THE ECONOMIC LOSS RULE AND PRIVATE ORDERING

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

I. THE ECONOMIC LOSS RULE IN GENERAL

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

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

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

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

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

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

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

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

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

II. HISTORICAL BACKGROUND: THIRD-PARTY ECONOMIC LOSS

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

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

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

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

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4. *Id.* ch. 2.
5. (1842) 152 Eng. Rep. 402 (Exch.).
6. Sav. Bank v. Ward, 100 U.S. 195, 203 (1879).
7. *Id.* at 200.
8. 174 N.E. 441, 445 (N.Y. 1931).
9. 111 N.E. 1050 (N.Y. 1916).
10. *Ultramares*, 174 N.E. at 448.
11. "If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Id.* at 444.
12. *Id.* at 445.
13. 320 P.2d 16 (Cal. 1958).

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

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

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

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

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14. *Id.* at 19.

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

16. FEINMAN, supra note 3, § 2.3.

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

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

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

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

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

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

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

A. Border Wars

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

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

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

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

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

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

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

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

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

B. The Restatement and Private Ordering in General

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

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

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

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

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

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

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

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

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

30. *Id.* § 9(2).

31. *Id.* § 9 cmt. b.

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.* § 9(2).

36. *Id.* § 9 cmt. b.

37. *Id.* § 9(3)(b).

38. *Id.* § 9(3)(c), 9(3)(c)(i).

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

C. Third Party Cases and Private Ordering

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

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

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

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39. *Id.* § 9 cmt. e(i).

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

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

42. *Id.* § 13(2)(a)–(b).

43. *Id.* § 13(3).

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

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

46. *Id.*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IV. PRIVATE ORDERING AND THE LIMITS OF CONTRACT LAW

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

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

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

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

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

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

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

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

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

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

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

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

65. *Id.* at 14–29.

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

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

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

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

V. BROADER CONTEXTS: LAW AND POLITICS

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

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

68. *Id.* at 26–29.

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

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

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

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

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

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

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

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

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

VI. CONCLUSION

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

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

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

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

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DECEPTION, ECONOMIC LOSS AND MASS-MARKET CUSTOMERS: CONSUMER PROTECTION STATUTES AS PERSUASIVE AUTHORITY IN THE COMMON LAW OF FRAUD

Jean Braucher*

INTRODUCTION

In the 1960s and 1970s, most states across the country enacted broad consumer protection statutes, and now every state has at least one.[1] Although there have been occasional legislative adjustments to these statutes, mostly broadening them further[2] and occasionally cutting back their scope,[3] repeal has never been

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1. JONATHAN SHELDON & CAROLYN L. CARTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES 1, 967–89 (6th ed. 2004) (noting that all states, the District of Columbia, Puerto Rico, Guam and the Virgin Islands have one or more consumer protection statutes, and presenting an analysis of each of these statutes, including two each from Georgia, Hawaii, Illinois, Maine, Minnesota, Nebraska, New York, Ohio, Puerto Rico, Utah and Wisconsin). All such statutes prohibit fraudulent or deceptive practices, and most broadly address both unfair or deceptive acts. MICHAEL M. GREENFIELD, CONSUMER LAW: A GUIDE FOR THOSE WHO REPRESENT SELLERS, LENDERS, AND CONSUMERS 158–62 (1995). This state legislation was patterned after the Federal Trade Commission Act with two exceptions: Most state statutes add a private right of action, which is not authorized by the FTC Act, and they do not require a public interest impact from a practice, a requirement for an FTC enforcement action. *Id.*

2. *See, e.g.*, 73 PA. CONS. STAT. § 201-2(4)(xxi) (2006) (amended by 1996 Pa. Legis. Serv. 146 § 2(xxi) (West) to add "or deceptive" in the catchall provision "any other fraudulent or deceptive conduct"); ARIZ. REV. STAT. ANN. § 44-1533 (2006) (amended by 1981 Ariz. Sess. Laws ch. 295, § 5 to add subsec. A, explicitly making remedies under the Arizona Consumer Fraud Act cumulative with other legal remedies).

attempted, suggesting the wide popularity of consumer protection. State consumer protection statutes typically reach deceptive and unfair practices; by going beyond clear and outright dishonesty,[4] they are designed to provide an easier basis for consumers to recover than common law intentional misrepresentation, also known as fraud.[5] Common law fraud independently has become more expansive in its reach,[6] so a convergence with the consumer protection statutes is perhaps already in progress. In addition to relaxing standards for liability, consumer protection statutes have expanded remedies, for example providing for minimum damages, multiple damages, and attorneys' fees to encourage consumers to become private attorneys general to advance the public interest in a transparent, efficient consumer marketplace.[7]

Before the modern campaign for state consumer protection began, President Kennedy urged in a speech in 1962 that consumer rights to choice, information, and freedom from deception are matters of national interest.[8] Encouraged by the Federal Trade Commission,[9] state legislatures took up these principles and wrote them into law, typically providing both for state level public enforcement and private rights of action.[10] A partnership between the federal agency and the states resulted, in which FTC actions and policies became a basis for enforcement at the state level.[11] The early state court opinions show great

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3. *See* TEX. BUS. & COM. CODE ANN. §§ 17.41 to 17.63 (Vernon 1990) (amended in numerous ways by 1995 Tex. Gen. Laws 414); *see also* A. Michael Ferrill & Leslie Sara Hyman, *Deceptive Trade Practices—Consumer Protection Act*, 54 SMU L. REV. 1269, 1270 (2001) (discussing 1995 amendments that restricted the statute's applicability to professional services and excluded nonresidential transactions involving large dollar amounts).

4. *See* GREENFIELD, *supra* note 1, at 173–76; SHELDON & CARTER, *supra* note 1, at 144–56 (both discussing relaxation or elimination of common law elements of misrepresentation under a statutory consumer protection cause of action).

5. I will use "intentional misrepresentation" and "common law fraud" as synonyms. As we shall see, relaxation of the scienter or bad intent requirement is consistent with the consumer protection law move toward setting a liability standard based on the perspective of the ordinary consumer. *See infra* Part II.

6. *See* GREENFIELD, *supra* note 1, at 173.

7. SHELDON & CARTER, *supra* note 1, at 1, 737–836 (discussing expanded remedies available under a statutory cause of action and noting that every state but Iowa provides a private statutory right of action).

8. CUTS Ctr. for Consumer Rights & Training, *Consumer Rights and Its Expansion* (1999), http://www.cuts-international.org/Consumer-Rights.htm.

9. *See* DONALD P. ROTHSCHILD & DAVID W. CARROLL, CONSUMER PROTECTION: TEXT AND MATERIALS 887 & n.248, 889 & n.261 (2d ed. 1973) (noting that the Federal Trade Commission both proposed mini-FTC Acts for the states and helped in the drafting of a similar model consumer protection statute for the Council of State Governments from the mid-1960s through the early 1970s). There had been earlier efforts at more narrow state consumer protection, such as in "Printer's Ink" model law drafted in 1911 and named after an advertising trade journal; it was directed at deceptive advertising and was enacted in more than 40 states. *Id.* at 885–86.

10. *See* SHELDON & CARTER, *supra* note 1, at 738 (noting availability of private right of action in every state but Iowa); *id.* at 931–66 (discussing state agency enforcement).

11. *See id.* at 137–38 (discussing deference to FTC interpretations by state courts, often under explicit direction in state statutory language).

enthusiasm for liberal application of the then-new consumer protection statutes, a nearly contemporaneous indication of the legislative intent.[12]

The popularity of consumer protection reflects a transformation of norms; deception in the marketplace may be common, but it is no longer considered acceptable behavior. As a result, the idea of a civil obligation not to use deceptive practices is hardly novel. Consumer protection statutes are sometimes restricted to household consumers,[13] but mass-market customers buying for other uses are often subject to the same disadvantages when entering into transactions or seeking contractual relief for being cheated.[14] Even a large business cannot afford to investigate for possible deception in every small purchase nor can it afford to pursue contract remedies when a small problem comes to light; it is more efficient for the law to recognize an obligation in sellers not to deceive their customers and to provide remedies that effectively deter that behavior. Tort law has a role to play that is different from contract. This is why the common law of fraud should be open to development by following the trail blazed by consumer protection statutes. It should not ossify or lie dormant because some of the most compelling fraud cases are now better pursued using a statutory theory.

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12. This enthusiasm is evident in a 1974 decision of the Pennsylvania Supreme Court:

> The Legislature sought by the Consumer Protection Law to benefit the public at large by eradicating, among other things, 'unfair or deceptive' business practices. . . . Since the Consumer Protection Law was in relevant part designed to thwart fraud in the statutory sense, it is to be construed liberally to effect its object of preventing unfair or deceptive practices.

Commonwealth v. Monumental Props., Inc., 329 A.2d 812, 815, 817 (Pa. 1974). A similar understanding of the expansive legislative intent was expressed in Arizona that same year:

> [T]he rule of the common law that penal statutes shall be strictly construed has no application. . . . There is today a trend away from the doctrine of caveat emptor toward caveat venditor. . . . Without effective private remedies the widespread *economic losses* that result from deceptive trade practices remain uncompensable and a private remedy is highly desirable in order to control fraud in the marketplace.

Sellinger v. Freeway Mobile Home Sales, Inc., 521 P.2d 1119, 1122 (Ariz. 1974) (emphasis added, citation omitted).

13. SHELDON & CARTER, *supra* note 1, at 15–16, 89–96 (noting that some statutes limit actions to consumers who acquire for personal, family or household purposes and also discussing possibility of business plaintiff under at least 20 states' statutes).

14. Jean Braucher, *The Failed Promise of the UCITA Mass-Market Concept and Its Lessons for Policing of Standard Form Contracts*, 7 J. SMALL & EMERGING BUS. LAW 393, 417–19 (2003) [hereinafter Braucher, *Mass-Market Concept*] (discussing promise of mass-market concept if naturally defined to cover instances when businesses are in the same circumstances as consumers, that is, when there is only one form and no negotiation over contingent terms and where shopping is the means of introducing market competition, typically making the market policing of terms weak). *See also* Jean Braucher, *New Basics: 12 Principles for Fair Commerce in Mass-Market Software and Other Digital Products* (Ariz. Legal Studies, Discussion Paper No 06-05, 2006), *available at* http://ssrn.com/abstract=730907 (also discussing the power of the mass-market category).

Before I can get to that primary argument, however, I must first address a rear-guard maneuver in the other direction, one that involves a judicial attempt to rewrite history and claim that both common law fraud and statutory deception causes of action in a contractual context are subject to an economic loss rule. The result of such an approach, currently only adopted by a handful of courts,[15] would be to seriously restrict or even eliminate fraud and deceptiveness as grounds to recover for pecuniary harm if a contract theoretically could have protected the plaintiff or plaintiffs.[16]

It is rather aggressive for judges—especially federal judges—to attempt to roll back the reach of popular state statutes.[17] The dominant perspective of the public is that consumer protection is an unproblematic good. This is no doubt why President George W. Bush declared "National Consumer Protection Week" in the spring of 2006, noting that nearly 25 million Americans are victims of consumer fraud each year and that, "My Administration is committed to vigorous enforcement of the consumer protection statutes . . . ."[18] Whether or not that commitment is real, we can see that the wisdom of consumer protection is no longer considered debatable in mainstream politics. Instead, judges wage the battle against consumer protection out of popular view.

The basic proposition lately promoted, particularly in some federal court decisions using diversity jurisdiction,[19] is that contract law provides the only remedy (if any) for customers who have been cheated, whether by outright lying, half-truths, misleading implications or strategic silence. In this view, tort and statutory consumer protection causes of action should not be allowed for those who in theory could have protected themselves using contracts. "In theory" is a key point to be developed later, in light of the law-in-action perspective on contract law, which includes such obvious points as that most customers cannot as a practical matter read and shop over the terms in long form contracts and that contract remedies rarely make parties whole and certainly do not provide

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15. *See, e.g.*, Werwinski v. Ford Motor Co., 286 F.3d 661 (3d Cir. 2002); *see also* Steven C. Tourek, Thomas H. Boyd, *Bucking the "Trend": The Uniform Commercial Code, the Economic Loss Doctrine, and Common Law Causes of Action for Fraud and Misrepresentation*, 84 IOWA L. REV. 875 (1999) (questioning the premature description of an emerging trend of applying an economic loss rule to fraud actions and noting that the "trend" has predominantly occurred in federal court decisions inaccurately predicting change in state law); *see also infra* notes 52–82 and accompanying text for a discussion of this and other cases taking this approach.

16. *See* R. Joseph Barton, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1807–08 (2000) (describing how courts sometimes create an exception to an economic loss rule for fraud claims in a contractual context if the fraud is extraneous to the contract rather than interwoven with it, but explaining that the practical effect of applying this distinction is to render the exception a nullity).

17. *See* Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813 (2006); *see also supra* note 15.

18. *See* Proclamation No. 7979, 71 Fed. Reg. 6,333 (Feb. 3, 2006), *available at* http://www.whitehouse.gov/news/releases/2006/02/20060203-12.html.

19. *See supra* note 15.

deterrence of fraud and deception.[20] Also, shopping becomes particularly difficult for a customer who must assume that all product claims are lies. Nonetheless, the conservative side in the legal culture war believes customers should insist on warranties to protect themselves against deceptive practices, and if they don't, *caveat emptor*, which is Latin for "Lump it." This side takes the position that common law fraud and consumer protection statutes should not be used in contractual settings to police even flagrant dishonesty.

The opposing world view, which I share, is that consumer protection is smart, popular policy, empirically well grounded and part of minimum decency. Consumer protection in its myriad forms makes sense in an economy that measures its health by consumer confidence to go forth and spend exuberantly.[21] There has long been good evidence that, no matter what law professors and judges think consumers ought to do, most are not wary. For example, most consumers accept what the law considers obvious puffing as "completely true" or "partly true."[22] Furthermore, most consumers who feel cheated lump it without even complaining to the seller, let alone going to a lawyer.[23] Unless they count on repeat purchases from the same customers, businesses that engage in deception come out ahead when they only rarely have to pay damages on any theory, unless those damages are substantial. The hardy few customers willing and able to sue[24] need encouragement if we are to deter, even weakly, lying and misleading, which do not result in efficient allocation of resources. If there is a problem with consumer protection law, in this view, it is that it is seldom enforced, with the poor bearing the brunt of the ease with which con artists and slick operators can get away with their scams.[25] The result is not only inefficiency but redistribution from the relatively worse off to the relatively better off.

Interestingly, Judge Posner has not embraced the idea of applying an economic loss rule to common law intentional fraud. In an opinion discussing the issue, he noted that the origin of this notion seems to be in a recent misuse of dicta,

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20. *See infra* Parts I.B & II.A.

21. *See* Press Release, The Conference Bd., The Conference Board Consumer Confidence Index Posted a Gain in September (Sept. 26, 2006), http://www.conference-board.org/economics/consumerConfidence.cfm (setting forth the index of consumer confidence, which is used as a basic measure of economic trends).

22. *See* Ivan L. Preston, *Puffery and Other "Loophole" Claims: How the Law's "Don't Ask, Don't Tell" Policy Condones Fraudulent Falsity in Advertising*, 18 J.L. & COM. 49, 80 (1998) (describing research that showed a majority of respondents giving "completely true" and "partly true" assessments of such statements as "State Farm is all you need to know about life insurance," "Ford has a better idea," "You can trust your car to the man who wears the star," about Texaco, and "Perfect rice every time," about Minute Rice).

23. *See* Jean Braucher, *An Informal Resolution Model of Consumer Product Warranty Law*, 1985 WIS. L. REV. 1405, 1450–51 [hereinafter Braucher, *Informal Resolution Model*] (discussing research indicating that most consumers do not complain to sellers when they perceive a problem with a transaction).

24. *Id.* at 1455 (concerning research indicating that consumers with a serious dispute over a major purchase consult a lawyer only seven percent of the time).

25. *See* Nat'l Consumer Law Ctr., About Us, http://www.consumerlaw.org/about/ (last visted Oct. 18, 2006) (describing the mission of the National Consumer Law Center and discussing greater vulnerability of the poor to deceptive practices).

not in some longstanding common law rule.[26] On the policy question, he floated several opposing arguments, declared the issue a difficult one, and avoided deciding it.[27] However, he went out of his way to state that he considered the policy issue close in the context of a negotiated agreement but not in cases involving consumers.[28]

Part I of this article will explain why the question whether to bar a fraud theory in a contractual context is not close. The answer should clearly be no. It will further explain why it is outlandish to suggest that consumer protection statutes were intended to be limited to cases in which the consumer did not enter into a contract with the deceiver or the fraud did not directly concern the subject-matter of the contract. Part II then turns to the arguments for using consumer protection statutes as a source of persuasive authority for expansion of the common law of fraud, particularly in mass-market contexts. The new Restatement (Third) of Torts: Economic Torts and Related Wrongs being drafted by the American Law Institute[29] should pervasively incorporate discussion of consumer protection statutes, both to correct the misconception that these statutes merely repeat the common law and also to make them more accessible and better understood, both for direct and indirect use.[30] If these or other widely-enacted types of state statutes are ignored, the Restatement will not provide an accurate picture of the relevant law. Furthermore, the Restatement should also correct the a-historical and unsound idea that common law fraud is subject to an economic loss rule.[31] Fraud is centrally a tort about pecuniary harm, most frequently in a contractual setting.[32]

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26. *See* All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 866–67 (7th Cir. 1999); *see also infra* notes 44–52 (concerning recent invention of an "economic loss rule" applicable to common law fraud by a few courts, mostly federal courts deciding diversity cases without definitive state court opinions to follow).

27. *All-Tech*, 174 F.3d at 867; *see also infra* notes 92–106 and accompanying text (discussing the opinion in *All-Tech*).

28. *See id.* at 866.

29. *See Institute Launches New Projects on Aggregate Litigation, Software Contracts, and Economic Torts*, THE ALI REPORTER (Winter 2005), *available at* http://www.ali.org/ali/3-2702_Launches.htm (noting the ALI Council approved the project in December 2004). A list of those involved with the project is available on the ALI website. http://www.ali.org/ (follow "Projects and Participants" hyperlink; then follow "Current Projects and Participants" hyperlink; then follow "Restatement of the Law, Torts: Liability for Economic Loss" hyperlink).

30. Restatements have done this before; for example, the RESTATEMENT (SECOND) OF CONTRACTS (1981) pervasively incorporates references to and discussions of sections of the Uniform Commercial Code, Articles 1 and 2. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 22 cmt. b (assent by conduct) (citing U.C.C. §§ 2-208(1), 2-204 and 2-207(3)); *id.* § 205 cmts. a & c (duty of good faith and fair dealing) (citing U.C.C. §§ 1-201(19), 2-103(1)(b), 1-203 and 2-209); *id.* § 356 cmt. a (liquidated damages and penalties) (citing U.C.C. §§ 2-718 and 2-719). The new torts Restatement should also incorporate analysis of other types of widely-enacted statutes, such as Racketeer Influenced and Corrupt Organization (RICO) statutes. *See* SHELDON & CARTER, *supra* note 1, at 1019–24 (analyzing state RICO statutes, which are based on the federal RICO statute, 18 U.S.C. §§ 1961–1968).

31. *See infra* Part I.B.

32. *See id.*

I. DROWNING IN A SEA OF DISSEMBLING: THE STRANGE ARGUMENTS FOR AN ECONOMIC LOSS RULE APPLICABLE TO COMMON LAW FRAUD AND CONSUMER PROTECTION LAWS

A. Background on the "Economic Loss" Rule

The idea of an "economic loss" rule or doctrine, or perhaps more accurately a "pecuniary harm" or "commercial loss" rule,[33] typically arises in at least two very different settings, the law of negligence generally and the law of products liability (both strict liability and negligence). In the first of these settings, the economic loss doctrine is concerned with "liability without end."[34] The general law of negligence has struggled to a subtle and difficult distinction. In cases of negligent misrepresentation, members of a small group of persons intended to benefit from a defendant's activity may recover for pecuniary harm (for example when a professional negligently gives an opinion knowing it will be relied on by a small group of others with whom the professional did not have a contract).[35] In contrast, in cases of negligently caused physical harm (personal injury or property damage) with ripple effects causing pecuniary harm to others, those suffering only from the ripple effects cannot recover. For example, island commercial establishments cannot recover their lost profits from someone who negligently caused injury to the only bridge connecting the island to the mainland.[36]

Products liability law is another setting for an economic loss rule. When the privity rule was abolished for negligence recovery of loss caused by defective products, the rationale was protecting safety; thus recovery was limited to cases involving personal injury or damage to property other than the product itself.[37] With the arrival of strict liability in tort in the mid-20th century, the courts revisited the question whether to limit products liability recovery to cases involving personal injury and property damage.[38] Most courts ultimately decided that if the only loss is to the product itself, the end-use customer must rely on warranties, if any, and not on the tort law of products liability.[39]

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33. All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 865 (7th Cir. 1999) (Posner, J.) (noting that "commercial loss" would be more accurate than "economic loss" because damage to property and even to person can be understood as economic loss).

34. Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513, 1533 (1985) (discussing economic ripple effects from accidents as raising this concern).

35. *See* DAN B. DOBBS, THE LAW OF TORTS 1372–73 (2000); RESTATEMENT (SECOND) OF TORTS § 552(2) (1977).

36. Rabin, *supra* note 34, at 1528 & n.47 (discussing Rickards v. Sun Oil Co., 41 A.2d 267 (N.J. Misc. 1945)).

37. *See* DOBBS, *supra* note 35, at 973.

38. *See id.* at 974–75 (discussing the rise of the theory of strict liability in tort). *Compare* Santor v. A & M Karagheusian, Inc., 207 A.2d 305 (N.J. 1965) (liability for product damage only), *with* Seely v. White Motor Co., 403 P.2d 145 (Cal. 1965) (no liability for product damage only).

39. Herbert Bernstein, *Civil Liability for Pure Economic Loss Under American Tort Law*, 46 AM. J. COMP. L. 111, 118–19 (1998) (noting that most jurisdictions do not allow tort recovery where the product flaw only damages the product itself). Non-customers

From a contract law perspective, both settings involve situations that could be viewed as raising privity problems, problems that might be solved using third-party beneficiary theory[40] or by dispensing with the requirement of privity.[41] The small group of people, not clients, relying on a professional opinion might be considered intended beneficiaries of the contract between the professional and the client. For example, when a business owner retains an accountant to prepare financial statements with the understanding they will be presented to potential buyers of the business, the parties to the contract may intend to benefit those potential buyers by giving them an independent analysis of the finances of the business. Alternatively, we might think of the case as involving a warranty without privity, on which the non-clients reasonably rely. Thus contract law can provide alternative theories to the tort theory of negligent misrepresentation to reach the same result. In the case of manufacturers' warranties, we no longer worry about lack of privity; end-use customers can be seen as third-party beneficiaries of warranties given to retailers or as beneficiaries of warranties mandated by law. The Uniform Commercial Code uses a hybrid of third-party beneficiary theory and tort-like extension of mandatory warranties to those who suffer personal injury or property damage.[42] Remote customers can also be seen as having contracts because they are encouraged to rely on manufacturers' warranties introduced by the manufacturer downstream into the marketplace, even when the manufacturer has no direct dealings with the end-use customer.[43] In sum, the law of manufacturers' warranties also lies in the borderland of contract and tort.

B. Economic Loss Due to Fraud

As late as the mid-1980s, no authority on torts seems to have thought that an "economic loss rule" applied to the law of intentional misrepresentation or fraud. This tort is not centrally targeted at dangerous behavior or products that cause personal injury and accidental loss to property. Fraud is a pecuniary loss tort, not typically associated with physical harm.[44] In the core fraud case, the defendant knowingly lies to the plaintiff, who justifiably relies and suffers economic loss.[45] More often than not, the form of the reliance is entering into a transaction. For example, we find this summation of the law as of 1986 in a leading torts treatise:

> Originally allied to the action for breach of warranty, it was not until 1789 that an action for deceit was available to one other than a party

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may also be covered by extended warranties, particularly for personal injury and perhaps even for purely pecuniary loss. *See* U.C.C. § 2-318 alternative C (2000).

40. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 302, 304 (1981).

41. *See* U.C.C. § 2-318 (2000).

42. *See id.*

43. *See* RESTATEMENT (SECOND) OF CONTRACTS § 90 (providing for liability based on reliance on a promise). Proposed Amended Article 2 would add pass-through warranties and warranties by advertising, concepts that are already recognized in case law. *See* U.C.C. §§ 2-313A cmt. 1, 2-313 cmt. 1 (Proposed Amendment 2006) (noting basis in case law and commercial practice of these proposed new statutory warranties). Proposed Amended Article 2 has not been enacted anywhere.

44. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 726–27 (5th ed. 1984).

45. *See id.* at 728.

> to a business transaction with his deceiver. In *Pasley v. Freeman* it was held by a divided court that one who fraudulently induced another to extend credit to a person known to be untrustworthy could be held liable to the person thereby defrauded. After *Pasley* deceit, as a distinct tort, was definitely disassociated from actions for breach of warranty and the basis for the legal duty was perceived to be independent of contractual relations between the parties. The source of the duty is the law and the basis is the relationship of the parties which usually, but not necessarily, involves a business transaction between them.
>
> The type of interest protected by the law of deceit is the interest in formulating business judgments without being misled by others—in short, in not being cheated. Generally, the law of deceit is limited to misrepresentations that mislead another into an unwise judgment in some business enterprise resulting in financial loss.[46]

Clearly, the common law did not cut off fraud liability if there was a contract; initially, a contract was an essential element to a deceit action, and the late development was allowing recovery without a contract. The common law also did not cut off fraud liability when the loss was only pecuniary or financial. The final edition of *Prosser and Keeton on the Law of Torts*, published in 1984, also identified tort theories of misrepresentation and nondisclosure (originally called the common law action of deceit) as "confined in practice very largely to the invasion of interests of a financial or commercial character, in the course of business dealings."[47] More recently, Professor Dobbs has explored the idea of an economic loss rule in misrepresentation cases under headings dealing with negligent and innocent misrepresentation, but not in his discussion of intentional misrepresentation.[48] Even where the misrepresentation is only negligent, Dobbs raises doubt that an economic loss rule makes sense in some transactional contexts:

> When the facts are peculiarly within the knowledge of the defendant and inaccessible to the plaintiff, commercial dealings between the parties must come to a halt unless the plaintiff can put confidence in reasonable accuracy of the defendant's statements. So courts sometimes impose a duty of care when the defendant had peculiar knowledge or expertise.[49]

He also describes the core case of misrepresentation, involving intentional fraud, as one that concerns liability for "commercial harm" in "the bargaining context."[50]

In a case decided in 1999, Judge Posner suggested that the origin of some courts' discovery of an "economic loss rule" barring common law fraud recovery

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46. 2 FOWLER V. HARPER ET AL., THE LAW OF TORTS, 377–78 (2d ed. 1986) (citing Pasley v. Freeman, (1789) 100 Eng. Rep. 450 (K.B.)) (footnote call numbers omitted).

47. KEETON ET AL., *supra* note 44, at 726 (explaining the reason for this in terms of other torts typically being used when, for example, personal injury resulted, although fraud could also have been used).

48. *See* DOBBS, *supra* note 35, at 1353, 1356.

49. *Id.* at 1351.

50. *Id.* at 1343.

is in reading dicta out of context, treating broad language as if it were a statute not limited by the facts of the case.[51] A textbook example of this phenomenon is *Werwinski v. Ford Motor Co.*,[52] in which a Third Circuit panel held that an economic loss rule applied to both a common law intentional fraud claim and to a state consumer protection statutory claim. Both causes of action involved allegations that Ford knew of but did not disclose serious defects it had found in some models of its cars.[53] Specifically, the customers alleged that Ford's technical service bulletins and multiple redesign efforts demonstrated that the company knew of the defects but that it never warned most car owners about the defects and continued to market and sell automobiles with defective transmissions, while cutting the warranty term from six to three years for its 1991 models.[54] The *Werwinski* plaintiffs alleged that the defects in their cars caused transmission failure, including "sudden acceleration, delayed forward or reverse engagement, sudden shifts into reverse, and a total loss of acceleration or forward movement."[55] They were not amused by these unexpected thrilling experiences.

A significant part of the *Werwinski* opinion is given over to making sure that the case, originally brought in state court and removed to federal court by Ford, would stay in federal court. We see the spectacle of each side making the other's arguments, with the plaintiffs arguing that their claims could not possibly be worth $75,000 each, attempting to escape the clutches of the federal court under diversity jurisdiction.[56]

In the economic loss sections of the opinion, the Third Circuit panel in *Werwinski* relied centrally on broad language in a U.S. Supreme Court admiralty products liability case, *East River S.S. Corp. v. Transamerica Delaval, Inc*,[57] in which the Court noted the danger that "contract law would drown in a sea of tort" without an economic loss rule applicable to products liability cases.[58] *Werwinski* also relied on the Supreme Court's reasoning that express and implied warranty theories under contract law are best suited to compensate for a loss in product value, both to avoid substantial costs to society and to permit the parties to negotiate the allocation of risk.[59] In addition, the *Werwinski* court cited an

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51 All-Tech Telecom, Inc. v. Amway Corp., 174 F. 3d 862, 866–67 (7th Cir. 1999).

52. 286 F.3d 661 (3d Cir. 2002).

53. *Id.* at 664.

54. *Id.*

55. *Id.* Werwinski thus is a "near miss" case, a type that courts have struggled with in the products liability context because of the presence of a danger of personal injury and property loss other than to the product itself. *See* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 862, 868–71 (1986) (noting that a concurring and dissenting judge in the court of appeals decision would permit recovery in a "near miss" case and discussing various approaches to drawing the line between warranty and products liability cases depending on the nature of the injury).

56. *Werwinski*, 286 F.3d at 665–70.

57. 476 U.S. 858 (1986).

58. 286 F.3d at 671 (quoting *East River*, 476 U.S. at 866).

59. *Id.* (citing reasoning in *East River*, 476 U.S. at 872–73).

intermediate appellate court decision in Pennsylvania adopting much of the reasoning of *East River* in a business-to-business products liability case.[60]

The plaintiffs in *Werwinski* made two arguments to distinguish *East River* and the Pennsylvania products liability case following it—that those cases both involved commercial entities as plaintiffs and that neither case involved intentional fraud.[61] On the first point, the court made the interesting concession that even businesses purchasing mass-produced products cannot necessarily negotiate warranties and that business buyers are not necessarily more sophisticated than consumer buyers, but the court retreated to the point that negotiation was not the way to escape bad warranties, but rather selection of a different deal, such as "a more expensive car with a longer-term warranty."[62] Let them eat cake.

It is true that shopping is the market mechanism for competition in form terms.[63] However, the market in contingent non-negotiated terms is not robust. Form terms are written in legalese that few customers, even business customers, can understand, and often the terms for all products of a particular kind are very similar. Higher prices do not necessarily neatly line up with better terms. A customer who must assume that everything said about the product is a lie or a misleading half-truth would have particular difficulty shopping for the best deal.

In response to plaintiffs' arguments that intentional fraud is different from product liability, the court found the Pennsylvia law "unsettled"[64] and then based its decision on federal court decisions in the 1990s interpreting Florida, Wisconsin and Minnesota law[65] and a 1995 intermediate appellate court decision by a Michigan court, one that made a distinction drawn from a 1989 federal court decision in New Jersey between fraud-in-the-inducement claims "extraneous to the contract," as opposed to those "interwoven with the breach of contract," which it said were barred by the economic loss rule.[66] The practical effect of the

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60. *Id.* (citing REM Coal Co. v. Clark Equip. Co., 563 A.2d 128, 129 (Pa. Super. Ct. 1989)). The court did not at this point cite a fraud case from a Pennsylvania trial court noting that Pennsylvania has not adopted an economic loss rule for fraud cases, although the case later discusses whether to have an intentional fraud exception to the economic loss rule. *Id.* at 679.

61. *Id.* at 670–71.

62. *Id.* at 673.

63. Jean Braucher, *Delayed Disclosure in Consumer E-Commerce as an Unfair and Deceptive Practice*, 46 WAYNE L. REV. 1805, 1810–12 (2000) (noting that shopping, not bargaining, is the mechanism for market discipline of mass-market terms but also discussing the weakness of the market in standard form terms, which makes it prudent to have substantive checks on terms in addition to advance disclosure).

64. *Werwinski*, 286 F.3d at 675.

65. *See* Hoseline, Inc. v. U.S.A. Diversified Prods., Inc., 40 F.3d 1198, 1200 (11th Cir. 1994) (Florida law); Cooper Power Sys., Inc. v. Union Carbide Chem. & Plastics Co., 123 F.3d 675, 682 (7th Cir. 1997) (Wisconsin law); Nelson Distrib., Inc. v. Steward Warner Indus. Balancers, 808 F. Supp. 684, 688 (D. Minn. 1992) (Minnesota law).

66. *See* Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541, 545 (Mich. Ct. App. 1995) (relying on Pub. Serv. Enter. Group, Inc. v. Phila. Elec. Co., 722 F. Supp. 184, 201 (D.N.J. 1989)).

"extraneous to the contract" test for allowing a misrepresentation to be actionable fraud is to eliminate most, and perhaps all, fraud claims.[67]

It is notable that the idea of an economic loss rule applicable to fraud claims seems to date from the late 1980s, but no earlier. The notion has been promoted primarily by federal courts, who only decide common law issues in diversity jurisdiction cases, in which they are supposed to follow state law.

The *Werwinski* court, faced with an issue of Pennsylvania law, quoted the Michigan court's statement that, "where the only misrepresentation by the dishonest party concerns the quality or character of the goods sold, the other party is still free to negotiate warranty and other terms to account for possible defects in the goods."[68] The *Werwinski* court had already conceded that negotiation does not occur in the mass-market but then used the idea again.[69] We see the power of a paradigm of negotiated private ordering, even when it is clearly inapposite. Playing along with the negotiation fallacy to some extent, the plaintiffs argued that it is difficult to allocate risks fairly based on anticipation that the other party is making intentional misrepresentations.[70] They further argued that a party making an intentional misrepresentation should bear the risk of loss from the undisclosed circumstances because that party knows the risk and is thus in a better position to plan for it.[71] The Third Circuit at that point quotes a federal court decision taking issue with the reasoning of the Michigan intermediate appellate decision on the following grounds:

> Although it makes sense to allow parties to allocate the risk of mistakes or accidents that lead to economic losses, it does not make sense to extend the [economic loss] doctrine to intentional acts taken by one party to subvert the purposes of the contract. Although theoretically parties could include contractual provisions discussing the allocation of responsibility when one party intentionally lies or misleads the other, it would not be conducive to amicable commercial relations to require parties to include such clauses in contracts. Expressing such a basic lack of trust in the other party would be likely to sour a deal from the start.

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67. *See* Barton, *supra* note 16, at 1808. The distinction is incoherent because any misrepresentation that induced the making of a contract could in theory have been the subject matter of contract terms; a test that precludes a fraud action if the misrepresentation concerns the quality of a product or other performance excludes most fraud cases. With or without the exception for fraud extraneous to the contract, the fallacy underlying application of an economic loss rule to fraud actions is to think that it is a costless or practically workable approach for parties to presume rampant fraud and try to contract to protect against it. *See infra* notes 91–118 and accompanying text.

68. 286 F.3d at 676 (quoting Huron Tool & Eng'g Co., 532 N.W. 2d at 545).

69. 286 F.3d at 676–77.

70. *Id.* at 679 (accepting appellants' claim that "parties to a contract should not have to anticipate possible intentional misrepresentations by the other party when negotiating the allocation of risk between the parties").

71. *See id.* at 679.

> A party to a contract cannot rationally calculate the possibility that the other party will deliberately misrepresent terms critical to that contract. Public policy is better served by leaving the possibility of an intentional tort suit hanging over the head of a party considering outright fraud . . . .[72]

A similar point can be made where there is no negotiation and the customer's only way to deal with risk is to shop for the best mass-market warranty. As discussed below,[73] customers operating under the assumption that all product descriptions (express warranties) are false or misleading cannot choose wisely among either products or their warranties.

As hoary a contracts case as *Hadley v. Baxendale* makes a similar point about the difficulty of dealing with unknown, unlikely risk; the second rule of the case is that there is no liability for consequential damages stemming from special circumstances that were not communicated.[74] This is because, "had the special circumstances been known the parties might have specially provided for the breach of contract by special terms as to the damages in the case; and of this advantage it would be very unjust to deprive them."[75] Contracting parties are not expected to guess about unusual events (such as that one party is lying, or what amounts to the same thing, concealing a material defect) and contract as to every possible one of them.

The power of the point that it is hard to assess risks when all one has to go on is misinformation seemed to prod the Third Circuit to allow itself a second thought: "Both parties provide plausible explanations for their respective positions."[76] So why favor the defendant? The court gives these reasons: "appellants are unable to explain why contract remedies are inadequate to provide redress when the alleged misrepresentation relates to the quality or characteristics of the goods sold."[77] Thus, "the plaintiff can be made whole under contract law" and "allowing additional tort remedies will impose additional costs on society."[78] Of course, as will be explained, fraud also imposes costs.[79]

Ultimately, the court explained that it favors a default rule of no liability, absent a Pennsylvania Supreme Court case to the contrary, because "[t]he

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72. *See id.* at 679 (quoting First Republic Bank v. Brand, 50 Pa. D. & C. 4th 329 (Pa. Com. Pl. 2000)). Although the *Werwinski* court cited the *Pennsylvania First Republic Bank* case, it did not note that it had rejected the idea that an economic loss rule applies to intentional fraud. *Id.*

73. *See infra* notes 91–118 and accompanying text.

74. (1854) 156 Eng. Rep. 145 (Exch.).

75. *Id.*

76. *Werwinski*, 286 F.3d at 679.

77. *Id.*

78 *Id.* at 680; *see infra* notes 112–118 and accompanying text (concerning why contract liability and contract remedies are often inadequate to protect a defrauded party).

79. *See infra* note 104 and accompanying text (concerning Judge Posner's points about the costs of abolishing the intentional fraud cause of action in a contractual context).

economic loss doctrine is designed to place a check on limitless liability for manufacturers and establish clear boundaries between tort and contract law."[80]

With mass-marketing, of course, a mass defrauder risks mass liability, but under tort law only to those who suffer loss.[81] Liability without end is quite avoidable by the simple expedient of not cheating customers; deterrence of fraud is a happy outcome and the object of fraud liability. This is not an instance of disproportionate liability, a central concern behind the economic loss rule.[82] Furthermore, because cheaters often do not get caught, punitive damages help in deterrence as well as in expressing outrage with unacceptable behavior.

The "clear boundaries" argument neglects to note that fraud involves an extra element (the fraud) not present in a contract action; it is like arguing that murder and armed robbery should never both be found in one incident of bad behavior. A crime can be both of these, just as certain transactional behavior can be both a breach of contract and a tort. Furthermore, the formality of the clear boundaries argument sits especially uneasily in a commercial law context. Commercial law, particularly in the Uniform Commercial Code, is a blend of contract, tort and property principles. For example, the obligation of good faith is a hybrid of contract and tort law; it requires honesty in fact in the performance and enforcement of every contract and often also reasonable commercial standards of fair dealing. [83] Good faith cannot be disclaimed.[84] The U.C.C. "imposes" it as part of every contract.[85] Furthermore, the U.C.C. recognizes warranties between parties to a contract of sale[86] and provides for their extension to non-parties,[87] and it also explicitly states that the law of fraud supplements its provisions.[88] The U.C.C. goes further, making a change in the remedial law of fraud in some jurisdictions, extending remedies for non-fraudulent breach to cases involving fraud, recognizing the overlapping nature of these causes of action.[89] It states, "Remedies

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80. *Werwinski*, 286 F.3d at 680.

81. *See* DOBBS, *supra* note 35, at 1345 (causing harm is an element of the tort of common law fraudulent misrepresentation).

82. *See* Rabin, *supra* note 34, at 1534 (discussing deep abhorrence in the Anglo-American judicial tradition to disproportionate penalties for wrongful behavior).

83. *See* U.C.C. § 1-201(b)(20) (Proposed Amendment 2006) (broadening general standard of good faith to include not only honesty in fact but also reasonable commercial standards of fair dealing); *see also* U.C.C. § 2-103(1)(b) (2000) (provision still in effect in many states, requiring reasonable commercial standards of fair dealing as part of good faith obligation of a merchant). The official text of Revised Article 1's expanded definition of good faith has not been enacted in most states, but the expanded definition was already part of the obligations of merchants under Article 2.

84. *See* U.C.C. § 1-302(b) (Proposed Amendment 2006).

85. *See id.* § 1-304.

86. *See id.* §§ 2-313 to 2-318 (2000) (containing warranty provisions of Article 2).

87. *See id.* § 2-318 (2000).

88. *Compare id.* § 1-103, *with* U.C.C. § 1-103(b) (2006) (unchanged in substance).

89. *See* U.C.C. § 2-721 (2000). This section changed pre-Code case law in some states using a reliance, or out-of-pocket, measure for fraud. The reliance measure has

for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach."[90] If a fraud cause of action would not lie in cases where there is a breach of contract, there would be no need to extend the expectancy measure of damages to fraud actions. In sum, the U.C.C. in Article 2 emphatically does not contemplate a separation of the realms of tort and contract and is quite comfortable blending them to produce commercial law.

It is worth considering the underlying question of policy: whether it would be a good idea to change longstanding common law and the U.C.C. and embrace the approach of dealing with fraud in contractual settings primarily or only using contract law.[91] Judge Posner discussed but did not decide that question in *All-Tech*.[92] He mentioned the argument that there is no need for tort remedies because they "would duplicate the contract remedies, adding unnecessary complexity to the law."[93] But the easy answer is that if warranties merely duplicated the tort law of fraud, the added complexity would be minor—two names for one basis of recovery. Of course the reality is that a cause of action for breach warranty involves different elements[94] and fraud, as an intentional tort, carries the possibility of punitive damages.[95]

Posner went on to consider another argument, that allowing a fraud cause of action in a contract setting would "undermine contract law."[96] Parties to a contract, he noted, often try to rely on the written word and avoid exposure to juries by making use of the parol evidence rule.[97] Left out of his discussion is the long-standing doctrine that the parol evidence rule does not bar evidence of fraud,[98] an indication that the common law conceives of contract and tort as bodies

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become a minority approach in the common law. *See* GREENFIELD, *supra* note 1, at 31–32 (concerning arguments that expectancy measure should be used in cases of fraud).

90. *See* U.C.C. § 2-721 (2000).

91. The approach of allowing a fraud action only when the fraud does not directly involve a description of the product or other subject matter of the contract would eliminate the fraud action in most cases. *See* Barton, *supra* note 16, at 1807–08. It is also a tortured distinction, because parties could in theory also contract about representations that do not directly involve the subject matter of the contract but somehow bear on it, something that is routinely done in large transactions between sophisticated entities. *See supra* note 67.

92. All-Tech Telecom Inc. v. Amway Corp., 174 F.3d 862, 865–67 (7th Cir. 1999).

93. *Id.* at 865.

94. *See* DOBBS, *supra* note 35, at 1345 (discussing the elements of common law fraudulent misrepresentation); *see also infra* note 140 and accompanying text (setting forth the elements of this tort). The elements of express warranty under Article 2 of the U.C.C. include an affirmation of fact or promise that relates to the goods or any description of the goods or any sample or model, when made part of the basis of the bargain, and a failure to deliver goods conforming to the warranty, causing a loss in relation to the expectancy created by the warranty. U.C.C. §§ 2-313, 2-714 (2000).

95. *See* DOBBS, *supra* note 35, at 1381 (noting the possibility of punitive damages when intentional misrepresentation is sufficiently malicious or oppressive).

96. *All-Tech*, 174 F.3d at 865.

97. *Id.* at 865–66.

98. RESTATEMENT (SECOND) OF CONTRACTS § 214(d) (1981) (listing fraud as among the invalidating causes that can be proved using parol evidence); E. ALLAN FARNSWORTH, CONTRACTS 429 (4th ed. 2004) (noting general agreement in the case law

of law that can both apply to one interaction, with different consequences depending on the theory used. Furthermore, the reason that parol evidence of fraud is admissible is revealing; it is that there is no valid formation of an agreement to integrate the contract when it is induced by fraud.[99] In short, the law treats the contract induced by fraud as invalid and voidable by the fraud victim,[100] and not as something we should worry about undermining.

As an aside, Judge Posner noted that even if there is an economic loss rule cutting off fraud liability, it is important to distinguish commercial contracting parties from "consumers and other individuals not engaged in business."[101] This is certainly right and related to another dubious argument for a contract-only approach to fraud: the parties "could easily have protected themselves from the misrepresentation of which they now complain."[102] Posner recognized that this is a particularly unrealistic idea for consumers, but he sets forth these arguments that a commercial buyer should insist that oral representations be written down:

> To allow him to use tort law in effect to enforce an oral warranty would unsettle contracts by exposing sellers to the risk of being held liable by a jury on the basis of self-interested oral testimony and perhaps made to pay punitive as well as compensatory damages. This menace is averted by channeling disputes into warranty (contract) law, where oral warranties can be expressly disclaimed, or extinguished by operation of the parol evidence rule. . . . It is true that, in principle, the cheapest way to prevent fraud is to punish the fraudfeasor; but in practice, owing to the ever-present possibility of legal error, the really cheapest way in some cases may be to place a burden of taking precautions on the potential victim.[103]

Having stated this position as a vigorous advocate might, Judge Posner immediately questioned it, even in the business-to-business context, noting that eliminating the commercial fraud tort would add transaction costs in "*every* commercial contract, not just the tiny fraction that end up in litigation," as parties resorted to longer contracts and longer negotiations to spell out all representations.[104] He also noted that the law has "safeguards against false [fraud] claims, such as pleading with particularity" or in some jurisdictions a heightened

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that the parol evidence rule does not bar extrinsic evidence to show fraud, including showing fraud in order to recover in a tort action for damages); *see also* Justin Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 CAL. L. REV. 877 (1961) (criticizing minority view barring evidence of promissory fraud out of fear that contract actions could be routinely transformed into actions for promissory fraud).

99. *See* Sweet, *supra* note 98 (noting that the admissibility of evidence of fraud is sometimes mistakenly described as an exception to the parol evidence rule, when the reason for admissibility is that fraud prevents valid assent to integration of the contract).

100. *See* RESTATEMENT (SECOND) OF CONTRACTS § 164(1) (providing that contract is voidable by party who is induced to make a contract by the fraud of the other party).

101. *See All-Tech*, 174 F. 3d at 866.

102. *See id.*

103. *Id.* (citations omitted).

104. *Id.* at 867.

burden of proof.[105] He ended by finding the balance of considerations close and declining to decide the issue.[106]

The real debate is about whether to allow fraud recovery when contract law is unavailable, either formally or as a practical matter. It might be unavailable for many reasons. Warranties may have been excluded, at least formally if not by real assent.[107] Also, the contract statute of limitations may have run, while a tort action is still possible because a discovery-of-the-fraud rule applies to begin the running of the statute of limitations.[108] More commonly, contract remedies may be insufficient to pay for litigation; the reason for using fraud is often to get a shot at punitive damages.[109]

One who lies or misleads orally to induce a contract will often cleverly add a merger clause to the written contract, stating that it is a complete and exclusive statement of terms. In consumer contracts, the consumer will not have read or understood such language, and thus it is pure fiction to say that the parties (plural) intended to exclude the oral representations. Consumers do not insist on having everything that is said to them prior to a sale written down; nor do they insist on having warranties against undisclosed defects. Neither do many business buyers. Outright disclaimer of express warranties is treated as questionable and is disfavored under the U.C.C.[110] It is one thing for parties to conduct negotiations in which some possible terms are discussed but ultimately are excluded from the final deal by mutual agreement. It is quite another to make oral promises and representations and then try to disclaim them in a clause buried in a long form.[111] The parol evidence rule should not be the friend of defrauders. When a party induces a contract by deception, the parol evidence rule is not meant to aid in a cover-up, and this is a primary reason for the parol evidence exception for fraud.[112]

Even when express warranties are included in a contract, no customer thinks of a warranty as equivalent to having a sound product. The obvious fallacy in the *Werwinski* reasoning, to the effect that a warranty is an adequate substitute

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105. *Id.*

106. *See id.*

107. *See* U.C.C. § 2-316 (2000) (concerning exclusion of warranties).

108. *See* SHELDON & CARTER, *supra* note 1, at 664–66 (discussing use of discovery rule in deception cases).

109. The American rule on attorneys fees is that they are not recoverable absent an agreement or statute so providing. FARNSWORTH, *supra* note 98, at 758 & n.5; *see also id.* at 311, 819 (discussing consumer statutes that provide for attorneys fees and also concerning agreement to attorneys fees). For non-consumer plaintiffs, punitive damages for fraud thus may be the only way to obtain both full compensation to the defrauded party and fees for that party's lawyer; in small dollar amount cases, contract damages will not even cover attorneys fees, let alone leave anything for the defrauded party.

110. *See* U.C.C. § 2-316(1) (2000) (favoring constructions of words or conduct creating warranties and words or conduct negating or limiting warranties as consistent wherever reasonable).

111. *See* RESTATEMENT (SECOND) OF CONTRACTS § 216 cmt. e (1981) (recognizing that a merger clause does not control the question of whether the parties intended to make a final and complete statement of their terms).

112. *See supra* note 98 (concerning parol evidence exception for fraud).

for a fraud cause of action, is that customers do not buy known lemons even if they come with terrific warranties. This is particularly true where the product flaw will result in terrifying near-miss experiences, as alleged in *Werwinski*.[113] Warranty claims would not compensate customers for being scared witless. Even without this added element, customers generally seek unproblematic deals, and if they have to use warranties, they at best get a big hassle, in which their lost use and trips to the dealer are not compensated.[114] If they have to sue to enforce a warranty, customers may have difficulty recovering costs of litigation.[115] Also, the producer may have chosen in its form an arbitral forum sympathetic to its interests.[116] In sum, the law-in-action perspective[117] adds that warranty recovery using the law is typically chancy and at best partial. Contract remedies in theory award the benefit of the bargain, but this is rarely the reality. If the defendant contests a warranty claim, the buyer more often than not will give up, particularly when the amount in controversy is not huge. Litigation is long and arduous, with unpredictable results. This is why, if a customer knows that a product has a defect, especially a defect that the defendant has not disclosed, the customer would not go through with the transaction even if the warranty is excellent. Where the seller knows of a defect and the buyer does not, the transaction does not result in efficient allocation of the subject matter of the contract, the product. Furthermore, customers do not primarily rely on their legal rights under warranties;[118] they expect the warrantor to perform the warranty to maintain its reputation. When the warrantor is trying to pass off faulty goods as sound ones, reputation is probably not a primary concern of that warrantor to that customer or her circle. Such a warrantor is likely to have little hesitance about denying that there is a problem when the customer seeks warranty relief. Legal rights will then prove unusable as a practical matter, absent some stronger remedies than warranty law supplies. As a practical matter, warranties are not sufficient to redress fraud, let alone to deter it.

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113. *See* Werwinski v. Ford Motor Co., 286 F.3d 661, 664 (3d Cir. 2002).

114. Consequential damages in the form of lost use are typically excluded. Even when they are not excluded, or when consequential damages are allowed because of failure to repair, the value of lost use may be considered too uncertain to be recoverable. *E.g.*, Murray v. Holiday Rambler, Inc., 265 N.W.2d 513 (Wis. 1978) (overturning award of $2,500 for consequential damages as speculative).

115. The Magnuson-Moss Warranty Act provides for attorneys' fees for a prevailing plaintiff, but at the discretion of the judge, making this type of litigation a high-risk venture. 15 U.S.C. § 2310(d)(2) (2000) (providing that prevailing plaintiff "may be allowed by the court" attorneys' fees "reasonably incurred").

116. The form drafter is a repeat player who will know the record of any arbitral forum and choose another one if unhappy with results.

117. *See* STEWART MACAULAY ET AL., CONTRACTS: LAW IN ACTION 26–29 (2d ed. 2003) (giving an overview of the law-in-action perspective, including that it focuses on the gap between the law on the book and the reality of how contract law is delivered to consumers because of such factors as the costs of using the courts and the uncertainty about prevailing).

118. *See* Braucher, *Informal Resolution Model*, *supra* note 23, at 1406 (noting the primarily informal, extra-legal nature of the process of resolving consumer product quality complaints and disputes).

C. Economic Loss Due to Deceptive Practices

I have argued above that it is an error, both of policy and of reading the common law and the U.C.C. accurately,[119] to apply an economic loss rule to an intentional misrepresentation cause of action. If this is right, then *a fortiori* an economic loss rule does not apply to statutory consumer protection causes of action. But even if one thought common law fraud actions should not lie in some or all contractual contexts, one would have to ask the question why the states would have enacted broad statutes to protect consumers from unfair and deceptive acts but with an intent to limit the statutes to cases where no contract resulted or where the fraud was extraneous to the contract, without mentioning any such limitations.

The Third Circuit in *Werwinski* ignored this obvious question and treated the economic loss issue as the same under the common law of fraud as under the Pennsylvania consumer protection statute, saying only that "the same policy justifications" are present.[120] The policy justifications given by the court were as follows: "The economic loss doctrine is designed to place a check on limitless liability for manufacturers and establish clear boundaries between tort and contract law."[121]

It is especially hard to read into the Pennsylvania statute an intent to limit actions under it to cases involving more than pecuniary loss, given statutory language providing for recovery of "any ascertainable loss of money or property" as a result of the use of a prohibited practice.[122] As for the argument that clear boundaries are intended between warranty and a statutory consumer protection cause of action, this is untenable given that one of the unlawfully deceptive practices under the Pennsylvania statute is "[f]ailing to comply with the terms of any written guarantee or warranty given to the buyer at, prior to or after a contract for the purchase of goods or services is made . . . ."[123] This provision reflects the standard consumer protection analysis that non-performance of warranty obligations leaves most customers without usable warranty remedies and thus is a deceptive practice to be deterred with stronger remedies.[124]

Werwinski cited neither the statutory language referring to warranties nor that providing for recovery of loss of money for deceptive practices. Instead, we see a federal court in the ideological grip of an anti-liability fervor, making no real attempt to read a state statute accurately. It is not surprising that Pennsylvania courts have refused to follow *Werwinski*.[125] After even a federal district court in

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119. *See supra* Part I.B.

120. *See* Werwinski v. Ford Motor Co., 286 F.3d 661, 681 (3d Cir. 2002).

121. *Id.* at 680.

122. 73 PA. CONS. STAT. § 201-9.2 (2006).

123. *Id.* § 201-2 (4)(xiv).

124. *See infra* notes 133–134 and accompanying text (concerning same conclusion by Federal Trade Commission).

125. *See* Smith v. Reinhart Ford, 68 Pa. D. & C. 4th 432 (Pa. Com. Pl. 2004) (economic loss doctrine does not bar claims for either common law fraud or violation of Pennsylvania consumer protection statute); Oppenheimer v. York Int'l, No. 4348, 2002 WL 31409949 (Pa. Com. Pl. Oct. 25, 2002) (same); and Zwiercan v. Gen. Motors Corp., 58 Pa.

Pennsylvania[126] refused to follow the *Werwinski* case, another Third Circuit panel backed away from its reasoning, noting inadequate briefing in the case on a related issue.[127]

Werwinski is easily discredited, but it would be a mistake to apply an economic loss rule to other states' consumer protection statutes even when they lack specific references to recovery of money lost and to non-performance of warranties as a deceptive practice.[128] In most states, consumer protection statutes expanded the basis for liability, covering not only misrepresentation but also "unfair or deceptive practices," sometimes (but not always) with a list of examples and a catch-all provision for other conduct that "similarly creates a likelihood of confusion or of misunderstanding."[129] Even in the few state statutes that refer to fraud rather than deception,[130] the statute clearly adds remedies, indicating that common law remedies were viewed as inadequate. Furthermore, there was no "economic loss rule" for common law fraud in the 1960s and 1970s when consumer protection statutes were enacted.[131] Even if the common law of fraud has changed in a few places since then to recognize such a doctrine, it is dubious to apply it to limit the scope of these statutes, absent legislative action. To do so is not statutory interpretation but judicial statutory amendment.

Pennsylvania's statute is in step with consumer protection analysis elsewhere.[132] The FTC's Policy Statement on Deception, widely used as guidance

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D. & C. 4th 251 (2002) (Pennsylvania consumer protection statute claim is not subject to an economic loss rule).

126. *See* O'Keefe v. Mercedes-Benz USA, L.L.C., 214 F.R.D. 266, 276–77 (E.D. Pa. 2003).

127. Samuel-Bassett v. Kia Motors Am., Inc., 357 F.3d 392, 400, 401 n.5 (3d Cir. 2004).

128. *See* C.S.I.R. Enters. v. Sebrite Agency, Inc., 214 F. Supp. 2d 1276, 1290 (M.D. Fla. 2002) (narrowly construing a Florida Supreme Court decision, Comptech Int'l Inc. v. Milam Commerce Park, Ltd., 753 So. 2d 1219 (Fla. 1999), as holding that an economic loss rule did not apply to a statutory cause of action "only when" statutory language clearly indicated an intent to create a remedy in addition to other available remedies). *But see* Kollar v. Wells, No. 804CV937T17TGW, 2005 WL 2456198 (M.D. Fla. Oct. 5, 2005) (in an opinion decided by the same judge as *C.S.I.R.*, rejecting prior interpretation as "too narrow" and as not taking into account the doctrine of separation of powers).

129. ROTHSCHILD & CARROLL, *supra* note 9, at 886 (discussing this type of provision in one form of consumer protection statute); *id.* at 884–93 (describing the various types of consumer protection statutes, which usually have general language prohibiting unfair or deceptive practices).

130. SHELDON & CARTER, *supra* note 1, at 145 (noting that a few states' statutes do not mention deception but instead prohibit "misleading" or "fraudulent" practices and arguing that statutory fraud should be treated as akin to deception rather than common law fraud).

131. This notion seems to have been invented in the late 1980s. *See supra* notes 44–51 and accompanying text.

132. *See, e.g.*, TEX. BUS. & COM. CODE ANN. §§ 17.41 to 17.63 (Vernon 2002) (creating statutory consumer protection cause of action for breach of warranty); SHELDON & CARTER, *supra* note 1, at 188–89 (criticizing *Werwinski* and noting that most state courts do not hold that the economic loss rule bars UDAP claims of deception).

in the interpretation of state consumer protection statutes, clearly indicates an intention to use a deception theory to enforce warranties.[133] It lists "failure to meet warranty obligations" as an example of a deceptive practice and also notes, "When a product is sold, there is an implied representation that the product is fit for the purposes for which it is sold. When it is not, deception occurs."[134] Consumer protection statutes were enacted to protect consumers, not to codify the common law.[135] The point was to expand protection beyond what the common law of tort and contract provided at the time, usually both by eliminating common law restrictions on liability and by expanding remedies.[136] These broad and flexible statutes, which have characteristics of both tort and contract law, also go beyond either common law theory.[137]

II. CONSUMER PROTECTION STATUTES AS PERSUASIVE AUTHORITY IN THE COMMON LAW OF FRAUD

A. Extension of Consumer Protection Analysis to the Mass-Market Customer

If the courts leave the scope of consumer protection statutes alone and do not cut back on their range with an ersatz common law economic loss rule, the common law of fraud will not matter as much to consumers as to non-consumers. Consumers often will be better off using a statutory deception theory, which typically is easier to establish, particularly in class actions, and accompanied by better remedies, although sometimes it is desirable to pursue both a statutory cause of action and common law fraud, to have a chance at actual damages, attorneys' fees, and punitive damages.[138] In about 20 states, some non-household consumers

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133. *See* Letter from James C. Miller III, Chairman, FTC, to the Hon. John D. Dingell, Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce (Oct. 14, 1983), *reprinted in In re* Cliffdale Assocs., Inc., 103 F.T.C. 110 app. at 174 (1984), *available at* http://www.ftc.gov/bcp/policystmt/ad-decept.htm [hereinafter FTC Deception Policy]. For a discussion of the influence of FTC actions on interpretation of state consumer protection laws, see GREENFIELD, supra note 1, at 64.

134. FTC Deception Policy, *supra* note 133, at 169, 175.

135. *See* GREENFIELD, *supra* note 1, at 158–62, 173–76 (describing the types of consumer protection statutes and their general purpose to "put an end to the notion of caveat emptor in consumer transactions).

136. *See id.* at 173–76.

137. *See* SHELDON & CARTER, *supra* note 1, at 1 (also noting that the flexibility and breadth of these statutes allow them to be used creatively to address new forms of abusive practices).

138. *See id.* at 144 (describing statutes as "less stringent" than fraud); *id.* at 146 (noting that intent need not be proved); *id.* at 158, 781 (noting that reliance is often not a necessary element of a statutory claim and that this makes it easier to bring a class action); *id.* at 738 (describing statutory remedies as designed to "protect the public by enforcing sanctions," including "the beneficial deterrent value of multiple damage awards"). Courts have been willing to award multiple damages under consumer protection statutes without proof of intent. *Id.* at 148. On the other hand, where intent and reliance can be shown, punitive damages may be greater. Using both causes of action can permit recovery of actual damages and attorneys fees under a statute and punitive damages under a common law theory. *Id.* at 770. If statutory multiple damages are also sought, the plaintiff may have to elect which to take, unless the awards relate to separate violations. *Id.* at 778.

are covered by consumer protection statutes.[139] Again, the common law will often not be their best theory. Thus, the primary focus of this section is on customers who fall outside the scope of the applicable consumer protection statute and are not adequately covered by the common law of fraud, which therefore ought to expand to provide compensation and deterrence. Many non-household customers are in very similar circumstances to consumers in the narrow personal and household sense—specifically, mass-market customers.

The common law action of intentional misrepresentation, also known as deceit or fraud, is conventionally thought to require the following elements: intentional (scienter) misrepresentation of fact or opinion that is material, with intent to induce reliance, resulting in reliance that is reasonable or justified, and proximately causing pecuniary harm.[140] As we shall see, there is give in these elements.[141] Assuming no economic loss rule barring an intentional misrepresentation cause of action, the strictest version of the elements would usually be satisfied easily by a party defrauded in a large, fully-lawyered, negotiated deal between two sophisticated parties. Such a transaction typically involves detailed disclosures and representations on every material point both about the expected performance and background circumstances such as the financial condition of each party and market conditions that bear on the deal. Because so much is said and so much background is investigated and discussed, it is harder to conceal the truth without engaging in brazen lying. The common law fraud elements thus are likely to be easily met. The fraud action should lie to save the parties the added transaction costs of getting every representation put down in writing[142] and trying to fashion agreed remedies for fraud, for example a liquidated damages clause that will pass the "no penalty" test by detailing the uncertain, difficult-to-measure losses from all possible forms of fraud.[143] The costs of such a process would include breeding mistrust.

A strict version of the elements for common law fraud may not be so easy to show in many mass-market transactions, even if the customer is a large, sophisticated business. Elsewhere I have written about the many similarities between the situations of household consumers and mass-market customers with business purposes when it comes to shopping for and analyzing differences in terms offered on a take-it-or-leave-it basis.[144] Even a large business making a mass-market purchase often acts just as a household consumer does, paying attention to price and key elements of the deal, such as needed product functions, but not to the contingent legal terms. There is often no lawyer involved in

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139. *See id.* at 16–21, 89–96 (collecting case law and statutory provisions permitting statutory actions by individuals or businesses with non-household purposes).

140. DOBBS, *supra* note 35, at 1345.

141. *See infra* notes 152–156.

142. All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 867 (7th Cir. 1999) (pointing out that these costs would be imposed in all negotiated deals, not just those that end up in litigation).

143. *See* RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981); U.C.C. § 2-718(1) (2000).

144. Braucher, *Mass-Market Concept*, *supra* note 14, at 397, 418–19 (discussing ways in which business mass-market customers have the same difficulties as consumers).

reviewing terms, and the seller presents no opportunity for the buyer to negotiate and thus to draw the seller out on characteristics of the product. Shopping for the best terms (gathering them, analyzing the relevant law, and then comparing them) would be costly for the mass-market customer, with not enough likely at stake to justify that investment.[145]

The mass-market seller, on the other hand, typically puts a huge amount of planning into all aspects of the transaction, from advertising, packaging and display to the presentation and content of contingent form terms. Such a seller can spread all this costly effort over many transactions, while for the customer the purchase decision is likely to be much more rough and ready—involving a quick impression and little investigation. It would not be sensible to proceed otherwise with either a small transaction or even a larger one where there is no willingness on the part of the seller to negotiate and no readily available better alternative deal. The business customer often will not be able, as a practical matter, to discover concealed flaws in the product (such as those in computer software) or limitations in its terms (such as those in the rules of an arbitration organization specified as the only forum). In contrast, the mass-market seller will have ample opportunity through repeated transactions of the same type to identify ways in which its practices disadvantage and mislead its customers. As a result, it is appropriate for the common law to relax the elements of fraud in this type of context, taking cues from the law of consumer protection.

B. The Role that Consumer Protection Analysis Could Play

Aided by advocates, courts could mine a vast amount of case law under state consumer protection statutes for persuasive authority about how to move the common law of fraud to address deception in mass-market contexts involving business customers.[146] As noted earlier, the history of consumer protection statutes is that the Federal Trade Commission promoted them.[147] Many of the state statutes explicitly call upon state courts to interpret them in light of FTC interpretations of its powers to regulate unfair and deceptive practices.[148] Even when the statutes lack an explicit reference to FTC interpretations, the courts often use FTC interpretations because of the similarity of language between the FTC Act and the state "little FTC Acts," as they are often called.[149] Concerning its deception power,

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145. *See* William J. Woodward Jr., *Neoformalism in a Real World of Forms*, 2001 WIS. L. REV. 971, 989–90 (using a choice of law clause as an example of a term even a large business cannot afford to analyze and thus understand when entering into a relatively small transaction).

146. Two treatises have gathered and analyzed much of this case law. *See* SHELDON & CARTER, *supra* note 1; GREENFIELD, *supra* note 1.

147. *See supra* notes 9–12 and accompanying text.

148. *See* GREENFIELD, *supra* note 1, at 64 (discussing use of the federal law of deception by state courts either as a guide or because state statutory language expressly so directs).

149. *See id.* at 63, 176; ROTHSCHILD & CARROLL, *supra* note 9, at 886–93 (discussing various consumer protection statutes, including "mini-FTC Acts" closely patterned on the FTC Act); SHELDON & CARTER, *supra* note 1, at 1 (noting that the name "little FTC Act" is often used to refer to statutes addressing unfairness or deception, even when not exactly patterned on the FTC Act).

the FTC has issued a particularly lucid, and conservative, statement of principles about when it will act.[150] Because of its influence in many states and its refined analysis, the FTC Deception Policy makes a good illustration of the influence consumer protection law could have on common law fraud, and that policy will be my focus here. The FTC's analysis could usefully be included throughout the new Restatement's discussion of the common law of misrepresentation. So could analysis from the state-by-state case law under state consumer protection statutes.[151]

As previously mentioned, there are many pressure points in the traditional common law fraud elements.[152] To recap, those elements are intentional (scienter) misrepresentation of fact or opinion that is material, with intent to induce reliance, resulting in reliance that is reasonable or justified, and proximately causing pecuniary harm.[153] The requirement of scienter refers to making a misrepresentation either knowing of its falsity or in reckless disregard of whether it is true or false. Because the defendant rarely admits bad intent, scienter can typically only be proved circumstantially.[154] If an entity making a misrepresentation should have known of falsity, that showing may permit the inference that the entity did know.[155] Thus there is a fuzzy line between intentional and negligent misrepresentation. The element of intent to induce reliance is also one that often needs to be inferred, for example from the making of a material misrepresentation.[156]

In addition, the elements overlap and could benefit from simplification. For example, justifiability of reliance provides another cut at the plaintiff's actual reliance; it also tests again whether the defendant had an intent to induce reliance.[157] The requirement of a material misrepresentation also overlaps with justifiability of reliance.[158]

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150. FTC Deception Policy, *supra* note 133. The policy was issued to allay concerns in Congress that the FTC was out of control, which helps to explain why it does not give the most expansive possible scope to deception. *See* GREENFIELD, *supra* note 1, at 70–72 (discussing the "controversial" policy statement's apparent toughening of standards for two of the three elements of deception but then suggesting that if read carefully, the deception policy may not differ from earlier traditional articulations of FTC deception standards); SHELDON & CARTER, *supra* note 1, at 153, 157–58 (noting changes in FTC Deception Policy from earlier analysis, making it harder to establish deception, but also noting nuances in the changes that make them not that great; also discussing case law in some states continuing to follow older FTC authority using lower bar for finding deception).

151. *See generally* SHELDON & CARTER, *supra* note 1; GREENFIELD, *supra* note 1. These two treatises would be useful starting points for mining this case law.

152. *See supra* note 141.

153. *See supra* note 140.

154. DOBBS, *supra* note 35, at 1347.

155. *Id.*

156. *Id.* at 1349 (suggesting this is the better test, as opposed to "intent to deceive" which may be difficult or impossible to show if the defendant had a strong belief in his statement even though he had no basis for it).

157. *Id.* at 1360–61.

158. *Id.* at 1359.

The FTC Deception Policy provides that actionable deception occurs when three tests are met: (1) there is a material representation, omission or practice (2) that is likely to mislead (3) a reasonable consumer (reasonable according to a middling standard, that is, typical of at least a minority of the target audience).[159] In contrast to the many traditional elements of common law fraud, the FTC's three elements provide a more elegant and empirically grounded statement of principles, recognizing the typically inferential evidence of intent and switching to the customer perspective. The policy does not require a showing of intent to deceive; it is enough that a representation, omission or practice is material and likely to mislead a reasonable consumer.[160] This approach is consistent with assuming that intent typically is present when a seller makes material claims or omissions that are likely to mislead reasonable consumers. The FTC analysis could aid in resolution of borderline cases of scienter and intent to induce reliance in the common law of fraud as applied to mass-market transactions. A mass-marketer by definition is a repeat player in a position to learn that a significant group of its customers is being misled by its claims, omissions or practices. Because of its sophistication, it has the ability to anticipate this sort of effect and to avoid it as part of its typically elaborate planning process. Thus a showing that some customers were misled by a misrepresentation or practice should easily permit the inference that the mass-marketer did know that effect or at the very least was acting with reckless disregard as to whether customers would be deceived. In cases of doubt, the perspective that those who engage in mass-marketing likely know what impact they are having should help to resolve borderline cases in favor of finding actionable fraud.

The FTC Deception Policy also relaxes the traditional common law requirement of a misrepresentation of fact and treats as deception the practice of stating an opinion that implies facts that are not so. The Restatement (Second) of Torts already treats opinions that imply facts as a sufficient basis for liability,[161] and Professor Dobbs has suggested that the better analysis would focus "less on supposed rules about opinions and more on the effect that the words would be likely to have in the bargaining transactions before the court . . . ."[162] This approach is consistent with the FTC's deception analysis, in that the FTC looks at whether the "typical buyer"[163] is likely to be misled, so that obviously exaggerated or puffing representations are not actionable, but those likely to be taken seriously are. A consumer interpretation can be a secondary meaning and still be reasonable.[164] The FTC also stresses that customers can react to opinions as factual because facts are implied by a statement of opinion and, as a result, customers take away a "net impression" that is deceptive.[165] The law of fraud could more deliberately incorporate the customer perspective when analyzing whether any given representation or omission should be actionable. A particularly misguided

159. FTC Deception Policy, *supra* note 133, at 170–71.
160. *See id.*
161. *See* RESTATEMENT (SECOND) OF TORTS § 542 (1977).
162. DOBBS, *supra* note 35, at 1366.
163. FTC Deception Policy, *supra* note 133, at 179.
164. *Id.* at 179–80 n.2.
165. *Id.* at 179, 181.

recent case by this standard is *Tietsworth v. Harley-Davidson, Inc.*, in which the majority—over a strong dissent by Chief Justice Abrahamson—concluded that advertising a Harley TC-88 as "a masterpiece" and "filled to the brim with torque and ready to take you thundering down the road," were instances of puffery, not actionable under the state's deceptive trade practices statute even if consumers could prove loss of value due to defective engines with a propensity for premature engine failure.[166] Chief Justice Abrahamson protested that Harley-Davidson has built its reputation on producing high quality products, and in that context the claim that it built "a masterpiece" would lead a reasonable person to conclude that the motorcycle in question did not have a material defect.[167] More than 60 years ago, Justice Traynor noted that "[c]onsumers no longer approach products warily but accept them on faith, relying on the reputation of the manufacturer,"[168] and a wealth of research since has confirmed that consumers respond to much puffery as implying facts about quality.[169]

The common law of fraud has independently become more expansive and now covers nondisclosures in some situations and not just false statements. First, there was recognition of "fraud by silence" in certain circumstances, perhaps most obviously when a defendant did not correct misimpressions created by half-truths.[170] The Restatement (Second) of Torts goes further and adds an obligation of disclosure when the defendant knows that the plaintiff is acting under a mistake that is basic to the transaction, even though not induced by the plaintiff's statements or actions, but where disclosure to correct a misimpression would reasonably be expected.[171] This approach finds support in, and could be informed by, the FTC's Deception Policy, as well. Because there is an implied representation that products are fit for the purposes for which they are sold, it is deceptive not to disclose flaws that make products unfit.[172] Generally, incomplete information and omitted information about material aspects of a transaction are deceptive.[173] A seller's silence about a material known flaw is a failure to correct an implied representation of fitness and thus is equivalent to stating a half-truth.

The concept of materiality of a deceptive statement or omission is present both in the common law and in consumer protection law.[174] The common law concept could be informed by consumer protection analysis, particularly by analysis of what sorts of claims and omissions should be treated as presumptively material. The FTC in its Deception Policy stated that it presumes all express claims

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166. 677 N.W.2d 233, 237, 245–46 (Wis. 2004).

167. *Id.* at 259 (Abramson, J., dissenting).

168. Escola v. Coca Cola Bottling Co., 150 P.2d 436, 443 (Cal. 1944) (Traynor, J., concurring).

169. Preston, *supra* note 22, at 80–83 (describing consumer reliance on the truth of what the law calls puffery and lack of empirical support for the notion that consumers view puffery as meaningless).

170. *See* DOBBS, *supra* note 35, at 1375.

171. *See* RESTATEMENT (SECOND) OF TORTS § 551(2)(e) (1977).

172. FTC Deception Policy, *supra* note 133, at 175.

173. *See id.* at 175, 186.

174. *See supra* note 140 (concerning materiality as an element of common law fraud); *supra* note 159 (same as element of deception).

are material.[175] If a seller states something about a product or service, presumably it is because it thinks that customers will be influenced by that statement. In the case of either claims or omissions, the FTC treats as presumptively material information pertaining to safety, efficacy, cost, or other central characteristics of a product or service.[176]

CONCLUSION

Common law fraud is a tort designed to compensate for and deter active and passive transactional cheating that causes pecuniary harm. Misusing dicta from products liability cases, a handful of courts—mostly federal courts in diversity cases—have lately invented an "economic loss" rule limiting use of a fraud action in a contractual context. This move is neither historically grounded nor defensible policy. Warranty law is rarely fully compensatory, and it most certainly is not designed to deter fraud. Private ordering is impaired when it is founded on misrepresentation; it is hard to shop for the best deal if one must assume all claims, express or implied, are false.

An even more outrageous development is the extension of an economic loss rule to statutory consumer protection claims. Consumer protection statutes were enacted in the 1960s and 1970s to protect consumers by expanding the basis of liability beyond what the common law of contract or tort provided and by improving the remedies for loss of value due to unfair or deceptive practices, thus making litigation more feasible.

Because every state has a broad consumer protection statute, it is appropriate to view these statutes and interpretations of them as a powerfully persuasive body of law that can help to modernize the common law of fraud. The Federal Trade Commission's interpretations of its own powers are very influential in the interpretation of state consumer protection laws and could also be a source of development of the common law. Many state consumer protection laws apply to some customers who are not household consumers. Because mass-market customers often have the same difficulties as household consumers when it comes to trying to avoid or redress deception, the common law of fraud should be particularly open to expansion as applied to the mass-market, making use of consumer protection analysis.

The American Law Institute's Restatement (Third) of Torts: Economic Loss could serve a useful purpose by clarifying that common law fraud is a pecuniary loss tort, not limited by an economic loss rule. The Restatement could also help to modernize the common law of fraud, make it more empirically grounded and increase its deterrent effect by incorporating in its commentary insights from consumer protection law, making this vast body of law more accessible for direct use on behalf of consumers and as persuasive authority where appropriate.

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175. FTC Deception Policy, *supra* note 133, at 188.
176. *Id.* at 188–89.

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