
Article

The Remains of the Citadel (Economic Loss Rule in Products Cases)

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INTRODUCTION

“[P]roducts liability law lies at the boundary between tort and contract.”¹ At the outset of the twentieth century, product defect claims were squarely within the province of contract law—one could only recover if in privity of contract with the product seller, and only in accordance with the specific provisions and limitations of contract.² By the end of the century, products liability had emerged as a vibrant branch of tort law because of several dramatic changes in the law. Chief among these was the fall of the “citadel” of privity—“the cluster of rules precluding liability for certain kinds of wrongs unless the victim and injurer were in privity of contract.”³ Another related

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1. RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 21 cmt. a (AM. LAW INST. 1998).

2. See, e.g., George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461, 461 (1985) (“In the 1920s, recovery for injuries resulting from product use was chiefly determined by contract law . . .”). One could recover if the seller had violated an express warranty, or an implied warranty required by law, such as a default warranty that a good was merchantable. *Id.* But see MARK A. GEISTFELD, PRINCIPLES OF PRODUCTS LIABILITY 10–19 (2d ed. 2011) (tracing the evolution of strict products liability from implied warranty, which had its origins in tort principles dating to the 18th century).

3. Kenneth S. Abraham, *Prosser’s The Fall of the Citadel*, 100 MINN. L. REV. 1823, 1823 (2016). The key case was *MacPherson v. Buick Motor Co.*, 111 N.E. 1050 (N.Y. 1916) (holding that a consumer could sue a manufacturer in tort for negligence). Before this, a consumer injured by a shoddily manufactured car would have had to sue the seller for breach of contract based on a breach of an express or implied warranty, and then perhaps the seller would

trend was the expansion of the theory of implied warranty of merchantability beyond retailers and buyers.⁴ Additionally, traditional contract restrictions controlling warranties, such as the ability for parties to limit or disclaim liability, or notice requirements, were dropped; this turned the implied warranty remedy into a de facto strict liability tort.⁵ Finally, the rise of the theory of strict products liability fueled this transformation of product defect claims from contract into tort.⁶ By the 1960s, an injured consumer not in privity with the manufacturer could often successfully sue using both a breach of contract (implied warranty) theory and a tort theory (either negligence or strict liability).⁷

The privity requirement was a device for preventing “concurrent remedies” in contract and tort,⁸ with the fall of the priv-

sue the manufacturer for breaching the contract between them. Now, the consumer had a direct remedy in tort against the manufacturer in addition to his or her contractual remedies.

4. See *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 82–84 (N.J. 1960) (holding that an implied warranty of merchantability exists between a third-party manufacturer and the ultimate purchaser, and that “[a]bsence of agency between the manufacturer and the dealer who makes the ultimate sale is immaterial”). This allowed a consumer to sue directly a manufacturer for breach of contract under a theory of a breach of an implied warranty.

5. A general distinction between tort and contract is that contract imposes various restrictions on suing under warranty—such as notice requirements, limitations on recovery and on the statute of limitations, and a seller’s ability to disclaim liability; as courts began loosening those restrictions, the difference between suing in contract and tort narrowed. See, e.g., *La Hue v. Coca-Cola Bottling, Inc.*, 314 P.2d 421 (Wash. 1957) (holding that the notice requirement for warranties does not apply when a consumer is suing a manufacturer not in privity); see also *Greeno v. Clark Equip. Co.*, 237 F. Supp. 427, 429 (N.D. Ind. 1965) (describing strict products liability as “hardly more than what exists under implied warranty when stripped of the contract doctrines of privity, disclaimer, requirements of notice of defect, and limitation through inconsistencies with express warranties”). To put it another way: “*Henningsen* effectively imposed strict liability in tort, although the court did not describe it that way.” Abraham, *supra* note 3, at 1833.

6. This changed the standard from negligence to strict liability for consumers suing manufacturers in tort. See *Greenman v. Yuba Power Prods., Inc.*, 377 P.2d 897, 901 (Cal. 1963) (adopting strict products liability for manufacturing defect that caused physical injury); *Escola v. Coca Cola Bottling Co. of Fresno*, 150 P.2d 436, 461–68 (Cal. 1944) (Traynor, J., concurring) (arguing that strict liability should govern product defect claims for various policy reasons).

7. See Curtis R. Reitz & Michael L. Seabolt, *Warranties and Product Liability: Who Can Sue and Where?*, 46 TEMP. L.Q. 527, 527–31 (1973) (discussing purchasers’ dual lines of attack and how old restrictions on both began to lose force).

8. See Vernon Palmer, *Why Privity Entered Tort: An Historical Reexami-*

ity limitation in products cases, there was a search for a new limiting principle for both the scope of liability and for concurrent theories of liability. The economic loss rule in products cases rears its head in the mid-1960s—not coincidentally, right at the triumphant moment for strict products liability and the widespread adoption of the Uniform Commercial Code’s set of warranties between retailers and buyers (i.e., parties in privity of contract)—to reassert the contract-tort border, circumscribe the strict liability rule, and defend privity’s last bastion.

Judge Benjamin Cardozo coined a phrase in 1931 when he famously opined: “The assault upon *the citadel of privity* is proceeding in these days apace.”⁹ But it was William Prosser who assured its place in the legal firmament with a pair of path-breaking articles, the first in 1960 proclaiming, *The Assault upon the Citadel (Strict Liability to the Consumer)*,¹⁰ and the second six years later, announcing, *The Fall of the Citadel (Strict Liability to the Consumer)*.¹¹

Prosser’s prophecy in *The Assault upon the Citadel* was prescient¹² and his proclamation of *The Fall of the Citadel* and the triumph of strict liability theory in the area of defective products resolute. But his exuberance led him to overlook the last remaining bastion of privity: purely financial losses stemming from product defects.

nation of Winterbottom v. Wright, 27 AM. J. LEGAL HIST. 85, 85 (1983) (arguing that disfavor for concurrent remedies was a significant factor in explaining *Winterbottom* and other cases requiring privity to reduce the scope of negligence liability).

9. *Ultramares Corp. v. Touche*, 174 N.E. 441, 445 (N.Y. 1931) (emphasis added).

10. William L. Prosser, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099 (1960) [hereinafter Prosser, *Assault*]. G. Edward White has praised *The Assault upon the Citadel* as “a model of how legal scholarship can serve to further doctrinal change in a common law subject.” G. EDWARD WHITE, *TORT LAW IN AMERICA: AN INTELLECTUAL HISTORY* 169 (exp. ed. 2003).

11. William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791 (1965) [hereinafter Prosser, *Fall*].

12. See, e.g., Priest, *supra* note 2, at 506 (“The timing of [the] publication [of *The Assault upon the Citadel*] must have created a sensation. Prosser’s article describing the trend toward the abolition of privity and the invalidation of disclaimers appeared one month . . . after [Henningsen] abolish[ed] privity and invalidat[ed] disclaimers. . . . This simultaneity of prediction and confirmation is extraordinary and is unknown even in scientific work.”); see also Abraham, *supra* note 3, at 1832 (“Prosser was both a prophet and more. As he had been in the past in predicting other changes in tort law, Prosser was extremely adept at prophesying legal change, even if he was apt to exaggerate the support he had for his predictions.”).

By and large, “through the late 1950s and early 1960s defective product cases were controlled by contract law with its privity requirement and, to a substantially lesser extent, by negligence law.”¹³ Moreover, as Prosser explained in *The Borderland of Tort and Contract*, concurrent remedies in implied warranty and negligence were commonly available; implied warranty was itself the “borderland” between tort and contract.¹⁴ Thus, when Prosser wrote *The Assault upon the Citadel* in 1960—and decried, “the dam has busted, and . . . those in the path of the avalanche would do well to make for the hills”—he paid scant attention to the “refusal on the part of a few courts to allow recovery for pecuniary loss to the consumer caused by defects in the products itself, such as the cost of repairing it when it breaks down.”¹⁵ He thus overlooked the significance of a handful of notable stalwarts, holding fast to privity in the realm of negligently-inflicted purely economic losses.

Chief among these was *Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, in which the New York Supreme Court of New York County, in 1955, rebuffed a negligence claim seeking the replacement cost of allegedly defective airplane engines with the admonition: “If the ultimate user were allowed to sue the manufacturer in negligence merely because an article with latent defects turned out to be bad . . . there would be nothing left of the *citadel of privity* . . .”¹⁶ *Trans World Airlines (TWA)* was a harbinger of the modern economic loss rule, a judicially created doctrine protecting the “remains of the citadel,” and one that would face increasing pressure to withstand the onslaught of claims following the rise of strict liability in products.

Part I traces the fall of “the shackles of privity,”¹⁷ the rise of strict products liability, and the emergence of the economic

13. Priest, *supra* note 2, at 462.

14. WILLIAM L. PROSSER, *The Borderland of Tort and Contract*, in SELECTED TOPICS ON THE LAW OF TORTS 422–29 (1954); *see also* William L. Prosser, *The Implied Warranty of Merchantable Quality*, 27 MINN. L. REV. 117 (1943) (reviewing the common law underpinnings of the implied warranty of merchantability in the Uniform Sales Act).

15. Prosser, *Assault*, *supra* note 10, at 1103 n.27 (citing *Wyatt v. Cadillac Motor Car Div.*, 302 P.2d 665 (Cal. Ct. App. 1956); *Lucette Originals, Inc. v. Gen. Cotton Converters, Inc.*, 185 N.Y.S.2d 854 (App. Div. 1959); *Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, 148 N.Y.S.2d 284 (Sup. Ct. 1955); *A. J. P. Contracting Corp. v. Brooklyn Builders Supply Co.*, 11 N.Y.S.2d 662 (Sup. Ct. 1939), *aff'd mem.*, 15 N.Y.S.2d 424 (App. Div. 1939), *aff'd per curiam*, 28 N.E.2d 412 (N.Y. 1940)).

16. 148 N.Y.S.2d at 289–90 (emphasis added).

17. Prosser, *Fall*, *supra* note 11, at 799.

loss rule. *MacPherson v. Buick Motor Co.* ushered in the revolution in 1916 by announcing the fall of privity.¹⁸ The *TWA* case was more than an outlier of its time; it was the harbinger of the economic loss rule in products cases, which gathered momentum in the face of the rise of strict products liability. Once strict liability threatened to make manufacturers insurers for disappointed economic expectations of remote consumers, courts drew a bright line and limited recovery to contracting parties, via express or implied warranty. Whereas the fall of privity and rise of strict products liability enabled product defect cases to move from contracts into torts, the economic loss rule forged a new dividing line, keeping purely financial loss cases within the domain of contract. From this vantage point, the economic loss rule emerged to protect the “remains” of the citadel of privity.

Part II takes up the debate over the emergence of the economic loss rule in products cases, as it was framed by the opposing positions taken by a pair of cases decided in 1965: the New Jersey Supreme Court in *Santor v. A & M Karagheusian* that opposed the rule¹⁹ and the California Supreme Court in *Seely v. White Motor Co.* that embraced it.²⁰ Two decades later, in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, the U.S. Supreme Court sided with *Seely* over *Santor*, ensuring the survival and spread of the economic loss rule to partition the “separate spheres” of products liability and contract law.²¹ Part II further examines the competing rationales for rejecting the imposition of nondisclaimable tort duties independent of any contractual undertakings when product defects lead to financial losses. The Conclusion then analyzes the normative significance of preserving the “remains of the citadel.”

I. THE “REMAINS OF THE CITADEL”

In *The Assault upon the Citadel*, Prosser chronicles the transition of liability “where the seller of chattels defends against the ultimate consumer, with whom he stands in no

18. 111 N.E. 1050 (N.Y. 1916); *see also, e.g.*, *Mazetti v. Armour & Co.*, 135 P. 633, 634 (Wash. 1913) (defining the privity bar as “a general rule that a manufacturer is not liable to any person other than his immediate vendee; that the action is necessarily one upon an implied or express warranty, and that without privity of contract no suit can be maintained; that each purchaser must resort to his immediate vendor”).

19. 207 A.2d 305 (N.J. 1965).

20. 403 P.2d 145 (Cal. 1965).

21. 476 U.S. 858, 870–71 (1986).

privity of contract,” from a regime governed by privity and warranties to one ruled by negligence and strict liability.²² Prosser noted that while the requirement of privity had fallen in the face of claims of negligence in manufacturing, there was “still a refusal on the part of a few courts to allow recovery for pecuniary loss to the consumer caused by the defects in the product itself, such as the cost of repairing it when it breaks down.”²³ Prosser nonetheless asserted: “Apart from these few cases, no one now seriously disputes the broad general rule that the seller of a chattel is *always* liable for his negligence.”²⁴

Prosser, however, underestimated the force of the opposition. Far from being an outlier, *TWA*, one of the “few cases” mentioned by Prosser,²⁵ presaged the emergence of the economic loss rule in the face of the rise of strict products liability. With Prosser’s attention fully captured by the dramatic siege on the citadel of privity, he overlooked the significance of the “remains of the citadel” pushing back by shutting out tort claims for purely financial losses.²⁶ The citadel did fall when it came to claims of physical harm to persons or property, but the economic loss rule emerged to limit manufacturers’ and sellers’ liability for purely financial losses and thus defend this last bastion of privity.

A. THE FALL OF PRIVITY AND LIABILITY FOR ECONOMIC LOSSES IN TORT

The early common law followed the *Winterbottom v. Wright* general rule of nonliability to persons not in privity of contract.²⁷ Specifically, absent privity of contract, a plaintiff could

22. Prosser, *Assault*, *supra* note 10, at 1099.

23. *Id.* at 1103.

24. *Id.* (emphasis added); *see also id.* at 1143 (discussing pure pecuniary loss cases in the same context as physical property damage cases).

25. *Id.* at 1103 & n.27.

26. In a similar vein, Baz Edmeades has argued that, for all of Prosser’s language about the end of a dramatic siege, the greater part of the citadel remains unharmed: “[L]itigants alleging economic loss, instead of personal injury or property damage, are still without any remedy when they lack privity of contract with the defendant.” Baz Edmeades, *The Citadel Stands: The Recovery of Economic Loss in American Products Liability*, 27 CASE W. RES. L. REV. 647, 648 (1977).

27. (1842) 152 Eng. Rep. 402; 10 M. & W. 109. *Winterbottom* is the 1842 English case in which “the citadel of privity was erected, or at least first recognized.” Abraham, *supra* note 3, at 1826. For further discussion, *see id.* at 1826–28 (detailing “the rise and fall of the citadel in negligence” from *Winterbottom* to *MacPherson*). *But see* GEISTFELD, *supra* note 2, at 10 (arguing

not recover in tort for harms caused by defective products. *MacPherson v. Buick* marked a shift in the early twentieth century away from the privity requirement to impose a duty on a “remote” product manufacturer under negligence for dangerous products, regardless of contract or warranty.²⁸ In hindsight, *MacPherson* was monumental in setting the stage for the dawn of strict products liability (to unfold over the subsequent four decades). Its actual holding was more modest, extending negligence liability in tort to manufacturers of motor vehicles as “imminently dangerous” products—a category already recognized as an exception to the privity bar.²⁹ Nonetheless, “[w]hether, technically speaking, *MacPherson* overruled *Winterbottom* or only created a broader exception that eventually swallowed up the *Winterbottom* rule, within decades scholars took the former view, and we certainly now understand *MacPherson* to have abolished the privity rule.”³⁰

What remained unclear was the scope of the manufacturer’s duty under negligence liability and, in particular, whether it extended to purely financial losses. At that time, in the early twentieth century, jurisdictions differed in how broadly they extended the scope of the manufacturer’s duty of care under negligence—specifically, whether it extended beyond physical injuries to persons and property to cover purely economic losses.

In 1913, in *Mazetti v. Armour & Co.*—described by Prosser as the “very first case which threw overboard the bar of privity”³¹—the Washington Supreme Court allowed a retailer of

that the doctrine of implied warranty, based on tort principles, long predated *Winterbottom*, but conceding that “[w]hen *Winterbottom* was decided in the 1840s, the implied warranty was firmly entrenched as a doctrine of contract law”).

28. 111 N.E. 1050 (N.Y. 1916).

29. In other words, in holding that a defective automobile was “a thing of danger,” the court expanded on a doctrine that had previously only been applied to products commonly regarded as inherently dangerous, such as poisons and explosives. *See id.* at 1053 (“We hold, then, that the principle of *Thomas v. Winchester* is not limited to poisons, explosives, and things of like nature, to things which in their normal operation are implements of destruction.” (citing *Thomas v. Winchester*, 6 N.Y. 397 (1852))); *see also, e.g.*, Priest, *supra* note 2 (suggesting that the change wrought by *MacPherson* was not so great, given that “it extended negligence liability only to manufacturers of products regarded as ‘imminently dangerous’ and only where it could be shown that the purchaser or an intermediate dealer would not inspect the product for defects”).

30. Abraham, *supra* note 3, at 1827.

31. Prosser, *Fall*, *supra* note 11, at 821.

goods to sue the manufacturer in negligence, absent privity of contract, for purely financial losses, namely “injury to his business and loss of reputation.”³² The *Mazetti* court staunchly refused to draw the privity divide at physical injuries (or “health and comfort”³³):

It seems that the test should not rest in finding the plaintiff's damage in health or business, but in answering the question whether there has been a damage which may be justly attributed to the negligence or a breach of duty on the part of the one who had power and whose duty it was to prevent the wrong.³⁴

The Washington Supreme Court thus applied the privity exception across the board, enabling claimants to bring negligence suits for breach of the duty of care, regardless of whether the ensuing damage impacted one's “health” or one's “business.”³⁵

In the first four decades following *MacPherson*, a few courts followed *Mazetti*'s lead—explicitly or implicitly—in not throwing down the gauntlet of privity to bar negligence claims against manufacturers for purely economic losses.³⁶ But at the same time that these state supreme courts were dismantling the citadel of privity in product defect cases for all negligently inflicted losses—including purely financial losses—other courts were uniting in resistance. Significantly, in New York, “such an extension of the *MacPherson* rule [was] rejected.”³⁷ New York and other “resisters” considered *MacPherson* the frontier and

32. 135 P. 633, 634 (Wash. 1913). *Mazetti* is a pre-*MacPherson* case that fashioned an additional exception to the privity bar that otherwise limited a manufacturer's liability to any person other than his immediate buyer. *Id.* at 636 (“To the old rule that a manufacturer is not liable to third persons who have no contractual relations with him for negligence in the manufacture of an article should be added another exception . . . arising . . . from changing conditions of society.”). For discussion of *Mazetti*, see *infra* Part I.A.1.

33. *Mazetti*, 135 P. at 634.

34. *Id.*

35. *Id.*

36. *E.g.*, *Sw. Ice & Dairy Prods. v. Faulkenberry*, 220 P.2d 257, 258–60 (Okla. 1950).

37. *Karl's Shoe Stores v. United Shoe Mach. Corp.*, 145 F. Supp. 376, 377 (D. Mass. 1956) (citing *A. J. P. Contracting Corp. v. Brooklyn Builders Supply Co.*, 11 N.Y.S.2d 662 (Sup. Ct. 1939), *aff'd mem.*, 15 N.Y.S.2d 424 (App. Div. 1939), *aff'd per curiam*, 28 N.E.2d 412 (N.Y. 1940)). In rejecting plaintiff's claim for loss of revenue and good will based upon defective shoe cement that caused plaintiff's shoes to be unfit for sale to the public, the court elaborated: “No case has been found in which a manufacturer has been held liable where no personal injury or physical injury to property was involved, and the plaintiff's only complaint was of financial damage such as loss of business, revenue and good will.” *Id.* (citing *A. J. P. Contracting*, 11 N.Y.S.2d 662; *Creedon v. Automatic Voting Mach. Corp.*, 276 N.Y.S. 609 (Sup. Ct. 1935)).

clung to privity in the realm of financial losses. These opposing camps are explored in turn below.

1. Privity Barrier Falls: Recovery for Negligently-Inflicted Economic Losses

The Washington Supreme Court, in *Mazetti v. Armour & Co.*,³⁸ was the first to extend negligence-based liability against a product manufacturer to freestanding, purely financial losses. *Mazetti* involved a plaintiff restaurant that purchased from an intermediary grocery company a “carton of cooked tongue” manufactured by defendant Armour & Co. A patron of the restaurant was served a portion of the tongue—which was adulterated with “a foul, filthy, nauseating, and poisonous substance”—became violently ill, and “then and there in the presence of other persons publicly expose[d] and denounce[d] the service to him of such foul and poisonous food.”³⁹ In such a case, it was fairly well established that the patron of the restaurant—who became violently ill from the adulterated food—could sue the manufacturer in negligence, even absent privity of contract.⁴⁰

But it was a matter of first impression whether the restaurant could sue the manufacturer under negligence for its purely financial losses. The court recognized an exception to privity for food products that “rests on the principle that the original act of delivering the article is wrongful, and that everyone is responsible for the natural consequences of his wrongful acts.”⁴¹ The court extended liability to the business losses caused by damage to the reputation of the retailer, stating that when a manufacturer sells goods in a market: “[H]e, in effect, represents to each purchaser that the contents of the can are suited to the purpose for which it is sold, the same as if an express representation to that effect were imprinted upon a label.”⁴² Thus, “a manufacturer of food products under modern conditions impliedly warrants his goods when dispensed in original packages, and that such warranty is available to all who may be dam-

38. 135 P. 633.

39. *Id.* at 633–34.

40. *Id.* at 634–35 (discussing various cases finding that the ultimate consumer of prepared food may bring an action of negligence or breach of implied warranty directly against a manufacturer even if no privity exists between the two parties).

41. *Id.* at 635.

42. *Id.* at 636.

aged by reason of their use in the legitimate channels of trade.”⁴³

Subsequently, courts relied on *Mazetti* and allowed for the recovery, absent privity, of negligently-inflicted, pure economic losses. In 1950, the Oklahoma Supreme Court allowed a grocer to recover economic losses from a manufacturer for loss of business under a theory of *res ipsa loquitur*, where a customer discovered a dead mouse in a bottle of milk.⁴⁴ In 1953, the Florida Supreme Court allowed a planter to recover for economic losses against a wholesaler who negligently mislabeled his seed, which grew into a different crop than the one anticipated by the planter.⁴⁵ And, extending the rationale beyond food cases, in the 1958 case *Spence v. Three Rivers Builders & Masonry Supply*, the Michigan Supreme Court held that privity was not a barrier to either negligence or implied warranty claims for financial losses, regardless of product type.⁴⁶ *Spence* involved an implied warranty claim (which the court treated as a negligence claim) by a buyer against a manufacturer of defective cinder blocks used to construct a cottage. The defective cinder blocks were deteriorating and ugly but had not caused physical injury to persons or property.⁴⁷ Allowing the case to proceed on a negligence theory, the court reasoned:

Either lack of privity should always be a defense in these cases, or it never should be. The basically contractual notion of privity in this context has largely to do with the right of a party to bring his action against the person he seeks to hold, regardless of injury suffered We . . . find no reason in logic or sound law why recovery in these sit-

43. *Id.*

44. *Sw. Ice & Dairy Prods. v. Faulkenberry*, 220 P.2d 257, 258–60 (Okla. 1950) (“A manufacturer or processor of food products under modern conditions impliedly warrants his goods when dispensed in original packages or bottles, and such warranty is available to all who may be damaged by their use in the legitimate channels of trade, including those who purchase them for resale.” (citing *Mazetti*, 135 P. 633)).

45. *See Hoskins v. Jackson Grain Co.*, 63 So. 2d 514, 515 (Fla. 1953) (citing *Blanton v. Cudahy Packing Co.*, 19 So. 2d 313 (Fla. 1944) (citing *Mazetti*, 135 P. 633)).

46. 90 N.W.2d 873, 876 (Mich. 1958). In embracing the fall of privity, the court remarked that “the question presently before the Court is whether we are going to continue to be hobbled by such an obsolete rule and its swarming progeny of exceptions.” *Id.* at 877.

47. Aside from the issue of privity, the court held: “[I]n these circumstances and in this day and age appearance as well as structural safety and durability is an important factor in determining the merchantable quality and fitness of these particular products as used in this case.” *Id.* at 876.

uations should be confined to injuries to persons and not to property, or allowed in food and related cases and denied in all others.⁴⁸

Spence thus set a precedent for negligence-based recovery for defective products causing financial losses.⁴⁹ For many courts the only relevant question concerned whether or not privity applied, not what type of damages was at issue. In the words of a Michigan appellate court, “[C]ourts throughout the land have allowed recovery for economic loss, as did our Supreme Court in *Spence*.”⁵⁰

2. Privity Barrier Stands: Foreshadowing the Economic Loss Rule

As noted above, Prosser paid only passing attention to a small group of cases that continued to require privity to recover for negligently inflicted economic losses by defective products. Warren Seavey, taking note of the same set of cases laying out a rule of no recovery, accorded them slightly more significance, suggesting that imposing liability for economic loss due to negligently manufactured products would “take a far greater step” than for physical damage.⁵¹

But neither foresaw that this small cadre of resistance would become a bulwark against the expansion of tort claims after the fall of privity in *MacPherson* and the subsequent rise of strict products liability. Nor did either find the seeds within *Trans World Airlines, Inc. v. Curtiss-Wright Corp. (TWA)*,⁵² one of the first resisters, of what would become the formidable, judicially-created economic loss rule in products liability.

48. *Id.* at 878 (emphasis omitted).

49. Ken Abraham notes that Prosser showcased *Spence* as “bringing down the citadel” in the third edition of his treatise, published in 1964. *See* Abraham, *supra* note 3, at 1835–36 (citing WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS 677 (3d ed. 1964)).

50. *Cova v. Harley Davidson Motor Co.*, 182 N.W.2d 800, 809 (Mich. Ct. App. 1970). *But see* *McGhee v. GMC Truck & Coach Div.*, 296 N.W.2d 286, 291 (Mich. Ct. App. 1980) (finding no liability “where the foundation of the relationship between the parties is contractual and no personal injury or damage to property other than the subject goods themselves is alleged”). Indeed, there is apparently a split of authority on this issue in Michigan courts. *See* *Michels v. Monaco Coach Corp.*, 298 F. Supp. 2d 642, 650 (E.D. Mich. 2003) (noting that Michigan courts disagree as to whether privity retains its validity in the state).

51. Warren A. Seavey, *Actions for Economic Harms*, 32 N.Y.U. L. REV. 1242, 1242 (1957); *see also id.* (“[O]nly within relatively modern times has [the common law] protected pecuniary interests divorced from tangible harm.”).

52. 148 N.Y.S.2d 284 (Sup. Ct. 1955).

In hindsight, TWA was a significant harbinger of the economic loss rule.⁵³ The case involved “inferior engines” for a plane whose mechanics discovered the defects before there was an accident:

The damage asserted by TWA is for replacement cost of allegedly inferior engines—a matter of qualitative inadequacy in a product purchased from Lockheed, a proper subject for a claim of breach of warranty, pure and simple. It is true that when the engines “failed to operate,” the planes became “imminently dangerous”; but the danger was “averted.” There was no accident. The malfunctioning of the engines had not yet turned into a misadventure.⁵⁴

The New York court held that privity was required for recovery when a negligently manufactured airplane engine required repair but had not caused any physical injury or property damage. The court reasoned:

If the ultimate user were allowed to sue the manufacturer in negligence merely because an article with latent defects turned out to be bad when used in “regular service” without an accident occurring, there would be *nothing left of the citadel of privity* and not much scope for the law of warranty.⁵⁵

Moreover, the court continued:

There seems . . . to be good reasoning for maintaining that, short of an accident, *the citadel should be preserved*. Manufacturers would be subject to indiscriminate lawsuits by persons having no contractual relations with them, persons who could thereby escape the limita-

53. Nor did TWA stand alone. Prosser cited three other “resisters.” See Prosser, *Assault*, *supra* note 10, at 1103 & n.27; see also, e.g., *Wyatt v. Cadillac Motor Car Div.*, 302 P.2d 665 (Cal. Ct. App. 1956) (holding privity was required for recovery when a negligently manufactured automobile had not caused any physical injury or property damage but required repair, reasoning that “[d]efendant’s duty was confined to the exercise of reasonable care to see that the car was so manufactured and assembled as to be free from defects which might be reasonably expected to produce bodily injury or damage to other property”); *Lucette Originals, Inc. v. Gen. Cotton Converters, Inc.*, 185 N.Y.S.2d 854 (App. Div. 1959) (holding privity required for negligently manufactured garments since product not inherently dangerous); *A. J. P. Contracting Corp. v. Brooklyn Builders Supply Co.*, 11 N.Y.S.2d 662, 664 (Sup. Ct. 1939) (holding privity was required when a plaster wall needed repair due to building owner’s extraction of a defective lathe made by defendant on the ground that “the duty of the manufacturer for breach of which liability attaches runs only to those who suffer personal or property injury as a result of either using or being within the vicinity of use of the dangerous instrumentality”), *aff’d mem.*, 15 N.Y.S.2d 424 (App. Div. 1939), *aff’d per curiam*, 28 N.E.2d 412 (N.Y. 1940). And Seavey cited, in addition, *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200 (Ohio Ct. App. 1946). Seavey, *supra* note 51, at 1242 n.3 (“[O]ne who causes economic loss to another by committing a tort upon a third, is not liable to the other unless he acted for the purpose of causing the loss.”).

54. *Trans World Airlines*, 148 N.Y.S.2d at 289–90.

55. *Id.* at 290 (emphasis added).

tions, if any, agreed upon in their contract of purchase. Damages for inferior quality, per se, should better be left to suits between vendors and purchasers since they depend on the terms of the bargain between them.⁵⁶

The court justified its embrace of privity with arguments based upon fear of boundless liability and deference to contract—thereby foreshadowing two dominant justifications to emerge in defense of the economic loss rule in products liability cases.⁵⁷

B. THE RISE OF STRICT PRODUCTS LIABILITY AND EMERGENCE OF THE ECONOMIC LOSS RULE

Even after *MacPherson* ushered in the fall of privity, as George Priest has noted, “through the late 1950s and early 1960s defective product cases were controlled by contract law with its privity requirement and, to a substantially lesser extent, by negligence law.”⁵⁸ Moreover, as Prosser noted, “[a]ll but a few of the [negligence] cases . . . involved personal injuries.”⁵⁹ This perhaps best explains Prosser’s failure to discern the significance of *TWA* and the cadre of other “resister” courts at that time.

Though its seeds were planted long before, the economic loss rule in products emerged precisely at the moment when strict products liability threatened to dismantle entirely the contract-tort boundary line for cases involving defective products. The familiar tale of the rise of strict liability in products, from Justice Roger Traynor’s influential concurrence in *Escola v. Coca Cola Bottling Co.*,⁶⁰ to the expansion of implied warranty theory and elimination of privity of contract in *Henningsen v. Bloomfield Motors*,⁶¹ to the full embrace of strict products liabil-

56. *Id.* (emphasis added).

57. *See infra* Part II (discussing those justifications).

58. Priest, *supra* note 2, at 462.

59. Prosser, *Assault*, *supra* note 10, at 1143.

60. 150 P.2d 436, 461–68 (Cal. 1944) (Traynor, J., concurring).

61. 161 A.2d 69 (N.J. 1960). *Henningsen* eliminated the requirement of privity of contract and thereby extended implied warranty of merchantability to the ultimate user of a product. The court held that the defendant automobile manufacturer breached its implied warranty of merchantability when the wife of the purchaser of the automobile was injured when a defective steering wheel caused her to crash into a wall; moreover, the court refused to recognize as valid the manufacturer’s disclaimer of such liability in the contract of sale between the dealer and purchaser. *Id.* at 84 (“[W]e hold that under modern marketing conditions, when a manufacturer puts a new automobile in the stream of trade and promotes its purchase by the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of

ity in *Greenman v. Yuba Power Products, Inc.*⁶² and the *Restatement (Second) of Torts* § 402A,⁶³ will not be rehashed here. Instead, I will focus on the implications of the rise of strict products liability for the recovery of negligently inflicted economic losses.

My contention is that, at the very moment when strict liability replaces negligence in product defect cases, courts begin to look for ways to limit liability, where previously they had let the battle against privity proceed unchecked. In some jurisdictions that had previously embraced the fall of privity across the board, I trace evidence of a retreat from negligence for purely economic losses. Prosser, moreover, comes to embrace (albeit tepidly) the emerging economic loss rule in products cases. With the rise of strict products liability and the widespread adoption of *Second Restatement* § 402A, privity's "last bastion" holds firm, and its forces even retake some ground.

1. Retreat from Negligence Liability for Economic Losses

Mazetti—the first product defect case "which threw overboard the bar of privity"⁶⁴—stood as an early defender of the complete fall of privity, extending negligence claims to cover not only physical injuries but also purely financial losses. It is thus instructive to consider the fate of *Mazetti* after the rise of

the ultimate purchaser."). In a nutshell, *Henningsen* expanded the special rules as pertaining to food and drink to engulf all products. See Richard A. Epstein, *The Unintended Revolution in Product Liability Law*, 10 CARDOZO L. REV. 2193, 2202 (1989) ("In essence, *Henningsen*, *Greenman*, and the *Restatement (Second) of Torts* reserved to the courts a legal monopoly to fashion the relevant terms and conditions on which *all* products should be sold in all relevant markets.").

62. 377 P.2d 897 (Cal. 1963). In *Greenman*, the California Supreme Court "dispel[led] the confusion attending the recent development of strict manufacturer's liability by grounding it explicitly in tort and abandoning the use of warranty concepts." Note, *Strict Products Liability and the Bystander*, 64 COLUM. L. REV. 916, 933 (1964). The court thereby drew a bright line between warranty-based recovery and tort recovery.

63. Prosser was the sole Reporter for the *Restatement (Second) of Torts*. As Ken Abraham recounts:

During these years . . . Prosser prepared successive drafts that attempted to capture the developing law on the subject. Finally, his 1965 draft of § 402A of the Restatement provided that there was strict liability for injury caused by a product in a "defective condition, unreasonably dangerous to the user or consumer." . . . [T]he fall of the citadel had begun, and it would be consummated across the country over the next decade.

Abraham, *supra* note 3, at 1833.

64. Prosser, *Fall*, *supra* note 11, at 821–22.

strict products liability. In 1960, the Washington Supreme Court revisited *Mazetti* in *Dimoff v. Ernie Majer*, a false representation case.⁶⁵ The court purported to adhere to *Mazetti*—specifically the exceptions to privity enumerated therein⁶⁶—but declined to see a malfunctioning fuel line in a car as within any of the exceptions. And while *Mazetti* is distinguishable as a product case involving adulterated food, the *Dimoff* court retreated from the earlier court’s broader language implying extensive implied warranties when it denied strict liability for the false representation claim.⁶⁷ Indeed, in *The Assault upon the Citadel*, Prosser noted that the fiction of implied warranty often creates strict liability for false representations, but mentioned that the Washington Supreme Court staunchly rejected such strict liability.⁶⁸

This retreat was rather subtle and, as later developments confirmed, only partial. In 1976, in *Berg v. General Motors Corp.*, the Washington Supreme Court allowed a purchaser of goods to recover in negligence against a manufacturer for purely economic losses.⁶⁹ In that case, a fishing boat broke down due to an error in assembly. The court reasoned that, so long as foreseeability is met, “there is nothing in the tort of negligence which prevents lost profits from being a species of recompensable harm which is actionable against the remote manufacturer.”⁷⁰ The *Berg* decision was, nonetheless, short-

65. 347 P.2d 1056 (Wash. 1960). Absent privity, the court rejected the plaintiff’s claim for economic damages stemming from the truck’s crimped fuel line, and dismissed any inference of negligence because the crimp was discovered after 27,000 miles of driving.

66. The *Dimoff* court listed the following exceptions to privity enumerated in *Mazetti*:

- (1) Where the thing causing the injury is of a noxious or dangerous kind;
- (2) where the defendant has been guilty of fraud or deceit in passing off the article; and
- (3) where the defendant has been negligent in some respect with reference to the sale or construction of a thing not imminently dangerous.

Id. at 1059 (quoting *Fleenor v. Erickson*, 215 P.2d 885, 889 (Wash. 1950)).

67. *Id.* The court conceded that it would have found liability without privity under a theory of fraud, but held that the essential elements were not established. *Id.* (“Fraud was not established . . .”). Moreover, the court held that all express warranties were met while implied warranties were disclaimed. *Id.* at 1058.

68. Prosser, *Assault*, *supra* note 10, at 1134–37 (citing *Dimoff*, 347 P.2d 1056).

69. 555 P.2d 818 (Wash. 1976).

70. *Id.* at 823 (“Each theory has a historical basis and should have its identity kept intact. ‘Privity’ as a limitation, only inheres in warranty. ‘Foreseeability’ as a limitation, only inheres in negligence. ‘Personal or property

lived. In 1981, the Washington Legislature “effectively overruled” *Berg* with the enactment of the Washington Products Liability Act (WPLA).⁷¹ As the Washington Supreme Court explained: “Under the WPLA, the Legislature specifically excluded recovery in tort for economic losses, deferring such claims instead to the Uniform Commercial Code.”⁷²

The retreat away from liability for purely financial losses in products cases takes place as the underlying theory of liability for recovery morphs from negligence to strict liability. The requirement of negligence makes the ever-broadening exceptions to the privity barrier seem more palatable; once strict liability takes hold, however, the requirement of privity takes on greater significance as a means by which to restrict otherwise boundless liability. Consider, for instance, the justification provided by a California court in 1958 in *Fentress v. Van Etta Motors*, when it declined to apply privity to bar an action where a defective product caused injury only to itself (i.e., not damaging any other property).⁷³ The court emphasized that, by removing privity, it would not thereby “make the manufacturer a warrantor to the ultimate purchaser” because “negligence must be proved.”⁷⁴ Prosser, likewise, at that time seemed at ease with recovery in cases of physical damage to the product, writing in *The Assault upon the Citadel* that the privity requirement did not hold “where there is physical damage to the chattel itself, as where an automobile is wrecked because of bad brakes, [and] recovery is allowed.”⁷⁵

damage’ as a limitation only inheres in strict liability.”). Moreover, the court reasoned, “[a] distinction that would allow recovery if the product in question destroyed the property of another, yet would deny recovery were the same product merely to disintegrate, is a specious one.” *Id.* at 822.

71. *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist.* No.1, 881 P.2d 986, 990 (Wash. 1994).

72. *Id.*

73. 323 P.2d 227 (Cal. App. Dep’t Super. Ct. 1958) (holding privity not required even when the negligently manufactured product was not inherently dangerous but an accident resulted).

74. *Id.* at 229.

75. Prosser, *Assault*, *supra* note 10, at 1103 n.27. In addition to *Fentress*, Prosser cites *Quackenbush*, *International Harvester*, and *C.D. Herme* as examples of cases allowing recovery for purely economic loss damages when a chattel damages itself. *Id.* (citing *Quackenbush v. Ford Motor Co.*, 153 N.Y.S. 131 (App. Div. 1915) (holding privity not required to recover for repair to car caused by negligently manufactured brakes that resulted in a car crashing); *Int’l Harvester Co. v. Sharoff*, 202 F.2d 52 (10th Cir. 1953) (holding privity not required to recover for tractor-trailer which overturned due to component defect); *C.D. Herme, Inc. v. R. C. Tway Co.*, 294 S.W.2d 534 (Ky. 1956) (holding

Note the contrast with *East River Steamship Corp. v. Transamerica Delaval Inc.*—the canonical 1985 U.S. Supreme Court case that established the “other property” limitation on recovery for physical damage in admiralty product defect cases.⁷⁶ More specifically, *East River Steamship* established that a plaintiff cannot recover for physical damage a defective product causes to itself; but it made clear that this limitation on liability did not extend to damage caused to “other property.”⁷⁷ In setting forth the limitation, the Court explained: “[A]ll but the very simplest of machines have component parts, [thus, a contrary] holding would require a finding of ‘property damage’ in virtually every case where a product damages itself. Such a holding would eliminate the distinction between warranty and strict products liability.”⁷⁸

The most significant shift from 1958 (when *Fentress* was decided) to 1985 (when *East River Steamship* was decided) was the rise of strict products liability and the vast expansion of product defect claims in tort.⁷⁹ Indeed, the *Fentress* court anchored its holding allowing manufacturer liability for economic losses, absent privity, to the necessity to prove negligence.⁸⁰ Once negligence is replaced by strict liability, the fear that the

privity not required to recover for repair to a trailer caused by negligently manufactured kingpin (connector) which resulted in damage to trailer and cargo)).

Prosser may have overstated the significance of these cases. These cases involve injury not just to the product itself, but also other property. For example, *C.D. Herme* involved damage to the product (a semi-trailer) and its cargo. 294 S.W.2d at 536. Prior to the U.S. Supreme Court’s decision in *East River Steamship*, few courts paid much attention to this distinction. Moreover, the test articulated in *C.D. Herme* focused on the manufacturer being liable if its *negligence* creates “an unreasonable risk of causing bodily harm to those who lawfully use it,” and the manufacturer should be liable even if “the actual injury in the particular case happen to be to *property* only.” *Id.* at 537. This evolved into the intermediate position that allowed recovery when a product injures only itself in certain circumstances—a position the Supreme Court later deemed “unsatisfactory.” *E. River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 869–70 (1986).

76. 476 U.S. at 870–71. *East River Steamship* is discussed further below. See *infra* Part II.B.

77. 476 U.S. at 867.

78. *Id.* (quoting *N. Power & Eng’g Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324, 330 (Alaska 1981)).

79. For discussion of another significant development, the adoption of the Uniform Commercial Code, see *infra* Part II.B.2.

80. *Fentress v. Van Etta Motors*, 323 P.2d 227, 229 (Cal. App. Dep’t Super. Ct. 1958) (“To accept the rule of the *Quackenbush* case will not make the manufacturer a warrantor to the ultimate purchaser. In the first place, *negligence must be proved . . .*” (emphasis added)).

manufacturer would become “a warrantor to the ultimate purchaser” rears its head, and the economic loss rule provides the means by which contract-based warranty claims are kept distinct from tort-based strict products liability.

2. Privity’s Last Bastion

Prosser’s view of product defect claims involving purely financial losses evolves ever so slightly by the time of *The Fall of the Citadel* in 1966. First, he distinguishes among three categories of damages (today, all recognized as purely economic losses): (1) damage caused to the purchased chattel from an accident created by its own defect, “as where an automobile is wrecked by reason of its own bad brakes;”⁸¹ (2) consequential commercial losses, such as lost profits;⁸² and (3) a defective or disappointing product, i.e., “mere loss on the bargain, which is to say that the product which the plaintiff has received is only worth less than the price he has paid for it.”⁸³ According to Prosser, the “difficulty” when it comes to pecuniary losses concerns this third “loss on the bargain” category.⁸⁴ He then subdivides cases concerning “loss on the bargain” into two then-emerging camps: a “small majority” of cases that denied strict liability;⁸⁵ and three cases that permitted liability.⁸⁶

81. Prosser, *Fall*, *supra* note 11, at 820–21. This position is supported by *Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, 148 N.Y.S.2d 284, 290 (Sup. Ct. 1955), which held that for a defective product, the only remedy is to sue under breach of warranty unless “the danger inherent in a defectively made article causes an accident”—only then can a negligence claim of action be sustained. Prosser describes this category as a chattel causing damage to other property, not resulting in a purely pecuniary loss. Prosser, *Fall*, *supra* note 11, at 821. However, he does note, without any discussion, that dicta in *Seely* overrules one of the cases allowing for this kind of recovery. *See id.* at 821 n.164. And in fact, *Seely*’s logic forecloses the “damage to the purchased chattel itself” category. *See Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

82. Prosser, *Fall*, *supra* note 11, at 821–22. He labels as pecuniary losses both consequential damages and “indirect physical harm to other property,” such as a batch of dough being ruined by glass in one of the ingredients. *Id.* He cites several cases allowing for recovery, but again mentions in a footnote that *Seely* would seem to stand against allowing recovery in tort for these kinds of losses as well. *Id.* at 822 n.165.

83. *Id.* at 822.

84. *Id.* at 821–22 (“Pecuniary loss, mere pocketbook damage, offers more difficulties. . . . The difficulty concerns mere loss on the bargain . . .”). Prosser mostly approves (or simply assumes) that recovery in the first two aforementioned categories is desirable and accepted by most courts. *Id.* at 822–23.

85. *Id.* at 822 n.169 (citing *Dennis v. Willys-Overland Motors, Inc.*, 111 F. Supp. 875 (W.D. Mo. 1953); *Seely*, 403 P.2d 145; *Inglis v. Am. Motors Corp.*, 197 N.E.2d 921 (Ohio Ct. App. 1964), *affd on other grounds*, 209 N.E.2d 583

Finally, Prosser adopts a tentative normative position: “[D]enial would appear to be the sounder rule.”⁸⁷ According to Prosser, given that the “[l]oss on the bargain must depend upon what the bargain is,” and it is “a matter properly between the purchaser and dealer,” liability should be denied.⁸⁸ However, he tries to define “loss on the bargain” narrowly, to mean only “the product which the plaintiff has received is only worth less than the price he has paid for it.”⁸⁹

Significant for my purposes here, Prosser then reframes the cases he cited earlier in *The Assault upon the Citadel* as lone hold-outs against the fall of privity in negligence as strong evidence that, even when a manufacturer was liable under negligence, courts denied recovery for certain purely financial losses.⁹⁰ Prosser does not explain why what he described in *The Assault upon the Citadel* as “a refusal on the part of a few courts,”

(Ohio 1965); *Price v. Gatlin*, 405 P.2d 502 (Or. 1965); *Ford Motor Co. v. Lonon*, 398 S.W.2d 240 (Tenn. 1966); *Kyker v. Gen. Motors Corp.*, 381 S.W.2d 884 (Tenn. 1964).

86. *Id.* at 822 n.170 (citing *Continental Copper & Steel Indus., Inc. v. E. C. “Red” Cornelius, Inc.*, 104 So. 2d 40, 41 (Fla. Dist. Ct. App. 1958)); *Santor v. A & M Karagheusian, Inc.*, 207 A.2d 305 (N.J. 1965); *Lang v. General Motors Corp.*, 136 N.W.2d 805 (N.D. 1965)). As aptly summarized by the court in *Continental Copper*:

The general rule that an ultimate purchaser may not sue the wholesaler is not an absolute one and it seems to be losing force with the passage of time. “There is a conflict of opinion regarding the accountability of a manufacturer to a consumer on the theory of implied warranty in the absence of privity, but this court has become aligned with those courts holding that suit may be brought against the manufacturer notwithstanding want of privity.” It appears that the courts have departed from the general rule that recovery could not be had from a manufacturer on an implied warranty absent privity of contract.

104 So. 2d at 41 (quoting *Hoskins v. Jackson Grain Co.*, 63 So. 2d 514, 515 (Fla. 1953)).

87. Prosser, *Fall*, *supra* note 11, at 822–23.

88. *Id.* at 823.

89. *Id.* at 822. The policy rationales underlying this category had nonetheless already begun to spread to the first two categories of cases, and would lead directly to the modern economic loss rule. *See, e.g.*, *Karl’s Shoe Stores, Ltd. v. United Shoe Mach. Corp.*, 145 F. Supp. 376, 377 (D. Mass. 1956) (“No case has been found in which a manufacturer has been held liable where no personal injury or physical injury to property was involved, and the plaintiff’s only complaint was of financial damage such as loss of business, revenue and good will.”); *Seely*, 403 P.2d at 151 (discussing how a consumer cannot recover in tort for purely economic losses, but only for physical harm to person or property).

90. Prosser, *Fall*, *supra* note 11, at 822–23 (discussing how recovery has been denied in these cases even when the manufacturer has been proven negligent).

(such as *TWA*)⁹¹ to embrace the fall of privity across the board now supports the majority position.⁹² But it is clear that what changed within the span of six years separating Prosser's two articles was the rapid expansion and growth of strict products liability and an appreciation of privity's "last bastion," i.e., product defect claims involving purely financial losses.

The economic loss rule for products liability thus emerges to protect this last bastion of privity. It is codified in the *Restatement (Second) of Torts* § 402A, which holds sellers of products only strictly liable for physical harm caused to a consumer or his property for a defective product regardless of care or privity.⁹³ By doing so it barred recovery in tort for all three categories of economic loss if not accompanied by physical injury or damage to other property.⁹⁴

The economic loss rule's evolution towards covering damages from all three categories discussed by Prosser can be seen in Prosser's own Casebook. By 1971, Prosser's Torts Casebook (with Wade) describes cases as falling primarily into the camp of denying strict liability for purely financial losses.⁹⁵ While discerning "nothing about the nature of pecuniary loss to prevent recovery," Prosser now frames the issue (as in *The Fall of the*

91. Prosser, *Assault*, *supra* note 10, at 1103 & n.27.

92. Prosser, *Fall*, *supra* note 11, at 822-23.

93. The *Restatement* comments discuss the extension of strict liability beyond the sellers of food to other products intended for intimate bodily use, and then "of any product which, if it should prove to be defective, may be expected to cause physical harm to the consumer or his property." RESTATEMENT (SECOND) OF TORTS § 402A cmt. b (AM. LAW INST. 1965). Herbert Titus argues that Prosser drafted § 402A (heavily influenced by Justice Traynor) to oppose the majority approach of dealing with liability through theories of warranty and contract. Herbert W. Titus, *Restatement (Second) of Torts Section 402A and the Uniform Commercial Code*, 22 STAN. L. REV. 713, 726 (1970) (arguing that the history of the Uniform Sales Act and products cases from England through 1960 suggested contract and privity were key to the concept of warranty). But the triumph of strict liability in tort was not complete.

Baz Edmeades criticizes § 402A from the other direction, as a "truncated restatement of the effect of these cases since it excludes liability for economic loss and retreats from the strictness of warranty liability." Edmeades, *supra* note 26, at 649-50. According to Edmeades, the adoption of § 402A "was a rejection of implied warranty and economic loss recovery founded upon faulty analysis and questionable case authority." *Id.* at 663.

94. See Edmeades, *supra* note 26, at 652 (lamenting that following § 402A, "economic loss claims have been denied . . . even where the defect in question threatens physical harm or personal injury in addition to rendering the chattel unusable").

95. WILLIAM L. PROSSER & JOHN W. WADE, TORTS CASES AND MATERIALS 736 (5th ed. 1971).

Citadel) as the potential for recovery “as to mere loss of the bargain,” a loss that can occur even when goods are in no way defective.⁹⁶ Prosser now aligns with many courts refusing recovery on theories of implied warranty or strict liability, and recognizes “recovery for loss of the bargain” only via express warranty.⁹⁷ Thereafter, Prosser’s book took a sharper turn toward deference to contract rationales and, in the 1976 edition, stated that the Uniform Commercial Code (UCC) governs defects that destroy the product itself.⁹⁸ By the 1984 version of the *Prosser and Keeton on Torts* hornbook, the economic loss rule had taken hold, and the UCC is described therein as the “exclusive source for ascertaining when a seller is subject to liability for damages if the claim is based on intangible economic loss not attributable to physical injury to person or harm to a tangible thing other than the defective product itself.”⁹⁹

II. THE “SEPARATE SPHERES” OF PRODUCTS LIABILITY AND CONTRACT LAW

The two decades that followed *The Fall of the Citadel* witnessed the unfolding of the debate over the economic loss rule in products cases, as it was framed by the opposing positions taken by a pair of cases decided in 1965: the New Jersey Supreme Court in *Santor v. A & M Karagheusian, Inc.*¹⁰⁰ and the California Supreme Court in *Seely v. White Motor Co.*¹⁰¹

Santor and *Seely* set the key terms of the debate on the economic loss rule in products. *Santor* involved a suit to recover the cost of carpeting sold as Grade #1 by the manufacturer.¹⁰² After the retailer installed the carpet in the plaintiff’s home, an

96. *Id.*

97. *Id.*

98. WILLIAM L. PROSSER, JOHN W. WADE & VICTOR E. SCHWARTZ, TORTS CASES AND MATERIALS 800 (6th ed. 1976). The book distinguishes *Santor* (and like cases) as cases that existed “prior to the time the UCC was in force in the state and there was no apparent conflict with any provision of the Uniform Sales Act.” *Id.* at 800–01.

99. WILLIAM L. PROSSER & W. PAGE KEETON, PROSSER AND KEETON ON TORTS 680 (5th ed. 1984); see *id.* (“[I]nsofar as liability for economic losses are concerned, it would appear that the obligations of warranty law have been obligations imposed on the basis of express or implied promises or express or implied representations by the seller . . . [I]t should be so in order to make an intelligible distinction between contractual obligations and tortious obligations.”).

100. 207 A.2d 305 (N.J. 1965).

101. 403 P.2d 145 (Cal. 1965).

102. *Santor*, 207 A.2d at 306.

“unusual line” was discovered in it, and since the retailer had gone out of business, the plaintiff located the manufacturer, who admitted the carpet provided to the retailer had been manufactured defectively.¹⁰³ The New Jersey Supreme Court held that a manufacturer can be strictly liable for damage to a product, even where the losses are purely financial, here, limited to the loss of value of defective carpeting.¹⁰⁴ The court staked out the position that there was no just cause for recognition of the existence of an implied warranty of merchantability and a right to recovery for breach thereof regardless of lack of privity of the claimant in the one case and the exclusion of recovery in the other simply because loss of value of the article sold is the only damage resulting from the breach.¹⁰⁵

Indeed, the court cites Prosser for support of the proposition that there is no sensible reason for distinguishing between personal injury and property damage.¹⁰⁶ According to the court: “[C]onsiderations of justice require a court to interest itself in originating causes and to apply the principle of implied warranty on that basis, rather than to test its application by whether the personal injury or simply loss of bargain resulted from the breach of warranty.”¹⁰⁷ Moreover, for the court, again favorably citing Prosser for support, it did not make sense to forge an artificial divide between contract and tort given that the manufacturer’s duty “bespeaks a *sui generis* cause of action. Its character is hybrid, having its commencement in contract and its termination in tort.”¹⁰⁸

Just four months later, Justice Traynor fired back by writing the *Seely* decision.¹⁰⁹ *Seely* marks the restriction of strict liability in product cases when the product only harms itself. The case involved a defective truck purchased by the consumer that overturned and was damaged. The plaintiff sued and claimed damages from disappointed expectations for the value of the truck, lost profits, and damage to the truck caused by the acci-

103. *Id.* at 306–07.

104. *Id.* at 314.

105. *See id.* at 309.

106. *Id.* at 310 (“[W]e approve Dean Prosser’s comment that there is no sensible reason for distinguishing in such cases between personal injury and property damage claims.” (citing Prosser, *Assault*, *supra* note 10, at 1143)).

107. *Id.* at 309.

108. *Id.* at 311. The court elaborated: “[T]he law has imposed on manufacturers a duty to such persons irrespective of contract or a privity relationship between them.” *Id.*

109. *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

dent. The court held that a manufacturer could not be held strictly liable in tort for purely economic losses.¹¹⁰ In this context, outside the realm of physical injuries, the court recognized a strong deference to contract rationale, highlighting the existence of the UCC and its codification by the state legislature as a superior method for dealing with a bargain between two parties.

Thus, under *Seely*, a plaintiff (often a consumer) does not have a tort action when she has suffered purely financial losses from a defective product. Instead, she may have a contractual remedy against the seller and/or the manufacturer for breach of an express or implied warranty. In *Seely*, the plaintiff was able to recover against the manufacturer because the court found that it had expressly warranted the truck would be free from defects.¹¹¹ However, as *Seely* makes clear, if the seller had sold the good “as is” (disclaiming all warranties) then the buyer would have had no contractual or tort remedy for her purely economic losses.¹¹²

Two decades later, in 1985, the U.S. Supreme Court sided with *Seely* in a common law maritime case, *East River Steamship Corp. v. Transamerica Delaval, Inc.*¹¹³ In *East River Steamship*, the defendant manufactured defective turbines, which, once installed by the shipbuilder in the supertankers leased by the plaintiffs, malfunctioned. As a result, the plaintiff supertanker charterers lost significant income and sued the de-

110. *Id.* at 147. Ironically, everything in the opinion concerning economic losses and tort was dicta. The court affirmed the trial court’s award of damages for lost profit and money paid towards the purchase price of the truck to the plaintiff under an express warranty claim. *Id.* at 148. It also affirmed the trial court’s denial of awarding damages for the truck’s repair because the plaintiff did not prove that the defect caused the accident. *Id.* at 148, 152. Justice Peters penned a forceful dissent, arguing that “[t]he nature of the damage sustained by the plaintiff is immaterial, so long as it proximately flowed from the defect. What *is* important is not the nature of the damage but the relative roles played by the parties to the purchase contract and the nature of their transaction.” *Id.* at 153 (Peters, J., dissenting); see also Marc A. Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 STAN. L. REV. 974, 978 (1966) (“For Peters, the crucial question was whether the relation is a ‘commercial’ sale, in which case sales law should control, or a sale to an ultimate consumer, in which case tort law would control. Peters claimed this test was more rational than Traynor’s test of type of harm suffered.”).

111. *Seely*, 403 P.2d at 148.

112. *Id.* at 150 (“Had defendant not warranted the truck, but sold it ‘as is,’ it should not be liable for the failure of the truck to serve plaintiff’s business needs.”).

113. 476 U.S. 858 (1986).

fendant manufacturer in tort, based on a products liability theory.¹¹⁴ The Court framed the question as: “[C]harting a course between products liability and contract law, we must determine whether injury to a product itself is the kind of harm that should be protected by products liability or left entirely to the law of contracts.”¹¹⁵ The Court acknowledged that warranty law was insufficient to deal with physical injury, noting that we impose liability in tort for products “because ‘public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market.’”¹¹⁶ And, indeed, without much elaboration, the court suggested that this tort law protection extends to property damage as well: “For similar reasons of safety, the manufacturer’s duty of care was broadened to include protection against property damage.”¹¹⁷ But the Court held that “a commercial product injuring itself is [not] the kind of harm against which public policy requires manufacturers to protect, independent of any contractual obligation.”¹¹⁸

While *Santor* represented the minority position in the debate, it did attract support from several courts.¹¹⁹ But, accord-

114. The initial complaint had also listed the shipbuilder as a plaintiff who alleged breach of contract and warranty as well as tort claims. However, the manufacturer raised a statute of limitations defense, after which the charterers alone proceeded with the suit in tort. *Id.* at 861. The charterers could not assert warranty claims. *Id.* at 875. But, according to the Court, “[e]ven so, the charterers should be left to the terms of their bargains, which explicitly allocated the cost of repairs.” *Id.*

115. *Id.* at 859.

116. *Id.* at 866 (quoting *Escola v. Coca Cola Bottling Co. of Fresno*, 150 P.2d 436, 441 (1944) (Traynor, J., concurring)).

117. *Id.* at 867. The Court cites *Marsh Products v. Babcock & Wilcox Co.*, which stated, where the article, if negligently manufactured, will be imminently dangerous to human safety, liability should extend to property damage in all cases where a causal connection can be established. *Id.* (citing 240 N.W. 392, 399 (Wis. 1932)).

118. *Id.* at 866; *id.* at 871 (“[W]e . . . hold that a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself.”).

119. A majority of the Courts of Appeals sitting in admiralty adopted the rule in *Santor* over *Seely* on the ground that “the safety and insurance rationales behind strict liability apply equally where the losses are purely economic.” *Id.* at 869 (citing *Emerson G.M. Diesel, Inc. v. Alaskan Enter.*, 732 F.2d 1468 (9th Cir. 1984)). Outside of admiralty, *Santor* likewise garnered some support. *See, e.g.*, *Alaskan Oil, Inc. v. Central Flying Serv., Inc.*, 975 F.2d 553, 555 (8th Cir. 1992) (“Arkansas law permits recovery under strict liability even when the only damages sustained are to the defective product itself.” (citing *Berkeley Pump Co. v. Reed-Joseph Land Co.*, 653 S.W.2d 128, 131 (Ark. 1983) (discussing how in dicta they approved of *Santor*, and they see “no need to review

ing to the U.S. Supreme Court, “[t]he [*Santor*] view fails to account for the need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages.”¹²⁰ And ultimately, the Court declined to let contract law “drown in a sea of tort,”¹²¹ which heavily influenced the development of state court jurisprudence on the economic loss rule.¹²²

This Part explores various justifications raised by *Seely* and *East River Steamship* for why some privity restrictions relating to product defect torts survived the products liability revolution of the 1960s in the form of the economic loss rule.

A. FLOODGATES

The *Seely* court raised a concern that liability imposed by law, that could not be disclaimed, would open the manufacturer to unknown and unlimited damages.¹²³ Specifically, if a manufacturer could not limit “the scope of his responsibility for harm caused by his products” he “would be liable for damages of unknown and unlimited scope.”¹²⁴ Or, in more colorful language: “Where there is no privity . . . there is concern that liability imposed upon the remote manufacturer will result in unanticipated

that choice” when it came to parties recovering damages for economic losses for a product in a defective condition)); *Mead Corp. v. Allendale Mut. Ins. Co.*, 465 F. Supp. 355, 363–66 (N.D. Ohio 1979) (commercial buyer allowed to recover under strict liability in tort for direct and indirect economic losses due to defective steam turbine); *Cova v. Harley Davidson Motor Co.*, 182 N.W.2d 800, 804 (Mich. Ct. App. 1970) (owners of golf course may recover against manufacturer in strict liability in tort for direct and indirect economic losses resulting from defects in golf carts); *Iacano v. Anderson Concrete Corp.*, 326 N.E.2d 267, 271 (Ohio 1975) (homeowner permitted to maintain an action in tort for damage to concrete driveway due to defective materials and workmanship); *City of La Crosse v. Schubert*, 240 N.W.2d 124, 127 (Wis. 1976) (manufacturer of defective roofing materials may be liable for loss of value of roof under strict liability in tort, and, in dicta, consequential economic damages are also recoverable).

120. *E. River*, 476 U.S. at 870–71.

121. *Id.* at 866.

122. Though the words “economic loss doctrine” are nowhere to be found in *East River Steamship*, the case is seminal to the development of the doctrine. See Mark Geistfeld, *Economic Loss, Endangered Consumers, and the Error of East River Steamship*, 65 DEPAUL L. REV. (forthcoming 2016) (manuscript at 2–4) (on file with author).

123. *Seely v. White Motor Co.*, 403 P.2d 145, 150–51 (Cal. 1965).

124. *Id.* at 151; see also Friedrich Kessler, *Products Liability*, 76 YALE L.J. 887, 892 (1967) (“Properly understood, privity is only a means of protecting a party guilty of a breach against losses suffered by remote parties which are unanticipated and therefore not included in the calculation of costs.”).

ed and extensive economic losses which may kill an otherwise useful goose who lays an occasional unmerchantable egg.”¹²⁵

This echoed the earlier concern raised by the *TWA* court that abandoning privity could “hamper the enterprising manufacturer whose ingenuity was the chief factor in causing the economy to expand” by exposing him to unpredictable and potentially unlimited losses.¹²⁶ Moreover, it is a thread continued by the U.S. Supreme Court in *East River Steamship*: “Permitting recovery for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums. It would be difficult for a manufacturer to take into account the expectations of persons downstream who may encounter its product.”¹²⁷ The Court states that “a realistic limitation on damages” must be maintained and highlights that “[a] warranty action also has a built-in limitation on liability, whereas a tort action could subject the manufacturer to damages of an indefinite amount.”¹²⁸

The concern dates back to *Winterbottom v. Wright*—the canonical case representing the strength of the privity barrier in the nineteenth century—where Lord Abinger warns that any plaintiff injured in any capacity by the product may be able to sue, leading to “the most absurd and outrageous consequences, to which I can see no limit.”¹²⁹ Other lords echoed this view, fearing that otherwise no limiting principle could be devised.¹³⁰

The floodgates concern is by no means unique to the realm of economic losses due to defective products. Indeed, it is a common fear whenever a tort right is expanded.¹³¹ The thrust of

125. Richard E. Speidel, *Warranty Theory, Economic Loss, and the Privity Requirement: Once More into the Void*, 67 B.U. L. REV. 9, 24 (1987).

126. *Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, 148 N.Y.S.2d 284, 287, 290 (Sup. Ct. 1955) (citing this as a long-standing justification for privity and later defending privity and the citadel as needing to be preserved in this area to protect the manufacturer from “indiscriminate lawsuits”).

127. *E. River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 874 (1986).

128. *Id.* at 871, 874.

129. (1842) 152 Eng. Rep. 402, 405; 10 M. & W. 109, 114.

130. Baron Edward Hall Alderson warned that if this action was allowed, “there is no point at which such actions would stop.” *Id.*

131. Consider, for example, the birth of the tort of intentional infliction of emotional distress. See William L. Prosser, *Intentional Infliction of Mental Suffering: A New Tort*, 37 MICH. L. REV. 874, 875–78 (1939), for a discussion about the difficulty of quantifying damages, and how “the most valid objection to the protection” of emotional interests would be “the ‘wide door’ which might be opened, not only to fictitious and fraudulent claims, but to litigation in the field of trivialities and mere bad manners.” However, Prosser later says “this

the floodgates concern is typically dealt with via proximate cause limitations; seen in this light, it does not provide the strongest rationale for acoustic separation of tort and contract law.¹³² The concern of contract “drowning in a sea of tort,” by contrast, moves the debate from the default of no liability in the absence of tort to the default of contract-based liability.

B. CONTRACT “DROWNING IN A SEA OF TORT”

In *East River Steamship*, the U.S. Supreme Court worried about the prospect of contract law “drown[ing] in a sea of tort” in considering “whether a commercial product injuring itself is the kind of harm against which public policy requires manufacturers to protect, independent of any contract[.]”¹³³ The Court held that “a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself.”¹³⁴ Why? The law of warranty is better suited to address plaintiff’s contractual disappointments, and the Court preferred warranty law’s “built-in limitation on liability.”¹³⁵ The Court also wanted to protect a manufacturer from worrying about “the expectations of persons downstream who may encounter its product.”¹³⁶ *TWA* had expressed a similar concern, fearing that by allowing claims in tort “there would be nothing left of the citadel of privity and not much scope for the law of warranty.”¹³⁷

To be sure, as a descriptive matter, the economic loss rule operates in this realm as the dividing line between tort and contract. But we must probe more deeply to uncover the normative justification for the existence of these separate spheres and the urge to stave off contract’s “drowning” in tort. As products

is a poor reason for denying recovery for any genuine, serious mental injury” and the law can and should find a way to separate out worthy claims from the unworthy. *Id.* at 877.

132. Moreover, the floodgates rationale has particular force in non-contractual settings, where there is no way for the tortfeasor to recover the costs of tort liability. In contractual settings, by contrast, the manufacturer/seller can pass on the increased costs of liability to purchaser/consumer victims—at least under certain assumptions regarding competitive markets and fully informed purchasers/consumers. And, as Mark Geistfeld has explained, this returns us to the contracting rationale for determining the scope of duty.

133. *E. River*, 476 U.S. at 866.

134. *Id.* at 871.

135. *Id.* at 874.

136. *Id.*

137. *Trans World Airlines, Inc. v. Curtiss-Wright Corp.*, 148 N.Y.S.2d 284, 290 (Sup. Ct. 1955).

cases moved from contracts to torts, courts began to recognize a pressing need to prevent tort law from “swallowing” the law of contracts.

1. Essence of Tort and Contract

One way of understanding the concern about contract losing itself in tort is the need to preserve a boundary between the separate “essences” of tort and contract.¹³⁸ As summed up in *Seely*, “[a]lthough the rules of warranty frustrate rational compensation for physical injury, they function well in a commercial setting.”¹³⁹

On this view, the “core” of tort law is to protect the public from physical injury—primarily to persons, but also to property. More specifically, the original justification for the extension of strict liability to product defect cases centered on protecting the public from physical injuries arising from dangerous products.¹⁴⁰ In *Seely*, Justice Traynor—who authored the seminal *Greenman* decision introducing strict products liability for

138. See, e.g., *First Nat'l Bank of Louisville v. Brooks Farms*, 821 S.W.2d 925, 930 (Tenn. 1991) (“[A] line must be drawn between contract actions in which the basis of the plaintiff's complaint is that he failed to receive the quality of product expected; and tort actions, the basis of which is that the plaintiff has been exposed, through a hazardous product, to an unreasonable risk of injury to person or property.” (quoting 4 AM. L. PRODS. LIAB. § 60:20 (3d. 1987))).

139. *Seely v. White Motor Co.*, 403 P.2d 145, 150 (Cal. 1965) (citing Prosser, *Assault*, *supra* note 10, at 1130, 1133). “Commercially a disclaimer may not be at all an unreasonable thing, particularly where the seller does not know the quality of what he is selling and the buyer is willing to take his chances. Commercial buyers are usually quite able to protect themselves.” Prosser, *Assault*, *supra* note 10, at 1133. Neither the *Seely* court nor Prosser elaborate on the significance of this passage—which, I argue below, contains seeds of a “cheapest cost avoider” argument. See *infra* notes 190–98 and accompanying text.

140. See, e.g., *Greenman v. Yuba Power Prods., Inc.*, 377 P.2d 897, 901 (Cal. 1963) (“The purpose of such liability is to insure that the costs of injuries resulting from defective products are borne by manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves.”); see also Speidel, *supra* note 125, at 23 (“Strict products liability evolved in response to concerns about safety, difficulties in proving negligence, and the alleged imbalance in the capacities of enterprises and individuals to detect product defects and to bear and distribute the resulting damage to person or property. Strict products liability does not depend upon representations by the seller; its emphasis upon power imbalance and loss distribution collides with the traditional assumptions that underlie exchange transactions, namely, that the parties have relatively equal capacities and should be held to both their selection of contracting partners and their allocation of the risk of unknown product conditions.”).

product defect cases¹⁴¹—distinguished this prior holding as limited to the distinct problem of physical injury: “The history of the doctrine of strict liability in tort indicates that it was designed, not to undermine the warranty provisions of the sales act or of the Uniform Commercial Code but, rather, to govern the distinct problem of physical injuries.”¹⁴²

Justice Traynor explained that prior strict products liability cases were concerned with loss spreading as it related to bodily injuries, but not loss spreading for every harm.¹⁴³ According to Justice Traynor, insuring persons against the overwhelming misfortune of a bodily injury is justified and “the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business.”¹⁴⁴

But this is very different from forcing the public to pay more so that if every product does not meet every business expectation of every purchaser, that purchaser will be insured. As Justice Traynor explained in *Seely*: “[The] rationale [for extending tort to cover economic losses] in no way justifies requiring the consuming public to pay more for their products so that a manufacturer can insure against the possibility that some of his products will not meet the business needs of some of his customers.”¹⁴⁵ To hold otherwise would destroy the value of contracting about risk. Contract, at its core, protects economic expectations. And the consumer can “be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will.”¹⁴⁶

In sum, Justice Traynor argued that a space for contracting should be preserved because it often functions better than tort in a commercial setting.¹⁴⁷ Subsequent courts have echoed this rationale. For example, the Oregon Supreme Court in 1965 (citing *Seely*) reasoned that “the social and economic reasons which courts elsewhere have given for extending enterprise liability to the victims of physical injury are not equally persuasive in a case of a disappointed buyer of personal property.”¹⁴⁸

141. *Greenman*, 377 P.2d at 898.

142. *Seely*, 403 P.2d at 149.

143. *Id.* at 151.

144. *Id.* (citing *Escola v. Coca Cola Bottling Co. of Fresno*, 150 P.2d 436, 441 (Cal. 1944) (Traynor, J., concurring)).

145. *Id.*

146. *Id.*

147. *Id.* at 150.

148. *Price v. Gatlin*, 405 P.2d 502, 503 (Or. 1965); *see also id.* at 503–04 (Holman, J., concurring) (arguing that courts distinguish between economic

And the Minnesota Supreme Court in 1970 (citing *Seely*) also concurred, stating: "The laws of warranty still meet the needs of commercial transactions and function well in a commercial setting. However, the *Restatement* theory of responsibility more adequately meets the public policy need to protect consumers from the inevitable risks of bodily harm created by mass production and complex marketing conditions."¹⁴⁹

The U.S. Supreme Court picked up this rationale in *East River Steamship*, when it concluded that "[d]amage to a product itself is most naturally understood as a warranty claim."¹⁵⁰ The Court elaborated:

Such damage means simply that the product has not met the customer's expectations, or, in other words, that the customer has received "insufficient product value." The maintenance of product value and quality is precisely the purpose of express and implied warranties. Therefore, a claim of a nonworking product can be brought as a breach-of-warranty action. Or, if the customer prefers, it can reject the product or revoke its acceptance and sue for breach of contract.¹⁵¹

In sum, according to the Court, "the injury suffered—the failure of the product to function properly—is the *essence* of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain."¹⁵² And even if, in some cases, tort and contract principles may overlap, "the main currents of tort law run in different directions from those of contract and warranty, and the latter seem to us far more appropriate for commercial disputes of the kind involved here."¹⁵³

In other words, as the Court reiterated in its subsequent *Saratoga Fishing* case, "the courts should not ask tort law to

harm and other harms for social reasons—namely that personal injury cases involve "a personal disaster of major proportions to the [harmed] individual," whereas when it comes to pure economic losses, "the damaged person's health, and therefore his basic earning capacity, has remained unimpaired" and there is less of a social necessity in providing compensation).

149. *Farr v. Armstrong Rubber Co.*, 179 N.W.2d 64, 71 (Minn. 1970) (citation omitted); *accord* *Iowa Elec. Light & Power Co. v. Allis-Chalmers Mfg. Co.*, 360 F. Supp. 25, 32 (S.D. Iowa 1973) ("The doctrine of strict liability in tort, designed to aid the consumer in an unequal bargaining position who is physically injured, loses all meaning when a large public utility or other large company is the plaintiff and is suing solely for commercial loss."); Geistfeld, *supra* note 122 (arguing that instead of defining the economic loss rule in terms of the damage caused, the focus should be on the risk of physical harm posed to the consumer).

150. *E. River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 872 (1986).

151. *Id.* (citation omitted).

152. *Id.* at 868 (emphasis added).

153. *Id.* at 873 n.8.

perform a job that contract law might perform better.”¹⁵⁴ But what precisely falls within the wheelhouse of contract or warranty law and outside of tort?

In *Saratoga Fishing*, the Court made clear that the “mere possibility” of contracting by no means precludes tort liability.¹⁵⁵ In *Saratoga Fishing*, a shipbuilder sold a fishing vessel with a defective hydraulic system to an initial user, who added equipment to the vessel and then sold it to a subsequent purchaser.¹⁵⁶ While in use by the subsequent purchaser, the vessel caught fire and sank due in large part to the defective hydraulic system, and destroyed the added equipment.¹⁵⁷ The Court held that the added equipment was “other property,” and the economic loss rule does not cover damage to other property.¹⁵⁸

The Court rejected the argument that the initial user should have been expected to offer a warranty to the subsequent purchaser for the items the initial user added to the vessel.¹⁵⁹ According to the Court, unlike the situation in *East River Steamship*, warranty law (even if theoretically available) was

154. *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 880 (1997).

155. *Id.* at 882 (arguing that while a user and a reseller could contract for a warranty, so could a manufacturer and an initial user regarding damage to other property, but “[n]o court has thought that the mere possibility of such a contract term precluded tort recovery for damage to an Initial User’s other property”).

156. *Id.* at 877.

157. *Id.*

158. *Id.* at 877–78 (holding that the product was the ship created by the defendant manufacturer, and the added equipment was other property). The difficult question facing the Court was whether the initial user-added equipment should be treated as part of the “product itself” or as “other property.” *Id.* For example, the initial user of the ship could not have sued the manufacturer of the defective hydraulic system under a theory that its malfunctioning harmed “other property” added by the ship’s final manufacturer. *Id.* at 883; see also *Casa Clara Condo. Ass’n v. Charley Toppino & Sons Inc.*, 620 So. 2d 1244 (Fla. 1993) (holding that a house is a single finished product, and purchasers cannot recover in tort even though defective concrete ruined the value of the house, because the entire house is treated as a single defective product, and is thus covered by the economic loss rule). Thus, as the court elaborated in *Casa Clara*, “[t]he concrete [component part] became an integral part of the finished product and, thus, did not injure ‘other’ property.” 620 So. 2d at 1247. Instead, courts deem the finished product (the ship) to be a single item that harmed itself, even if only one of its component parts fail, and thus best left to warranty law. *Saratoga Fishing*, 520 U.S. at 883 (discussing how lower courts have held, following *East River Steamship*, that “it is not a component part [the hydraulic system], but the vessel—as placed in the stream of commerce by the manufacturer and its distributors—that is the ‘product’ that itself caused the harm”).

159. *Saratoga Fishing*, 520 U.S. at 882–83.

ill-suited to protect against a malfunctioning product that causes physical damage to user-added items:

Initial users, when they buy, typically depend upon, and likely seek warranties that depend upon, a manufacturer's primary business skill, namely, the assembly of workable product components into a marketable whole. Moreover, manufacturers and component suppliers can allocate through contract potential liability for a manufactured product that does not work There is no reason to think that initial users systematically control the manufactured product's quality or . . . systematically allocate responsibility for user-added equipment . . . in similar ways.¹⁶⁰

Moreover, having decided in favor of recovery for damage to the user-added equipment, the Court downplayed the potential for unlimited liability, relying on the fact that "a host of other tort principles," such as "foreseeability, proximate cause, and the 'economic loss' doctrine" would continue to impose restrictions.¹⁶¹

2. Deference to UCC

A second way of understanding the concern about contract losing itself in tort prioritizes private ordering, namely deference to contract, specifically to the Uniform Commercial Code (UCC) in the realm of products liability. It is the law of sales, and not the law of torts, which protects the buyer's interest in the benefit of his bargain. Parties are free to determine by contract the quality of goods which the seller is bound to deliver or remedies available to the buyer in the event goods do not measure up to agreed-upon quality. If the loss is purely economic, the UCC gives the purchaser ample recourse under the particular provisions and requirements of the Code. On this view, strict products liability developed in large part to fill the gaps in the law of sales with respect to consumer purchasers. Limiting the application of strict products liability to consumers' actions involving physical injury allows the UCC to satisfy

160. *Id.* at 883–84 (citation omitted); see also *id.* at 882 ("The *East River [Steamship]* answer to this question—because the parties can contract for appropriate sharing of the risks of harm—is not as satisfactory in the context of resale after an initial use. That is because . . . the Subsequent User does not contract directly with the manufacturer (or distributor). . . . [I]n the absence of a showing that it is ordinary business practice for user/resellers to offer a warranty comparable to those typically provided by sellers of new products, the argument for extending *East River [Steamship]*, replacing tort law with contract law, is correspondingly weak.")

161. *Id.* at 884.

the needs of the commercial sector and still protect the legitimate expectations of consumers.

The UCC was drafted with the intangible economic interests of those who purchase products in mind. Under the UCC, the buyer may recover from the seller for “injury to person or property proximately resulting from any breach of warranty”;¹⁶² other consequential loss is recoverable only if the seller had reason to anticipate its occurrence.¹⁶³ “Thus, while harm to person and property is measured in traditional tort terms, the Code treats recovery for economic loss as an action in contract.”¹⁶⁴ Moreover, as explained by a Georgia court, “[a] manufacturer’s duty to sell goods meeting consumer expectations is governed by the requirements of warranty law . . . as set out in the Uniform Commercial Code.”¹⁶⁵ The court stated further that “if strict liability in tort were considered to apply to the loss of bargains by disgruntled consumers, the subtle and technical provisions of warranty law established . . . through its enactment of the UCC would be useless.”¹⁶⁶ Courts have therefore expressed twin desires to defer to the legislature (which adopted the UCC) and to protect the space for contracting and allocating risk carved out by warranty law.

Indeed, this reasoning is at the heart of *Seely*.¹⁶⁷ At the outset, the court stressed that the “legislative scheme of recovery” had not been superseded by tort, and that “[t]he law of sales has been carefully articulated to govern the economic relations between suppliers and consumers of goods.”¹⁶⁸ Thus, the court concluded that strict liability did not develop to replace the UCC.¹⁶⁹

162. UCC § 2-715(2)(b) (AM. LAW INST. & UNIF. LAW COMM’N 2014).

163. *Id.* § 2-715(2)(a).

164. Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 948 (1966).

165. *Chrysler Corp. v. Taylor*, 234 S.E.2d 123, 125 (Ga. Ct. App. 1977).

166. *Id.*; see also Note, *supra* note 164, at 958 (“The establishment of manufacturer’s liability to subpurchasers for economic loss would effectively nullify several provisions of the [UCC] intended to permit contracting parties to control their economic relations through the bargaining process.”).

167. *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

168. *Id.* at 149. *Seely* cites Prosser, *Assault*, *supra* note 10, at 1130, 1133, in support of the argument that various legislative rules concerning warranties, notice, and contracting work well in a commercial setting. *Seely*, 403 P.2d at 150.

169. See *Seely*, 403 P.2d at 149 (holding that strict liability in tort evolved to deal with physical injuries, “not to undermine the warranty provisions of the sales act or of the Uniform Commercial Code”). But this point—that the

Subsequent courts placed even greater reliance on fidelity to the UCC and legislative intent. The Alaska Supreme Court held that “adoption of the doctrine of strict liability for economic loss would be contrary to the legislature’s intent.”¹⁷⁰ The court reasoned that “[u]nder the [UCC] the manufacturer is given the right to avail himself of certain affirmative defenses which can minimize his liability for a purely economic loss.”¹⁷¹ Disclaimers of liability and the entitlement to notice of the claimed breach are rights of the manufacturer that would be circumvented in a manner “not envisioned by our legislature when it enacted the UCC Further, manufacturers could no longer look to the [UCC] provisions to provide a predictable definition of potential liability for direct economic loss.”¹⁷²

Ultimately, this rationale proved so strong that even the New Jersey Supreme Court, which led the charge to expand strict liability to economic losses in *Santor*, retreated from its position. First, in 1985, in *Spring Motors Distributors v. Ford Motor Co.*, the court narrowed the scope of *Santor* by refusing to apply its holding to a dispute between two commercial parties, recognizing that the rationale of achieving “justice” for the consumer did not apply where the parties had more equitable bargaining power.¹⁷³ The court reasoned that “economic expect-

UCC was meant to preclude tort liability for benefit of the bargain—has been contested. See Comment, *Manufacturers’ Liability to Remote Purchasers for “Economic Loss” Damages—Tort or Contract?*, 114 U. PA. L. REV. 539, 545 (1966) (“The comment to the privity section of the [UCC] states that the section is ‘not intended to enlarge or restrict the developing case law on whether the seller’s warranties, given to his buyer who resells, extend to other persons in the distributive chain.’” (citing UCC § 2-318 cmt. 3 (AM. LAW INST. & UNIF. LAW COMM’N 2014))).

170. *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279, 286 (Alaska 1976); see also *id.* at 285–86 (“[R]ecognition of a doctrine of strict liability in tort for economic loss would seriously jeopardize the continued viability of these [UCC] rights. The economically injured consumer would have a theory of redress not envisioned by our legislature when it enacted the UCC, since this strict liability remedy would be completely unrestrained by disclaimer, liability limitation and notice provisions.”).

171. *Id.* at 285.

172. *Id.* at 285–86; see also *Avenell v. Westinghouse Elec. Corp.*, 324 N.E.2d 583, 588 (Ohio Ct. App. 1974) (“[T]he doctrine of implied warranty in tort must be limited in its applicability. Otherwise, unlimited application of the doctrine would emasculate the [UCC] provisions dealing with products liability.”).

173. *Spring Motors Distribs. v. Ford Motor Co.*, 489 A.2d 660, 670–71 (N.J. 1985); see also *id.* at 670 (“In the present case, which involves an action between commercial parties, we need not reconsider the *Santor* rule that an ultimate consumer may recover in strict liability for direct economic loss.”).

tations that are protected by the UCC are not entitled to supplemental protection by negligence principles.”¹⁷⁴ And then, in 1997, in *Alloway v. General Marine Industries*, it officially abrogated *Santor*.¹⁷⁵ The court emphasized that *Santor* had been decided “[o]ver thirty years ago, before the UCC took effect.”¹⁷⁶ The court retreated from *Santor*, holding that where “the harm suffered is to the product itself, unaccompanied by personal injury or property damage, we conclude[] that principles of contract, rather than of tort law, [are] better suited to resolve the purchaser’s claim” when determining the appropriate statute of limitations.¹⁷⁷ “By providing for express and implied warranties, the UCC amply protects all buyers—commercial purchasers and consumers alike—from economic loss arising out of the purchase of a defective product.”¹⁷⁸

CONCLUSION: SHOULD THE CITADEL BE PRESERVED?

Prosser’s discussion of the products liability tort law in 1966 in *The Fall of the Citadel* reveals just how much it was in a state of flux concerning purely economic losses. Various doctrines competed against each other and the future was unclear. One could imagine a future where a disappointed user could not generally recover pure economic losses, but a user who suffered lost profits because of a product defect could.¹⁷⁹ Or perhaps a user could recover economic losses, including the loss of value of the product, if it destroyed itself.¹⁸⁰ Or if the defect was one which posed an unreasonable threat to bodily harm.¹⁸¹ Or in all cases.¹⁸² Instead, the defenders of privity consolidated their forces around *Seely* and launched a furious counter-attack under the banner of the economic loss rule.¹⁸³

174. *Id.* at 673.

175. *Alloway v. Gen. Marine Indus.*, 695 A.2d 264 (N.J. 1997).

176. *Id.* at 269.

177. *Id.* at 270.

178. *Id.* at 275.

179. *E.g.*, *Mazetti v. Armour & Co.*, 135 P. 633 (Wash. 1913) (applying an exception to privity of contract to allow suit for recovery for business and reputational financial losses).

180. The position taken in *Quackenbush v. Ford Motor Co.*, 153 N.Y.S. 131 (App. Div. 1915).

181. A position that crystalized in *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.2d 1165 (3d Cir. 1981).

182. The position taken in *Santor v. A & M Karagheusian, Inc.*, 207 A.2d 305 (N.J. 1965).

183. *See Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

In *The Fall of the Citadel*, Prosser deserves credit for noting the emergence of two camps on strict liability recovery for “loss of bargain” damages, but his embrace of the no-recovery position is tentative, restricted to a narrow category of damages, and not backed by much (if any) theoretical justification.¹⁸⁴

Subsequently developed rationales based upon acoustic separation of contract and tort, so as to prevent contract law from drowning “in a sea of tort,”¹⁸⁵ are likewise missing underlying theoretical justification. Vincent Johnson has posited:

If there is a convincing rationale for the economic loss rule, it is that the rule performs a critical boundary-line function, separating the law of torts from the law of contracts. More specifically, “the underlying purpose of the economic loss rule is to preserve the distinction between contract and tort theories in circumstances where both theories could apply.”¹⁸⁶

This boundary line function is a truism (and an insightful one). But it is also question begging, a truism in search of a sound theoretical justification. Commentators and courts have recognized that “[b]roadly speaking, the economic loss rule is intended to maintain the boundary between contract law and tort law.”¹⁸⁷ But debates about the economic loss rule have obscured the fundamental issue: the justification for recognizing public policy imposed duties in tort, especially in the sphere of commercial or financial losses. Only once this is decided—namely the appropriate domain for tort law—can the economic loss rule police the borders.

Many courts and scholars have recognized grey areas where tort and contract overlap. Prosser famously described

184. Prosser likewise did not anticipate that the damage a defective chattel causes to itself and consequential losses flowing from a defective product would be swept into the economic loss rule.

185. *E. River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 866 (1986).

186. Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 546 (2009). Johnson does not—in my view—provide a satisfactory answer to the question of what belongs in the domain of tort. He relies instead on an argument that tort claims supported by “fundamental tort policies” should not be preempted by contract claims. *See id.* at 559 (“Contractual performance always takes place within a matrix of other legal obligations, including those imposed by the law of torts.”); *id.* at 563 (“Tort liability should be imposed to encourage safe practices, not to ensure that careless conduct goes unremedied. . . . [There are] important public policies relating to fault, deterrence, and compensation that are the basis of American tort law.”); *id.* at 571 (“[J]udicial determination that considerations relating to fault, deterrence, personal responsibility, and compensation warrant the imposition of liability.”).

187. *Town of Alma v. AZCO Const., Inc.*, 10 P.3d 1256, 1259 (Colo. 2000).

“[t]he borderland of tort and contract, and the nature and limitations of the tort action arising out of a breach of contract, [as] poorly defined.”¹⁸⁸ And Prosser memorably characterized warranty law as “a freak hybrid born of the illicit intercourse of tort and contract.”¹⁸⁹ Looking to the “essence” of tort and contract is not likely to be fully satisfactory, especially as categories of claims—product defect serving as a prime example—have migrated across the divide. Nor does the conventional deference to contract rationale, which posits that the voluntary allocation of economic risks between contracting parties (or, more broadly, parties that could have contracted) produces better social outcomes than forcing the seller or manufacturer to bear them fully, satisfactorily answer the questions when and why one should privilege such private ordering.

A sounder theoretical grounding is provided by a “cheapest cost avoider” rationale—one of the animating justifications for strict products liability for product manufacturers, but which plays out differently with respect to consideration of economic risks.¹⁹⁰ Whereas manufacturers are almost always in a better position to control and insure risks in the manufacturing production process, and perhaps as a general matter (apart from the situations where products are not used as intended or are modified by the end user) with respect to risks of physical harm and damage to property, the conclusion flips with respect to considerations of economic risks for which the end user often possesses an informational advantage over the seller about potential uses and the consequential risk flowing from those uses.¹⁹¹

188. PROSSER, *supra* note 14, at 452. According to Prosser, the uncertainty “permitted a degree of flexibility” that freed courts “to look to the purpose of the rule of law in question.” *Id.*

189. Prosser, *Fall*, *supra* note 11, at 800.

190. See generally GEISTFELD, *supra* note 2, at 258 (“In evaluating the respective roles of [tort and contract law], . . . the appropriate rule depends on whether consumers can adequately protect themselves with contracting. . . . As applied to the issue of pure economic loss, this principle means that the tort duty should not encompass the risk of pure economic loss if the ordinary consumer has good information about the risk and can adequately protect her interests by contracting with product sellers.”).

191. See Richard E. Speidel, *Products Liability, Economic Loss and the UCC*, 40 TENN. L. REV. 309, 317–18 (1973) (“While the social needs associated with product safety justify strict liability where the product is so dangerous that damage to person or property can occur, the case is not so compelling where other commercial losses are involved.”).

Purchasers of products typically plan to use the product in a certain way or desire a product of a certain quality. In *Seely*, for example, the court remarked how, given the different ways in which truckers could use particular trucks in their respective businesses, such information is more readily knowable to purchasers, as opposed to the seller.¹⁹² The user has information about how they want to use a truck that the manufacturer does not have. This informational advantage means the end user is in the best position to assign usage risks, to know which risks are worth assuming and which are not.¹⁹³ The end user, moreover, may also be in a better position than the seller to mitigate and insure against certain risks, at least when it involves potentially disappointed economic expectations.¹⁹⁴ Allowing parties to allocate risk enables the party best able to bear that risk to assume that risk—maximizing efficiency from a deal.¹⁹⁵

The U.S. Supreme Court likewise implicitly embraced such a cheapest cost avoider rationale in *Saratoga Fishing*, allowing the subsequent purchaser to sue in tort, notwithstanding the fact that it was theoretically possible for him to have protected

192. *Seely v. White Motor Co.*, 403 P.2d 145, 150–51 (Cal. 1965); see also GEISTFELD, *supra* note 2, at 259 (“The consumer knows how the product will be used and has better information about the financial harms, like lost profits, that could be caused by a defect.”).

193. See *Trans World Airlines Inc. v. Curtiss-Wright Corp.*, 148 N.Y.S.2d 284, 290 (Sup. Ct. 1955) (“Damages for inferior quality, per se, should better be left to suits [with privity] since they depend on the terms of the bargain . . .”).

194. See *Pa. Glass Sand Corp. v. Caterpillar Tractor Co.*, 652 F.2d 1165, 1169 (3d Cir. 1981) (“[C]ontract law . . . provides the appropriate set of rules when an individual wishes a product to perform a certain task in a certain way, or expects or desires a product of a particular quality so that it is fit for ordinary use.”); see also GEISTFELD, *supra* note 2, at 259 (“This information enables the ordinary consumer to protect her interests by either contracting with the seller for warranty coverage, purchasing other types of insurance, or obtaining a supply of spare parts.”); William K. Jones, *Product Defects Causing Commercial Loss: The Ascendancy of Contract over Tort*, 44 U. MIAMI L. REV. 731, 765–66 (1990) (“[T]he buyer is clearly in the best position to insure against the [economic] loss [to the buyer’s business]” given the availability of business interruption insurance as well as buyer’s ability to “maintain[] spare parts, excess capacity, alternative operating modes, and the like.”).

195. See *Purvis v. Consol. Energy Prods. Co.*, 674 F.2d 217, 222 (4th Cir. 1982) (“The right to disclaim warranties and limit remedies enables commercial parties to allocate risks between the buyer and the seller in the most efficient manner and thereby to maximize their respective gains from a transaction.”); see also Jones, *supra* note 194, at 797 (“When contract is available as an alternative, it is possible for parties to reach efficient solutions appropriate to their particular circumstances.”).

himself via contract.¹⁹⁶ The Court reasoned that, while initial users of products seek warranties depending upon a manufacturer's ability to create finished products, and while manufacturers and component suppliers can allocate risk through contract, initial users are poorly positioned to do so when they sell to subsequent purchasers.¹⁹⁷

Prosser offered just the slightest hint of such a "cheapest cost avoider" rationale for the economic loss rule in products, namely, that "commercial buyers are usually quite able to protect themselves."¹⁹⁸ With this seed, a further field of exploration is opened up. Seen in this light, the citadel's last bastion—the economic loss rule in products cases—is justified as a means to induce the putative victims, here, the parties with superior information regarding risk of financial loss, to protect themselves.

196. *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 882 (1997).

197. *Id.* at 882–84.

198. Prosser, *Assault*, *supra* note 10, at 1133. Prosser's formulation, emphasizing "commercial" buyers raises a further question: What about unequal bargaining power, as might be likely with respect to noncommercial buyers? Justice Traynor remarked in *Seely*: "The law of warranty is not limited to parties in a somewhat equal bargaining position." *Seely v. White Motor Co.*, 403 P.2d 145, 151 (Cal. 1965). Justice Peters, however, suggested the need to distinguish "commercial transactions" involving more sophisticated parties and sales to "ordinary consumer[s]." *Id.* at 156 (Peters, J., concurring and dissenting); see also Jones, *supra* note 194, at 796–97 (defending the economic loss rule for "commercial transactions" as distinct from "general run of manufacturer-consumer transactions," given "limitations on consumer knowledge" and "disparities in consumer wealth" that apply to the latter category).