

# SOME THOUGHTS ON “THE ECONOMIC LOSS RULE” AND APPORTIONMENT

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For the Tucson symposium, I was asked to comment on the applicability of apportionment to the economic torts covered by the proposed Restatement. This led me to consider two questions subsumed in the problem: First, the central proposition about which the Restatement appeared to be organized, as reflected in the proposed Section 8; and second, the importance of apportionment altogether. Since that conference there have been interesting developments in the evolution of that central concept—or at least in the expression of it—that go a long way toward mitigating my misgivings.

Perhaps a recapitulation of the evolution of Section 8 over the past year or so may be of some interest. This evolution illuminates the intended scope of the new Restatement. And it may reflect the collegial processes by which discussions within the American Law Institute, and among those who follow its work, encourage its Reporters in the refinement of their proposals. Ultimately, it is to be hoped, a fair degree of consensus can thereby be achieved among experienced participants in the effort.

At the time of the symposium, it was my understanding that the central proposition of the Restatement was intended to be a statement in Section 8, to be called “the economic loss rule.” In effect, this would assert that there is no liability in negligence, products liability, or strict liability for accidentally caused pecuniary harm that does not result from a wrongful injury to the person or property of the claimant, except as set out in certain subsequent sections of the Restatement. This was not what Section 8 said in the previously published draft,<sup>1</sup> but I understood

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

**§ 8. The economic loss rule.**

An actor who accidentally causes pecuniary harm to another that does not result from a wrongful injury to the person or property of

from remarks of the Reporter, Professor Mark Gergen, at a meeting of the ALI Members Consultative Group in October 2005 that this was what he intended to provide.

This suggestion gave me pause, because I had not previously thought that there was any such thing as a single “economic loss rule.” Instead, I had thought that there was a constellation of somewhat similar doctrines that tend to limit liability, in the case of purely economic loss, from what might have been expected under *Palsgraf* in the case of physical loss.<sup>2</sup> These doctrines seemed to work in somewhat different ways in different contexts, for similar but not necessarily identical reasons, with exceptions where the reasons for limiting liability were absent.

The core concept of this constellation, not quite a “rule”, seems to me to be an inhibition against liability in negligence for economic harm not resulting from bodily injury to the claimant or physical damage to property in which the claimant has a proprietary interest.<sup>3</sup>

The reasons for this inhibition have not traditionally been clear. Perhaps there is here a flavor of a “standing” issue—a difference sensed between a complaint about harm to one’s own property as compared with harm to another’s. Perhaps, similarly, there is a concern with the possibility of duplicative claims, if these boundary lines are crossed. Fear of “indeterminate” or “incalculable” damages is sometimes expressed, for reasons not specified—perhaps concern about actuarial unmanageability, that is, non-insurability, except at exorbitant premiums, or subject to unwelcome restrictions, such as deductibility requirements.

Two caveats are in order here. First, the courts do not usually *say* that their concern is the risk of uninsurability<sup>4</sup> (although they also do not say why there should be any concern about liability that is readily insurable). Second, lawyers and judges would be well advised to avoid assumptions about insurability or non-insurability in the absence of expert evidence of what the insurance market is in fact prepared to provide.

These concerns are often coupled with references to the expected “ripple-effects” in the economic impacts from negligence, where the expected physical effects would be more limited.

There may have been another reason for the inhibition: A paradoxical situation can arise where there is a very large number of potential victims (as in

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the other is subject to liability in tort for neglect of a duty of care to the other only as stated in §§ 9–21.

2. *Palsgraf v. Long Island R.R.*, 162 N.E. 99 (N.Y. 1928); *cf.* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL HARM § 7 cmt. j & reporter’s note (Proposed Final Draft No. 1, 2005).

3. *See generally* FOWLER V. HARPER, FLEMMING JAMES JR. & OSCAR S. GRAY, THE LAW OF TORTS §§ 25.18A–25.18D (2d ed. 1986 and Supp. 2006); *see also* *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303, 308–09 (1927).

4. For a thoughtful exception, see *State of Louisiana ex rel. Guste v. M/V Testbank*, 752 F.2d 1019, 1029 (5th Cir. 1985).

conflagration cases, in the realm of physical damages)<sup>5</sup> and better risk distribution may be obtained by leaving losses to lie where they fall than by attempting to concentrate them on an injurer—even if the injurer is to some extent insured.

Other somewhat related concepts are also encountered, in which distinctions are drawn on the basis of the availability of compensation for economic losses, depending on whether particular kinds of physical harm exist. For instance, in the case of liability of suppliers of chattels to purchasers, there is no tort liability, even if there is harm to claimants' property resulting from a defect in the product sold, unless the harm is to property—*other* than the defective item sold.<sup>6</sup> The reason, evidently, is that the risk of loss is better handled under contract law applicable to the transactions in which the parties have engaged than under tort law—a reason that fits the claims of purchasers better than those of bystanders or other affected third parties.

There is yet another somewhat related doctrine. In the case of negligent misrepresentation, there is in most jurisdictions liability for purely economic loss, but only to those in privity with the defendant or to whom, or for whose benefit, the misrepresentation was made. The limitations on recovery reflect fear of “indeterminate” or “incalculable” liability, perhaps because of fear of non-insurability (again—*caution*), perhaps because of the paradox mentioned above as to risk distribution.<sup>7</sup>

At the time of the Tucson conference, I thought that the Reporter had ably differentiated these doctrinal strands but had attempted to make the case that they had become “crystallized” in a single “economic loss rule,” with specific exceptions that pick up the types of liability to which I have referred.

I could not say that he was wrong. The trend he depicted had probably come to pass in some jurisdictions. Some courts would probably say what he appeared to say. But some courts would say all kinds of things—for example, that the “economic loss rule” applies generally to all torts, a plainly incorrect position that the Reporter himself would strongly repudiate.

Enough courts have said a sufficiently diverse variety of things about the supposed rule that we are not driven by precedent to accept a “crystallization” unless we think it is desirable to do so. It is not desirable to do so for several reasons:

(a) It is difficult to foresee all the circumstances in which the question will arise as to whether liability should be extended for economic harm caused by

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5. The potential for such an outcome may underlie *H.R. Moch Co. v. Rensselaer Water Co.*, 159 N.E. 896 (1928). It may also underlie the “harm of a different kind” requirement for liability to individuals in public nuisance. RESTATEMENT (SECOND) OF TORTS § 821 (1) (1979); *cf.* RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 20 (2)(b) (Preliminary Draft No. 2, 2006).

6. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21(c) (1998).

7. A more sophisticated discussion of supposed reasons for the “rule” than is normally encountered in judicial opinions is presented by the Reporter in RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8 cmt. b (Preliminary Draft No. 2, 2006).

conduct that is considered tortious. The answer in any newly-encountered circumstance should not be driven by the supposed constraints of a generalization that has been adopted for aesthetic reasons. It should arise instead from an analysis of the specific circumstance at issue and of the reasons, if there are any, for limiting liability in those circumstances.

At the October 2005 Members Consultative Group Meeting, Professor Michael Green<sup>8</sup> cautioned the ALI against premature acceptance of generalizations about strict liability, in light of the number of odd miscellaneous applications of strict liability that might present considerations of their own, such as liability for harm caused by animals. He was unable, on the spur of the moment, to suggest how strict liability for animals could give rise to liability for purely economic loss, but with the benefit of further reflection, I could do so, by the time of the Tucson conference.

The example I gave concerns the impregnation of purebred breeding stock by trespassing non-pure-bred livestock (or livestock of another breed). Damages in such a cross-breeding case are awarded on the theory that impregnation does not constitute injury to the impregnated animal, but her value is thereby diminished in these circumstances and her owner entitled to compensation for this loss of value. This is the case whether the liability of the owner of the trespassing bull or stallion is based on negligence or on strict liability for trespassing livestock.<sup>9</sup>

Accordingly, this serves as an example of an exception to the proposed “economic loss rule,” not picked up as of that time in the proposed Restatement, that applies to negligence as well as to strict liability. The example is not important, except as an illustration of the hazards of premature generalization, as contrasted with category-by-category consideration of the reasons, if any, for limiting liability.

(b) The proposed crystallization makes the default rule a non-liability rule, which is regrettable, not only for the reasons already discussed, but also because it seems wrong in principle. The proposed rule seemed to come perilously close to being a “no-duty” rule. Section 8 in Preliminary Draft No. 1 is not quite presented in terms of limitations of duty (as distinguished from extent of liability). However, I understood the Reporter to have acknowledged that he intended for it to be so understood, notwithstanding that the draft Physical Harm Restatement rejected the *Palsgraffian* “duty” analysis in the case of the classical limitation of liability to foreseeable victims.<sup>10</sup> This inversion appears perverse to me. Surely in principle we owe foreseeable victims of our negligence a duty of care—in the sense that we ought to exercise reasonable care toward them—regardless of how we may explain our non-liability to unforeseeable victims and regardless of any

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9. See, e.g., *Crawford v. Williams*, 48 Iowa 247 (1878) (negligence); *Fuchser v. Jacobson*, 290 N.W.2d 449 (Neb. 1980) (recognizing same result in either negligence or strict liability); *Hall v. Umiker*, 209 N.W.2d 361 (S.D. 1973) (strict liability).

10. See *supra* note 2.

countervailing considerations we may accept as limitations of our liability for harm caused by our breach of that duty of care.

Against this background, it now appears that the proposed Section 8 has been changed again, this time for the better. In Restatement (Third) of Torts: Economic Torts and Related Wrongs, Preliminary Draft No. 2, section 8<sup>11</sup> appears as follows:

§ 8. Economic Loss Rule

(1) An actor is not subject to liability under the negligence, strict liability, and products liability actions described in the Restatement Third, Torts: Liability for Physical Harm and Restatement Third, Torts: Products Liability for solely pecuniary harm resulting from the actor's unreasonable conduct, abnormally dangerous activity, or defective product.

(2) Pecuniary harm not resulting from an injury to the plaintiff's person or property is solely pecuniary.

(3) An actor is subject to liability for solely pecuniary harm resulting from the actor's breach of a duty of care as stated in §§ 9–18 or resulting from the actor's unreasonable conduct, abnormally dangerous activity, or defective product as stated in §§ 9 and 19–21.<sup>12</sup>

This formulation, together with accompanying comments, has the virtue of explicitly limiting the effect of the phenomenon which it expresses to three actions: negligence, strict liability for abnormally dangerous activities, and products liability.<sup>13</sup>

The claim underlying the proposed “rule” is the assertion that there is a “boundary” to these tort actions, limiting their availability to cases of physical harm to the plaintiff, with certain exceptions. Furthermore, the draft sets out certain reasons for the exceptions that are, on the whole, well-presented.<sup>14</sup>

Although I consider this formulation to be a serious improvement from our earlier versions, I have residual misgivings for at least two reasons. I respectfully question the assumption that previous decisions of the ALI constitute a common “barrier” to the application of all three of these actions in the absence of physical injury to the plaintiff. The claim is probably justified in the case of the

11. RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8 (Preliminary Draft No. 2, 2006).

12. Section 9 sets out certain “General Principles” that determine when an actor should be subject to liability for “solely pecuniary harm.” Section 19 deals with “Relational Economic Loss” as in, for example, actions for loss of consortium or wrongful death. Section 20 deals with actions for public nuisance. Section 21 relates to “Preventive Expenses” to repair, monitor or mitigate risks of serious bodily harm.

13. This draft makes it clear, for instance, that “[t]he economic loss rule is not a general rule of non-liability for inadvertent or accidental pecuniary harm not accompanying physical injury.” RESTATEMENT (THIRD) OF TORTS: ECON. TORTS & RELATED WRONGS § 8 cmt. a (Preliminary Draft No. 2, 2006).

14. *Id.* § 9.

ALI's work on products liability.<sup>15</sup> I doubt, however, whether the inclusion, in a Restatement that purports to deal specifically with physical harm, of language limiting liability in a strict liability action for abnormally dangerous activities to certain types of physical harm is equivalent to a barrier against the recognition elsewhere of analogous strict liability applicable to non-physical harm. And I consider the claim overstated as it applies to negligence law, unless softened as suggested below.

More specifically, I believe that the presentation would be strengthened by a generalization from the reasoning used to explain the exceptions to the "rule" that are specified in the draft. It should be understood not only that these exceptions are explained by the non-existence in certain circumstances of factors such as are specified in proposed section 9(3) of Preliminary Draft No. 2, but also that courts may be expected to recognize additional exceptions whenever there is an absence of all such factors. The drafters may intend to cover this by proposed section 9(4). If so, explicit reference to this in Section 8 as well would clarify the draft.

As to the applicability of apportionment to economic torts, I would approach the question by considering reasons for or against its use in particular contexts. There are three principal potential applications of apportionment. The first concerns whether claimant's recovery from a tortfeasor should be reduced or eliminated because of claimant's own negligence, that is, the issue of contributory negligence or comparative negligence (or fault). Here I am usually inclined to consider first whether, in the absence of comparative fault, a contributory negligence bar would apply to plaintiff's conduct. If it would, then comparative negligence is preferable, in that its consequences are less disproportionate to plaintiff's fault than would be the all-or-nothing contributory negligence bar. Otherwise, I am not inclined to introduce apportionment against the claimant except as an alternative to contributory negligence for two reasons.

First, the effect of reducing or eliminating claimant's recovery is usually to shift the loss from a party relatively capable of causing it to be distributed to a party less able to effect loss distribution, such as an ordinary consumer. Second, the claim that such a penalty will encourage more reasonable conduct—and hence loss minimization—on the part of claimants has always seemed to me to rest on unrealistic psychological assumptions. At least where the claimants are not institutions, for instance, their ability to assess risks and to compare near-term with long-term costs and benefits is very limited. Particularly in the case of claims by ordinary individuals against business enterprises, the disparity between the parties' ability to assess risk is so great as to make the sauce-for-a-goose argument for treating claimants and tortfeasors alike completely illusory. And the notion that such a rule is likely to deter risky conduct on the part of claimants seems equally unrealistic. The force of the prospect of the loss itself that is foreseeable from plaintiff's lack of care should ordinarily outweigh that of the prospect of the application of a legal rule to the claim for that loss. Here, however, some potential differences between economic torts and torts involving physical injury are

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15. See, e.g., RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. §§ 1, 21 & cmt. a (1998).

apparent. Where claimant has risked life and limb, it is much more clear that an additional risk to his potential claim against a tortfeasor is not likely to have a decisive effect on his conduct than where claimant has been careless only with regard to his economic interests. And, if by economic torts we refer to disputes between business organizations, it is likely that both sides have relatively equal abilities to assess risks and to govern their conduct accordingly. Nevertheless, on balance I would not welcome the introduction of apportionment against claimants where contributory negligence would not apply in its absence, unless its application could be reliably limited so as not to disadvantage ordinary individuals. An exception for consumer transactions might be a way to approach this objective, but would probably not go far enough.

A second major application for apportionment may be in the case of contribution among joint tortfeasors. I suppose that if we have contribution at all—and it is generally accepted that we should—comparative contribution is more fair than per capita contribution. I would, however, caution restraint as to the importance of the subject. It may be worth recalling Fleming James's opposition to contribution, on the ground that defendants are almost always insured, so that contribution deals only with the adjustment of claims among liability insurers, who are perfectly capable of working such matters out among themselves without the social expense of having courts do it for them. Not all defendants are insured by liability insurers, of course—some, for example, are self-insured—so I suppose we must have default contribution rules, but on the whole it is questionable whether it matters much what those rules are.

The third possible application, of course, is for the determination of the liability of multiple defendants under several liability statutes. Here, I suppose, the wording of the statutes is likely to be more determinative than any attempts at generalization that have occurred to me. If there is a question under the statutes (which I assume would ordinarily call for apportionment), and if there are substantive reasons for treating economic torts differently from those involving physical harm for purposes of several liability, I look forward with interest to learning about them from those who have thought more clearly on the subject than I have done.

### POSTSCRIPT

As this article goes to press, yet another version of section 8 has appeared, in Restatement (Third) of Torts: Economic Torts and Related Wrongs, Council Draft No. 1 (October 2, 2006). Section 8 has now been retitled "Economic loss rule and reasons precluding liability." The proposed section has been revised beyond my ability to discuss it in detail at this writing. Briefly, it does set out specific considerations that purport to exclude liability. In doing so, it makes some questionable claims that can be expected to attract critical attention, for example, that contributory negligence bars recovery entirely, a proposition that I think, as it stands, unnecessarily and improperly undervalues the importance of the apportionment principle.

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