see, e.g., United States for the use and benefit of *Control Systems, Inc. v. Arundel Corp.*, 896 F.2d 143 (5th Cir. 1990) (applying Miss. law); Floor Craft v. Parma General Hospital, 560 N.E.2d 206 (Ohio 1990); Blake Constr. Co. v. Alley, 353 S.E.2d 724 (Va. 1987).

transaction for which the parties negotiate a unique contract, serious allocation of the costs and benefits of the construction process (including the costs and benefits of contracting with respect to risks) characterizes the contracting process.

2. *The Relational Argument*

The contractual argument can be insufficiently sensitive to two issues: the extent to which the parties' written contracts do not accurately reflect the nature of their relationships, and relational characteristics of the setting that are either extracontractual or noncontractual. The second line of argument responds to these issues by emphasizing relational characteristics.

In an ideal contracting situation, the parties' contracts embody the culmination of a planning process in which the parties have specified the terms of their performance and the allocation of risks. In many real contracting situations, however, unlike the theorized ideal, there are a number of factors that indicate that the ideal has been met. A first factor is the extent to which the parties have actually specified performance terms and allocated risks in their contracts. Often the contract may incompletely specify the responsibilities and risks each party has assumed. Sometimes the parties adopt a standard form contract when one or both of them is not completely aware of its terms. Where parties have carefully considered and negotiated the complete performance and risk terms of their relationship, the resulting contracts are more likely to represent effective planning and a reasonable allocation of responsibilities; where the parties have simply adopted a prevailing form, or when one party has imposed the form on another, the planning process is less worthy of deference.

A second factor that can indicate the extent to which the written contract represents a real allocation of responsibilities and risks by the parties is the extent to which they observe the fruits of their planning in actual practice. Where they frequently depart from the strict requirements of the contractually-specified performance, actions speak louder than words. In such a case, the parties' conduct can provide a guide to interpreting the contract or can be an alternative source of relational obligation where the conduct is inconsistent with the contract. For example, where an architect significantly directs the progress of the work even though its contractual obligation to do so is either limited or

unclear, and the contractor accepts such supervision, the architect bears some responsibility when its direction is in error. By their conduct the parties have indicated that norms other than those specified in the contract are significant in their relationship, or that the need for flexibility in developing their relationship takes precedence over their initial planning.

As this factor suggests, in the relational argument contractual relations are seen as composed of extracontractual and noncontractual relations as well as contractually-defined obligations. In successful relationships, the participants are cooperative and flexible in the face of changes and difficulties, and they do not insist on limiting their performance to their contractual duties and on their partner's strict performance of their contractual rights. Moreover, participating in an intertwined relation necessarily creates obligations to other participants. The contractual argument rests on a vision of party autonomy and limited obligation; the relational argument rests on a vision of connection and responsibility. While the contracts are an important source of the definition of the parties' obligation, other sources are equally important and often even more important. The professional status and superior expertise of a party; the implicit understandings, tacit assumptions, and customary practices of the trade; the parties' course of dealing in the past and their course of performance; the need for trust and cooperation; for example, all give rise to expectations about a participant's appropriate role that supplement the parties' explicit planning.

From this expanded perspective, the law's role is not limited to enforcement of the express terms of the parties' contracts. The express terms must be supplemented by relational factors from the context, broadly construed, and by concern for policies not adequately captured in the concept of enforcing the parties' contracts. In the relational approach, the law has values to serve in addition to effectuating the parties' explicit planning—particularly the value of relational responsibility and values expressed in tort policies. Accordingly, tort liability is an appropriate supplement to liability on the contract.

C. Subclassifications of Cases

A doctrinal structure, like any other taxonomy, is composed of parts and subparts. Contract is a basic-level classification, private law is a higher-level classification, and unconscionability is a lower-level classification. Each classification suggests something about the degree of relationship among its constituents, relative to the constituents of other categories. All contract cases share features that they generally do not share with tort cases; unconscionability cases are distinctive in some

ways that render them worthy of treatment apart from other contract cases.

The same kind of subclassification is evident in economic negligence. The initial grouping of cases together as belonging to economic negligence is based on certain similarities among the cases. Once that grouping is accomplished, it also is possible to see similarities and differences among smaller sets of the cases. Identifying those similarities and differences can aid in the analysis of particular cases.

This section suggests some factual distinctions among economic negligence cases. The factual distinctions are significant because they suggest directions for the analysis of the cases according to the categories in which the cases fall.

1. Extent of Relationship

One method of categorizing cases across factual settings measures the extensiveness of the parties' relationships. There are three such classes of cases:

• The defendant and the second party enter into a contract, the performance of which affects the third party (the plaintiff), but the second party and the plaintiff have no contractual relationship. An example is a will beneficiary case in which the attorney and the client enter into a contract to draft a will, but the putative beneficiary has no contract with the client.

When the contract benefits the third party, as in the will beneficiary case, the dictates of private ordering and tort policies suggest that the defendant owes a duty to the third party. The contracting party's objectives can be effectuated only by granting an action to the third party since the second party is either unavailable or has little incentive to enforce the defendant's duty to perform with reasonable care. Likewise, the obligations that attach to the defendant's position affect and can be enforced only by the third party. Ordinarily, the defendant will be able to anticipate the loss to the third party, so no indeterminacy problem arises.

When the contract creates a relationship which is not primarily beneficial to the third party, more careful consideration of the elements of the relation is required. A client who retains an attorney for litigation is creating a relationship adverse to the third party who is its opponent in litigation; it is unlikely in such a case that relational obligations will

attach. An attorney-client relationship also may affect third parties who are not wholly adverse, such as the children of a divorcing spouse. The result in those cases depends on particular elements of the relationship and the setting.

• The defendant and the second party enter into a contract, the performance of which affects the third party, and the second party and the plaintiff also have a contract, the performance of which does not affect the defendant. Some of the elements of a typical real estate transaction illustrate: The surveyor and the termite inspector each contract with the seller of the property, and the seller contracts with the buyer to furnish the survey and the termite report. Another form of case in this category is the chain relationship cases, in which the three parties are in a vertical relationship with each other, such as a product manufacturer, retailer, and ultimate purchaser; or a home builder, initial purchaser, and subsequent purchaser.

The issues in this type of case flow both from the parties' specific act of private ordering and from the broader aspects of the relationship in which they are situated. The seller contracts with the termite inspector to provide a report which is satisfactory to the buyer, so private ordering concerns and tort policy concerns suggest that the buyer be able to enforce the obligation. In many cases, though, the intention to benefit the third party is less explicit and the third party may never directly receive the performance; an appraisal report may be delivered solely to the lender, not the buyer. Then, the obligation derives, if at all, more clearly from the general context, in which the buyer intangibly relies on the lender's judgment that the price for the property is appropriate. When the relationship becomes too attenuated, however, the concern for indeterminate liability comes into play. On the other hand, when the case involves only a loss of a known character that will befall either the third party or a successor, the loss is not indeterminate in kind. Thus, the case for liability is stronger.

• The defendant, the second party, and the plaintiff have contracts that require interlocking performances in a complex relationship, as in a typical construction project.

In this category of cases, relational concerns predominate. The parties' specific private ordering through contract is recognized to the extent that it represents a real exercise of choice and planning by the parties and to the extent that it is complete. In many cases, however, the contracts will be formulaic and incomplete, so tort policies are needed to supplement the parties' planning. Relational obligations arising from custom, tacit understandings, and fairness concerns then supplement or even overcome the written contract. As the relations become more

encompassing, the threat of indeterminate liability becomes a greater concern.

2. *Single Loss Versus Class of Parties*

A second method of grouping cases across factual settings is according to the nature of the loss: the number of parties who may potentially suffer loss from the defendant's negligent performance and the possible extent of that loss. Some cases involve only a single potential loss which is predictable in its nature, if not its amount. When a title abstracter issues an erroneous title report, or a surveyor performs an inaccurate survey, the error may not be discovered until the property has been transferred to a subsequent purchaser, even several years after the original transaction. Whenever the loss caused by the error is realized, however, it will occur only once—to the current owner of the property. This kind of loss is also predictable in its nature; it will be limited to the value of the property and improvements, although the actual amount of the loss will depend on the change in value of the property and the extent of improvements. Similarly, when an attorney issues an opinion in connection with the sale of a business, only the purchaser or lender to whom the opinion is issued suffers the loss, which is limited to the value of the business.

The single loss cases present a particularly strong case for liability. Where there is only a single loss, the threat of indeterminacy is relatively small. The limit of this principle is reached when the single loss occurs long after the defendant's performance, because the defendant's ability to anticipate or calculate the liability is diminished.

A second group of cases includes those cases in which the loss from the defendant's negligent performance may be incurred by the members of a class of plaintiffs. Here the size of the class and the predictability of the size are important. An accountant's audit of the financial statements of a limited partnership may be used only by the small group of limited partners. Its audit of a large corporation may be used by a much larger and less predictable group of investors, lenders, and others. Within that group, some plaintiffs will be more predictable than others; trade creditors may directly rely on the report, while purchasers of stock may rely on it in a much less direct manner. Because of the variation in the fact settings, it is difficult to generalize about these cases,

although indeterminacy often accompanies an increase in the size of the group.

3. *Evaluating Business Services*

There are a number of situations in which one person engages another person to provide a professional or expert evaluation of condition, quality, or value; a third party relies on the evaluation and suffers a loss because it turns out to be incorrect. Most of these cases fall into one of five categories:

(a) actions against pest control services for performing an inadequate inspection or control treatment;[99]

(b) actions against title abstracters for preparing an erroneous title report;[100]

(c) actions against appraisers for a negligently conducted appraisal;[101]

(d) actions against engineers for inadequate testing or inspection in connection with the construction or purchase of a building;[102] and

(e) actions against surveyors for surveying a property incorrectly.[103]

All of these types of cases can usefully be considered economic negligence cases of a certain type: cases involving "evaluative business services."

The paradigmatic evaluative business service case[104] contains the following elements:

- The defendant is a licensed professional or an expert.
- The defendant contracts with a second party to perform an evaluation of condition, quality, or value within its area of expertise.
- The contract is entered into in contemplation of a specific transaction made or to be made between the second party and a person in the position of the plaintiff.

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99. *E.g.*, Perschall v. Raney, 484 N.E.2d 1286 (Ill. Ct. App. 1985); Barrie v. V.P. Exterminators, Inc., 625 So. 2d 1007 (La. 1993).

100. *E.g.*, First Am. Title Ins. Co. v. First Title Service Co. of the Florida Keys, 457 So. 2d 467 (Fla. 1984); Williams v. Polgar, 215 N.W.2d 149 (Mich. 1974).

101. *E.g.*, Stotlar v. Hester, 582 P.2d 403 (N.M. Ct. App.), *cert. denied*, 585 P.2d 324 (N.M. 1978); Alva v. Cloninger, 277 S.E.2d 535 (N.C. Ct. App. 1981).

102. *E.g.*, Robert & Co. Assocs. v. Rhodes-Haverty Partnership, 300 S.E.2d 503 (Ga. 1983); Stanford v. Owens, 265 S.E.2d 617 (N.C. Ct. App.), *review denied*, 301 N.C. 95 (1980).

103. *E.g.*, Kent v. Bartlett, 49 Cal. App. 3d 724, 122 Cal. Rptr. 615 (1975); Rozny v. Marnul, 250 N.E.2d 656 (Ill. 1969).

104. On the concept of a paradigm case, see Feinman, *supra* note 1, at 696-705.

- The defendant knows or has reason to know that its employment relates to the transaction and that the person in the position of the plaintiff in that transaction is likely to rely on its evaluation.
- The defendant improperly performs its evaluation, resulting in an erroneous evaluation.
- The plaintiff learns of the defendant's report of its evaluation from the second party in the course of the contemplated transaction, relies on it, and suffers economic injury because the evaluation is incorrect.

In the paradigm case, the defendant is brought into the underlying transaction, specifically as an expert, to provide a specialized evaluation of the condition, quality, or value of some aspect of the transaction. A title abstracter, for example, has distinctive, if not unique, access to information concerning the state of the title essential to the transaction. The abstracter is brought into the transaction to make use of that access to further the objectives of the parties by providing security for the buyer concerning the property being conveyed. All of the participants understand that the expert's task is to provide an objective evaluation according to professional standards, an evaluation providing information that will be relied on by its employer and by the third party. The parties' assign this role to the expert, and an important element of the transaction is the third party's ability to trust the expert's evaluation. From the expert's point of view, providing the evaluation for use by its employer, the third party, or both, is what it is being paid for. In the typical transaction, the abstracter certainly should be aware that the abstract will be relied on by someone other than the party who orders it. For example, the custom in the locality may be for a seller to order the report for use by the buyer, a custom of which the abstracter should be aware; in any event, the abstracter certainly should know that a property owner seldom orders a title abstract except in contemplation of a sale or loan. The risk of loss to the third party should be anticipated by the expert, and it is the risk of that loss that the expert is being paid to prevent.

In the transaction, the expert evaluator is the party best situated to deal with the potential risk of error. The expert is retained to avoid the risk of error that the other, nonexpert participants in the transaction might otherwise commit. The only means the nonprivity participant has to avoid the risk of error by the defendant is to retain a second expert to perform the same evaluation, a step that would produce obvious inefficiencies. Moreover, the cost of the error can be more readily

allocated to the expert's line of business than to the other parties in the transaction. In the case of a title examination, for example, the cost of an erroneous report more reasonably can be borne and spread by the abstracter in the business of conducting examinations than by the other parties—the occasional buyer and seller of a house.

In a practical sense, a defendant such as an abstracter provides a service for the transaction, not only for the party who hires it. The defendant is compensated for this service, and it matters little whether the compensation comes directly from the user of the service or indirectly as one of the transaction costs which must be borne by and allocated among the parties. The compensation in effect covers two elements: the cost of providing the service with reasonable care, and the risk that the abstractor will have to pay for failing to perform with reasonable care. Only the second element is potentially greater when liability is extended to a third party.

In fact, however, the abstracter's risk is increased little by the extension of liability. The paradigm evaluative service case presents a particularly strong argument for liability because of the absence of the problem of indeterminate liability. The harm that occurs from a defective evaluation occurs only once, to a single party, so there is no concern with an indeterminate number of plaintiffs. An inadequate survey, termite report, or appraisal will affect only the current owner of the property, whether that owner is the party in privity with the expert or a third party. Similarly, an incorrect subsurface report will affect only the contractor who relies on it. Moreover, the damages that will flow from the negligent report in each case are relatively determinate: the cost to repair termite damage, the diminished value of the property, or the additional cost of constructing the building, and each are the obvious consequence of the defendant's error. Only when there are significant consequential damages does the indeterminate damages problem arise, and in those cases the unpredictability of damages does not differ much from the ordinary tort case. Accordingly, liability is appropriately imposed in the paradigm evaluative business services case.

4. Rules of Thumb

A judge or attorney analyzing an economic negligence case must employ the full range of decisional techniques available, but the classification of economic negligence as a field of law provides a number of helpful guidelines. These "rules of thumb" arise from consideration of cases of different types across the range of economic negligence. These are not legal rules, or even principles of general application; rather, they are tendencies that emerge from analysis of a

large number of different settings. The rules of thumb can be used as guidelines for an intermediate stage of analysis, but they do not obviate a full analysis. Indeed, some of the rules of thumb lead in opposite directions in particular cases.

One group of rules speaks to the status of the parties.

• Where there is a significant disparity of knowledge, status, or power between participants in a relation, the dominant party should take account of the interests of the subordinate party.

• In particular, professionals should adhere to the higher requirements of their professional role. Their highest duty is to their clients, but their status creates duties toward nonclients as well.

• Where an actor in a relation engages in activity which is specifically directed at another participant or is intended or is likely to affect the other participant's interests in a particular or distinctive way, the actor has a special responsibility toward the other participant.

• Where it is difficult for the actor to be compensated for the benefit of the service it provides or to be compensated for the risk of liability that may result from harm that occurs in the rendition of the service, the lack of reciprocity suggests that the obligation ought to be less. This is more often the case with the provision of information for which it is hard to capture the benefit, or with the provision of a benefit to a large or indeterminate group.

A second group of rules speaks to the balance between planning and flexibility in the relationships from which economic negligence cases arise.

• Where there has been a considered application of planning by all parties involved which is intended to govern the subject matter of the dispute, the planning is entitled to considerable weight.

• Where the planning process is limited or deficient in some respect, it is entitled to less weight. Common limitations and deficiencies include the use of a form contract the terms of which are not subject to negotiation or are not likely to be considered by one party, a failure to consider specific applications of a general provision of a contract, and a significant inconsistency between the terms of a document and the parties' actions to execute the planning contemplated in the document.

• In relations of greater complexity or longer duration, or when conditions have changed or unanticipated circumstances have arisen, flexibility is very important and informal, ongoing planning is important,

but formal planning, especially formal planning at the beginning of the relationship, is less important.

In a sense, these rules of thumb (and others that could be devised) more closely resemble what are ordinarily thought of as legal principles than do the kinds of themes, arguments, and factual subclassifications that were described previously. Nevertheless, while their form is familiar they are not more useful—and perhaps less useful—in the analysis and decision of cases than are the other sorts of description. The emphasis on classification in this Article suggests that these other, more factually-oriented concepts may be more useful in legal-problem solving than are rules of thumb that resemble black-letter law.

CONCLUSION

Roscoe Pound, who wrote one of the most important works on the classification of legal doctrine,[105] cautioned that "we must renounce extravagant expectations as to what may be accomplished through classification of law."[106] Even more than in Pound's era, modern lawyers and legal scholars understand that classification can be misleading and that the determination of legal results ultimately rests on judgment, not classification. Nevertheless, doctrinal classification is a central activity of the law. This Article concludes that legal argument, analysis, and decision can be improved by reformulating the current classification of contract and tort law to recognize economic negligence as a new field of law.

105. Roscoe Pound, *Classification of Law*, 37 HARV. L. REV. 933, 944 (1924) (*emphasis omitted*).
106. *Id.* at 938.