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## Recovery of Economic Damages in Products Liability Actions and the Reemergence of Contractual Remedies

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# RECOVERY OF ECONOMIC DAMAGES IN PRODUCTS LIABILITY ACTIONS AND THE REEMERGENCE OF CONTRACTUAL REMEDIES

Michael E. Solimine\*

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## I. INTRODUCTION

Traditionally, businesses selling products to other companies operated comfortably within the purported distinction between contract and tort law.<sup>1</sup> The agreement between the parties typically served as the sole source of their respective obligations, as supplemented by the Uniform Sales Act or the superceding Uniform Commercial Code (U.C.C.). Thus, warranties concerning the product could be identified or disclaimed, and remedies for a malfunctioning product could be limited by or liquidated in the contract. Plaintiffs had to be in privity with defendants to bring suit, and damages were usually limited to replacement or repair of the product itself. Recovery of any consequential damages (such as lost profits) were limited to those contemplated by the parties or which were the foreseeable result of a breach of the agree-

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1. See W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER & KEETON ON TORTS § 92 (5th ed. 1984) [hereinafter PROSSER & KEETON ON TORTS] (discussing common law distinctions between recovery under tort and contract law).

ment.<sup>2</sup> Tort liability, with its notions of duty imposed by law, proximate cause, and compensatory damages, had little if any relevance to this scheme.

In contrast, businesses in the consumer product market after the second World War were increasingly faced with court decisions limiting or eliminating barriers to contract or warranty suits for personal injuries resulting from use of the product. Eventually, contractual remedies were superceded entirely by tort causes of action sounding in negligence and strict liability.<sup>3</sup> Indeed, the apparent reluctance of courts to apply tort law to suits for damage to the product itself, or consequential, non-personal injury (usually characterized as "economic") damages flowing therefrom, was often thought anomalous in light of these developments.<sup>4</sup> Over two decades ago, courts finally began to address the issue.

The leading cases on this point were decided within four months of each other in 1965. In the first, *Santor v. A & M Karagheusian, Inc.*,<sup>5</sup> the New Jersey Supreme Court held that a buyer of defective carpeting could recover in strict liability for damage to the product itself. In contrast, the California Supreme Court in *Seely v. White Motor Co.*,<sup>6</sup> held that the U.C.C., not tort law, provided the sole means of recovery for a plaintiff suffering monetary loss from replacement of a malfunctioning truck and loss of profits. The *Seely* approach has been adopted by most jurisdictions,<sup>7</sup> and it was recently followed by the United States Supreme Court in *East River Steamship Corp. v. Transamerica Delaval, Inc.*,<sup>8</sup> an admiralty case where the Court was formulating a "common law" for use by federal courts in that context.

These developments have important implications for transactions between sophisticated parties. On the one hand, most businesses in commercial disputes involving products will be free from the spectre of tort suits, and need only be concerned with the application of and defenses under the U.C.C.

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2. This rule is derived from the famous case of *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854). *Hadley* has "won universal acceptance in the common law world." J. CALAMARI & J. PERILLO, *LAW OF CONTRACTS* 523 (2d ed. 1977). As Professor Farnsworth notes, the "result [of *Hadley*] was to impose a more severe limitation on the recovery of damages for breach of contract than that applicable to actions in tort or for breach of warranty, in which substantial or proximate cause is the test." E. FARNSWORTH, *CONTRACTS* § 12.14, at 875 (1982) (footnote omitted).

3. See generally PROSSER & KEETON ON TORTS, *supra* note 1, ch. 17.

4. See Edmeades, *The Citadel Stands: The Recovery of Economic Loss in American Products Liability*, 27 CASE W. RES. L. REV. 647, 648 (1977); Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN L. REV. 1513, 1513-14 (1985).

5. 44 N.J. 52, 207 A.2d 305 (1965) (discussed *infra* text accompanying note 14).

6. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965) (en banc) (discussed *infra* notes 15-22 and accompanying text).

7. For a listing of jurisdictions, see *infra* note 24.

8. 106 S. Ct. 2295 (1986).

But disgruntled plaintiffs, seeking the benefit of tort causes of action, will undoubtedly seek to circumvent the U.C.C. by contending that the U.C.C. should not apply at all. Moreover, it follows that the benefits of *Seely* will probably only be visited upon disputes *not* involving ordinary consumers who, to the extent they suffer economic loss, will still have the full panoply of U.C.C. and tort weapons at their disposal.

This article will address the twenty-year debate between the *Santor* and *Seely* approaches, and explore the reasons for the seeming triumph of the *Seely* doctrine. The Supreme Court's decision in *East River* will be addressed, followed by a discussion of cases and commentary which now appear to have largely resolved the debate in favor of *Seely*. This resolution is defended on the basis of sound contractual and economic theory, with the suggestion that appropriate use of contractual language can largely moot the issue.

## II. THE *Santor-Seely* DEBATE AND ITS AFTERMATH

Before embarking on a brief exploration of *Santor* and *Seely*, and their progeny, two parameters are in order concerning the definition of "economic damages" and the field of "products liability" as compared to other areas of tort law.

First, the lines between personal injury, economic loss, and property damage are not always easy to draw but are nevertheless manageable. In the "paradigmatic products liability action" resulting in bodily injury to a consumer, the product itself, typically owned by the consumer, is usually damaged or destroyed. But such damage rarely becomes an issue in such products cases, presumably due to the relatively small monetary amount of such damage and its coverage by insurance.<sup>10</sup> Economic loss covers damages broader than that resulting immediately from the tortious event. Thus, such damages will typically include "direct" economic loss (e.g., deterioration or internal breakage of the product, loss of the bargain, costs of replacement and repair) and "consequential" loss (e.g., lost profits). Property damage usually refers to physical damage to property, other than the product itself (the latter being designated as a direct economic loss).<sup>11</sup>

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9. *Id.* at 2300.

10. Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 957 (1966).

11. *Id.* at 918. Courts have usually applied these remedial distinctions in the relevant cases. *E.g.*, *East River*, 106 S. Ct. at 2300; *Spring Motors Distrib. v. Ford Motor Co.*, 98 N.J. 555, 566, 489 A.2d 660, 665 (1985). This is not to deny that the lines are sometimes blurred. Ribstein, *Guidelines for Deciding Product Economic Loss Cases*, 29 MERCER L. REV. 493, 498-500 (1983); Note, *Manufacturers' Liability to Remote Purchasers for "Economic Loss" Damages—Tort or Contract?*, 114 U. PA. L. REV. 539, 548 n.54 (1966) [hereinafter Penn. Note]; Note, *Privity Revisited: Tort Recovery by a Commercial Buyer for a Defective Product's Self-Inflicted Dam-*

Second, the question of recovery of such damages in products cases should be differentiated from the related issue of recovery of economic loss in the non-products (typically negligence) context. While much of the caselaw denies recovery in such contexts,<sup>12</sup> it nevertheless concerns policies largely

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age, 84 MICH. L. REV. 517, 518 & n.10 (1985) [hereinafter Michigan Note]; see *infra* note 39.

One authority sums up the distinction as follows:

The distinction between "property damage" and "economic loss" is not always a clear one. Although there is little difficulty when a product causes physical damage to other property (property damage) or when the only damage is loss of use of the product itself or other consequential economic losses (economic loss), substantial difficulties arise when there is "damage" to the product itself. The most common approach is to treat damage to the product itself as "property damage" when it results from a sudden calamitous occurrence or accident which could endanger people or other property, but to treat such damage as "economic loss" when it does not result from such an accident.

Gaebler, *Negligence, Economic Loss, and the U.C.C.*, 61 IND. L.J. 593, 595 n.8 (1986).

A less confusing term might be "commercial loss," as used in the Product Liability Reform Act, S. 2760, 99th Cong., 2d Sess. (1986). The Act defined that term as "economic injury, whether direct, incidental, or consequential, including property damage and damage to the product itself, incurred by persons regularly engaged in business activities consisting of providing goods and services for compensation." *Id.* § 102(a)(5); cf. *id.* § 102(a)(7) (defining "economic loss" as "pecuniary loss" subject to empirical measurement and confirmation). For further discussion of the Act, see *infra* note 28.

12. See generally Rabin, *supra* note 4; Schwartz, *Economic Loss in American Tort Law: The Example of J'Aire and of Products Liability*, 23 SAN DIEGO L. REV. 37 (1986). Most courts explicitly observe the distinction between products and non-products cases, e.g., *East River*, 106 S. Ct. at 2302 n.6; *Spring Motors Distrib. v. Ford Motor Co.*, 98 N.J. 555, 576-77, 489 A.2d 660, 671 (1985), while other cases observe it silently, e.g., *People Express Airlines v. Consolidated Rail Corp.*, 100 N.J. 246, 495 A.2d 107 (1985) (permitting, in certain circumstances, recovery of economic loss for negligent conduct, with no discussion of *Seely* or *Santor*); *J'Aire Corp. v. Gregory*, 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979) (same). Still other courts apparently ignore the distinction and discuss recovery of economic loss in strict products liability and negligence cases together. See Gaebler, *supra* note 11, at 597-98. Nevertheless, some authorities insist that these two lines of cases should be treated as one. See *Golden Eagle Distributing Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1535 (9th Cir. 1986) (assuming, for purposes of reviewing sanctions imposed under FED. R. CIV. P. 11, that the holding in *J'Aire* was "adverse" to that in *Seely*); Note, *Warranty Law Revived by the East River Treatment: The Basis of the Bargain Redefined*, 1986 COLUM. BUS. L. REV. 201, 204 n.7 (citing *J'Aire* as "overruling" *Seely*).

One commentator, an advocate of the *Santor* line of cases, acknowledges this lack of cross-citation but vigorously argues that the apparent trend toward permitting recovery of economic loss in non-products torts cases should inform the *Seely-Santor* debate. R. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS 57-69 (2d ed. 1978 & Supp. 1985). His argument is unconvincing, primarily because he fails to appreciate the unique policies (e.g., strict liability) which underlie the products cases and gen-

outside of the products field and is beyond the scope of this discussion.

With these guidelines in mind, we next turn to both the antecedents and progeny of *Santor* and *Seely*. In this century, the growth of tort law for personal injury actions was spurred by the fall of the privity barrier and the judicial imposition of strict liability against manufacturers. These developments also held true for actions for damage to a product itself. However, recovery for economic loss (particularly consequential loss) was almost always left to contractual remedies, sounding in breach of express representations, or breach of warranty under statute. Tort actions for such damages were typically not permitted, except for cases involving fraud or interference with contractual relations.<sup>13</sup>

So stood the law when *Santor* and *Seely* were decided. *Santor* involved an action for direct economic damages from defective carpeting. The court permitted the plaintiff to recover damages to the carpet under either an implied warranty theory or strict liability, holding that use of those doctrines was not limited to cases involving the dangerousness of a defective product to humans.<sup>14</sup>

Shortly thereafter, the California Supreme court in *Seely* rejected the *Santor* approach and severely limited a plaintiff's ability to recover economic loss in tort actions. *Seely* concerned a truck that suffered from "galloping" and other apparent defects in manufacture. The plaintiff sued the manufacturer for breach of express warranty, and in negligence and strict liability. In an opinion written by Justice Traynor, the guru of strict products liability,<sup>15</sup> the court permitted recovery of lost profits for breach of express warranties.<sup>16</sup> In lengthy dicta, however, the court rejected recovery under tort theories for such damages. Initially, Traynor asserted that strict liability had not been developed to swallow warranty law or the U.C.C., but only "to govern the distinct problem of physical injuries" to persons.<sup>17</sup> Warranty rules, he argued, were appropriate for and functioned well in the commercial setting.<sup>18</sup> Expressly disagreeing with *Santor*, Traynor stated that the use of strict liability did not depend on the "luck" of receiving personal as opposed

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erally have no application in the non-products field. See *Spring Motors*, 98 N.J. 555, 489 A.2d 660. Of course, the two lines of cases would seem easy to differentiate, since it will be immediately obvious in most instances whether or not a product is involved.

13. The summary of law in this paragraph is well developed at much greater length in Note, *supra* note 10, at 919-42. See also PROSSER & KEETON ON TORTS, *supra* note 1, § 101, at 708-09.

14. 44 N.J. at 60, 207 A.2d at 309.

15. So characterized due to his pathbreaking opinion advocating use of strict liability in products actions by consumers. See *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

16. 63 Cal. 2d at 14, 403 P.2d at 148.

17. *Id.* at 15, 403 P.2d at 149.

18. *Id.* at 16, 403 P.2d at 149-50.

to economic injury. Rather, he continued, the distinction rested "on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products."<sup>19</sup> The policies that underlie strict products liability—compensation for misfortune and loss spreading by the manufacturer among customers—were not appropriate when only "business needs" of a buyer were not met.<sup>20</sup> Justice Peters dissented from the latter portion of Traynor's decision. Echoing *Santor*, he contended that products liability law should apply to *all* types of damages, and that the record did not demonstrate that the transaction involved was truly "commercial" in nature.<sup>21</sup> Policies in favor of strict liability in the "consumer" setting applied equally well, he felt, in the commercial setting where the buyer was an "ordinary consumer" who, at the end of the retailing chain, lacked any bargaining power.<sup>22</sup>

While a few states have followed *Santor*,<sup>23</sup> the overwhelming majority of jurisdictions have adopted the *Seely* doctrine of denying recovery for economic loss under tort in products cases.<sup>24</sup> In an apparent attempt at

19. *Id.* at 18, 403 P.2d at 151.

20. *Id.* at 19, 403 P.2d at 151.

21. *Id.* at 27-28, 403 P.2d at 156-57 (Peters, J., concurring and dissenting).

22. *Id.* at 28, 403 P.2d at 157.

23. Apparently, only four decisions have explicitly followed *Santor*. See *City of LaCrosse v. Schubert, Schroeder & Assocs.*, 72 Wis. 2d 38, 240 N.W.2d 124 (1976); *Cova v. Harley-Davidson Motor Co.*, 26 Mich. App. 602, 182 N.W.2d 800 (1970); *Iacono v. Anderson Concrete Corp.*, 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975); *Berkeley Pump Co. v. Reed-Joseph Land Co.*, 279 Ark. 384, 653 S.W.2d 130 (1983).

24. See *Sharp Brothers Contracting Co. v. American Hoist & Derrick Co.*, 703 S.W.2d 901 (Mo. 1986); *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*, 626 F.2d 280 (3d Cir. 1980) (Pennsylvania law); *Hagert v. Hatton Commodities*, 350 N.W.2d 591 (N.D. 1984); *Monsanto Agricultural Prods. Co. v. Edenfield*, 426 So. 2d 574 (Fla. Dist. Ct. App. 1982); *Schiavone Constr. Co. v. Elgood Mayo Corp.*, 56 N.Y.2d 667, 436 N.E.2d 1322, 451 N.Y.S.2d 720 (1982) (summarily reversing on basis of dissent below which follows *Seely*. 81 A.D.2d 221, 227-34, 439 N.Y.S.2d 933, 937-40 (1981) (Silverman, J., dissenting)); *Arrow Leasing Corp. v. Cummins Arizona Diesel*, 136 Ariz. 444, 666 P.2d 544 (1983); *Iowa Elec. Light & Power Co. v. Allis-Chalmers Mfg. Co.*, 360 F. Supp. 25 (S.D. Iowa 1973) (Iowa law); *Hiigel v. General Motors Corp.*, 190 Colo. 57, 544 P.2d 983 (1975); *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 435 N.E.2d 443 (1982); *Price v. Gatlin*, 241 Ore. 315, 405 P.2d 502 (1965); *Nobility Homes v. Shivers*, 557 S.W.2d 77 (Tex. 1977); *2000 Watermark Ass'n v. Celotex Corp.*, 784 F.2d 1183 (4th Cir. 1986) (South Carolina law); *Sanco, Inc. v. Ford Motor Co.*, 771 F.2d 1081 (7th Cir. 1985) (Indiana law); *Clark v. International Harvester Co.*, 99 Idaho 326, 581 P.2d 784 (1978); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159 (Minn. 1981); *National Crane Corp. v. Ohio Steel Tube Co.*, 213 Neb. 782, 332 N.W.2d 39 (1983); *Local Joint Executive Bd. v. Stern*, 98 Nev. 409, 651 P.2d 637 (1982); *Star Furniture Co. v. Pulaski Furniture Co.*, 297 S.E.2d 854 (W. Va. 1982); *Copiers Typewriters Calculators, Inc. v. Toshiba Corp.*, 576 F. Supp. 312 (D. Md. 1983) (Maryland law); *Cargill, Inc. v. Products Eng'g Co.*, 627 F. Supp. 1492, 1495 (D. Minn. 1986) (Wash-

compromise, some states have charted an intermediate approach, generally following *Seely* but adopting *Santor* when the tortious event could or did endanger the persons of disappointed users. Such determinations depend on the nature of the product defect, the type of risk, and the manner in which the injury arose.<sup>25</sup> The commentators are somewhat divided as well, though most seem to applaud the *Santor* doctrine or at least Justice Peters' approach in *Seely*.<sup>26</sup>

### III. THE FEDERAL COMMON LAW RESPONSE: *East River*

The *Santor-Seely* debate has been left to be resolved wholly to the caselaw, since neither the U.C.C. nor the appropriate provisions of the Restatement of Torts address the issue.<sup>27</sup> Nor does federal legislation appear to

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ington law) (dicta).

In some states, the caselaw still yields no definitive answer. *See, e.g.,* Mead Corp. v. Allendale Mutual Ins. Co., 465 F. Supp. 355 (N.D. Ohio 1979) (Ohio law permits recovery for economic loss in strict liability but not in negligence). *But see* Cincinnati Gas & Elec. Co. v. General Elec. Co., No. C-1-84-988 (S.D. Ohio Sept. 4, 1986) (unpublished decision located on WESTLAW, DCT database) (adopts *Seely* approach, citing the *East River* decision) [hereinafter *Cincinnati Gas*]. *See generally* R. DUNN, *supra* note 12, at 58-68, for a review of the cases, some of which appear to conflict even within a state. Part of the seeming inconsistency can be explained by the distinction between products liability cases and general negligence cases. *See supra* note 12.

25. *See* Russell v. Ford Motor Co., 281 Ore. 587, 575 P.2d 1383 (1978); Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165 (3d Cir. 1981) (Pennsylvania law); Northern Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324 (Alaska 1981); Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, 306 S.E.2d 253 (1983). *See generally* East River S.S. Corp. v. Transamerica Delaval, 106 S.Ct. 2295, 2301-02 (1986).

26. For approval of *Seely*, see Schwartz, *supra* note 12; Speidel, *Products Liability, Economic Loss, and the U.C.C.*, 40 TENN. L. REV. 309 (1973); Wade, *Tort Liability for Products Causing Physical Injury and Article 2 of the U.C.C.*, 48 Mo. L. REV. 1, 26 n.87 (1983); Manuel & Richards, *Economic Loss in Strict Liability — Beyond the Realm of 402A*, 16 MEMPHIS ST. U. L. REV. 315 (1986); Gaebler, *supra* note 11, at 620-27; PROSSER & KEETON ON TORTS, *supra* note 1, § 101, at 708-09; Note, *supra* note 10; Penn. Note, *supra* note 11; Michigan Note, *supra* note 11.

For approval of *Santor*, see Shapo, *A Representational Theory of Consumer Protection: Doctrine, Function and Legal Liability for Product Disappointment*, 60 VA. L. REV. 1104, 1270-73 (1974); Ribstein, *supra* note 11; Edmeades, *supra* note 4; *see also infra* notes 68-77 (discussing economic literature on the subject).

27. As correctly observed by the Supreme Court in *East River*, 106 S. Ct. at 2300 n.3, the authoritative RESTATEMENT (SECOND) OF TORTS § 402A (1965), outlining strict liability, simply does not address the issue. It is worth noting, however, that both Professor Prosser, *see* Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1134 (1960) and the Reporter for the Second Restatement, Wade, *supra* note 26, support the *Seely* approach. In addition, the U.C.C. warranty provisions do not address the issue. *See* Wade, *supra* note 26; Spring Motors Distrib. v. Ford Motor Co., 98 N.J. 555, 570, 489 A.2d 660, 668 (1985).



be the answer in the near term.<sup>28</sup> Recently, the United States Supreme Court, applying its little used common law powers,<sup>29</sup> undertook in *East River* to review the debate in the context of admiralty law and essentially adopted the *Seely* approach. Despite the relatively narrow context in which it arose, *East River* is worthy of notice given the depth of treatment devoted to the subject and the likelihood that its reasoning will prove persuasive to state courts.

*East River* was a suit between companies that, respectively, built and purchased turbines for installation on four super-tankers. Eventually, the turbines malfunctioned, damaged themselves, and had to be replaced; one malfunction occurred at sea during a storm off Alaska. The purchasers filed suit under admiralty jurisdiction in federal district court, alleging that the defendant manufacturer was strictly liable for defective design of the turbines, and liable (for one of the ships) for negligent supervision of the repair

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28. A variety of bills were introduced in the 99th Congress in an effort to "solve" the perceived liability "crisis." See generally Birnbaum, *Tort Reform Proposals Analyzed*, NAT'L L.J., June 23, 1986, at 15, col. 1. Several of the bills would have excluded recovery for economic loss in products liability actions, but none were passed by the 99th Congress. *East River*, 106 S. Ct. at 2300 n.3 (listing bills pending in Congress at the time of the decision).

The only "tort reform" bill to be reported out of a committee was the Product Liability Reform Act, S. 2760, 99th Cong., 2d Sess. (1986). However, that bill never reached a vote on the Senate floor before the 99th Congress adjourned. Nevertheless, some provisions of this bill are relevant to this article. After defining "commercial loss" in section 102(a)(5) (see *supra* note 11), the bill excluded recovery of such loss from the coverage of the Act. S. 2760, 99th Cong., 2d Sess. § 102(a)(9) (1986) (defining "harm" as personal injury). The Act preempted, under the Commerce Clause, certain aspects of state tort law and set out uniform standards of products liability to apply in federal and state courts. But according to the legislative history, a "civil action for commercial loss is not subject to this bill and is to be governed by applicable commercial or contract law." S. REP. NO. 422, 99th Cong., 2d Sess. 21 (1986). This report, which accompanied S. 2760, went on to cite and favorably discuss *Seely* and the Supreme Court's decision in *East River*, S. REP. NO. 422, at 24, and concluded that "recovery for [commercial] losses is left to commercial law and the Uniform Commercial Code. These losses are, in essence, contract damages and not tort damages. They arise in the course of commercial dealings and can be resolved through contracts and claims based on those contracts." S. REP. NO. 422, at 24 (footnotes omitted). This analysis is, of course, consistent with that developed in this article.

29. The federal courts' common law powers, greatly circumscribed by *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), now are generally limited to admiralty cases and, in certain cases, to filling the interstices of federal statutes and rules. See generally Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 881 (1986); Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1 (1985). It has already been suggested that *East River* will have persuasive force in state and federal courts outside of the admiralty context. See Note, *supra* note 12, at 201-02 n.4; Smith, Greene & Okun, *High Court Ruling Could Facilitate Summary Disposition of Tort Claims*, NAT'L L.J., Feb. 9, 1987, at 26-27; see, e.g., *Cincinnati Gas*, *supra* note 24.

of the turbines. Damages in the form of repair costs and lost income were sought.<sup>30</sup> Suit was brought in tort alone, as breach of contract and warranty claims were voluntarily dismissed when a statute of limitations defense was interposed.<sup>31</sup> The district court granted summary judgment to the defendant, a decision affirmed by the Third Circuit sitting *en banc*, which applied the "intermediate" approach described above.<sup>32</sup>

The Supreme Court affirmed the lower courts, in a unanimous decision authored by Justice Blackmun. The first sentence of the opinion squarely presented the issue and, as we shall see, charted some limits to the scope of the decision: "[W]e must decide whether a cause of action in tort is stated when a defective product purchased in a commercial transaction malfunctions, injuring only the product itself and causing purely economic loss."<sup>33</sup> After confirming the trend in the lower courts to incorporate concepts of products liability predicated both on strict liability and negligence in admiralty cases,<sup>34</sup> the Court turned to the *Santor-Seely* debate at common law.

Initially, the Court discussed the development of products liability caselaw. This caselaw, the Court observed, "grew out of a public policy judgment that people need more protection from dangerous products than is afforded by the law of warranty."<sup>35</sup> But the Court continued "if this development were allowed to progress too far, contract law would drown in a sea of tort."<sup>36</sup> "The paradigmatic products liability action," the Court stated, for bodily injury from a defective product can now proceed against the manufacturer of the product without privity and with the benefit of strict liability.<sup>37</sup> These doctrines have been extended to property damage aside from the product itself.<sup>38</sup> The present question was "whether injury to a product itself may be brought in tort."<sup>39</sup>

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30. 106 S. Ct. at 2296-97.

31. *Id.* at 2297.

32. 752 F.2d 903 (3d Cir. 1985) (*en banc*), *aff'd*, 106 S. Ct. 2295 (1986). The "intermediate" test is described *supra* note 25 and accompanying text.

33. 106 S. Ct. at 2296.

34. *Id.* at 2299.

35. *Id.* at 2299-2300 (citing *Seely v. White Motor Co.*, 63 Cal. 2d 9, 15, 403 P.2d 145, 149, 45 Cal. Rptr. 17, 21 (1965) (*en banc*)).

36. *Id.* at 2300 (citing G. GILMORE, *THE DEATH OF CONTRACT* 87-94 (1974)).

37. *Id.* (citing *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 461-62, 150 P.2d 436, 440 (1944) (Traynor, J., concurring) and *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 389, 111 N.E. 1050, 1053 (1916) (Cardozo, J.)).

38. *Id.*

39. *Id.* Strictly speaking, the *East River* decision concerned damage to the turbines themselves (i.e., property damage, see *supra* notes 9-11 and accompanying text), not other forms of direct or consequential loss. See *supra* text accompanying note 33. Indeed, the Court purported to "not reach the issue whether a tort cause of action can ever be stated in admiralty when the only damages sought are economic." 106 S. Ct. at 2302 n.6. Clearly, though, the court's reasoning applies to the whole range of economic loss, as that term is broadly defined, sought in products actions. See, e.g., *infra* text accompanying note 42.

After reviewing the *Seely*, *Santor*, and intermediate approaches,<sup>40</sup> the Court answered the question in the negative. The intermediate approach was found “unsatisfactory” since it “turns on the degree of risk [and is] too indeterminate to enable manufacturers easily to structure their business behavior.”<sup>41</sup> Even when the damage-causing event is “accident-like,” the Court continued, “the resulting loss due to repair costs, decreased value, and lost profits is essentially the failure of the purchaser to receive the benefit of its bargain—traditionally the core concern of contract law.”<sup>42</sup> The Court rejected the minority approach because it failed to separate products liability and contract law and failed “to maintain a realistic limitation on damages.”<sup>43</sup> Thus, the Court adopted “an approach similar to *Seely*” and held that, in admiralty actions, “a manufacturer in a commercial relationship” would not be liable under either negligence or strict liability for damage to the product.<sup>44</sup> Acknowledging “legitimate questions” about “restricting products liability” in this manner,<sup>45</sup> the Court then addressed the arguments against its approach. Invoking *Seely*, the Court observed the “tort concern with safety” is considerably lessened when economic loss is involved.<sup>46</sup> These losses can be insured by a contracting party, and recovery of such losses is already provided for through U.C.C. warranties.<sup>47</sup> Particularly in the commercial context, “generally [not involving] large disparities in bargaining power,” the parties should be left to the risks they have allocated in their contract.<sup>48</sup> The Court pointed out that economic loss is best characterized as “expectation damages” or “benefit of the bargain,” the traditional contract remedies.<sup>49</sup>

Finally, the Court asserted that warranty actions have “built-in limitation[s] on liability” (such as the privity requirement and the foreseeability of consequential damages rule), while no such limitations are available in

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40. 106 S. Ct. at 2301.

41. *Id.* at 2302.

42. *Id.* (citing E. FARNSWORTH, *supra* note 2, § 12.8, at 839-40).

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.* at 2302-03 (citing U.C.C. §§ 2-313, 2-314, 2-315 (1977)); *cf.* Michigan Note, *supra* note 11, at 520 n.30 (studies indicate that products liability insurance can be obtained at a cost of about 1% of sales). At this point, the Court also stated that the “increased cost to the public that would result from holding a manufacturer liable in tort for injury to the product itself is not justified.” *East River*, 106 S. Ct. at 2302 (citing *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947) (L. Hand, J.)).

48. *Id.* at 2303 (citing *Henningsen v. Bloomfield Motors*, 32 N.J. 358, 161 A.2d 69 (1960)).

49. *Id.* at 2303 & n.9 (citing, *inter alia*, R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.8 (3d ed. 1986) and *Hawkins v. McGee*, 84 N.H. 114, 146 A. 641 (1929) (the “hairy hand” case)).

tort.<sup>50</sup> Permitting tort claims “for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums.”<sup>51</sup> Accordingly, “both the nature of the injury and the resulting damages” makes the warranty, not tort, remedy appropriate.<sup>52</sup>

Several characteristics of the *East River* decision serve as powerful predictors of the potential influence the opinion may have on the development of the caselaw in the states. The first is the scholarly quality of the opinion, carefully developing at length the arguments in favor of *Seely* and refuting opposing rationale. With its frequent reference to leading cases in both tort and contract,<sup>53</sup> *East River* can literally serve as a textbook example of a court’s struggle with the *Santor-Seely* dichotomy.

Equally noteworthy is the Court’s explicit reference to economic analysis. Judge Frank Easterbrook recently has suggested that the Supreme Court is more sophisticated in its use of economic reasoning than at any prior period.<sup>54</sup> This sophistication, he contends, is demonstrated by *ex ante* perspectives as opposed to *ex post*, “fairness” arguments,<sup>55</sup> and by reference to incentive and marginal effects.<sup>56</sup> These factors received full attention in *East River*: the Court referred to the burden upon manufacturers if the *Santor* rule were adopted in the commercial setting,<sup>57</sup> and stated that the increased cost to the public (passed along by manufacturers) of the *Santor* rule was not outweighed by the benefits of the rule.<sup>58</sup> The Court added that the risk of economic loss,

50. *Id.* at 2303-04 (citing, *inter alia*, *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854)).

51. *Id.* at 2304.

52. *Id.* at 2303.

53. *See, e.g.*, *Henningsen v. Bloomfield Motors*, 32 N.J. 358, 161 A.2d 69 (1960); *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 150 P.2d 436 (1944) (Traynor, J., concurring); *Hawkins v. McGee*, 84 N.H. 114, 146 A. 641 (1929); *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 111 N.E. 1050 (1916) (Cardozo, J.); *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854).

54. Easterbrook, *The Supreme Court, 1983 Term—Foreward: The Court and the Economic System*, 98 HARV. L. REV. 4, 4-5 (1984). As an example of the Court’s prior unsophistication, Judge Easterbrook referred to *Pope & Talbot, Inc. v. Hawn*, 346 U.S. 406, 409 (1953), where the Court held, with only vague references to “fairness,” that contributory negligence would not be incorporated into the common law of admiralty. Easterbrook, *supra*, at 29-30. In *East River*, the Court made one reference to *Pope* as authority for its power to exercise “traditional discretion in admiralty.” 106 S. Ct. at 2302. Of course, Judge Easterbrook’s view of what the Court is or should be doing with economic analysis has not gone unchallenged. *See Tribe, Constitutional Calculus: Equal Justice or Economic Efficiency?*, 98 HARV. L. REV. 592 (1985).

55. Easterbrook, *supra* note 54, at 10-11.

56. *Id.* at 12-14.

57. 106 S. Ct. at 2302, 2304; *see supra* notes 41, 49, and accompanying text.

58. 106 S. Ct. at 2302; *see supra* note 45. The Court cited *The Carroll Towing* case where Judge Learned Hand set forth his famous mathematical formula for

allocated as a matter of law by tort principles, was better allocated by the parties in their contracts in the commercial setting.<sup>59</sup> Thus, the Court seemed to be explicitly adopting what in its mind was an efficient rule to govern this apparent clash between policies of tort and contract law. Though not denominated as such, this reasoning is clearly modern economic analysis, not mere pleas to justice or fairness.

*East River* clearly limited its adoption of the *Seely* rule to those cases involving economic loss<sup>60</sup> flowing from commercial transactions between businesses, or at least individuals of some business sophistication; the Court's frequent reference to the virtues of the contractual relationship admits of no other conclusion. But the caselaw among the states in this regard is not so clear.<sup>61</sup> It is that caselaw, as well as an analysis of the validity of the *Seely* rule, to which we now turn.

#### IV. THE DEBATE'S RESOLUTION: CONTRACTUAL REASONING AND ECONOMIC ANALYSIS

*East River* correctly resolved the *Santor-Seely* debate in favor of the majority rule, and it can and should serve as a model for those states that

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determining the existence of negligence. *East River*, 106 S. Ct. at 2302. Judge Hand stated that a defendant was negligent if, and only if, the probability of an accident occurring, multiplied by the gravity of resulting damage, is greater than the burden of taking adequate precautions against the accident taking place. *United State v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947). Judge Richard Posner, among others, has advanced the *Carroll Towing* formula as leading to an efficient economic result. See R. POSNER, *supra* note 49, § 6.1.

59. 106 S. Ct. at 2303; see *supra* notes 46-47 and accompanying text. It is also noteworthy that the Court cited at this point the 1986 edition of Judge Posner's *ECONOMIC ANALYSIS OF LAW*, the leading text in the field which espouses the positive analysis of law and economics, a field largely headquartered at the University of Chicago and led by Posner while he was a professor of law there. See L. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 693 (2d ed. 1985).

It is perhaps not surprising that the Court referred to such analysis, given its explicit (e.g., Gerhart, *The Supreme Court and Antitrust Analysis: The (Near) Triumph of the Chicago School*, 1982 SUP. CT. REV. 319) or implicit (e.g., Easterbrook, *supra* note 54) economic analysis in recent terms. *East River* demonstrates that reports of the death of the law and economics movement are greatly exaggerated. Cf. Barnett, Book Review, 97 HARV. L. REV. 1223, 1233-34 (1984) (arguing that the movement has been in an intellectual decline in the 1980s).

60. While the Court spoke in terms of a malfunctioning product, "injuring only the product itself and causing purely economic loss," 106 S. Ct. at 2296, it would seem to follow that in a bifurcated case involving *both* personal injury and economic loss, the former could be governed by strict liability principles while the latter could be determined under warranty law. See Schwartz, *supra* note 12, at 74; *Seely v. White Motor Co.*, 63 Cal. 2d 9, 18, 403 P.2d 145, 151, 45 Cal. Rptr. 17, 23 (1965) (en banc). But see R. DUNN, *supra* note 12, at 63-64 (suggesting that in such circumstances entirety of case would be governed by strict liability).

61. Dunn correctly observes that some of the cases which purport to follow *Seely* are, nevertheless, unclear as to what is precisely meant by a "commercial setting" or the impact, if any, on negligence actions in general. R. DUNN, *supra* note 12, at 65-66.

have not yet decided the issue. As observed by the Supreme Court, both the nature of the injury and the resulting damage in a products liability case causing economic loss lend themselves to contractual and warranty remedies, not to resolution in tort.<sup>62</sup> Admittedly, the *Santor* position has some intuitive appeal: why should strict liability not apply simply because of the "luck" of the type of damage? Why should a manufacturer be "rewarded" when, fortuitously, its defective product only caused economic loss? These apparent calls for "fairness" ignore the underlying purposes of contract, particularly the U.C.C., law and tort, particularly strict liability, law. The term "products liability" has no talismanic significance. It should first be determined how the product reached the user's hands and what type of damage it caused. If only economic loss is caused, then the policy arguments in favor of strict liability for a consumer are considerably lessened. The arguments are entirely washed away if a typical consumer, with little bargaining power, is not involved, but rather businesses or business persons are parties to the transactions. The risk of loss can be insured or appropriately contracted for, as the parties see fit. On the other hand, a typical consumer will not have such tools at his or her disposal, and such a plaintiff should be permitted to recover property damage or economic loss through strict liability. Of course, simply as a matter of definition, it would seem that typical consumers will rarely suffer economic loss, other than damage to the product itself. The *East River* court also correctly rejected the "inter-mediate" approach between *Santor* and *Seely*.<sup>63</sup> That approach has the virtue of compromise, but the detriment of indeterminacy. Courts need to engage in difficult line-drawing to determine when an accident which caused only economic loss nevertheless was a life-endangering event.<sup>64</sup> Moreover, the line-drawing is unnecessary since the two benchmarks suggested by *East River*—the commercial nature of the transaction and the type of damage—are far easier to measure objectively. They also better serve the interests of contract and warranty law supported by *Seely* and its progeny.

It is not without some irony or significance that the New Jersey Supreme Court has recently retreated from a broad interpretation of *Santor*. In *Spring Motors Distributors, Inc. v. Ford Motor Co.*,<sup>65</sup> that court candidly acknowledged that *Seely* had emerged as the majority approach.<sup>66</sup> The U.C.C. should apply, the court stated, "between commercial parties with comparable bargaining power."<sup>67</sup> At the same time, however, the court eliminated any "ver-

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62. *East River*, 106 S. Ct. at 2303.

63. *Id.* at 2302.

64. The lower court decision in *East River* struggled with this line-drawing. Compare 752 F.2d at 909-10 (majority opinion) with *id.* at 913-15 (Becker, J., concurring and dissenting). The difficulty illustrated in the two opinions may have influenced the Supreme Court to discard that approach entirely. See also Schwartz, *supra* note 12, at 74-76; Michigan Note, *supra* note 11, at 523.

65. 98 N.J. 555, 489 A.2d 660 (1985).

66. *Id.* at 573-75, 489 A.2d at 669.

67. *Id.* at 576, 489 A.2d at 670.

tical privity” requirement under U.C.C. section 2-318, enabling a warranty claim to be more easily brought by a plaintiff.<sup>68</sup>

Thus, even the court that authored *Santor* now has thrown in the towel, and virtually adopted the *Seely* approach. One remaining item of possible dispute is the determination of the “commercialness” of a transaction, an issue somewhat skirted by most of the cases, including *Seely*. A concurring opinion in *Spring Motors* suggested that three factors be examined: (1) the transaction’s commercial nature, (2) the commercial experience of the parties, and (3) whether the parties had comparatively equal bargaining power.<sup>69</sup> *Seely*, on the other hand, stated that equal bargaining power was unnecessary.<sup>70</sup> It is best to leave this inquiry to case-by-case development; an objective inquiry would be ideal, but it will be virtually unavoidable for courts to examine the more subjective factors suggested by the *Spring Motors* concurrence.<sup>71</sup> Any such subjectivity, however, should be kept to a minimum lest it undermine the result of *Seely*.

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68. *Id.* at 583-89, 489 A.2d at 675-77. The Supreme Court took the opposite tack in *East River*, finding the privity barriers in the U.C.C. warranty provisions to be supportive of the narrower scope of liability in contract law. Hence, the Court determined that the more appropriate nature of contract law should serve as the basis for a remedy for economic loss. 106 S. Ct. at 2304; accord Michigan Note, *supra* note 11.

The *Spring Motors* opinion explicitly stated what *East River* appeared to assume, that is, it was far easier to prevail under strict products liability than contract law. 98 N.J. at 570, 489 A.2d at 668. Some commentators, though, think the differences are more apparent than real. See Note, *supra* note 10, at 959-64; Penn. Note, *supra* note 11, at 544-48. See generally Razook, *The Ultimate Purchaser's and Remote Seller's Guide Through the Code Defenses in Product Economic Loss Cases*, 23 AM. BUS. L.J. 85 (1985); Schwartz, *supra* note 12, at 57-70.

69. 98 N.J. at 593, 489 A.2d at 680 (Handler, J., concurring).

70. 63 Cal. 2d at 18, 403 P.2d at 151, 45 Cal. Rptr. at 23. Justice Peters dissented partially on the basis that, in his view, plaintiff *Seely* was not sufficiently involved in a “commercial” transaction and was more like a typical consumer. *Id.* at 27-28, 403 P.2d at 156-57, 45 Cal. Rptr. at 29-30.

71. Courts have examined a similar combination of objective and subjective factors in determining whether the unconscionability rule, particularly as embodied in U.C.C. § 2-302 (1977), applies in “commercial settings.” See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 4-9, at 170-73 (2d ed. 1980); cf. Michigan Note, *supra* note 11, at 538-39 n.144 (noting difficulties in distinguishing commercial buyers from consumers).

A definition utilized by the proposed federal Product Liability Reform Act, see *supra* notes 11 & 28, is a sound one. There “commercial” parties are defined as those “persons regularly engaged in business activities consisting of providing goods and services for compensation.” S. REP. No. 422, 99th Cong., 2d Sess. 21 (1986) (explaining section 102(a)(5) of the Act, which defined “commercial loss”). This inquiry is essentially objective in nature and avoids the pitfalls of a subjective determination of the parties’ “bargaining power,” as suggested by the Peters’ opinion in *Seely* and the concurring opinion in *Spring Motors*.

The *Seely* rule in general, and its limitation to a commercial setting in particular, is supported by economic analysis of contract and products liability law. Economic theory tells us that the rule of liability, whether it be strict liability, negligence, or some other, will not matter since the affected parties will achieve an efficient allocative outcome through bargaining "around" the rule in a free market.<sup>72</sup> However, this injunction carries less force in a real world of high transaction, administrative, and informational costs.<sup>73</sup> As parties to transactions (e.g., buyers of products) carry imperfect knowledge, there is more justification for imposing a rule of liability on the manufacturer.<sup>74</sup> The more informational symmetry there is between manufacturers and consumers, though, the less justification there is to discard the market solution in favor of one imposed by tort or contract law.<sup>75</sup>

Application of these principles illustrates the efficiency of the *Seely* rule. An imperfect marketplace and the typical individual consumer's lack of information about a product may justify imposition of a strict liability rule.<sup>76</sup>

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72. This result is obtained by applying the "Coase Theorem," as found in Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). It should be noted that economic efficiency is referred to in this article as only one of several normative justifications for preferring the *Seely* rule. See also *infra* note 73. For problems encountered by exclusive reliance on efficiency theories, see Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 277-83 (1986).

73. See A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 11-14 (1983); R. POSNER, *supra* note 49, ch. 2.

74. A. POLINSKY, *supra* note 73, at 95-104; R. POSNER, *supra* note 49, § 6.6; Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 3-6 (1980). See generally Landes & Posner, *A Positive Economic Analysis of Products Liability*, 14 J. LEGAL STUD. 535 (1985). (It should be noted that the latter piece, despite its title, does not explicitly address the issues raised in this article.)

75. A. KRONMAN & R. POSNER, THE ECONOMICS OF CONTRACT LAW 6 & n.6 (1979); Bishop, *The Contract-Tort Boundary and the Economics of Insurance*, 12 J. LEGAL STUD. 241, 259 (1983).

More recently, Professor Bishop has advocated moving "away from the rigid rule" in tort law generally prohibiting the recovery of pecuniary (i.e., economic) loss. Bishop & Sutton, *Efficiency and Justice in Tort Damages: The Shortcomings of the Pecuniary Loss Rule*, 15 J. LEGAL STUD. 347, 369 (1986). This thesis is not in conflict with that in the present article, since *Seely* only governs (or at least I argue *should* only govern) in the commercial setting. In any event, Bishop's articles are somewhat limited by their concentration on English cases and their failure to address the specific issues or cases cited in this article. See also Rabin, *supra* note 4, at 1535-37 & nn.72-74 (noting critically the paucity of specific economic analysis in this area).

76. See Landes & Posner, *supra* note 74. While, as outlined above, *East River* in dicta strongly supported imposition of strict liability in personal injury actions, 106 S. Ct. at 2299-2300 (a view joined by Landes & Posner, *supra* note 74, among others), this position has not gone unchallenged. Compare R. EPSTEIN, MODERN PRODUCTS LIABILITY LAW ch. 5 (1980) (critical of current caselaw on strict liability due to, among other things, interference with free market forces) and Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 15 J. LEGAL STUD. 461 (1985) (same) with Sugarman, *Doing*



However, the “commercial setting” of *Seely*, *East River*, and *Spring Motors* presupposes fairly close symmetry of knowledge and economic acumen between the manufacturer and purchaser of the product. To be sure, this model does not represent the perfect, efficient market either, but it is close enough to make the market solution (the contract negotiated by the parties) appropriate, as opposed to a tort solution imposed by law.<sup>77</sup>

The previous paragraphs have focused, in the construct of *East River*, on the “nature of the injury.”<sup>78</sup> *East River* has also asserted that the nature of the damages supported the *Seely* approach.<sup>79</sup> Expectation damages enable a business person to receive the benefit of his or her bargain (had the contract been completed); damages usually awarded in tort cases place the plaintiff in the position he or she would have been but for the accident.<sup>80</sup> To adopt the *Santor*-tort approach in a commercial setting would, incongruously, per-

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*Away with Tort Law*, 73 CALIF. L. REV. 555 (1985) (arguing that products liability law does not serve goals of compensation or deterrence and should be replaced by a no-fault compensation scheme). See generally Schwartz, *Directions in Contemporary Products Liability Scholarship*, 15 J. LEGAL STUD. 763 (1985).

One might argue that information asymmetry does not necessarily lead to the conclusion that greater liability should fall on the manufacturer of a product. Put another way, it can be argued that consumers, at relatively little cost (e.g., by reading Consumer Reports) can obtain safety information about products and that, therefore, it is more economically efficient for contractual remedies (i.e., implied or express warranties under the U.C.C.) to be applied rather than strict liability. See Danzon, *Comment on Landes and Posner*, 15 J. LEGAL STUD. 569, 571-73 (1985). The problem with this theory is that it undoubtedly takes too optimistic a view of the cost to the typical consumer of obtaining and processing such “safety” information. See Landes & Posner, *supra* note 74, at 543-44 (cost of information will be disproportionate to the benefit of a negotiated level of safety by the manufacturer, as distinct from one imposed by law).

77. See A. POLINSKY, *supra* note 73, at 25; A. KRONMAN & R. POSNER, *supra* note 75, at 4-7. One need not be an adherent of the suprarational consumer, posited by the law and economics school, in order to accept a proposition that *Seely* provides a better rule than *Santor* when, on balance, a consumer enjoys some ability to obtain and process information when purchasing a product. See Latin, *Problem-Solving Behavior and Theories of Tort Liability*, 73 CALIF. L. REV. 677, 710-13 (1985); Michigan Note, *supra* note 11, at 537-38; *East River S.S. Corp. v. Delaval Turbine*, 752 F.2d 903, 914-15 n.5 (3d Cir. 1985) (Becker, J., concurring and dissenting), *aff'd sub nom.* *East River S.S. Corp. v. Transamerica Delaval*, 106 S. Ct. 2295 (1986). For a general review and criticism of the concept of a “rational” consumer, see Harrison, *Egoism, Altruism and Market Illusions: The Limits of Law and Economics*, 33 UCLA L. REV. 1309 (1986). In circumstances of relative information symmetry between the parties, the competitive market (i.e., the contract) will likely yield the liability and/or remedy terms desired by the parties. See Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297 (1981); Schwartz & Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1386 (1983).

78. See *supra* 37-52, 59-60, and accompanying text.

79. *East River*, 106 S.Ct. at 2303.

80. *Id.* at 2303 & n.9.

mit potentially vast economic damages to be awarded.<sup>81</sup> Economic analysis supports rejection of this result. When there is some symmetry of information and bargaining power between the parties, it is efficient to allocate consequential economic damages only when they are a foreseeable or expected result of the breach of contract.<sup>82</sup> These rules carry less force in a less perfect market setting, and account for compensatory damages in tort law. Thus, cabining the damages obtainable in an economic loss case also supports adoption of the *Seely* principle.

#### IV. CONCLUSION

Most of the states that have considered the issue have resolved the *Seely-Santor* debate in favor of the former rule, a result followed by the United States Supreme Court in *East River*. This resolution is supported both by traditional doctrinal analysis as well as by newer, more sophisticated tools of economic analysis. In light of this desirable trend in the courts, a legislative solution to the debate would appear unnecessary.<sup>83</sup> As suggested above, com-

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81. *Id.* at 2304. At this point, the Court cited Perlman, *Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 61, 72 (1982). There, Professor Perlman stated that:

Economic relationships are intertwined so intimately that disruption of one may have far reaching consequences . . . . Courts facing a case of pure economic loss thus confront the potential for liability of enormous scope, with no easily marked intermediate points and no ready recourse to traditional liability-limiting devices such as intervening cause.

*Id.* (footnote omitted).

One advocate of the *Santor* approach attempts to refute this argument: "The duty of care only runs to avoidance of foreseeable risks of harm. The unlimited liability the court foresees should not happen." R. DUNN, *supra* note 12, at 63; see also *People Express Airlines v. Consolidated Rail Corp.*, 100 N.J. 246, 252-53, 495 A.2d 107, 116-18 (1985) (adopting "particular foreseeability" standard for use as proximate cause standard in negligent, non-product economic loss cases). This argument fails because it glosses over (a) the distinction between causing an injury and causing the damages resulting from the injury, and (b) the great difficulties, in economic loss cases, of limiting the foreseeability test except in arbitrary ways. See Rabin, *supra* note 4, at 1522-26, 1534-39; see also Shavell, *An Analysis of Causation and the Scope of Liability in the Law of Torts*, 9 J. LEGAL STUD. 463, 463-64 & n.9, 499-500 (1980); McDowell, *Foreseeability in Contract and Tort: The Problems of Responsibility and Remoteness*, 36 CASE W. RES. L. REV. 286 (1985); Landes & Posner, *Causation in Tort Law: An Economic Approach*, 12 J. LEGAL STUD. 109, 129 (1983).

82. This is a restatement of the famous *Hadley v. Baxendale* rule, cited by the *East River* court. 106 S. Ct. at 2304. See R. POSNER, *supra* note 49, § 4.9; Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277, 286-300 (1972); Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683 (1986).

83. See *supra* note 28. Should the subject be addressed in congressional legislation, see *supra* note 28, the *Seely* approach, as clarified in *East River* and *Spring Motors*, should be codified.

mercial parties would probably view the *Seely* approach as a salutary one, since it removes one litigation weapon from the hands of their market adversaries. It seems likely, though, that the *Seely* rule will not apply to more typical consumer plaintiffs to the extent they suffer economic loss.<sup>84</sup> Moreover, plaintiffs will attempt to circumvent the majority approach by contending that they are ordinary consumers, that the transaction was not sufficiently commercial in nature, or that the U.C.C. should not apply at all. An example of the latter argument would be the position that the contract involved, in whole or in part, the rendition of services rather than the sale of goods.<sup>85</sup> Whether businesses by use of contractual language can entirely eliminate these difficulties is problematic;<sup>86</sup> still, it seems that with more complete and detailed contracts, courts will be hard pressed to find information assymetry which would support a finding of "non-commercialness." Likewise, manufacturers should consider placing in their sales contracts not only the usual disclaimers of warranties, but limitation of remedies which refer to economic loss and other damages potentially available in a *Santor*-type lawsuit.

Nor should the mere application of the U.C.C. or contract law in general leave businesses complacent. As *Spring Motors* demonstrates, courts have

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84. Cf. Schwartz, *supra* note 12, at 61 ("The average consumer is rarely in a position to suffer consequential losses such as loss of profits . . .").

85. The coverage of the U.C.C. is restricted to contracts concerning the sale of goods worth over \$500. U.C.C. §§ 2-102, 2-106(1), 2-201(1) (1977). See generally J. WHITE & R. SUMMERS, *supra* note 70, § 2-2, at 51-52. In *Republic Steel Corp. v. Pennsylvania Eng'g Corp.*, 785 F.2d 174 (7th Cir. 1986) (applying Illinois law), the court applied *Seely* "in light of the exhaustive contract provisions" between the parties, *id.* at 184, and prior to that rejected a contention by the plaintiff that the contract was for services, not delivery of goods. *Id.* at 180-81. Presumably, the plaintiff wished to rely on general contract theories since the contract contained the usual disclaimers and limitation of remedy clauses permitted by the U.C.C. *Id.* at 183. For a discussion of how this issue has been resolved in several economic loss cases, see Gaebler, *supra* note 11, at 635-36.

86. Cf. *Republic Steel Corp. v. Pennsylvania Eng'g Corp.*, 785 F.2d 174, 181 & n.10 (7th Cir. 1986) (doubting that parties to an agreement can avoid application of the U.C.C. merely by inserting language in the agreement itself characterizing the transaction).

Another contractual method to anticipate these issues would be to place a choice-of-law provision in the contract which would apply the law of a state following the *Seely* rule. Cf. *East River*, 106 S.Ct. at 2300-01 n.3 ("The issue is of concern in the area of conflict of laws."). Whatever conflict of laws test would be applied to measure the validity of such a provision, it will likely require some connection between the transaction and the state chosen. See generally R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 369-77 (3d ed. 1986). It seems likely that any such clause in a contract between commercially sophisticated parties will be enforced. See, e.g., *Sarnoff v. American Home Prods. Corp.*, 798 F.2d 1075, 1080-82 (7th Cir. 1986) (employment contract). For an example of the successful application of such a choice-of-law provision in the present context, see *Cargill, Inc. v. Products Eng'g Co.*, 627 F. Supp. 1492, 1496 n.6 (D. Minn. 1986) (contract applied Minnesota law).

become more willing to discard the privity requirements of the U.C.C.<sup>87</sup> Some courts are even willing in certain egregious breach of contract actions to permit recovery of punitive damages, a traditional reserve of tort law.<sup>88</sup> Thus, resolution of the *Seely-Santor* debate may nevertheless spawn other issues.

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87. See *supra* note 64. See generally J. WHITE & R. SUMMERS, *supra* note 70, §§ 11-2 to 11-7; Schwartz, *supra* note 12, at 59-61; Michigan Note, *supra* note 11; see also Note, *Enforcing Manufacturers' Warranty Exclusions Against Non-Privity Commercial Purchasers: The Need for Uniform Guidelines*, 20 GA. L. REV. 461, 465-66 (1986) (growing minority of states abandoning privity requirement in warranty disputes between commercial parties).

88. See, e.g., *Brink's, Inc. v. City of New York*, 717 F.2d 700 (2d Cir. 1983) (New York law). See generally D. LAYCOCK, *MODERN AMERICAN REMEDIES* 619-21 (1985); Note, *Damage Measurements for Bad Faith Breach of Contract: An Economic Analysis*, 39 STAN. L. REV. 161 (1986).

