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SUPREME COURT OF FLORIDA

CASA CLARA CONDOMINIUM ASSOCIATION,
INC., ETC., ET AL.,

Petitioners, CASE NO. 79,127

vs.

CHARLEY TOPPINO AND SONS, INC.,
ETC.,

Respondent.
_______________________________________/

CHRISTOPHER H. CHAPIN, ET AL.,

Petitioners, CASE NO. 79,128

vs.

CHARLEY TOPPINO AND SONS, INC.,
ETC.

Respondent.
_______________________________________/

AMICUS BRIEF OF MASONITE CORPORATION

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INTRODUCTION

In these proceedings, the Petitioners and their supporters have filed briefs urging this Court to overturn the decision of the Third District Court of Appeal in CASA CLARA CONDOMINIUM ASSOCIATION, INC. v. CHARLEY TOPPINO & SONS, 588 So.2d 631 (Fla. 3d DCA 1991) which held, inter alia, that a remote manufacturer or supplier of building materials cannot be sued in tort, based upon theories of negligence or strict products liability, for purely economic losses alleged to have been incurred because the building product supplied was defective. Although the Petitioners and their supporters each have their own separate axes to grind, the basic thrust of their arguments to this Court are essentially the same. They all claim to have suffered what are purely economic losses as a result of their "being stuck with" an allegedly defective building material or with a completed structure incorporating an allegedly defective building material. Although they will each deny it, the truth is that they are asking this Court to "break new ground" by recognizing the existence in Florida of a cause of action in tort (based on either negligence, strict products liability, or both) for the recovery of purely economic damages from a remote supplier or manufacturer of an allegedly defective building product.

For this Court to grant the Petitioners' request would require a radical departure from heretofore well-settled principles of tort law, would require this Court to overrule numerous prior decisions of its own and of the district courts of appeal, and would result in far-reaching economic consequences throughout the construction industry which would ultimately be detrimentally visited upon Florida homeowners through unnecessary price increases in building supplies and materials. We intend to demonstrate that the economic loss rule in the products liability arena is supported by the clear weight of decisional authority, and by sound commercial and public policy considerations. Any attempt to restrict the rule's scope through the creation of ad hoc exceptions should be met with the highest level of scrutiny and subjected to careful consideration and balancing of the interests of all parties concerned.

The various separate causes of action which presently exist under decisional and statutory law in Florida are more than sufficient to protect the interests of all parties concerned with and involved in the construction industry, from the ultimate homeowner to the remote product suppliers and manufacturers, and with very few exceptions, the system has proven to operate in a fashion which by and large protects the interests of all concerned. To disturb this fair and workable system for no other reason than sympathy for the isolated homeowner or developer who might have unfortunately become an innocent victim by virtue of dealing with small, inadequately financed contractors, subcontractors, or vendors is simply not warranted by any substantial public policy considerations. Individuals and businesses in Florida occupying the position of the Petitioners and their allies have simply never had a cause of action in tort against remote suppliers or manufacturers of building products for the recovery of purely economic losses they may have suffered, since for sound public policy reasons the courts in Florida (and, indeed, throughout this country) have never imposed a tort-based duty upon such suppliers or manufacturers to protect the mere economic interests or expectations of those who might purchase or utilize their products in the construction process or who might purchase a home incorporating those products.

FACTS REGARDING MASONITE'S INTEREST IN THE OUTCOME OF THIS CASE

Masonite is a foreign corporation primarily engaged in the business of developing, manufacturing, and distributing a wide variety of products utilized in the construction industry. Many of those products have been and continue to be used extensively throughout this country, including the State of Florida. Masonite's products reach their final destination as a result of a series of successive commercial sales transactions. Masonite first sells its products in bulk to wholesale distributors. These distributors in turn enter into independently negotiated wholesale sales contracts with local retailers. These local retailers then enter into their own sales contracts to supply the materials to residential and commercial developers, to general contractors, and to sub-contractors. At each successive level of the distribution system, the parties involved contractually allocate their respective risks and responsibilities and determine the sales price based thereon.

Among the many wood-based construction materials manufactured and sold by Masonite is a complete line of hardboard siding. Generally speaking, hardboard siding is manufactured by first chemically breaking wood down into its fibers, then adding various substances to those wood fibers to increase the wood's water repellency and resistancy. This final solution is then subjected to extreme pressure and heat, thus rebonding the fibers together to form the hardboard siding. Because of its performance characteristics[1] and its moderate price, and because of the modern construction industry trend towards building wood-framed structures in residential developments, the utilization of hardboard siding by developers and general contractors in Florida expanded dramatically during the residential building boom of the 1980s.

One of the developments in Florida which utilized Masonite's hardboard siding products is a 387-home residential development in Palm Beach County known as Victoria Woods. As a result of serious flaws in the design and construction of the homes themselves and as a result of the developer/contractor's failure to properly install Masonite's hardboard siding, a substantial number of the homes developed problems with leaks. Masonite's siding itself became a victim of the leaks; the siding began to exhibit various types of failures, including swelling and deterioration. Unfortunately, the homeowners were unaware of the underlying design, construction, and workmanship deficiencies which were the root cause of the water leakage into the residences. They therefore blamed the Masonite siding for their problems.

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[1]Satisfactory performance of hardboard siding, like that of all wood and wood-based products, is dependent upon its being utilized on a properly designed structure, upon its being installed in the manner specified by the manufacturer, and upon its being periodically maintained. Thus, satisfactory performance of

The situation resulted in the December, 1991 filing of a class action lawsuit by a group of Victoria Woods homeowners against both Masonite and the developer/general contractor, Robert C. Malt & Co., Inc. The homeowners sought purely economic damages based upon causes of action sounding in negligence and strict products liability. The strict liability count alleged that the hardboard siding manufactured and sold by Masonite, which was ultimately purchased by the developer/general contractor from a local retailer, "contained latent defects which caused [it] to degrade and deteriorate under normal weather conditions and usage and render[ed] said products inherently defective and unreasonably dangerous." The negligence count asserted that Masonite "breached its duty to manufacture siding and building materials in accordance with proper design and engineering practices such that these materials would be suitable for exterior application on residential structures and be free of any defect which caused premature deterioration."[2]

Masonite's siding products and its ability to live up to the ultimate consumer's expectations is for the most part dependent upon the actions of intermediate third parties over whom Masonite has absolutely no control. Indeed, as the demonstration recently visited upon South Florida developments by Hurricane Andrew attests, the quality of workmanship in home building is the most critical of all factors, and, unfortunately, the most suspect area in the construction industry at this time.

[2]We would note in passing that the class action lawsuit against Masonite was filed by one of the two law firms representing the plaintiff/homeowner association in the CASA CLARA case. As in CASA CLARA, the complaint against Masonite additionally alleged that the defective condition of the Masonite siding has caused "deterioration of the structural, wood-framed members of the homes ... and creates a risk of sudden, unexpected harm to persons and property ...."

Masonite responded to the class action complaint with the filing of a motion to dismiss, primarily urging that the homeowners' tort claims were barred, as a matter of law, by the economic loss doctrine. The homeowners responded to the motion to dismiss by arguing: (1) that their pleading alleged damage to "other property", thus falling outside the scope of the economic loss rule; and (2) that they had no alternative means of recovery against Masonite, therefore entitling them to pursue tort claims under the holding of LATITE ROOFING COMPANY, INC. v. URBANEK, 528 So.2d 1381 (Fla. 4th DCA 1988).

In an eight-page memorandum opinion a Palm Beach County Circuit Court judge denied Masonite's motion to dismiss (copy of order attached hereto as A. 1-8). The Circuit Court first held that under existing Florida law "the damage to the homes caused by the defective siding is not damage to 'other property' sufficient to avoid the application of [the economic loss] rule," citing CASA CLARA CONDOMINIUM ASSOC. INC. v. CHARLEY TOPPINO & SONS, INC., 588 So.2d 631 (Fla. 3d DCA 1991); GAF CORP. v. ZACK CO., 445 So.2d 350 (Fla. 3d DCA 1984), rev. den. 453 So.2d 45 (Fla. 1984); and AETNA LIFE & CAS. CO. v. THERM-O-DISC, INC., 511 So.2d 992 (Fla. 1987).

The court nevertheless proceeded to deny Masonite's motion to dismiss, basing its ruling upon what it believed was another "exception" to the economic loss rule, the so-called "no privity" (or "no alternative remedy") exception set forth in LATITE

ROOFING.[3] In denying Masonite's motion to dismiss, the West Palm Beach Circuit Court judge felt bound to apply LATITE ROOFING, which he perceived to stand for the proposition that:

> To properly apply the plain language of Latite, the court must determine whether a plaintiff has a cause of action against the defendant seeking the application of the economic loss rule, and not whether a plaintiff has a cause of action against any other party. This Court is required to follow the plain language of Latite which is in direct conflict with American Universal, a decision from another district (App. at p. 7). (all emphasis supplied by counsel unless otherwise noted.)

As a remote building products supplier which does not ordinarily enter into any direct sales contract with the ultimate consumer/building owner, it is absolutely essential that Florida trial and appellate courts be provided with some guidance from this Court with respect to this perceived conflict of decisions on the same point of law, i.e - whether one not in privity with a product manufacturer may sue in tort for purely economic losses.

STATEMENT OF THE CASE AND OF THE FACTS

Masonite will adopt as its own the statement of the case and of the facts set forth in the answer brief of Respondent, CHARLEY TOPPINO AND SONS, INC.

SUMMARY OF THE ARGUMENT

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[3]In his order, Judge Gross pointed out that LATITE could not be reconciled with a line of Florida cases where there was no privity between the plaintiff and the defendant manufacturer, yet the courts nevertheless applied the economic loss rule. See, CASA CLARA; GAF CORP.; and AMERICAN UNIVERSAL GROUP v. GENERAL MOTORS CORP., 578 So.2d 451 (Fla. 1st DCA 1991). See generally, The Economic Loss Rule: A Trial Lawyer's Guide to Protecting Contract Rights, April 1992 FLA. BAR J. 38, 39-40.

This Court should uphold the decision of the Third District in CASA CLARA, which held, inter alia, that a remote manufacturer or supplier of building materials cannot be sued in tort for purely economic losses alleged to have been incurred because the building product supplied was defective. The ruling of the Third District is consistent with prior Florida products liability precedent and is supported by the decisions of the vast majority of other courts throughout this country which have decided the same issue.

The economic loss rule is supported by sound commercial and public policy considerations. For this Court to grant the Petitioners' request that they be given a direct cause of action in tort against a remote product supplier would require a radical departure from heretofore well-settled principles of tort law, would require this Court to overrule numerous prior decisions of its own and of the district courts of appeal, and would result in far-reaching economic consequences throughout the construction industry which would ultimately be detrimentally visited upon Florida homeowners through unnecessary price increases in building supplies and materials.

The various separate causes of action which presently exist under decisional and statutory law in Florida are more than sufficient to protect the interests of all parties concerned with and involved in the construction industry. What the Petitioners and their allies really want this Court to do is to recognize and impose a new burden and duty upon manufacturers. Individuals and businesses in Florida occupying the position of the Petitioners and their allies have simply never had a cause of action in tort against remote suppliers or manufacturers of building products for the recovery of purely economic losses they may have suffered.

Both the "no privity" exception and the "risk of harm" exception which the Petitioners tender to this Court as covering their situation represent approaches which have already been rejected by the Florida courts, as well as the vast majority of the courts in other jurisdictions. Application of the economic loss rule has not been limited to only those disputes involving parties in privity with each other. On the contrary, it has been repeatedly recognized that the non-privity situations represent the broadest and most important area within which the economic rule must operate. Otherwise, the exception would certainly swallow up the general rule and would run contrary to the primary underpinnings of the economic loss rule itself -- to encourage parties <u>at each level</u> of the distributive chain to allocate their economic risks and benefits through negotiation and price. For the fundamental goal of predictability and certainty of commercial transactions to be realized, the economic loss rule must be applied throughout the various levels of the distributive chain.

The "risk of injury" exception has already been rejected by this Court when it aligned itself with the United States Supreme Court and adopted the "majority" approach to the economic loss rule. The "risk of loss" (the "intermediate") approach has properly been characterized as "too indeterminate to enable manufacturers easily to structure their business behaviors." Ultimately, the risk of injury rationale is simply a distinction without a difference since it, in effect, is nothing more than an effort to recoup expenditures for repair, replacement and loss of product value in situations where no physical harm has yet been done. The burden which would be placed upon the courts in attempting to adjudicate disputes in accordance with such an amorphous standard is obvious.

ARGUMENT

THE EXISTENCE AND SCOPE OF THE LIABILITY OF A MANUFACTURER OF A BUILDING PRODUCT WHICH IS NOT INHERENTLY OR UNREASONABLY DANGEROUS AND WHICH HAS CAUSED NO PHYSICAL INJURY TO PERSONS OR TO "OTHER PROPERTY" SHOULD BE GOVERNED BY THE LAW OF CONTRACTS AND THE UNIFORM COMMERCIAL CODE, NOT BY TRADITIONAL TORT PRINCIPLES.

I.

PREFACE

Viewed properly, the operative facts of this case present only a single, narrow legal issue: Whether Florida law does (or should) impose upon a manufacturer or intermediate supplier of building materials/products a tort-based duty owed to remote third parties to avoid causing them harm of a purely financial or economic nature? The Third District's negative answer to this question in its CASA CLARA decision represents the legally correct and appropriate response. The Third District's decision in favor of the product supplier (Respondent Toppino) is consistent in result with all of the Florida products liability decisions which have specifically addressed this precise narrow question.

Undaunted, the Petitioners and their allies try to convince this Court otherwise by misdirecting the Court's focus to non-products liability cases which for varying reasons have permitted negligence suits to be brought in limited circumstances against various providers of professional services,[4] by citing to one prior Florida district court decision where a products liability tort suit for pure economic damages was permitted, albeit without any direct discussion by the court in that case of the precise

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[4]See, e.g., FIRST FLORIDA BANK, N.A. v. MAX MITCHELL & CO., 558 So.2d 9 (Fla. 1990) (permitting negligence action for economic losses to be brought against accountant for negligently supplying information to be relied upon by known third parties, where elements of Restatement (Second) Torts §552 are met); ANGEL, COHEN & ROGOVIN v. OBERON INVESTMENT, N.V., 512 So.2d 192 (Fla. 1987) (permitting negligence action for economic losses to be brought against attorney, but duty only owed to client and specifically intended third party beneficiaries of the attorney/client contract); FIRST AMERICAN TITLE INS. CO., INC. v. FIRST TITLE SERVICE CO. OF THE FLORIDA KEYS, INC., 457 So.2d 467 (Fla. 1984) (permitting negligence action for economic losses to be brought against title abstractor, but duty only owed to client and specifically intended third party beneficiaries of the abstractor/client contract); A. R. MOYER, INC. v. GRAHAM, 285 So.2d 397 (Fla. 1973) (permitting negligence action for economic losses to be brought by general contractor against supervising architect, but duty only found to exist because the degree of control the architect exercised over the general contractor was tantamount to the "power of economic life or death").

While this Court did permit a negligence action in those cases, it did so based on policies not implicated here, it did so in a very narrow set of circumstances, and most importantly, it consistently rejected the plaintiffs' attempts in those cases to impose a broad tort-based duty owed "to any and all foreseeable injured parties." FIRST FLORIDA, 558 So.2d at 12-16; ANGEL, COHEN, 512 So.2d at 194; FIRST AMERICAN TITLE, 457 So.2d at 468. See, also, McELVY, JENNEWIN, STEFANY, HOWARD, INC., 582 So.2d 47 (Fla. 2d DCA 1991) (rejecting negligence action for economic losses brought by subcontractor against non-supervising architect); E. C. GOLDMAN, INC. v. A/R/C ASSOCIATES, INC., 543 So.2d 1268 (Fla. 5th DCA 1989) (rejecting negligence action for economic losses brought by subcontractor against consulting engineer). Finally, Section 552 of the Restatement is inapplicable here because suppliers of tangible goods are not generally held to "be in the business of supplying information to others." See, RANKOW v. FIRST CHICAGO CORP., 870 F.2d 356, 363-4 (7th Cir. 1989), and cases cited.

issue presented in this case,[5] and by citing to several isolated decisions from other states which are inconsistent with the Florida decisions directly on point. The Petitioners and their allies additionally rely upon a group of decisions involving the liability of developers, contractors, and other parties involved in the construction and sale of residential properties, which decisions, although containing some very emotionally appealing language in their supporting opinions, are nevertheless legally and analytically distinguishable from the situation presently before this Court.[6]

Stare decisis, as well as substantial economic and public policy considerations, counsel heavily against this Court's acceptance of the Petitioners' request to break new ground by ruling in their favor in the instant case. If tort law is to be expanded to grant any additional special protection to the Petitioners and their allies, then such a step should appropriately be taken by the Florida Legislature after it has been given the opportunity to thoroughly analyze whether any problem necessitating a solution really exists, and, if so, the various available solutions and the ramifications of each.

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[5]ADOBE BUILDING CENTERS, INC. v. REYNOLDS, 403 So.2d 1033 (Fla. 4th DCA 1981).

[6]See Petitioners' brief at pages 33-4. The decision in KENNEDY v. COLUMBIA LUMBER & MFG. CO., INC., 384 S.E.2d 730 (S.C. 1989), quoted by Petitioners and their allies, is inconsistent with Florida precedent, and it represents a clear example of unwarranted legislation by judicial fiat. *See*, House and Bell, *The Economic Loss Rule: A Fair Balancing of Interests*, Vol. II, No. 2, The Construction Lawyer p.1, for a critique of the KENNEDY decision.

II.

THE ECONOMIC LOSS RULE IN THE PRODUCTS LIABILITY ARENA

(A)

By Definition, This Is A Case Involving Purely Economic Losses

In the context of products liability litigation, the term "economic loss" has generally been defined as damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits, as well as the diminution in the value of the product because it is inferior in quality and does not work for the general purposes for which it was manufactured and sold. This general definition encompasses the ultimate aim of product warranty law -- to protect expectations of product suitability and quality. MOORMAN MFG. CO. v. NATIONAL TANK CO., 91 Ill.2d 69, 61 Ill. Dec. 746, 435 N.E.2d 443, 449 (1982); See generally, NOTE: ECONOMIC LOSS AND PRODUCTS LIABILITY JURISPRUDENCE, 66 Colum. L. Rev. 917, 918 (1966); COMMENT, MANUFACTURERS' LIABILITY TO REMOTE PURCHASERS FOR "ECONOMIC LOSS" DAMAGES -- TORT OR CONTRACT? 114 U. Pa. L. Rev. 539, 541 (1966). Regardless of whether the Petitioners classify their case as a "service" case, a "products" case, or a "property" case, the fact remains that this is a case involving only "economic loss", since what the Petitioners are really complaining of is that they are purchasers of "a defective or inferior product" which they want to repair.

(B)

The Problem of Economic Losses: Tort vs. Contract/Warranty Law Under The Uniform Commercial Code

(1)

Contract/Warranty Law Under The Uniform Commercial Code

Contract law involves a series of legal principles and rules that the courts have developed through the years to allow innocent parties to a contract which has been breached to recover the benefit of that party's bargain. At the heart of these rules lies the principle of protecting the economic expectation of the parties to the contract. Generally speaking, under principles of contract law, a party injured by a breach of contract is entitled to recover an amount of damages that will put that party in the same economic position it would have been in had the contract been performed. Many of the protections and limitations existing in contract law have been incorporated in the law of sales, with which the Uniform Commercial Code is concerned.

In response to what was perceived to be a need for nationwide uniformity in the law of commercial transactions, the Uniform Commercial Code was drafted. The Florida Legislature adopted and enacted its own version of the Uniform Commercial Code (UCC) in 1965. Laws 1965, c. 65-254, effective January 1, 1967 (codified in Chapter 672, Florida Statutes). Article 2 of the UCC (Ch. 672) governs transactions "in goods", and it generally displaces prior sales law.[7] The UCC defines in a uni-

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[7]Petitioners and their allies suggest that they are "legally excluded from the panoply of commercial rights and remedies used to justify the economic loss rule in business transactions." The suggestion is legally unfounded. First, it is beyond dispute that parties like the developer Babcock are extended warranty

form manner the rights and duties of parties to transactions relating to the sale of goods, including what remedies are available to a party in the event of a breach. See generally, Jones, Product Defects Causing Commercial Loss: The Ascendancy of Contract Over Tort, 44 U. Miami L. Rev. 731, 733-44 (1990). With respect to economic losses, the Code provides that an aggrieved buyer may recover consequential damages resulting from the failure of the product to meet the buyer's needs if the seller had reason to know of those needs. §672.2-715(2), Fla. Stat. (1991 Supp.). The buyer may recover consequential damages from the seller as long as the seller has reason to know of the buyer's general or particular requirements at the time of contracting; the seller need not consciously assume the risk of the buyer's consequential economic losses. Under the UCC, courts have generally permitted the recovery of most consequential economic damages, so long as such damages were sufficiently foreseeable. In most instances, the provisions of the Code are subject to change by agreement of the parties. The parties are allowed to shift those allocations of risks and responsibilities

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protections under the UCC to the extent that they structure their business operations in such a way that they directly purchase the materials and products to be utilized in their construction projects. If developers wish to obtain the security of UCC warranty protections as to those materials purchased by their contractors and sub-contractors, then such is also possible by contractual assignment. See, ASHLEY SQUARE, LTD. v. CONTRACTORS SUPPLY OF ORLANDO, INC., 532 So.2d 710 (Fla. 5th DCA 1988). Finally, the homeowners can obtain the same protections by assignments from the parties up the chain of distribution, from express contract provisions in their contract with the seller of the home, and from common law implied warranty of habitability recognized in Florida.

otherwise provided for or specified in the UCC, so long as any such change is not "unconscionable" and does not cause the contract to "fail in its essential purpose." Thus, the primary goal of the law of sales, as expressed in the UCC, is to protect parties' economic expectation interests as expressed in the agreements they have reached, with only minimal interference from the courts.

(2)

Tort Law

In contrast, tort law is designed to secure the protection of all citizens from the danger of physical harm to their persons or to their property. Tort standards are imposed by law (the courts) without reference to any private agreement. They obligate each citizen to exercise reasonable care to avoid foreseeable physical harm to others. As such, tort law primarily is concerned with enforcing standards of conduct so as to protect people from physical harm.

Within this context, economic interests -- particularly those relating to the quality of a product -- are not interests that tort law has traditionally protected. This view represents the weight of authority in this country and its validity is continually being reaffirmed. (See table of authorities contained in the Appendix at A. 9 - 17). The benefit to be gained by protecting individuals by shifting the burden of economic loss onto manufacturers through imposition of a tort-based duty is insufficient to justify the substantial economic impact which such cost-shifting would have on society as a whole. See, Jones,

PRODUCT DEFECTS CAUSING COMMERCIAL LOSS: THE ASCENDENCY OF CONTRACT OVER TORT, 44 U. Miami L. Rev. 731, 763-79, 797 (1990).[8] Manufacturers' prices would rise as they sought to insure against the possibility that some of their products would not meet the needs of some of their customers or other third parties. In SPRING MOTOR DISTRIBUTORS v. FORD MOTOR CO., 98 N.J. 555, 579-80, 489 A.2d 660 (1985) the court's evaluation of "policy choices about the relative roles of contract and tort law as the source of legal obligations" led it to the conclusion that "contract law ... provides the more appropriate system for adjudicating disputes arising from frustrated economic expectations" [489 A.2d at 672-73].

III.

THE ECONOMIC LOSS DOCTRINE: THE RULE THAT KEEPS THE LAW OF CONTRACTS/WARRANTY AND THE LAW OF TORT OPERATING WITHIN THEIR PROPER SPHERES.

It has been observed that the modern economic loss doctrine developed in response to three separate jurisprudential concerns: (1) the theoretical difficulties of using conduct oriented tort standards to protect economic expectancy interests created by contract; (2) the practical difficulty in fashioning a rule that permits recovery for economic loss in tort without subjecting the defendant to potentially limitless liability; and (3) the unavoidable conflict between expanding a manufacturer's tort-based

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[8] We have included in our Appendix an excerpt from Jones' law review article explaining (with supporting data) the "economics of risk allocation." (A. 18 - 34).

duty and still recognizing its rights under the UCC. See, Barrett, CONSTRUCTION CLAIMS: RECOVERY OF ECONOMIC LOSS IN TORT FOR CONSTRUCTION DEFECTS: A CRITICAL ANALYSIS, 40 S.C. L. Rev. 891 (1989) [hereinafter "Barrett"]. Although the use of tort theory to recover economic loss implicates each of these concerns, courts have been inconsistent in addressing or even recognizing them. Id., at 897-914.

(A)

Origin and Development of the Economic Loss Rule

Anyone attempting to critically analyze the origins and development of the economic loss doctrine in this country can attest to the accuracy of Barrett's observation that:

> By and large, courts that have allowed recovery of economic loss do not speak the same language as the courts that have held fast to the economic loss rule. The analysis employed by courts rejecting the economic loss rule tends to focus on the foreseeability of economic harm as the determinate of liability; those courts applying the economic loss rule to limit recovery often recognize the theoretical problems inherent in expanding the scope of tort duty to include economic interest not traditionally protected by tort law. Opinions from one camp often fail entirely to address the policy concerns of the other. The result is that the two sides of the issue appear as different as apples and oranges. [Barrett at 893].

For as long as injured plaintiffs have been denied recovery in contract for reasons such as the expiration of the statute of limitations for contract actions, the lack of privity, the unavailability of punitive damages, the avoidance of contractual limitations, or simply because some potential defendants are insolvent or unable to be located, resourceful lawyers have sought to recover in tort. Judicial hostility to the use of tort theory to recover purely economic losses predates the 20th-century battle over products liability. The early reluctance by the courts to permit the awarding of economic losses in an action based upon tort is well-illustrated in the case of ULTRAMARES CORP. v. TOUCHE, NIVEN & CO., 255 N.Y. 170, 174 N.E. 441 (1931).[9]

The issue in ULTRAMARES was whether an accountant who negligently prepared a financial statement for a client could be held liable in tort to remote third parties who were damaged as a result of relying upon the statement's accuracy.[10] The ULTRAMARES' opinion focused upon the nature of an accountant's duty in tort, and held that an accountant owes no duty to remote third parties to refrain from negligently causing economic injury to them. Judge Cardozo reasoned that the recognition of such a duty in tort would expose the defendant professional:

> To a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a <u>duty</u> that exposes to these consequences. (255 N.Y. at 179-80, 174 N.E. at 444).

Thus, the element of duty is the central focus of the economic loss doctrine. <u>See</u>, 2314 LINCOLN PARK WEST CONDOMINIUM

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[9]In GUARDIAN CONSTRUCTION CO. v. TETRA TECH RICHARDSON, INC., 583 A.2d 1378 (Del. 1990), the Delaware Supreme Court recently recognized that "the rationale behind the traditional rule as it applied to liability for economic losses was expressed by Justice Cardozo in <u>Ultramares</u>." <u>See generally</u>, Barrett, 40 S.C. L. Rev. at 897-901.

[10]This Court recently discussed ULTRAMARES in FIRST FLORIDA BANK, N.A. v. MAX MITCHELL & CO., 558 So.2d 9, 11 (Fla. 1990). While this Court broadened the scope of liability in tort beyond

ASSOC. v. MANN, GIN, EBEL & FRAZIER, LTD., 555 N.E.2d 346 (Ill. 1990) ("the concept of duty is at the heart of the distinction drawn by the economic loss rule"); DANFORTH v. ACORN STRUCTURES, INC., 1992 Del. LEXIS 234 (Del. 1992) (same); CLARK v. INTERNATIONAL HARVESTER CO., 581 P.2d 784, 794 (Idaho 1978) ("Rather than obscure fundamental tort concepts with contract notions of privity, we believe that it is analytically more useful to focus on the precise duty of care that the law of negligence, not the law of contract or an agreement of the parties, has imposed on the defendant"). With very few exceptions, Judge Cardozo's ruling that tort law recognizes no duty to avoid negligent infliction of economic loss has withstood challenge, and his concern about the potentially limitless liability which would follow the imposition of such a duty in tort to avoid economic losses remains one of the most persuasive policy arguments in favor of the modern economic loss rule.[11]

In order to properly understand the varying treatment accorded the economic loss doctrine, it is further necessary to

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just those in contractual privity with the accountant (pursuant to §552 of the Restatement), it specifically noted that it was "persuaded by the wisdom of the rule which limits liability to those persons or classes of persons whom an accountant 'knows' will rely on his opinion rather than those he 'should have known' would do so because it takes into account the fact that an accountant controls neither his client's accounting records nor the distribution of his reports." [558 So.2d at 15].

[11]In his law review article, Barrett aptly observes that those courts which have allowed recovery for economic loss in tort usually fail to analyze, or even address, the question of whether such a duty exists. For this reason, there are few courts that have expressly recognized a tort duty to avoid economic harm. BARRETT, n. 147-70 and accompanying text. Petitioners themselves have failed to cite even one such case involving a product supplier!

take into consideration the impact which the rise and fall of the "privity defense" has had in this area of law.[12] Beginning with the 1842 decision in WINTERBOTTOM v. WRIGHT, 152 Eng. Rep. 402 (1842) and up through at least the 1916 decision by the New York Court of Appeals in MacPHERSON v. BUICK MOTOR CO., 217 N.Y. 382, 111 N.E. 1050 (1916), contractors, manufacturers and vendors were generally held to be without any liability in tort to third parties having no contractual relations with them. See, HUSET v. J.I. CASE THRESHING MACHINE CO., 120 F. 865 (8th Cir. 1903).[13] This so-called "privity defense" provided contractors and manufacturers with a broad exemption from tort liability both as to physical harm and economic losses.

The process of the dismantling of the privity defense began with MacPHERSON. In that case, the plaintiff was injured when a defective wheel on his automobile failed. Rather than suing the dealer from whom he purchased the car, MacPherson sought recovery

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[12]As to the historic origins of the economic loss rule, this Court has observed that:

> ...[T]he economic loss rule approved in this opinion is not a new principle of law in Florida and has not changed or modified any decisions of this Court. In fact, the economic loss rule has a long, historic basis originating with the privity doctrine, which precluded recovery of economic losses outside a contractual setting.

FLORIDA POWER & LIGHT CO. v. WESTINGHOUSE ELECTRIC CORP., 510 So.2d 899, 902 (Fla. 1987).

[13]The HUSET court stated the general rule of England and the United States to be "that a contractor, manufacturer, or vendor is not liable to third parties who have no contractual relations with him for negligence in the construction, manufacture, or sale of the articles he handles." At that time, only three exceptions

from the manufacturer of the wheel. In rejecting the privity defense raised by the manufacturer, Judge Cardozo ruled that a manufacturer may be held liable in tort for physical injury sustained by a remote product user because of a negligently made, dangerous product, notwithstanding a lack of contractual privity between the parties. The MacPHERSON decision can be viewed as a case which either invalidated a defense of a product manufacturer (the privity defense) or as a case which first recognized and then imposed on a manufacturer a tort-based duty owed to remote third parties to protect them from physical harm caused by negligently made, dangerous products. Under neither view, however, could MacPHERSON be read to impose on a manufacturer a tort-based duty owed to remote third parties to protect them from mere economic injury caused by a negligently made product.

In Florida, this tort-based duty to avoid physical harm to remote third parties was first imposed upon manufacturers in the case of MATHEWS v. LAWNLITE CO., 88 So.2d 299 (Fla. 1956). MATHEWS, like MacPHERSON, was a case involving solely personal

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to the general rule of non-liablity were recognized: (a) "an act of negligence of a manufacturer or vendor which is "imminently dangerous to the life or health of mankind, and which is committed in the preparation or sale of an article intended to preserve, destroy, or affect human life, is actionable by third parties who suffer [injury] from the negligence;" (2) "an owner's action negligence which causes injury to one who is invited by him to use his defective appliance upon the owner's premises may form the basis of an action [for negligence] against the owner;" and (3) "one who sells or delivers an article which he knows to be imminently dangerous to life or limb to another without notice of its qualities is liable to any person who suffers an injury therefrom which might have been reasonably anticipated, whether there were any contractual relations between the parties or not."

injury -- an amputated finger caused by a dangerously designed aluminum rocking chair. The duty recognized, the breach of which would be actionable in a cause of action based upon negligence, was narrow and restricted to cases involving bodily harm:

> A manufacturer of a chattel made under a plan or design which makes it dangerous for the uses for which it is manufactured <u>is subject to liability</u> to others whom he should expect to use the chattel lawfully or to be in the vicinity of its probable use, <u>for bodily harm</u> caused by his failure to exercise reasonable care in the adoption of a safe plan or design. [88 So.2d at 300, quoting Restatement of Torts §398].

Unfortunately, as courts throughout this Country, including several in Florida, began to dismantle the privity defense, those same courts began to unknowingly equate the scope of liability in tort with the foreseeability of harm, without any regard whatsoever for the nature of the harm which was involved in the case before it. <u>See</u>, Barrett at 905 - 11. As a result, one began to see a group of cases being decided which would permit recovery of economic loss in both product, service and construction defect cases solely on the basis of the rationale that such economic loss was "foreseeable" to the manufacturer, service provider, contractor, or other construction professional. Typical of these cases is DREXEL PROPERTIES, INC. v. BAY COLONY, ETC., 406 So.2d 515 (Fla. 4th DCA 1981) involving a developer/contractor, and AUDLANE LUMBER & BUILDERS SUPPLY, INC. v. D. E. BRITT ASSOCIATES, 168 So.2d 333 (Fla. 2d DCA 1964) involving a design architect. Close analysis of those decisions discloses that the primary legal impediment to the claimant's pursuit of a negligence action which the courts chose to focus upon was the defense of lack of privity. Once the appellate courts disposed of that privity defense, they then erroneously felt that they were left with nothing but the simple rule that where it is foreseeable that the plaintiff will suffer the harm sued on, the product manufacturer or service supplier has a legal duty to use reasonable care to avoid causing that harm. DREXEL, 406 So.2d at 519; AUDLANE, 168 So.2d at 335.

While such a statement unquestionably reflected a correct and well-established rule of negligence law in product or service cases involving <u>physical injuries</u>, such a rule of law had not theretofore been employed in product or service cases which involved only a risk of mere <u>economic harm</u>. Most opinions that have relied on MacPHERSON to expand tort liability in cases involving mere economic loss show absolutely no awareness of the historic and proper distinction which the common law drew between physical harm and economic loss when determining whether a cause of action in tort existed. Thus, the courts that allowed foreseeability alone to govern recovery for economic loss in tort appeared totally unaware that they were expanding liability far beyond the scope of liability that Judge Cardozo envisioned in MacPHERSON or the Florida Supreme Court envisioned in MATHEWS v. LAWNLITE.[14]

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[14]As Barrett points out in his Law Review article:

> <u>Properly understood</u>, neither the demise of the privity defense in <u>MacPherson</u> nor the rejection of other similar defenses effected an expansion of tort liability. Rather, <u>MacPherson</u> simply restored the application of

(B)

Application Of The Economic Loss Rule In Florida Products Liability Cases

Beginning in the early 1980s a line of product liability cases were decided in Florida which properly concluded that no cause of action in tort was available to seek recovery of purely economic losses in the absence of physical harm to persons or other property. The correct conclusions were reached in those cases because the courts began their analysis with the fundamental concept of duty.

For example, in MONSANTO AGRICULTURAL PRODUCTS CO. v. EDENFIELD, 426 So.2d 574 (Fla. 1st DCA 1983), the court was presented with the question of whether a herbicide manufacturer could be held liable in tort to a farmer suffering purely economic losses allegedly resulting from defects in the herbicide. In concluding that a tort claim for such damages was not available, the First District focused upon the concept of duty:

> Tort law imposes upon manufacturers a duty to exercise reasonable care so that the products they place in the market place will not harm persons or property. <u>However, tort law does not impose any duty to manufacture only such products as will meet the economic expec-</u>

> traditional tort standards to manufacturers and contractors for liability for physical harm to remote parties. It placed manufacturers in the position they arguably should have occupied all along -- subject to a legal duty of exercising reasonable care to avoid injuring others. <u>The abolition of the privity defense created no new theory of recovery, but merely eliminated a defense to liability under traditional tort principles</u>. (BARRETT at 905).

> tations of purchasers. Such a duty does, of course, exist where the manufacturer assumes the duty as part of his bargain with the purchaser, or where implied by law, but the duty arises under the law of contracts, and not under tort law. [426 So.2d at 576]. (citations omitted).

Several years later the Third District was presented with a similar situation where a party attempted to sue a remote manufacturer of defective roofing materials. The plaintiff in that case, GAF CORP. v. ZACK, 445 So.2d 350 (Fla. 3d DCA 1984), was a roofing contractor who, in connection with two building projects on which it had secured roofing contracts, had purchased certain roofing materials from a local distributor. The roofing materials were manufactured and marketed by the defendant GAF Corporation. The materials were subsequently utilized during the plaintiff's construction of roofs on two Howard Johnson motor lodges. The roofing materials proved to be extremely defective in numerous respects, thereby causing the entire roofing systems constructed by the plaintiff to be defective.

The roofing contractor brought a products liability action against GAF asserting causes of action based upon negligence and breach of implied warranty. The case ultimately went to trial, resulting in a jury verdict for both compensatory and punitive damages. The defendant manufacturer appealed, claiming that the trial court erred in denying its motion for directed verdict. The Third District agreed, stating that:

> Under no tort or contract theory known to our law, then, does the plaintiff Zack have a cause of action for negligence or breach of implied warranty against the defendant GAF for the economic losses it sustained in this case. Plaintiff Zack's sole remedy, if any, for these economic losses would be an action

> for breach of implied warranty of merchantability under the Uniform Commercial Code [§672.314, Fla. Stat. (1981)] or a related breach of contract action against the party, East Coast Supply Corp. which sold the defective roofing materials to the plaintiff Zack --actions which were not brought below. [445 So.2d at 352].

In CEDARS OF LEBANON HOSPITAL CORP. v. EUROPEAN X-RAY DISTRIBUTORS, 444 So.2d 1068 (Fla. 3d DCA 1984), it was similarly held that a cause of action based on strict products liability under the Restatement (Second) of Torts §402A "should be reserved for those cases where there are personal injuries or damage to other property."[15]

Three years later the Third District decided AFFILIATES FOR EVALUATION AND THERAPY, INC. v. VIASYN CORP., 500 So.2d 688 (Fla. 3d DCA 1987). In that case, a consumer brought an action against a computer manufacturer for breach of implied warranty and for negligence. In affirming the trial court's dismissal of the action, the Third District held that the negligence count could not stand because the only damages sought in the case were "contract-type damages, namely, economic losses to plaintiff's business because the subject computer did not perform as it should have." Id. at 693. The Third District also affirmed dismissal of the breach of implied warranty claim on the basis that the plaintiff had failed to allege the essential element of privity of contract between itself and the defendant.

The plaintiff in the case claimed that the earlier decision of the Third District in GAF CORP. v. ZACK "was not good law."

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[15]The Petitioners and their allies argue that the Fourth District's decision in ADOBE BUILDING CENTERS, INC. v. L. D. REYNOLDS, 403 So.2d 1033 (Fla. 4th DCA 1981), supports their position that they have a viable strict products liability claim

The Third District, however, had no difficulty in reaffirming the continuing validity of that prior decision, stating:

> Plainly, the result reached in GAF Corp. is in full accord with the overwhelming weight of authority on this subject throughout the country. Dean Prosser summarizes this established law as follows:
>
> > "There can be no doubt that the seller's liability for negligence covers any kind of physical harm, ... But where there is no accident, and no physical damage, and the only loss is a pecuniary one, through loss of the value or use of the thing sold, or the cost of repairing it, the courts have adhered to the rule, . . . that purely economic interests are not entitled to protection against mere negligence, and so have denied the recovery." (footnotes omitted).

500 So.2d at 691, quoting W. Prosser, Law of Torts §101, at 665 (4th Ed. 1971).

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under the facts of the instant case. Petitioners thus claim that the decisions in CASA CLARA and CEDARS OF LEBANON directly conflict with ADOBE. However, it cannot be overlooked that ADOBE did not address the issue of a manufacturer's duty to prevent economic harm to remote third parties -- the pivotal issue presently before this Court. Instead, ADOBE initially assumed (albeit erroneously, in our opinion) that the type of harm caused by the defective stucco building material was "property damage" and thereupon proceeded to analyze only the following three issues: "(1) whether the Restatement (Second) of Torts §402(A) ... extends to property damage in addition to personal injury; (2) whether strict liability in tort ... may be asserted against retailers and distributors as well as manufacturers; and (3) whether under the facts of this case or as a matter of law, appellees/developers are ultimate users or consumers." [ADOBE 403 So.2d at 1035 (Hurley J. specially concurring)].

The opinion in ADOBE contains no discussion whatsoever regarding the economic loss doctrine, much less the issue of duty, and therefore cannot be said to create any express conflict on the same point of law with CEDARS OF LEBANON and CASA CLARA. Moreover, we have no doubt that had the point been argued in ADOBE, that Court would have seen that the harm at issue was a clear-cut case of "economic harm" (i.e. - qualitative defects in the stucco product), not "damage to other property" recoverable in tort.

The clear thrust of Florida law in this area was further clarified with the issuance of this Court's decision and opinion in FLORIDA POWER & LIGHT CO. v. WESTINGHOUSE ELECTRIC CORP., 510 So.2d 899 (Fla. 1987). The case arrived before this Court as a result of the certification of several questions from the Eleventh Circuit Court of Appeals in FLORIDA POWER & LIGHT CO. v. WESTINGHOUSE ELECTRIC CORP., 785 F.2d 952 (11th Cir. 1986). The certified questions revolved around what approach Florida takes to the economic loss rule in cases involving allegedly defective products. In its order certifying several legal questions to this Court, the Eleventh Circuit stated that it had "reviewed the Florida authority . . . and [was] persuaded that there [was] no clear and controlling precedent in the Florida courts." [785 F.2d at 952].[16]

The dispute in the FP&L case arose as a result of the purchase by a power company of allegedly defective nuclear steam generators from the manufacturer/seller, Westinghouse. Because of alleged defects in the design and manufacture of those steam generators, leaks subsequently developed, thus prompting FP&L to bring suit against Westinghouse for breach of express warranty and for negligence, seeking damages for the cost of repair, revision and inspection of the steam generators. The federal trial judge ultimately granted Westinghouse's motion for partial summary judgment on the negligence count on the grounds that Florida

[16]The cases specifically cited were: A. R. MOYER, GAF CORP., CEDARS OF LEBANON, MONSANTO, DREXEL PROPERTIES, and AUDLANE LUMBER.

law precluded the recovery of economic loss without any claim of personal injury or property damage to other property.

Before this Court, the appellant, FP&L, argued that a negligence claim based on traditional concepts of duty, causation, and foreseeability was the appropriate vehicle to resolve the dispute between the parties and that tort law imposed a duty on Westinghouse to avoid harming FP&L. In response, Westinghouse asserted that the trial court's view of the case was supported by the majority of decisions throughout the country which had considered the question of whether recovery in tort for purely economic damages is available when there is no personal injury or damage to other property. The plaintiff in FP&L thus relied upon the analysis employed in the "services cases" (A. R. MOYER, DREXEL PROPERTIES and AUDLANE LUMBER), while the defendant relied upon the products liability cases (GAF, CEDARS and MONSANTO). This Court ultimately sided with the defendant Westinghouse, approved of and ruled consistent with the prior Florida products liability cases of GAF, CEDARS and MONSANTO, and held that "contract principles are more appropriate than tort principles for resolving economic loss claims." Id. at 901.

In discussing the reasoning behind the majority view it was adopting, this Court in FP&L quoted from the opinion of Justice Trainor in SEELY v. WHITE MOTOR CO., 63 Cal.2d 9, 45 Cal. Rep. 17, 403 P.2d 145 (1965):

> The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of

the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was defined to meet the consumer's demands. [FP&L, 501 So.2d at 900-1, quoting from Seely, 403 P.2d at 151 (citations omitted)].

In reaching its decision in FP&L, this Court also found persuasive the just-issued decision of the United States Supreme Court in EAST RIVER STEAM SHIP CORP. v. TRANSAMERICA DELAVAL, INC., 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986). In that case, a shipbuilder contracted with the defendant to design, manufacture and supervise the installation of turbines that would be the main propulsion units for four oil-transporting supertankers which were to be constructed by a third party. After the supertankers were completed, one of them was chartered by plaintiff. When the ships were subsequently put into service, the turbines on all four ships malfunctioned due to design and manufacturing defects in the first-stage steam reversing ring. The defective rings disintegrated and caused substantial damage to the turbine propulsion units as a whole. Suit was ultimately filed by the plaintiff/ship charterer against the manufacturer of the defective ring component parts which damaged the turbine propulsion units. The causes of action were based upon tort theories and sought recovery for the cost of repairing the ship and for income lost while the ship was out of service. Summary judgment was entered in favor of the manufacturer, which precipitated appeals that ultimately worked their way to the United States Supreme Court.

The Supreme Court canvassed the various approaches which the courts throughout this country had taken to the issue presented. Under the "minority" approach, a manufacturer of a defective product could be held liable in tort for mere economic loss. See, SANTOR v. A & M KARAGHEUSIAN, INC., 44 N.J. 52, 66-7, 207 A.2d 305, 312-13 (1965), subsequently receded from in SPRING MOTORS DISTRIBUTORS, INC. v. FORD MOTOR CO., 98 N.J. 555, 579, 489 A.2d 660, 672 (1985), as to disputes involving commercial entities. Under the "intermediate" approach, a manufacturer of a defective product could be held liable in tort for a mere economic loss when the loss was based upon the cost of removing, repairing or replacing a product which presented an imminent, although unrealized, risk of bodily harm. See, e.g., CITY OF GREENVILLE v. W. R. GRACE & CO., 827 F.2d 975 (4th Cir. 1987) (involving fireproofing material containing asbestos);[17] TRUSTEES OF COLUMBIA UNIVERSITY v. MITCHELL/GIURGOLA ASSOCIATES, 492 N.Y.S.2d 371 (App. Div. 1985) (involving heavy pre-cast concrete panels and tiles installed as part of wall of a building located on a crowded university campus); DREXEL PROPERTIES, INC. v. BAY COLONY, ETC., 406 So.2d 515 (Fla. 4th DCA 1981) (involving a

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[17] Compare, ADAMS-ARAPAHOE SCHOOL DISTRICT NO. 28-J v. GAF CORPORATION, 959 F.2d 868 (10th Cir. 1992) (court rejected "risk of harm" approach in case involving vinyl asbestos floor tile and also found the proof of "damage to other property" caused by past releases of asbestos fibers to be legally insufficient to overcome the defendant/manufacturers' motion for directed verdict).

ceiling roof assembly which failed to meet building code requirement of one-hour fire resistant construction).

In a unanimous decision, the EAST RIVER court ultimately rejected both the "minority" and "intermediate" approaches and squarely held that a product manufacturer "owed no duty under a products-liability theory based on negligence to avoid causing purely economic loss." In declining to follow either the "minority" or "intermediate" positions, Justice Blackmun stated:

> We find the intermediate and minority land-based positions unsatisfactory. The intermediate positions which essentially turn on the degree of risk are too indeterminent to enable manufacturers easily to structure their business behavior. Nor do we find persuasive a distinction that rests on the manner in which the product is injured. We realize that the damage may be qualitative, occurring through gradual deterioration or internal breakage. Or it may be calamitous. But either way, since by definition no person or other property is damaged, the resulting loss is purely economic. Even when the harm to the product itself occurs through an abrupt, accident-like event, the resulting loss due to repair costs, decreased value, and lost profits is essentially the failure of the purchaser to receive the benefit of its bargain -- traditionally the core concern of contract law.
>
> We also decline to adopt the minority land-based view .... Such cases raise legitimate questions about the theories behind restricting products liability, but we believe that the countervailing arguments are more powerful. The minority 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. [East River, 476 U.S. at 870-71. (citations omitted)].

In aligning itself with EAST RIVER and the majority approach, this Court noted in FP&L that the "policy adopted by the majority of courts encourages parties to negotiate economic risk through warranty provisions and price." This Court also felt that the minority view's imposition of a duty of care to prevent mere economic harm resulted in a situation where "a manufacturer faced with this kind of liability exposure must raise prices on every contract to cover the enhanced risk." FP&L, 510 So.2d at 901. This Court pointed out that "the economic loss rule approved in this opinion is not a new principle of law in Florida," and it specifically discussed and approved of the decisions reached in MONSANTO, GAF, and CEDARS OF LEBANON.[18]

This Court aptly realized that by siding with the EAST RIVER/majority view, it would be furthering the public interest:

> We agree and find no reason to intrude into the party's allocation of risk by imposing a tort duty and corresponding cost burden on the public. We hold contract principles more appropriate than tort principles for resolving economic loss without any accompanying physical injury or property damage. The lack of a tort remedy does not mean that the purchaser is unable to protect himself from loss. We note that the Uniform Commercial Code contains statutory remedies for dealing with economic losses under warranty law, which, to a large extent, would have limited application if we adopted the minority view. Further, the purchaser, particularly in a large commercial transaction like the instant case, can protect his interest by negotiation and contractual bargaining or insurance. The purchaser has the choice to forego warranty protection in order to obtain a lower price. We conclude that we should refrain from injecting the judiciary into this type of economic decision-making. [FP&L, 510 So.2d at 902].

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[18]We would note in passing that the Petitioners excise this statement from the context in which it was made and then disingenuously argue that the statement represents this Court's approval of the Fourth District's decision in ADOBE. (See Petitioner's brief at pp. 20-1).

Most recently, the First District applied the economic loss rule in its decision in AMERICAN UNIVERSAL INSURANCE GROUP v. GENERAL MOTORS CORP., 578 So.2d 451 (Fla. 1st DCA 1991). That case involved review of a final order dismissing a suit against General Motors Corp. brought by a subrogated insurer seeking damages under theories of negligence and strict products liability for economic losses sustained by an insured when the engine on his commercial fishing vessel was destroyed by a fire alleged to have originated with a defective oil pump manufactured by General Motors. In affirming the trial court's dismissal of the complaint, the First District relied upon this Court's decision in FP&L, as well as upon decisions from various other states which had applied the majority rule espoused in EAST RIVER. The First District held that since General Motors' replacement oil pump was an integral, component part of the entire engine, the destruction of that engine when the pump malfunctioned did not constitute the type of "damage to other property" which would support a negligence or strict products liability claim for economic losses.[19] The court properly perceived the claim as being one for breach of warranty resulting in economic losses only, thus relegating the purchaser to his Uniform Commercial Code remedies against the direct seller of the allegedly defective product.

In sum, a review of the <u>Florida products liability decisions</u> which have dealt with the economic loss rule discloses a unani-

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[19]The Third District's determination in CASA CLARA that the case did not involve damage "to the other property" is consistent with the conclusions reached by those courts which have adopted the "majority" EAST RIVER approach. <u>See</u>, <u>e.g.</u>, EAST RIVER ((damage to ship's propulsion system caused by failure of component part of

mity of result -- no recovery has been permitted in tort, either under a negligence or a strict products liability theory, for the recovery of pure economic losses. These decisions are all grounded in the rule that a manufacturer simply does not owe a duty to remote third parties to protect their economic interests. Each party is relegated to the contractual and warranty remedies ordinarily available against the immediate seller at each level of the distributive chain. In the face of this unwavering line of decisions, Petitioners and their allies still suggest that the Third District's decision in CASA CLARA is either at odds with Florida law, or if it is not, then the law should be changed by this Court so as to permit them to pursue the Respondent Toppino in tort. This Court should reject the Petitioners' attempt to muddy the water in this extremely important area of law, particularly when the creation of one ad hoc exception would simply invite an uncontrolled inertia for the creation of additional

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turbine); AMERICAN HOME ASSURANCE CO. v. MAJOR TOOL AND MACHINE, INC., 767 F.2d 446 (8th Cir. 1985) (same); FLORIDA POWER & LIGHT CO. v. McGRAW EDISON CO., 696 F.Supp. 617 (S.D. Fla. 1988) (applying Florida law; damage to concrete walls, curbing, and pipes surrounding transformer which exploded); CHICAGO HEIGHTS VENTURE v. DYNAMIT NOBEL OF AMERICA, INC., 782 F.2d 723 (7th Cir. 1986) (water damage caused to ceilings and walls of lower building floors and loosening of bricks caused by defective roofing material); JONES & LAUGHLIIN STEEL CORP. v. JOHNS-MANVILLE SALES CORP., 626 F.2d 280 (3d Cir. 1980) (same); 2000 WATERMARK ASSOCIATION, INC., v CELOTEX CORP., 784 F.2d 1183 (4th Cir. 1986) (building damage and shortening building life expectancy caused by defective roofing shingles); PETROLEUM HELICOPTERS, INC. v. ARCO CORP., 930 F.2d 389 (5th Cir. 1991) (damage to helicopter which capsized as a result of a defective rebuilt emergency flotation device); MILLER v. U. S. STEEL CORP., 902 F.2d 573 (7th Cir. 1990) (damage to building's interior caused by corrosion of defective fabricated exterior steel panels).

ad hoc exceptions in future cases. This result would only serve to undermine and thwart the laudatory purposes of the Uniform Commercial Code, which are to simplify, clarify, modernize and make uniform the law governing commercial transactions.

IV.

THE PETITIONERS' ARGUMENTS AGAINST APPLICATION OF THE ECONOMIC LOSS RULE SHOULD BE REJECTED

(A)

Existing Common Law and UCC Warranty Law Adequately Protects Developers and Home Buyers

As should be clear by now, the foundation for any decision in favor of the Petitioners requires this Court to explicitly recognize and impose a tort-based duty onto construction material suppliers to protect the economic interests of remote third parties. Any such decision in this regard is obviously an exercise in judicial policy-making and should be made, if at all, only after weighing all competing interests and policy, as well as considering the practical impact upon litigation. Ultimately the decision must serve the best interests of society as a whole.

The first interests to consider are those of the parties in these proceedings who claim to have been injured, which includes both the Petitioners and their allies. In the context of this case, the injured parties are of two general types: first, the owners of homes or buildings which are claimed to have been constructed out of defective or inferior materials, and the second type is composed of all others in the distributive chain and construction enterprise having no contractual relationship with the remote materials supplier (this latter class would include developers, contractors, sub-contractors, and product retailers). Under the current state of Florida law, all of these injured parties are provided with adequate common law and UCC warranty causes of action upon which to seek redress for their economic losses.

The owner of the defective building has a contract and warranty remedy against either the seller or, in some cases, against the contractor, architect, or engineer. All of the intermediate parties in the chain of distribution likewise have the opportunity to bargain for and obtain some form of warranty or guaranty to protect against the possibility that the materials they are purchasing will not fulfill their expectations. As a practical matter therefore, the economic loss doctrine is an obstacle only to two classes of injured parties: (1) those who fail to bargain for the contract or UCC right to be compensated for economic losses; and (2) those whose contract rights are worthless because the seller or the person with whom they dealt in a contractual setting are insolvent. Because no rule of law can protect the second class while ignoring the first, the real issue is whether this Court should provide for a recovery in tort by those who fail to secure for themselves a remedy in contract. It should not. See generally, Barrett, 40 S.C. L. Rev. at 932-42; Note: Economic Loss in Products Liability Jurisprudence, 66 Colum. L. Rev. 917 (1966).

(B)

Remote Third Parties Should Not Be Allowed To Avoid Application Of The Economic Loss Rule By Alleging A Lack of Privity With The Building Material Supplier

One of the most astounding arguments advanced by the Petitioners and their allies is to the effect that the economic loss rule should not preclude a third party homeowner like the Petitioners (or a developer, like several amici) from suing a remote manufacturer of an allegedly defective building material in tort where that party has no viable contractual remedy against the manufacturer. Yet, it is precisely in this setting that the necessity for application of the economic loss rule is most warranted. If the economic loss rule is to serve its purpose, it must be applied in disputes both between parties in contractual privity and to disputes involving parties having no contractual relationship. Allowing suits in tort in the latter instance would destroy the benefits gained by precluding a tort suit in the former.

In its amicus brief supporting the Petitioners, developer Babcock recognizes that "the economic loss rule serves several compelling public policy interests," and states:

> More importantly, however, the rule preserves the sanctity of certain contracts by assuring the parties that, once they have reached an agreement, neither side will be permitted to utilize traditional tort principles as a means of altering the negotiated allocation of risks and benefits. This, in turn, adds certainty and predictability to commercial transactions. (Babcock Brief at 5).

In view of Babcock's recognition of the extreme importance of the economic loss rule to assuring certainty and predictability in transactions involving the sale of goods, one can only wonder how Babcock justifies its attempt to have this Court apply the economic loss rule solely at the top of the chain of product distribution, but allow all succeeding parties after the initial sales transaction to sue the remote product manufacturer in tort. Babcock supports its assertion that a "no alternative remedy exception" exists to application of the economic loss rule by premising its argument on several faulty initial assumptions.

The first faulty assumption is that the economic loss rule is only applicable to disputes between parties who are in contractual privity. However, this is not, and has not, been the law in Florida. See, GAF CORP. v. ZACK; AFFILIATES FOR EVALUATION AND THERAPY v. VIASYN CORP.; MONSANTO AGRICULTURAL PRODUCTS CO. v. EDENFIELD; AMERICAN UNIVERSAL INS. GROUP v. GENERAL MOTORS CORP.; AIRPORT RENT-A-CAR, INC. v. PREVOST CAR, INC., 788 F.Supp. 1203 (S.D. Fla. 1992).

Indeed, this was precisely the situation involved in the EAST RIVER decision, with which Florida has aligned itself in the FP&L decision. In EAST RIVER, the plaintiff ship charterer was not in contractual privity with the remote manufacturer of the component part which caused the ship's turbine propulsion system to fail. The plaintiff ship charterer thus had no recognized contractual remedy against the tortfeasor, yet the Supreme Court still applied the economic loss rule so as to bar the tort-based products liability claims. The overwhelming majority of decisions in other states have reached the same conclusion.[20]

For example, in MILLER v. U. S. STEEL CORP., 902 F.2d 573 (7th Cir. 1990), a building owner attempted to sue a remote manufacturer of fabricated steel panels in tort for damages to the exterior and interior of its building due to corrosion resulting from alleged defects. The building owner argued that he should be permitted to sue in tort because he had entered into no contract with the remote manufacturer. In rejecting the building owner's attempt to confine application of the economic loss rule to those disputes involving only parties in privity of contract, the Seventh Circuit opined:

> Our Millers [the building owners] had no contract with U. S. Steel [the remote product manufacturer], so we cannot be certain that the Supreme Court of Wisconsin would apply the [economic loss] doctrine in our case. But we think it would. Privity of contract is not an element of the economic loss doctrine. [citations omitted]. The insight behind the doctrine is that commercial disputes ought to be resolved according to the principles of commercial law rather than according to tort principles designed for accidents that cause personal injury or property damage. A disputant should not be permitted to opt out of commercial law by refusing to avail himself of the opportunities which that law gives him. Back when U. S. Steel was urging Mr. Miller to specify Cor-Ten steel for the walls of his building, he could have asked U. S. Steel for an express warranty, which he could then have enforced in a suit for breach of warranty. In fact, as we shall see, the literature that U. S. Steel put out contained an enforceable

[20] It should be noted that the Supreme Court of Delaware recently addressed the question of "whether the economic loss doctrine applies . . . based on the presence or absence of privity" in DANFORTH v. ACORN STRUCTURES, INC., 1992 Del. LEXIS 234 (Del. 1992). The court there concluded that the presence or absence of privity was irrelevant and that the issue of duty as related to the type of harm involved was controlling.

> warranty .... Alternatively, Miller could have extracted (again, for all we know, did extract) suitable warranties from the general contractor, which might in turn have extracted a warranty from U. S. Steel. <u>All Miller could not do was what he did do, recast his case as if one of the corroded wall panels had fallen and broken his foot</u>. [902 F.2d at 575].

The theory behind the economic loss rule is that <u>parties at each successive level of the chain of distribution should enter into contractual relationships</u> in which risks and burdens are allocated by contractual terms and the product price determinations are reached on the basis of those terms. In order for the goal of predictability and certainty in sales transactions to be realized, the contractual results of the negotiation of those risks and burdens should continue to be recognized at each successive level of the distributive chain. Otherwise, certainty and predictability in sales transactions would only exist between the two parties at the top of the chain, leaving the manufacturer exposed to limitless tort liability at all successive levels of the chain. It is thus obvious that acceptance of Petitioner's argument would, in ultimate effect, be to "throw the baby out with the bath water."

The second erroneous assumption upon which the Petitioners' argument proceeds is that application of the economic loss rule to their disputes "deprives" them of a previously recognized tort claim against a remote product manufacturer. However, as discussed earlier in this brief, in situations involving mere economic loss or unsatisfied consumer expectations, Florida courts have never recognized the existence of a negligence or strict products liability claim in favor of an ultimate purchaser against a remote product manufacturer. The only tort duty which has heretofore been imposed by the Florida courts is a duty to prevent physical harm to persons and property. See, MATHEWS v. LAWNLITE. Thus, the Petitioners and their allies are not truly asking this Court to remove a legal impediment to an otherwise pre-existing remedy, but, instead, are asking for this Court to create a new tort remedy for their benefit. See, e.g., WHEELING TRUST & SAVINGS BANK v. TREMCO, INC., 505 N.E.2d 1045 (Ill. App. 1987) (no violation of "access to courts" constitutional provision). If such a remedy is to be created, then such should not be accomplished through judicial fiat. Instead, such a new remedy should only be created by the legislature through revisions to the UCC warranty beneficiary provision [§672.317, Fla. Stat. (1991 Suppl.)] or through direct legislative enactment.[21]

The First District recently had occasion to address this "no privity" argument in AMERICAN UNIVERSAL INS. GROUP v. GENERAL MOTORS CORP., 578 So.2d 451 (Fla. 1st DCA 1991). In that case, the plaintiff had no contract or warranty remedy against the remote supplier of a defective oil pump which caused the engine in his boat to catch fire. Citing LATITE ROOFING CO., INC. v. URBANEK, 528 So.2d 1381 (Fla. 4th DCA 1988), the plaintiff contended that it had no alternative contract theory of recovery against General Motors, and thus should be permitted to sue in

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[21]For example, Minnesota's legislature has acted in this area. See, §604.09, Minn. Stat. (1991).

tort. In rejecting the plaintiff's attempt to carve out an unwarranted exception to application of the economic loss rule, the First District properly recognized that:

> This argument overlooks that a contract action remains pending against the seller of the allegedly defective product. Moreover, the end result of the East River and the Florida Power & Light decisions is that relegating parties to contract remedies in cases such as this allows parties to freely contract and allocate the risks of a defective product as they wish.

578 So.2d at 454-55. Accord, GAF CORP. v. ZACK (where the court pointed out that the plaintiff Zack's "sole remedy, if any, for these economic losses would be an action for breach of implied warranty of merchantability ... or a related breach of contract action against the party ... which sold the defective roofing materials to the plaintiff - actions which were not brought below"); AIRPORT RENT-A-CAR, INC. v. PREVOST CAR, INC. (in dismissing tort claims against remote bus manufacturer, court pointed out that owner of buses should bring contract or warranty action against the party who sold the buses to it).

Unfortunately, certain trial courts in this state (such as the one who recently denied a motion to dismiss by Masonite based upon the economic loss rule, have perceived LATITE ROOFING to stand for the proposition that "the court must determine whether a plaintiff has a cause of action against the defendant seeking the application of the economic loss rule, and not whether a plaintiff has a cause of action against any other party." (App. at p. 7). To the extent that LATITE ROOFING can be read in such a fashion, it should be overruled or brought into line with GAF and AMERICAN UNIVERSAL. Otherwise, the policy of the FP&L decision "which seeks to encourage negotiation of economic risks at all levels of the chain of supply of a product" will be undermined, the economic loss rule will be subject to manipulation by plaintiffs wishing to pursue only "the deep pocket", and the salutory goals of predictability and certainty in commercial transactions will be impossible to reach.

The lament of the Petitioners and their allies that the "peripheral parties in the home building industry" with which they deal are "frequently under-capitalized, insolvent or defunct" is an utterly insufficient basis to create a massive loophole in the economic loss rule. For, as aptly noted in KING v. HILTON-DAVIS, 855 F.2d 1047 (3d Cir. 1988):

> Implicit in the East River decision is the policy judgment that in a commercial context the possibility of an inadequate recovery occasioned by bankruptcy, a commercial risk that a purchaser assumes in choosing a seller does not justify permitting a tort recovery that will allow a purchaser to reach back up the production and distribution chain, thereby disrupting the risk allocations that have been worked out in the transactions comprising that chain. (855 F.2d at 1054).

Similarly unfounded is their attempt to convince this Court that if they are not allowed to directly sue a remote material supplier, then it "would place an unjustifiable burden on the court system and result in an indefensible waste of litigant and judicial resources." Implicit in this argument is the assumption that the "chain reaction" of claims and third party claims only proceed in a "south to north" direction on the products distribution road. Common sense and this Court's experience demonstrate, however, that permitting a direct suit against a remote material supplier would not substantially alter things. The only change which would be brought about is that the "chain reaction" of claims would simply reverse in direction and proceed down the distributive chain.

In sum, to carve out the requested "no privity" exception urged by Petitioners and their allies is legally unsupportable, commercially suicidal and in the end would do more damage than good to homeowners and the adjudicative process.

(C)

Recognition Of A "Risk of Personal Injury Or Property Damage" Exception To the Economic Loss Rule Is Unwarranted And Would Be Unworkable

The Petitioners and their allies additionally argue that this Court should recognize an exception to the economic loss rule in situations where it is shown that a product defect "creates a real and imminent risk of personal injury or property damage." However, this Court in FP&L has already rejected just such an exception. This Court, along with the Supreme Court in EAST RIVER and the vast majority of courts in other states, have rejected such an "intermediate" approach to application of the economic loss rule. The majority rule recognizes that any attempt by the judicial system to administer the "degree of risk" standard which the Petitioners are urging would deteriorate into nothing more than an unnecessary and unworkable ad hoc system of dispute resolution, which would be "too indeterminate to enable manufacturers easily to structure their business behaviors." EAST RIVER, 476 U.S. at 870.

The only Florida case which the Petitioners cite in support of their position is DREXEL PROPERTIES wherein the court reasoned that "a buyer [should not] have to wait for a personal tragedy to occur in order to recover damages to remedy or repair defects[.]" (406 So.2d at 519). We, on the other hand, submit that this Court should view the DREXEL case for what it really is -- a situation where the Court created a "false dilemma" in order to reach a result it thought was fair and appropriate, albeit erroneously so. This particular point was dealt with by the New York Court of Appeals in BELLEVUE SOUTH ASSOCIATES v. HRH CONSTRUCTION CORP., 78 N.Y.2d 282, 579 N.E.2d 195 (N.Y. App. 1991), which had this to say:

> The dissent's distinguishing test, moreover -- that liability should be allowed where the recovery sought is the cost of eliminating the hazard or making the product safe -- is no distinction at all. Whether a defective piece of equipment such as a truck hoist, or floor tiles, or virtually any other product, recovery of replacement costs always can be said to be sought for eliminating the hazard or making the product safe.
>
> * * *
>
> Plaintiff further argues that, as a matter of policy, strict liability is necessary because there would otherwise be no incentive to fix the defective floor, making it necessary for someone to suffer a severe injury before remedial action was taken. Even without tort liability, however, a purchaser in plaintiff's circumstances has every incentive to seek a remedy for the breach of contract . . . . Plaintiff would hardly forego legal action against the contractor or sub-contractor because no recovery in strict liability was possible against the manufacturer. Commercial interests, together with the fear of liability for any injuries that might occur, are a powerful incentive for such plaintiffs, without the need to open another avenue of redress in the law of torts.

See also, CROWELL CORP. v. TOPKIS CONSTRUCTION CO., 280 A.2d 730 (Super. Ct. Del. 1971) (pointing out that a plaintiff's duty to correct a dangerous condition on its property is not dependent on its ability to sue other parties who may have had some responsibility in creating the condition).

In closing, we would point out that the tort claims by homeowners presently pending against Masonite provide an excellent example of why recognition of a "risk of harm" exception to the economic loss rule should be rejected. Specifically, the homeowners have simply alleged in a conclusory fashion that defects in Masonite's siding have caused the siding to deteriorate, which in turn they claim results in a situation where the structural integrity of their home has been compromised, thereby creating a risk of harm to persons and property. They do not allege that a single home in the 380-home development has collapsed or that any individual has otherwise suffered any physical harm as a result of the deteriorated siding. Simply stated, their economic expectations have not been met.

Nevertheless, were this Court to recognize a "risk of harm" exception, then the case would have to proceed all the way up to trial, where it unquestionably would boil down to the typical "battle-of-the-experts", with each side rendering diametrically opposed opinions quantifying the degree of risk posed to the homeowners as a result of the deteriorated siding. We cannot think of any reason commending such an approach to the resolution of what are purely economic loss claims. Neither have other courts. Instead, the public and the judicial system is best served if these types of economic loss lawsuits are properly resolved at the earliest point in time. See, e.g., HEMMING v. CERTAINTEED CORP., 468 N.Y.S.2d 789 (N.Y. S.Ct. App. Div. 1983), (court applied the economic loss rule in dismissing plaintiff's tort claim seeking recovery of damages for allegedly defective siding systems they claim did not perform properly to protect their homes); BUTLER v. CALDWELL & COOK, INC., 505 N.Y.S.2d 290 (S.Ct. N.Y. App. Div. 1986) (same); ROXALANA HILLS, LTD. v. MASONITE CORP., 627 F.Supp. 1194 (D. W. Va. 1986) (same).

CONCLUSION

Based upon the reasoning and citations of authority set forth above, it is respectfully submitted that this Court should approve the decision of the Third District in CASA CLARA. As to Masonite's position with respect to this matter, we further submit that the existence and scope of its liability, as a manufacturer of building products which are not inherently or unreasonably dangerous and which have caused no physical injury to persons or to other property, should be governed by the law of contracts and the Uniform Commercial Code, not by traditional tort principles.

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IN THE CIRCUIT COURT IN AND
FOR PALM BEACH COUNTY, FLORIDA

Civil Division
CASE NO. CL-91-14357-AD

ROBERT AND HELEN ADLER et al.,

Plaintiff(s),

vs.

MASONITE CORPORATION AND ROBERT
C. MALT & COMPANY,

Defendant(s).
_____________________________________/

ORDER DENYING PART (A) OF MASONITE'S MOTION TO DISMISS

This case came before the Court on Defendant Masonite Corporation's Motion to Dismiss Counts II and III of Plaintiffs' Amended Complaint. For the purpose of this motion, the allegations of the Amended Complaint are taken as true. Plaintiffs are homeowners in a residential subdivision called Victoria Woods. Plaintiff Adlers purchased their home directly from the developer, Robert C. Malt & Co. Plaintiff Fignars purchased their home from a prior homeowner and have no direct privity of contract with the developer. The amended complaint alleges in pertinent part as follows:

> 10. From approximately 1985 to 1991, Malt, as general contractor, constructed the Improvements* at VICTORIA WOODS improperly by . . . applying defective lap siding manufactured by the Defendant Masonite to the exteriors of the wood-frame homes in said development. . .

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*Paragraph 4 of the amended complaint defines "the Improvements" as the homes in Victoria Woods, "Wood-frame structures sided with Masonite hardboard lap siding."

* * *

> 12. . . . The Defendant, MALT, as the builder/vendor of VICTORIA WOODS, purchased defective lap siding and other building materials from MASONITE. . . and incorporated said defective building materials into the Improvements as aforesaid. There is no privity of contract between Masonite and the Homeowners.
>
> 13. The defective Masonite lap siding and other building materials have prematurely deteriorated resulting in, among other things, substantial disintegration of the exterior walls of the Improvements, which disintegration has further resulted in water intrusion into the interior of the homes, deterioration of the structural wood-framed members to which the defective lap siding and other materials are attached, insect infestation and other damage which significantly impairs the structural integrity of the Improvements and which has significantly diminished the market value of all the Homeowners' Improvements.
>
> 14. The referenced degradation of the Masonite products and resultant damage to other property i.e., deterioration of the structural, wood-framed members of the homes has rendered the homes at VICTORIA WOODS structurally weak and creates a risk of sudden, unexpected harm to persons and property which, in concert with the resultant substantial water intrusion into the homes, renders the subject dwellings uninhabitable.

Count II of the Amended Complaint seeks recovery against Masonite on the theory of strict liability. That count contends that the lap siding and building materials manufactured and sold by Masonite to the general contractor "contained latent defects which caused them to degrade and deteriorate under normal weather conditions and usage and renders said products inherently defective and unreasonably dangerous." Count III sounds in negligence and asserts that Masonite breached its duty to manufacture siding and building materials "in accordance with proper design and engineering practices such that these materials would be suitable for exterior application on residential structures and be free of any defects which cause premature deterioration."

Masonite argues that the economic loss rule requires that Counts II and III be dismissed for failure to state a cause of action. Plaintiffs respond that (1) their pleading alleges damage to "other property" within the parameters of the rule and (2) that they have no alternative means of recovery against Masonite under the holding of Latite Roofing Company, Inc. v. Urbanek, 528 So. 2d 1381, 1383 (Fla. 4th DCA 1988).

The economic loss rule is that "recovery for purely economic losses under a negligent tort theory is normally not allowed absent a claim for personal injuries or property damage." Latite Rooding Company, Inc. v. Urbanek, supra, 528 So. 2d at 1382.* Plaintiffs' Amended Complaint does not seek damages for personal injury. Under existing Florida law, the damage to the homes caused by the defective siding is not damage to "other property" sufficient to avoid the application of the rule. Casa Clara Condominium

*The economic loss rule clearly applies to negligence and strict product liability theories of recovery. However, the rule has also been applied to bar recovery of economic damages caused by the fraud of one of the parties to a contract. J. Batten Corp. v. Oakridge Investments 85 Ltd., 546 So. 2d 68, 69 (Fla. 2nd DCA 1989); Interstate Securities Corporation v. Hayes Corporation, 920 F. 2d 769, 776-77 (11th Cir. 1991). This line of cases is in apparent conflict with AFM Corporation v. Southern Bell Tel. & Tel., 515 So. 2d 180, 181 (Fla. 1987) which indicates that a party to a contract may pursue a claim for economic losses if it can prove a tort "independent of the breach" of contract. See, Strickland-Collins Construction v. Barnett Bank of Naples, 545 So. 2d 476, 477 (Fla. 2nd DCA 1989).

Association, Inc. v. Charley Toppino & Sons, Inc., 588 So. 2d 631, 633 (Fla. 3rd DCA 1991); GAF Corporation v. Zack Company, 445 So. 2d 350, 351-52 (Fla. 3rd DCA 1984), rev. den., 453 So. 2d 45 (Fla. 1984); Aetna Life & Casualty Company v. Therm-O-Disc, Inc., 511 So. 2d 992, 994 (Fla. 1987).*

Plaintiffs contend that this case falls within the exception to the economic loss rule set forth in Latite Roofing Co., Inc. v. Urbanek, 528 So. 2d 1381 (Fla. 4th DCA 1988). In that case, Urbanek and his partner purchased a shopping center during construction. At the time of purchase, Latite Roofing (the roofing contractor) had built most of the roof before being compelled to stop work. Urbanek successfully sued Latite for negligent construction and installation of the roof. Latite raised the economic loss rule as a bar to Urbanek's claim for economic losses. The Fourth District found the rule to be inapplicable, citing AFM Corp. v. Southern Bell Telephone & Telegraph Co., 515 So. 2d 180 (Fla. 1987) and A.R. Moyer, Inc. v. Graham, 285 So. 2d 397 (Fla. 1973).

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*At least two Florida cases cite ~~the~~ following language from W. Prosser, The Law of Torts §101 (4th ed. 1971);

> There can be no doubt that the seller's liability for negligence covers. . . property damage to the defective chattel itself, as where an automobile is wrecked by reason of its own bad breaks, as well as damage to any other property in the vicinity.

Latite Roofing Co., Inc. v. Urbanek, supra, 528 So. 2d at 1383; Affiliates for Evaluation and Therapy, Inc. v. Viasyn Corp., 500 So. 2d 688, 691 (Fla. 3rd DCA 1987). The cited language would appear to be inconsistent with Florida law. However, a more recent edition of the same treatise adopts a position consistent with Casa Clara and GAF Corporation. W. Prosser, The Law of Torts, §101 (5th ed. 1984).

> . . . [I]t seems clear that invocation of the rule precluding tort claims for only economic losses applies only when there are alternative theories of recovery better suited to compensate the damaged party for a peculiar kind of loss.
>
> In the present case the complaint is cast in negligence, which appears to be Urbanek's sole theory upon which recovery can be had against Latite. Accordingly, we believe that the judgment for Urbanek's economic damages for cost of repair should be affirmed. Latite Roofing Co., Inc. v. Urbanek, supra, 528 So. 2d at 1383.

Two federal courts have relied on Latite in determining the scope of Florida's economic loss rule. Butchkosky v. Enstrom Helicopter Corporation, ___F. Supp. ____, 6 FLW Fed. D 29(S.D. Fla. 1992); Interfase Inc. v. Pioneer Technologies Group, Inc., ____F. Supp. ____, 5 FLW Fed. D463 (M.D. Fla. 1991). Latite conflicts with a line of Florida cases where there was no privity between the plaintiff and defendant and courts nonetheless applied the economic loss rule. Casa Clara Condominium Association, Inc. v. Charley Topinno & Sons, Inc., supra, 588 So. 2d at 633-34; GAF Corporation v. Zack Company, supra, 445 So. 2d at 351-52; Affiliates For Evaluation and Therapy, Inc. v. Viasyn Corp., supra, 500 So. 2d at 693. In each of these cases, negligence and products liability were the only possible theories of recovery against defendants who successfully raised the economic loss rule.

Masonite argues that the First District distinguished Latite in American Universal Insurance Group v. General Motors Corporation, 578 So. 2d 451 (Fla. 1st DCA 1991). In American Universal, the plaintiff purchased a replacement oil pump from a supplier. General Motors had manufactured the pump. After a pump malfunction burned up the engine, the plaintiff sued General Motors in negligence and strict liability and the supplier for breach of an implied warranty. The First District held that the economic loss rule barred the plaintiff's claim against General Motors. The plaintiff cited Latite and argued that because there was no privity with General Motors, there was no basis for recovery against GM except under the two tort theories. The First District rejected the Latite argument as follows:

> This argument overlooks that a contract action remains pending against the seller of the allegedly defective product. . . Moreover, the end result of the East River and the Florida Power & Light decisions is that relegating parties to contract remedies in cases such as this allows parties to freely contract and allocate the risks of a defective product as they wish. . . Id. at 454-55.

American Universal cannot be reconciled with Latite. In Latite, Urbanek brought no claim brought against the seller of the shopping center. However, under Latite, the existence of a potential claim against a third party is not germane to the analysis of whether the economic loss rule could be raised by a separate defendant. If the American Universal analysis is correct, it should apply also to a potential, but unnamed, defendant. A plaintiff should not be allowed to manipulate the application of the economic loss rule by whom it elects to sue. To properly apply the plain language of Latite, the Court must determine whether a plaintiff has a cause of action against the defendant seeking the application of the economic loss rule, and not whether a plaintiff has a cause of action against any other party.* This Court is required to follow the plain language of Latite which is in direct conflict with American Universal, a decision from another district.

The policy behind the economic loss rule is to encourage parties "to negotiate economic risks through warranty provisions and price." Florida Power & Light Co. v. Westinghouse Electric Corp., 510 So. 2d 899, 901 (Fla. 1987). This policy is based on the implied assumption that a purchaser can effectively protect his own interests. Id., at 902 (". . . further, the purchaser. . . can protect his interests by negotiation and contractual bargaining or insurance. . ."); American Universal Insurance Group v. General Motors Corporation, supra, 578 So. 2d at 455 (". . . relegating parties to contract remedies. . . allows parties to freely contract and allocate the risks of a defective product as they wish. . ."). In this case, Plaintiffs are private homeowners complaining of a defective product incorporated by the builder into their homes. In other contexts, the Florida courts have recognized that purchasers of homes are in an unequal bargaining position with a developer. Conklin v. Hurley, 428 So. 2d 654, 657-58 (Fla. 1983); Gable v.

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*Literal application of Latite could result in a situation contrary to the theoretical basis for the economic loss rule. Using the facts in Latite, assume that Urbanek bought the shopping center for a pittance, "as is," specifically because of the condition of the roof. He would not then be able to sue the seller, having negotiated a price based on the poor condition of the roof. Under Latite, Urbanek could still sue Latite Roofing for its negligence, because he would have no other theory upon which recovery could be had. Such a result would appear to be contrary to the policy of Florida Power & Light Co. v. Westinghouse Electric Corp., supra, which seeks to encourage negotiation of economic risks at all levels of the chain of supply of a product.

Silver, 258 So. 2d 11 (Fla. 4th DCA 1972), cert. dism., 264 So. 2d 418 (Fla. 1972). The seller of a residence is under a duty to disclose material defects in it, a duty not imposed on a seller of commercial property. Johnson v. Davis, 480 So. 2d 625 (Fla. 1985); Futura Realty v. Lone Star Building Centers, 578 So. 2d 363 (Fla. 3rd DCA 1991). Courts have fashioned special rules to take into account the realities of the home purchase transaction. The appellate courts might well decide that similar policy reasons should limit the application of the economic loss rule in a case such as this, where parties with the most economic muscle could limit their exposure for defective products, to the financial detriment of the ultimate homebuyer. Based on the foregoing, it is

ORDERED AND ADJUDGED as follows:

1. Masonite's Motion to Dismiss contained in paragraph 7 through 12 of its motion are denied.

2. The grounds contained in subpart (B) of its Motion to Dismiss shall be set for hearing on the Court's next non-jury docket.

DONE AND ORDERED in West Palm Beach, Florida this 21st day of May, 1992.

ROBERT M. GROSS
Circuit Court Judge

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Product Defects Causing Commercial Loss: The Ascendancy of Contract over Tort

WILLIAM K. JONES*

I. INTRODUCTION

Cayuga Harvester, a large-scale farmer, purchased a harvesting machine from Allis-Chalmers.[1] The machine malfunctioned and Cayuga was unable to harvest its crop.[2] When Cayuga sued for

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* William K. Jones is the Milton Handler Professor of Trade Regulation at Columbia University School of Law.

1. Cayuga Harvester, Inc. v. Allis-Chalmers Corp., 95 A.D.2d 5, 465 N.Y.S.2d 606 (1983).

2. *Id.* at 7, 465 N.Y.S.2d at 609.

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VIII. Appendix: The Economic Loss Doctrine in Commercial Sales Transactions

1. Absent an accident-like injury to the product itself, or to the person or other property of the buyer, the overwhelming majority of courts deny recovery, in negligence and in strict liability, to the buyer of a defective product:

Wisconsin Power & Light Co. v. Westinghouse Elec. Corp., 830 F.2d 1405 (7th Cir. 1987) (Wisconsin law) (negligence and strict liability); Shipco 2295, Inc. v. Avondale Shipyards, Inc., 825 F.2d 925 (5th Cir. 1987) (admiralty) (negligence and strict liability), *cert. denied*, 485 U.S. 1007 (1988); Twin Disc, Inc. v. Big Bud Tractor, Inc., 772 F.2d 1329 (7th Cir. 1985) (Wisconsin law) (negligence and strict liability); Sanco, Inc. v. Ford Motor Co., 771 F.2d 1081 (7th Cir. 1985) (Indiana law) (negligence); American Home Assurance Co. v. Major Tool & Mach., Inc., 767 F.2d 446 (8th Cir. 1985) (Minnesota law) (negligence and strict liability); Henry Heide, Inc. v. WRH Prods. Co., 766 F.2d 105 (3d Cir. 1985) (New Jersey law) (negligence and strict liability); Colonial Park Country Club v. Joan of Arc, 746 F.2d 1425 (10th Cir. 1984) (New Mexico law) (strict liability); R.W. Murray Co. v. Shatterproof Glass Corp., 697 F.2d 818 (8th Cir. 1983) (Missouri law) (negligence); Flintkote Co. v. Dravo Corp., 678 F.2d 942 (11th Cir. 1982) (Georgia law) (negligence); Purvis v. Consolidated Energy Prods. Co., 674 F.2d 217 (4th Cir. 1982) (South Carolina law) (strict liability); Mercer v. Long Mfg. N.C., Inc., 665 F.2d 61 (5th Cir. 1982) (Texas law) (strict liability); Pittway Corp. v. Lockheed Aircraft Corp., 641 F.2d 524 (7th Cir. 1981) (Illinois law) (strict liability); Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp., 626 F.2d 280 (3d Cir. 1980) (Illinois law) (negligence and strict liability); Two Rivers Co. v. Curtiss Breeding Serv., Div. of Searle Agric. Inc., 624 F.2d 1242 (5th Cir. 1980) (Texas law) (strict liability), *cert. denied*, 450 U.S. 920 (1981); Tokio Marine & Fire Ins. Co. v. McDonnell Douglas Corp., 617 F.2d 936 (2d Cir. 1980) (California law) (negligence and strict liability);

Scandinavian Airlines Sys. v. United Aircraft Corp., 601 F.2d 425 (9th Cir. 1979) (California law) (strict liability); S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363 (9th Cir. 1978) (California law) (negligence); Posttape Assocs. v. Eastman Kodak Co., 537 F.2d 751 (3d Cir. 1976) (Pennsylvania law) (strict liability); Southwest Forest Indus., Inc. v. Westinghouse Elec. Corp., 422 F.2d 1013 (9th Cir.) (Pennsylvania law) (strict liability), *cert. denied*, 400 U.S. 902 (1970); PPG Indus., Inc. v. Sundstrand Corp., 681 F. Supp. 287 (W.D. Pa. 1988) (California, Illinois, and North Carolina law) (negligence); Frey

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Dairy v. A.O. Smith Harvestore Prods., Inc., 680 F. Supp. 253 (E.D. Mich. 1988) (Michigan law) (negligence and strict liability); Klo-Zik Co. v. General Motors Corp., 677 F. Supp. 499 (E.D. Texas 1987) (Texas law) (strict liability); Richard O'Brien Cos. v. Challenge-Cook Bros., 672 F. Supp. 466 (D. Colo. 1987) (Colorado law) (negligence and strict liability); Mt. Holly Ski Area v. U.S. Elec. Motors, Div. of Emerson Elec. Co., 666 F. Supp. 115 (E.D. Mich. 1987) (Michigan law) (negligence); Mac's Eggs, Inc. v. Rite-Way Agri Distribs., Inc., 656 F. Supp. 720 (N.D. Ind. 1986) (Indiana law) (strict liability); Cincinnati Gas & Elec. Co. v. General Elec. Co., 656 F. Supp. 49 (S.D. Ohio 1986) (Ohio law) (negligence and strict liability); McConnell v. Caterpillar Tractor Co., 646 F. Supp. 1520 (D.N.J. 1986) (admiralty) (negligence and strict liability); Long Island Lighting Co. v. Transamerica Delaval, Inc., 646 F. Supp. 1442 (S.D.N.Y. 1986) (New York law) (negligence and strict liability); Agristor Leasing v. Kramer, 640 F. Supp. 187 (D. Minn. 1986) (Minnesota law) (negligence and strict liability);

Consumers Power Co. v. Mississippi Valley Structural Steel Co., 636 F. Supp. 1100 (E.D. Mich. 1986) (Michigan law) (negligence and strict liability); *In re* James Noel Flying Serv., Inc., 61 Bankr. 335 (W.D. La. 1986) (Louisiana law) (strict liability); Agristor Leasing v. Meuli, 634 F. Supp. 1208 (D. Kan. 1986) (Kansas law) (negligence and strict liability); Sylla v. Massey-Ferguson, Inc., 660 F. Supp. 1044 (E.D. Mich. 1984) (Michigan law) (negligence and strict liability); Sylla v. Massey-Ferguson Inc., 595 F. Supp. 590 (E.D. Mich. 1984) (Michigan law) (negligence and strict liability); Hart Eng'g Co. v. FMC Corp., 593 F. Supp. 1471 (D.R.I. 1984) (Michigan, Pennsylvania, and Rhode Island law) (negligence and strict liability); Eaton Corp. v. Magnavox Co., 581 F. Supp. 1514 (E.D. Mich. 1984) (Michigan law) (negligence and strict liability); Hammermill Paper Co. v. Pipe Sys., 581 F. Supp. 1189 (W.D. Pa. 1984) (Texas law) (strict liability); City of Clayton v. Grumman Emergency Prods., Inc., 576 F. Supp. 1122 (E.D. Mo. 1983) (Missouri law) (negligence and strict liability); Consolidated Edison Co. v. Westinghouse Elec. Corp., 567 F. Supp. 358 (S.D.N.Y. 1983) (New York law) (negligence and strict liability); Jaskey Fin. & Leasing v. Display Data Corp., 564 F. Supp. 160 (E.D. Pa. 1983) (Maryland law) (negligence); County of Westchester v. General Motors Corp., 555 F. Supp. 290 (S.D.N.Y. 1983) (New York law) (negligence and strict liability); General Pub. Utils. Corp. v. Babcock & Wilcox Co., 547 F. Supp. 842 (S.D.N.Y. 1982) (Pennsylvania law) (strict liability); Anglo Eastern Bulkships Ltd. v. Ameron, Inc., 556 F. Supp. 1198 (S.D.N.Y. 1982) (admiralty) (strict liability); Owens-Corning Fiberglas Corp. v. Sonic Dev. Corp., 546 F. Supp. 533 (D. Kan. 1982) (Kansas law) (negligence); Office Supply Co. v. Basic/Four Corp., 538 F. Supp. 776 (E.D. Wis. 1982) (California law) (negligence); Argo Welded Prods., Inc. v. J.T. Ryerson Steel & Sons, 528 F. Supp. 583 (E.D. Pa. 1981) (New Jersey and Pennsylvania law) (negligence); Baltimore Football Club, Inc. v. Lockheed Corp., 525 F. Supp. 1206 (N.D. Ga. 1981) (Georgia law) (negligence and strict liability); Kaiser Aluminum & Chem. Corp. v. Ingersoll-Rand Co., 519 F. Supp. 60 (S.D. Ga. 1981) (Georgia law) (negligence); Polycon Indus., Inc. v. Hercules Inc., 471 F. Supp. 1316 (E.D. Wis. 1979) (Michigan law) (strict liability);

Sioux City Community School Dist. v. International Tel. & Tel. Corp., 461 F. Supp. 662 (N.D. Iowa 1978) (Iowa law) (strict liability); Plainwell Paper Co. v. Pram, Inc., 430 F. Supp. 1386 (W.D. Pa. 1977) (Pennsylvania law) (strict liability); Midland Forge, Inc. v. Letts Indus., Inc., 395 F. Supp. 506 (N.D. Iowa 1975) (Iowa law) (strict liability); Arizona v. Cook Paint & Varnish Co., 391 F. Supp. 962 (D. Ariz. 1975) (Alaska, Arizona, California, Hawaii, and Texas law) (negligence and strict liability), *aff'd per curiam*, 541 F.2d 226 (9th Cir. 1976), *cert. denied*, 430 U.S. 915 (1977); Cooley v. Salopian Indus., Ltd., 383 F. Supp. 1114 (D.S.C. 1974) (South Carolina law) (strict liability); Iowa Elec. Light & Power Co. v. Allis-Chalmers Mfg. Co., 360 F. Supp. 25 (S.D. Iowa 1973) (Iowa law) (strict liability); Noel Transfer & Package Delivery Serv., Inc. v. General Motors Corp., 341 F. Supp. 968 (D. Minn. 1972) (Minnesota law) (strict liability); Karl's Shoe Stores, Ltd. v. United Shoe Mach. Corp., 145 F. Supp. 376 (D. Mass. 1956) (Massachusetts law) (negligence); Donovan Constr. Co. v. General Elec. Co., 133 F. Supp. 870 (D. Minn. 1955) (Minnesota law) (negligence); State *ex rel* Smith v. Tyonek Timber, Inc., 680 P.2d 1148 (Alaska 1984) (negligence); Northern Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324 (Alaska 1981) (negligence and strict liability); Beauchamp v. Wilson, 21 Ariz. App. 14, 515 P.2d 41 (1973) (strict liability); Berkeley Pump Co. v. Reed-Joseph Land Co., 279 Ark. 384, 653 S.W.2d 128 (1983) (strict liability); Sacramento Regional Transit Dist. v. Grumman Flexible, 158 Cal. App. 3d 289, 204 Cal. Rptr. 736 (1984) (negligence and strict liability); Kaiser Steel Corp. v. Westinghouse Elec. Corp., 55 Cal. App. 3d 737, 127 Cal. Rptr. 838 (Ct. App. 1976) (strict liability); Anthony v. Kelsey-Hayes Co., 25 Cal. App. 3d 442, 102 Cal. Rptr. 113 (1972) (negligence and strict liability); Florida Power & Light Co. v. Westinghouse Elec. Corp., 510 So. 2d 899 (Fla. 1987) (negligence); Affiliates for Evaluation & Therapy, Inc. v. Viasyn Corp., 500 So. 2d 688 (Fla. Dist. Ct. App. 1987) (negligence); GAF

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Corp. v. Zack Co., 445 So. 2d 350 (Fla. Dist. Ct. App.) (negligence and strict liability), *review denied*, 453 So. 2d 45 (Fla. 1984);
Cedars of Lebanon Hosp. Corp. v. European X-Ray Distribs., 444 So. 2d 1068 (Fla. Dist. Ct. App. 1984) (strict liability); Monsanto Agric. Prods. Co. v. Edenfield, 426 So. 2d 574 (Fla. Dist. Ct. App. 1982) (negligence); State v. Mitchell Constr. Co., 108 Idaho 335, 699 P.2d 1349 (1984) (negligence and strict liability); Adkinson Corp. v. American Bldg. Co., 107 Idaho 406, 690 P.2d 341 (1984) (negligence and strict liability); Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978) (negligence); Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988) (negligence and strict liability); Anderson Elec., Inc. v. Ledbetter Erection Corp., 115 Ill. 2d 146, 503 N.E.2d 246 (1986) (negligence); Moorman Mfg. Co. v. National Tank Co., 91 Ill. 2d 69, 435 N.E.2d 443 (1982) (negligence and strict liability); Album Graphics, Inc. v. Beatrice Foods Co., 87 Ill. App. 3d 338, 408 N.E.2d 1041 (1980) (negligence); Alfred N. Koplin & Co. v. Chrysler Corp., 49 Ill. App. 3d 194, 364 N.E.2d 100 (1977) (negligence); Dutton v. International Harvester Co., 504 N.E.2d 313 (Ind. Ct. App. 1987) (strict liability); Bay State-Spray & Provincetown S.S., Inc. v. Caterpillar Tractor Co., 404 Mass. 103, 533 N.E.2d 1350 (1989) (negligence and strict liability); Marcil v. John Deere Indus. Equip. Co., 9 Mass. App. Ct. 625, 403 N.E.2d 430 (1980) (negligence); Great Am. Ins. Co. v. Paty's, Inc., 154 Mich. App. 634, 397 N.W.2d 853 (1986) (negligence), *appeal denied*, 428 Mich. 874 (1987); A.C. Hoyle Co. v. Sperry Rand Corp., 128 Mich. App. 557, 340 N.W.2d 326 (1983) (negligence); McGhee v. GMC Truck & Coach Div., 98 Mich. App. 495, 296 N.W.2d 286 (1980) (negligence and strict liability); Valley Farmers' Elevator v. Lindsay Bros., 398 N.W.2d 553 (Minn. 1987) (negligence); S.J. Groves & Sons v. Aerospatiale Helicopter Corp., 374 N.W.2d 431 (Minn. 1985) (negligence and strict liability); Minneapolis Soc'y of Fine Arts v. Parker-Klein Assocs. Architects, Inc., 354 N.W.2d 816 (Minn. 1984) (negligence and strict liability); Superwood Corp. v. Siempelkamp Corp., 311 N.W.2d 159 (Minn. 1981) (negligence and strict liability); Holstad v. Southwestern Porcelain, Inc., 421 N.W.2d 371 (Minn. Ct. App. 1988) (negligence and strict liability);
Tri-State Ins. Co. v. Lindsay Bros., 364 N.W.2d 894 (Minn. Ct. App. 1985) (negligence and strict liability); St. Paul Fire & Marine Ins. Co. v. Steeple Jac, Inc., 352 N.W.2d 107 (Minn. Ct. App. 1984) (negligence and strict liability); Sharp Bros. Contracting Co. v. American Hoist & Derrick Co., 703 S.W.2d 901 (Mo. Ct. App. 1986) (strict liability); Forrest v. Chrysler Corp., 632 S.W.2d 29 (Mo. Ct. App. 1982) (strict liability); Clevenger & Wright Co. v. A.O. Smith Harves-

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tore Prods., Inc., 625 S.W.2d 906 (Mo. Ct. App. 1981) (negligence and strict liability); National Crane Corp. v. Ohio Steel Tube Co., 213 Neb. 782, 332 N.W.2d 39 (1983) (negligence and strict liability); Central Bit Supply Inc. v. Waldrop Drilling & Pump, Inc., 102 Nev. 139, 717 P.2d 35 (1986) (negligence and strict liability); Spring Motors Distribs., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985) (negligence and strict liability); Schiavone Constr. Co. v. Elgood Mayo Corp., 56 N.Y.2d 667, 436 N.E.2d 1322, 451 N.Y.S.2d 720 (1982) (strict liability); Utica Observer Dispatch, Inc. v. Booth, 106 A.D.2d 863, 483 N.Y.S.2d 540 (1984) (negligence); Mid-Hudson Mack, Inc. v. Dutchess Quarry & Supply Co., 99 A.D.2d 751, 471 N.Y.S.2d 664 (1984) (negligence and strict liability); Cayuga Harvester, Inc. v. Allis-Chalmers Corp., 95 A.D.2d 5, 465 N.Y.S.2d 606 (1983) (negligence and strict liability); Steckmar Nat'l Realty & Inv. Corp. v. J.I. Case Co., 99 Misc. 2d 212, 415 N.Y.S.2d 946 (Sup. Ct. 1979) (negligence and strict liability); Trans World Airlines, Inc. v. Curtiss-Wright Corp., 1 Misc. 2d 477, 148 N.Y.S.2d 284 (Sup. Ct. 1955) (negligence); Hagert v. Hatton Commodities, Inc., 350 N.W.2d 591 (N.D. 1984) (strict liability); Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989) (negligence and strict liability); Avenell v. Westinghouse Elec. Corp., 41 Ohio App. 2d 150, 324 N.E.2d 583 (1974) (strict liability); Brown v. Western Farmers Ass'n, 268 Or. 470, 521 P.2d 537 (1974) (strict liability); REM Coal Co. v. Clark Equip. Co., 1563 A.2d 128 (Pa. Super. 1989) (negligence and strict liability); Carolina Winds Owners' Ass'n v. Joe Hardin Builder, Inc., 297 S.C. 74, 374 S.E.2d 897 (Ct. App. 1988) (favorable comment on economic loss doctrine in context of construction case involving negligence); Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc., 572 S.W.2d 308 (Tex. 1978) (strict liability); Pioneer Hi-Bred Int'l, Inc. v. Talley, 493 S.W.2d 602 (Tex. Civ. App. 1973) (strict liability); Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 236 Va. 419, 374 S.E.2d 55 (1988) (favorable comment on economic loss doctrine in context of construction case involving negligence); Sunnyscope Grading Inc. v. Miller, Bradford & Risberg, 148 Wis. 2d 910, 437 N.W.2d 213 (1989).

2. There is some authority to the contrary, particularly in cases asserting negligence:

N. Feldman & Son v. Checker Motors Corp., 572 F. Supp. 310 (S.D.N.Y. 1983) (Michigan law) (negligence and strict liability); R & L Grain Co. v. Chicago E. Corp., 531 F. Supp. 201 (N.D. Ill. 1981) (Wisconsin law) (negligence and strict liability); Feeders, Inc. v. Monsanto Co., No. Civ. 4-77-306 (D. Minn. May 15, 1981) (LEXIS,

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Genfed library, Dist file) (Minnesota law) (negligence); Mead Corp. v. Allendale Mut. Ins. Co., 465 F. Supp. 355 (N.D. Ohio 1979) (Ohio law) (strict liability); Continental Oil Co. v. General Am. Transp. Corp., 409 F. Supp. 288 (S.D. Tex. 1976) (Ohio law) (negligence and strict liability); Berkeley Pump Co. v. Reed-Joseph Land Co., 279 Ark. 384, 653 S.W.2d 128 (1983) (negligence); Pisano v. American Leasing, 146 Cal. App. 3d 194, 194 Cal. Rptr. 77 (1983) (negligence); Webb v. Dessert Seed Co., 718 P.2d 1057 (Colo. 1986) (negligence); Omni Flying Club, Inc. v. Cessna Aircraft Co., 366 Mass. 154, 315 N.E.2d 885 (1974) (negligence); Spence v. Three Rivers Builders & Masonry Supply, Inc., 353 Mich. 120, 90 N.W.2d 873 (1958) (negligence); Lang v. General Motors Corp., 136 N.W.2d 805 (N.D. 1965) (negligence); State *ex rel.* W. Seed Prod. Corp. v. Campbell, 250 Or. 262, 442 P.2d 215 (1968) (negligence), *cert. denied*, 393 U.S. 1093 (1969); W.R.H., Inc. v. Economy Builders Supply, 633 P.2d 42 (Utah 1981) (negligence); Berg v. General Motors Corp., 87 Wash. 2d 584, 555 P.2d 818 (1976) (negligence); Nakanishi v. Foster, 64 Wash. 2d 647, 393 P.2d 635 (1964) (negligence); City of La Crosse v. Schubert, Schroeder & Assocs., 72 Wis. 2d 38, 240 N.W.2d 124 (1974) (strict liability and negligence); Air Prods. & Chems., Inc. v. Fairbanks Morse, Inc., 58 Wis. 2d 193, 206 N.W.2d 414 (1973) (Pennsylvania law) (strict liability).

The leading case upholding recovery in strict liability for economic loss was Santor v. A & M. Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965). The ruling was subsequently confined to consumer cases in Spring Motors Distributors., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985). *But cf.* Cinnaminson Township Bd. of Educ. v. U.S. Gypsum Co., 552 F. Supp. 855 (D.N.J. 1982) (upholding the recovery of the cost of replacing asbestos tile in a commercial context).

Many of the cases sustaining liability for economic loss are no longer authoritative or are subject to serious question: (1) the Massachusetts decision in *Omni Flying Club* has been disapproved in subsequent opinions, *see* Bay State-Spray & Provincetown S.S. Co. v. Caterpillar Tractor Co., 404 Mass. 103, 533 N.E.2d 1350 (1989); (2) the decisions under Michigan law in *Feldman*, *Spence*, and *Southgate* have been superseded, *see* Great Am. Ins. Co. v. Paty's, Inc., 154 Mich. App. 634, 397 N.W.2d 853 (1986), *appeal denied*, 428 Mich. 874 (1987); (3) the decision under Minnesota law in *Feeders* has been superseded, *see* Superwood Corp. v. Siempelkamp, 311 N.W.2d 159 (Minn. 1981); (4) the decisions under Ohio law in *Mead* and *Continental Oil* have been superseded, *see* Chemitrol Adhesives, Inc. v.

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American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989); (5) the Washington decisions in *Berg* and *Nakanishi* have been overturned by statute, *see* Wash. Rev. Code Ann. § 7.72.010(4), (6) (Supp. 1989); and (6) the decisions under Wisconsin law in *R & L Grain* and *City of La Crosse* are of questionable validity, *see* Wisconsin Power & Light Co. v. Westinghouse Elec. Corp., 830 F.2d 1405 (7th Cir. 1987); Sunnyslope Grading Inc. v. Miller, Bradford & Risberg, 148 Wis. 2d 910, 437 N.W.2d 213 (1989). In addition, there are unresolved conflicts in the California decisions with respect to negligence.

3. For the most part, state product liability statutes refer to "property damage" or the equivalent without further elaboration. *See* Ala. Code § 6-5-501(2) (Supp. 1989); Ariz. Rev. Stat. Ann. § 12-681(3) (1982); Ark. Stat. Ann. §§ 4-86-102, 16-116-102(5) (1987) (harm to property); Colo. Rev. Stat. § 13-21-401(2) (1987); Del. Code Ann. tit. 18, § 7001 (1989); Ky. Rev. Stat. Ann. § 411.300(1) (Baldwin Supp. 1988); Mich. Comp. Laws § 600-2945 (1987); Neb. Rev. Stat. § 25-21,180 (1985); N.C. Gen. Stat. § 99B-1(3) (1985); Or. Rev. Stat. § 30.900 (1988); R.I. Gen. Laws § 9-1-32(1) (1985); S.D. Codified Laws Ann. § 20-9-10 (1987); Tenn. Code Ann. § 29-28-102(6) (1980); Utah Code Ann. § 78-15-6 (1987). Some states exclude economic loss either expressly or by implication. *See* Conn. Gen. Stat. § 52-572n (Supp. 1988) (excluding claim for "commercial loss" as between "commercial parties"); Ind. Code Ann. § 33-1-1.5-2 (West Supp. 1988) (excluding claims for "gradually evolving damage to property or economic loss from such damage"); Kan. Stat. Ann. § 60-3302(d) (1983) (excluding claim for "direct or consequential economic loss"); Mont. Code Ann. § 27-1-719 (1989) (referring to "physical harm to property"); N.J. Stat. Ann. 2A:58C-1(b)(2) (West 1987) (referring to "physical damage to property, other than to the product itself"); Ohio Rev. Code Ann. § 2307.71(B), (G), (M) (Anderson Supp. 1988) (referring to "physical damage to property other than the product in question" and excluding a broadly defined category of "economic loss"); S.C. Code Ann. § 15-73-10 (Law. Co-op. 1977) (referring to "physical harm [to the user's] property"); Wash. Rev. Code Ann. § 7.72.010(4), (6) (Supp. 1989) (excluding claim for "direct or consequential economic loss" under the UCC). Two formulations are more expansive. *See* La. Rev. Stat. Ann. § 9-2800.53(5) (West Supp. 1989) (referring to "damage to the product itself and economic loss arising from a deficiency in or loss of use of the product," but only to the extent not covered by warranty law); N.H. Rev. Stat. Ann.

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§ 507-D:(1)(I) (1983) (referring to "property damage or other damage").

The product liability statutes cover issues of varying scope. They have received scant attention from the courts in resolving issues of economic loss. There are, however, exceptions. *See, e.g.*, Purvis v. Consolidated Energy Prods. Co., 674 F.2d 217 (4th Cir. 1982) (interpreting the South Carolina statute's reference to "physical harm" to exclude the failure of a structure to cure tobacco); Mac's Eggs, Inc. v. Rite-Way Agric. Distribs., 656 F. Supp. 720 (N.D. Ind. 1986) (interpreting the Indiana statute's requirement of "physical injury" to exclude a malfunction in a feed system which led to losses of chickens and a lower yield); Verdon v. Transamerica Ins. Co., 187 Conn. 363, 371, 446 A.2d 3, 8 (1982) (observing that the Connecticut statute permitted recovery for damage to the product sold, but not for economic loss); Washington Water Power Co. v. Graybar Elec. Co., 112 Wash. 2d 847, 774 P.2d 1199 (recognizing that Washington's statute disallowed claims for economic loss but expressing uncertainty about the scope of the economic loss concept), *amended*, 779 P.2d 697 (1989).

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In commercial sales transactions, the tort of misrepresentation is largely redundant. If a seller makes material representations which turn out to be false, the buyer can sue for breach of express warranty. If a seller fails to make disclosures about an inferior or defective product, the buyer can sue for breach of implied warranty. In both cases, the claims of the aggrieved buyer are subject to the terms of the seller's warranty, including limitations on liability and restrictions on remedy. Even so, a seller would not be protected against all challenges. In cases involving deliberate fraud, a court would be justified in striking down these contractual impediments to the buyer's claim[182] and permitting recovery for misrepresentation as well as for breach of warranty. In most instances, however, the warranty claim should suffice to protect the buyer.[183]

As in the case of negligence and strict liability, the issues will be more sharply focused and the contractual allocations of risk more generally respected if aggrieved buyers are compelled to proceed under the Uniform Commercial Code.

IV. The Economics of Risk Allocation

The Uniform Commercial Code, as well as many of the judicial decisions concerned with contractual allocations of risk, assume that it is socially desirable to permit contracting parties to allocate risks. That assumption is sound, at least in the context of the commercial sales transactions examined in this Article. The assumption requires further explication, however, including a consideration of applicable limits. Should contractual allocations of risk be sustained despite inequality of bargaining power between buyer and seller? Is the case for contractual allocations undermined by imperfections in the knowledge of the contracting parties? We begin with the general case and then consider possible limitations.

Supp. 381 (D.N.M. 1984) (New Mexico law); Utah Int'l v. Caterpillar Tractor Co., 108 N.M. 539, 775 P.2d 741 (N.M. Ct. App. 1989); Continental Ins. Co. v. Page Eng'g Co., 783 P.2d 641 (Wyo. 1989). For a further discussion of the duty to warn subsequent to sale, see Schwartz, *The Post-Sale Duty to Warn: Two Unfortunate Forks in the Road to a Reasonable Doctrine*, 58 N.Y.U. L. Rev. 892 (1983).

If the position in this Article is adopted and the law of torts is held to be inapplicable to commercial sales transactions, a post-sale duty to warn could be imposed as a matter of contract law. As such, it would be amenable to more precise definition in the contract of sale—to the same extent as other specifications are made respecting the responsibilities of the seller.

182. The term "deliberate fraud" refers to statements known to be false and statements made by the seller without regard to their truth or falsity, with the intention of inducing reliance by the prospective buyer.

183. *See* U.C.C. § 2-721 (1987); *cf.* Restatement (Second) of Contracts § 164 (1979).

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A. *The Logic of Risk Allocation*

The assumption of additional risk by the manufacturer, in the form of additional warranty responsibility, increases the manufacturer's costs in three ways: (1) product quality must be monitored to reduce the number of product failures; (2) a reserve must be accumulated (or an equivalent liability assumed) to compensate buyers for defects that occur despite improved quality control; and (3) transaction costs are incurred in processing warranty claims.

A buyer benefits from additional warranty protection in two ways: (1) to the extent that there are fewer product failures, the buyer will experience fewer incidents of damage to the purchased product, to other property of the buyer, and to the conduct of the buyer's business; and (2) to the extent that compensation is provided for product failures, the costs of any failures that do occur will be borne by the manufacturer rather than by the buyer. Like the manufacturer, the buyer incurs transaction costs in submitting warranty claims; the buyer's recovery will be reduced by such costs.

From a social perspective, it is desirable to extend warranty protection when the benefits to the buyer exceed the costs to the manufacturer. If the converse is true, and warranty costs exceed warranty benefits, warranty protection should be curtailed.

The typical manufacturer's warranty has three features: (1) a commitment, for a limited period, to repair or replace defective products or parts; (2) a disclaimer of all other warranties, express or implied; and (3) an exclusion of any liability for consequential damages. Under a wide range of circumstances, this form of warranty is likely to be more efficient than the statutorily prescribed remedies of the UCC. Consider the three general categories of commercial loss:

1. *Damage or destruction of the purchased product.* If the damage or destruction occurs within the warranty period and is a result of a product defect, the manufacturer is generally in the best position to provide a remedy of repair or replacement. It has the advantage of knowing its own product; it has the benefits of specialization and perhaps of economies of scale; and it can avoid the problem of moral hazard that arises if a buyer is free to spend the seller's money, with only loose constraints, in unilaterally obtaining replacement or repair. At the same time, the buyer is protected as long as the courts condition the exclusivity of the repair-or-replace remedy on timely and effective action by the manufacturer.[184]

2. *Damage to other property of the buyer.* Focusing initially on

184. *See supra* notes 48, 50-51.

casualty losses (fires, explosions, and the like), the buyer may or may not be in the best position to avert the mishap. But the buyer is clearly in the best position to insure against the loss. The standard casualty policy protects the buyer from losses associated with accidents caused by product failures, without segregation of risks or charges. The premium on such policies will be related to the value of the buyer's property and the general risk involved in the buyer's activities.[185] These are matters about which the seller has limited knowledge and almost no control. As to such losses, the buyer is in the best position to obtain optimal coverage under its own policy, described as first-party insurance.[186] The same insurance would apply to damages to the purchased product, occurring after the expiration of the warranty period, as long as the loss is a casualty loss.

The avoidance of unnecessary transaction costs is a major advantage of having the buyer look to its own insurance company. Litigation over the liability of the seller can consume substantial resources, whether the suit is ultimately resolved in favor of the buyer or the seller.

3. *Damage to the business of the buyer (including noncasualty property losses).* Again, the buyer may or may not be in the best position to avert the mishap, but it is clearly in the best position to insure against the loss. The manufacturer-seller cannot obtain insurance against noncasualty losses to the buyer's business.[187] By contrast, the buyer can obtain various types of insurance to guard against losses attributable to business interruption.[188] Further, the buyer can struc-

185. *See* H. DENENBERG, R. EILERS, J. MELONE & R. ZELTEN, RISK AND INSURANCE 460-65, 596-97 (2d ed. 1974); R. RIEGEL & J. MILLER, INSURANCE PRINCIPLES AND PRACTICES 621-30 (5th ed. 1966). For a discussion of the classification of insurance risks, see K. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY 67-100 (1986).

186. First-party insurance also enables the buyer and his insurance company to negotiate terms that are finely tuned to the costs and risks at stake, such as, ceilings, deductibles, copayments, and exclusions. *See* Goldberg, *Accountable Accountants: Is Third-Party Liability Necessary?*, 17 J. LEGAL STUD. 295, 305 (1988).

187. *See* 2 R. LONG, THE LAW OF LIABILITY INSURANCE § 11.01, at 11-9 to 11-13, § 11.10, at 11-80 to 11-82 (1989); Arness & Eliason, *Insurance Coverage for "Property Damage" in Asbestos and Other Toxic Tort Cases*, 72 VA. L. REV. 943, 949, 962-69 (1986); Sorensen, *Initial Investigation of Products Liability Claims*, 1974 INS. L.J. 255, 280; Note, *Products Liability Insurance Coverage*, 31 S.C.L. REV. 718, 749-52 (1980). For an illustrative case, see Yakima Cement Prods. Co. v. Great Am. Ins. Co., 93 Wash. 2d 210, 219, 608 P.2d 254, 259 (1980) ("Consequential damages arising from intangible injury may be awarded only when they result directly from injury to or destruction of tangible property." In the absence of property damage arising from defective concrete panels, the expenses of a customer's construction delay were not recoverable.).

188. *See* A. MILLER, "TYPES OF BUSINESS INTERRUPTION COVERAGE AVAILABLE" IN BUSINESS INTERRUPTION INSURANCE: A PRIMER 4-5, 18-20 (1987); R. MORRISON,

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ture its operations (by maintaining spare parts, excess capacity, alternative operating modes, and the like) so as to minimize any compounding of losses.

Holding the manufacturer responsible for losses to the buyer's business is inherently inefficient because of problems of adverse selection. Assume, for example, that a machine has a probability of failure of .001 (despite all cost-justified quality control measures). Assume further that the machine is used in businesses with differing degrees of sensitivity to product failure. In *A*'s business, a machine failure will cause losses of $5,000; in *B*'s business, the losses will be $50,000; and in *C*'s business, the losses will be $500,000. If the manufacturer sells the same number of machines to *A*, *B*, and *C*, it would have to charge a premium of $185 per machine to cover the risks assumed (($555,000 x .001)/ 3).

This premium would be clearly excessive in the case of *A* and *B*, resulting in either: (1) discontinuance of their use of a machine otherwise suitable for their businesses; or (2) burdening their businesses with costs associated with *C*'s operations—reducing the attractiveness, in terms of price and quality, of the products they sell. *C*, in turn, is subsidized to the extent that *A* and *B* bear part of the costs of *C*'s operations, which are highly sensitive to product failure.

One way of resolving the problem would be for the manufacturer to discriminate in price, charging *A* a $5 premium, *B* a $50 premium, and *C* a $500 premium (totaling the necessary $555). This approach, however, requires a degree of knowledge not available to manufacturers: information about the nature of each buyer's operations, not only at the time of sale, but subsequent to the sale (as long as the buyers do not change their operations so dramatically as to afford the manufacturer a defense of unforeseeability).[189] Clearly the preferable solution, and the one most compatible with access to relevant information, is to have each buyer assume the risk of disruption of its own business and obtain insurance (or self-insure) against the risk. In effect, *A* would pay a premium to its own insurance company based on $5,000 per failure; *B* would pay a premium based on $50,000 per failure; and *C* would pay a premium based on $500,000 per failure.

If the UCC's allocation of risks is inefficient in many instances, is this a serious shortcoming in the Code? Not necessarily. It would be difficult to formulate a universally applicable repair-or-replace warranty—considering, among other things, the duration of the warranty

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BUSINESS INTERRUPTION INSURANCE: ITS THEORY AND PRACTICE 73-76 (1986) (describing some of the risks against which insurance can be obtained).

189. *See supra* notes 75-76.

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and the possible exclusions of particular risks from warranty coverage. Moreover, the UCC's formulation may be appropriate for isolated ad hoc transactions in which the parties do not explicitly address the question of risk allocation. By placing the major initial responsibility on sellers, the UCC provides an incentive for sellers to formulate more precise solutions, suitable to their particular needs, and to apprise buyers of the degree of warranty protection afforded. In effect, the UCC forces the seller's hand and compels the seller to devise warranty limitations that are efficient in the context of transactions between the seller and its customers.

B. *Controlling the Incidence of Loss*

The typical repair-or-replace warranty appears to be efficient from the perspective of optimal insurance, considering, inter alia, problems of moral hazard and adverse selection. But is this warranty efficient in reducing the risk of loss associated with product defects? Courts resistant to contractual reallocations of risk express concern about the erosion of "prophylactic principles of tort law" that provide incentives to produce safe products.[190] The discussion thus far has maintained an attitude of agnosticism on whether the buyer or the seller is in the best position to avoid losses stemming from product defects.

As to the defect itself, control clearly rests with the seller. As to the consequences of the defect, the buyer exercises significant control, both in the manner in which the product is used and in precautions taken to avoid loss (such as periodic inspections and sensitivity to signs of trouble). In sum, the problem is one of joint care. In such cases, it is not possible to devise a liability rule that is optimal in all instances. For example, the diligence of the seller may be enhanced by increasing the probability that the seller will be held accountable for losses resulting from product defects. But the enhancement of seller diligence comes at the expense of buyer caution: The more probable it is that the seller will be held liable, the less care the buyer will take.

If, for example, a product defect will cause a loss of $100,000 and the probability of that loss can be reduced by one percent by a seller expenditure of $700, the expenditure, viewed in isolation, should be made ($.01 \times \$100,000 > \$700$). Similarly, if the consequences of product failure can be reduced by one percent by a buyer expenditure of $700, that expenditure, viewed in isolation, should also be made (an

190. *See supra* notes 144-48.

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identical calculation). Whether it is efficient for *both parties* to make the precautionary expenditures depends on the interaction between the two efforts. If the combined effects of the efforts of the buyer and seller are largely redundant—achieving a gain of $1,000 at a cost of $1,400—the expenditure of one of the parties is a waste. Under such circumstances, only one of the parties should make the precautionary expenditure. If the efforts are substantially independent, each achieving a gain of $1,000 at a cost of $700, both expenditures should be made. In most cases, the combined effects will be somewhere between these two extremes. No rule of law can make the appropriate distinctions, at least not with any precision, because the relationship between the efforts of buyers and sellers is strongly influenced by factors that are specific to particular transactions.[191]

This problem lends itself to a negotiated solution in which risks are allocated, each party assuming the responsibilities that are cost-effective in light of the responsibilities assumed by the other. More specifically, a seller offers a product accompanied by a warranty of particular scope at a certain price. A buyer can then seek to obtain more warranty protection (at a higher price) or less warranty protection (at a lower price) depending on whether the initial allocation assigned too little or too much responsibility to the seller. In making its determination, the buyer will consider: (1) the nature and magnitude of losses anticipated in the event of product failure; (2) the measures at the buyer's disposal to avoid or limit such losses; and (3) whether protection against such losses can be achieved more economically by negotiating a modification of the seller's warranty responsibilities (for example, by paying more to obtain additional protection).

At this point, an objection may be made that in most transactions no negotiation takes place. The buyer is confronted with a warranty term that is designed by the seller and tendered to the buyer on a take-it-or-leave-it basis. We now turn to instances in which negotiation of warranty terms is either unavailable or uninformed. Under such circumstances, can it be said that contractual allocations of risk are efficient and socially desirable?

C. *Objections to Contractual Allocations of Risk*

For present purposes, we assume that the contractual allocation

191. For other discussions of the problem of joint care, see S. SHAVELL, *supra* note 81, at 26-29 (affirming the absence of any single rule yielding optimal results in all cases of joint care); Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CALIF. L. REV. 1, 3-19 (1985) (discussing efficient solutions in accident and contract cases); Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1307-13 (1981) (emphasizing significance of buyer as well as seller precaution).

of risk is not concealed, disguised, or misleading—that is, the parties are informed about the nature of the contractual provision. Under this assumption, two objections may be raised: (1) The contractual provision is not necessarily efficient because it is not freely selected in a competitive market, but is instead imposed by the unilateral action of a powerful seller dictating to a weak buyer; and (2) the contractual provision is not necessarily efficient because the parties (particularly the buyer) are not sufficiently apprised of the risks posed by product defects. We will consider each objection in turn and explore interactions between the two.

1. PROBLEMS OF MARKET POWER

We assume, initially, that the seller's market is competitive and that both parties are knowledgeable about the risks posed by defective products. If under these circumstances an improved warranty will cost sellers $100 per unit and yield benefits to buyers of $150 per unit, the improved warranty will be provided. If the improved warranty is presently being offered, a manufacturer withholding the warranty could offer a price reduction of $100. Knowledgeable buyers, however, would shun such a proposal because it offers a savings of $100 at a cost of $150. If the improved warranty is not presently being offered, an innovative producer could increase its market share or raise its price (or both) by offering the improved warranty. For example, an offer of the improved warranty at a price increase of $125 would be attractive to the innovator and to customers alike, each gaining $25 per unit over the existing regime. Emulation of the innovator will yield a market in which the improved warranty is offered at cost ($100 per unit), with customers reaping a net gain of $50 per unit over the prior price/product combination. In sum, efficient warranties will drive out inefficient warranties in markets characterized by competitive conditions and knowledgeable participants.

Does market power make a difference? Take the extreme case in which the seller is a monopolist (but retaining the premise that both parties are knowledgeable). Assume, once again, that the improved warranty costs the seller $100 per unit and provides buyers with benefits of $150 per unit. Assume further that the seller, a monopolist, has established a profit-maximizing price of $1,050 per unit. It would be in the interest of both parties to increase the price to $1,175 and to provide the improved warranty. Buyers would achieve a net gain of $25 per unit and, therefore, would not buy less. The monopolist would obtain $25 additional profit per unit and, in addition, would be able to sell additional units (the number depending on elasticity of

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demand). Assume, for example, that the initial demand and cost schedule confronting the monopolist is as follows:

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
5800	1,065.00	600	465.00	2,697,000
5900	1,057.50	600	457.50	2,699,250
6000	**1,050.00***	**600**	**450.00**	**2,700,000**
6100	1,042.50	600	442.50	2,699,250
6200	1,035.00	600	435.00	2,697,200
6300	1,027.50	600	427.50	2,693,250
6400	1,020.00	600	420.00	2,688,000
6500	1,012.50	600	412.50	2,681,250

*** Profit-maximizing price.**

The addition of the improved warranty would increase cost by $100 per unit, but would increase demand at every point by $150. Thus:

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
5800	1,215.00	700	515.00	2,987,000
5900	1,207.50	700	507.50	2,994,250
6000	1,200.00	700	500.00	3,000,000
6100	1,192.50	700	492.50	3,004,250
6200	1,185.00	700	485.00	3,007,000
6300	**1,177.50***	**700**	**477.50**	**3,008,250**
6400	1,170.00	700	470.00	3,008,000
6500	1,162.50	700	462.50	3,006,250

*** Approximate profit-maximizing price.**

At the new profit-maximizing price of $1,175 (derived by interpolation), output is 6337 units (an increase of 337 units) and total profits are $3,010,075 (an increase of $310,075). At the same time, the value of the product to the buyer is increased by $25—the old price ($1,050) plus the value of the improved warranty ($150) minus the new price ($1,175).

The same reasoning applies to markets that are imperfectly competitive, but not fully monopolized: (1) markets characterized by product differentiation in which each producer has some discretion over price because of the distinctiveness of its product; and (2) markets characterized by small numbers of producers engaged in nonrivalrous behavior (including instances of overt and tacit collusion).

In the case of product differentiation, each producer is a limited monopolist. Within the bounds set by imperfect substitutes, a producer can raise its price without losing all patronage and can lower its price without necessarily triggering responses by rivals. The demand curve faced by each producer is the same as the demand curve faced

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by a true monopolist, except that the elasticity of demand is much greater: relatively small changes in price will induce relatively large changes in output as buyers turn to imperfect substitutes. The difference, however, is of no significance. A monopolist, whether facing a demand curve of high or low elasticity, can achieve higher profits (and increased output) by offering optimal warranty protection. The analysis of the monopoly case is not dependent on the elasticity of demand confronting the monopolist and is fully applicable to instances of imperfect competition premised on product differentiation.[192]

As to firms acting in concert, whether overtly or tacitly, the starting point is again the monopoly model. Taking the example previously stated, assume that there are now three firms: each sells 2,000 units of output at a price of $1,050 and a cost of $600; and each receives a $900,000 share in monopoly profits ($2,700,000 ÷ 3). It would be in the interest of all three participants to move to an improved warranty at a price of $1,175 and a cost of $750. Total output would increase by 337 units, presumably shared pro rata, and

192. Consider a monopolist (or producer of a differentiated product) facing an elastic demand curve:

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
4,750	705	600	105	498,750
5,000	**700***	**600**	**100**	**500,000**
5,250	695	600	95	498,750
5,500	690	600	90	495,000
5,750	685	600	85	488,750
6,000	680	600	80	480,000
6,250	675	600	75	468,750
6,500	670	600	70	455,000

* **Profit-maximizing price.**

If an improved warranty increases cost by $100 and demand by $150, the new situation facing the producer is:

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
4,750	855	700	155	736,250
5,000	850	700	150	750,000
5,250	845	700	145	761,250
5,500	840	700	140	770,700
5,750	835	700	135	776,250
6,000	830	700	130	780,000
6,250	**825***	**700**	**125**	**781,250**
6,500	820	700	120	780,000

* **Profit-maximizing price.**

Accordingly, the adoption of the improved warranty enables the producer to increase output from 5,000 units to 6,250 units and to increase its profit from $500,000 to $781,250.

For a discussion of the similarity between pricing decisions under conditions of monopoly and under conditions of product differentiation, see F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 15-16, 385 (2d ed. 1980). For a discussion of the economics of product differentiation, see *id.* at 384-405.

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each firm would increase its pro rata share of industry profit from $900,000 to $1,003,358. Just as a monopolist would find it advantageous to give an improved warranty, the firms comprising a shared monopoly would find it advantageous to do so. The improved warranty would increase the industry profit to be shared among the sellers, thereby increasing their individual shares.[193]

The need for concerted action is not an impediment. Once the

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193. This conclusion holds true regardless of the manner in which industry output is shared and regardless of the relative efficiency of the market participants. Assume, for example, that the industry leader controls 40% of output; that its costs are lower than the costs of other participants; and that the other firms have outputs of 30%, 20%, and 10%. Based on the monopoly example in the text, the initial demand and cost schedule facing the leading firm is:

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
2,320	1,065.00	600	465.00	1,078,800
2,360	1,057.50	600	457.50	1,079,700
2,400	**1,050.00***	**600**	**450.00**	**1,080,000**
2,440	1,042.50	600	442.50	1,079,700
2,480	1,035.00	600	435.00	1,078,800
2,520	1,027.50	600	427.50	1,077,300
2,560	1,020.50	600	420.00	1,075,200
2,600	1,012.50	600	412.50	1,072,500

* **Profit-maximizing price.**

If an improved warranty increases cost by $100 and demand by $150, the new situation facing the industry leader, assuming a continued 40% market share, is:

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
2,320	1,215.00	700	515.00	1,194,800
2,360	1,207.50	700	507.50	1,197,700
2,400	1,200.00	700	500.00	1,200,000
2,440	1,192.50	700	492.50	1,201,700
2,480	1,185.00	700	485.00	1,202,800
2,520	**1,177.50***	**700**	**477.50**	**1,203,300**
2,560	1,170.00	700	470.00	1,203,200
2,600	1,162.50	700	462.50	1,202,500

* **Approximate profit-maximizing price.**

At the new profit-maximizing price of $1,175 (arrived at by interpolation), output is 2,535 units (an increase of 135 units) and firm profits are $1,204,125 (an increase of $124,125). The industry leader would adopt a profit-maximizing price and corresponding warranty because it is in that firm's interest to do so; the other sellers must follow suit or offer an inferior combination and lose market share. Other sellers would not quote a lower price or offer a superior warranty because, by hypothesis, they are less efficient than the industry leader. With their higher costs, these other sellers would prefer a higher price than the one selected by the leader, but they are constrained by the price decision of the leader; they could quote a lower price, but only by sacrificing profits to no avail.

It is not necessary that the industry leader act as innovator in this sequence of events. The economic reasoning does not depend on the market share of the innovating firm. Yet, only the leading firm (assumed to be the most efficient) can compel others to follow its lead. An inefficient innovator can be undercut by a more efficient firm, and it might be reluctant to initiate changes that could lead to intensified rivalry. Even so, the improved warranty serves the interests of all producers, and in a context of knowledgeable firms, the innovator would expect emulation with respect to the improved warranty. For a discussion on the dynamics of oligopoly pricing, see F. SCHERER, SUPRA note 192 at 156-58.

virtue of an improved warranty is perceived by any one of the three producers, that producer will offer the warranty and make the appropriate price change. In a context of knowledgeable sellers and buyers, the change will be made by the other producers as well. If they failed to do so, they would be offering an inferior product (all things considered), and knowledgeable buyers would shun that product.

Accordingly, as long as all market participants are knowledgeable, there is no reason to object to risk allocation provisions imposed by monopolists or others possessing lesser degrees of market power. The dominant seller has a strong incentive to develop an efficient provision, and both buyer and seller share in the resulting gain.[194]

2. PROBLEMS OF IGNORANCE

There are three types of ignorance that need to be considered: (a) buyer ignorance; (b) seller ignorance; and (c) universal ignorance (neither party knowledgeable).

a. Buyer Ignorance

Assume, as before, that an improved warranty costs sellers $100 per unit and yields benefits of $150 per unit for buyers. If buyers are ignorant, they might resist the new warranty because they prefer a cost saving of $100 (or less) to a warranty with unrecognized benefits of $150. This configuration has posed major problems in analyses of consumer markets,[195] but it is not a significant problem if buyers are commercial enterprises.

i. Competitive Markets

If buyers and sellers operate in competitive markets, buyer ignorance must be massive to prevent the introduction of the improved warranty. If one or more buyers are enlightened enough to seek an improved warranty, the following consequences ensue (assuming the

194. For more formal proofs of the irrelevance of market power absent information deficiencies, see Courville & Hausman, *Warranty Scope and Reliability under Imperfect Information and Alternative Market Structures*, 52 J. BUS. L. 361, 370-73 (1979); M. GEISTFELD, PERFECT INFORMATION AND OPTIMALITY: A THEORY OF CONSUMER PRODUCT WARRANTY REVISITED 4-14, 18-19, 23-25 (Columbia Law School Center for Law & Economic Studies Working Paper No. 29, 1987).

195. *See* Schwartz & Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387, 1425-50 (1983); Spence, *Consumer Misperceptions, Product Failure and Producer Liability*, 44 REV. ECON. STUD. 561, 562-64 (1977); Note, *Imperfect Information, the Pricing Mechanism, and Products Liability*, 88 COLUM. L. REV. 1057, 1059-60 (1988). Shavell makes this same point, but he fails to limit his observation to consumer transactions; yet, the discussion makes clear that consumer cases are the focus of attention. S. SHAVELL, *supra* note 81, at 61-62.

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improved warranty is priced at $125 per unit): Enlightened buyers now have an advantage of $25 per unit over ignorant buyers, and those who sell to enlightened buyers have an advantage of $25 per unit over those who sell to ignorant buyers. This is hardly a stable situation. Enlightened buyers will gain in their resale markets at the expense of ignorant buyers, and those who sell to enlightened buyers will gain at the expense of those who sell to ignorant buyers. Ignorance imposes penalties on buyers (as well as on those who sell to such buyers), and such penalties are a threat to survival in competitive markets. Ignorant buyers would be under great pressure to follow in the footsteps of their enlightened rivals, and those who sell to such buyers would have strong incentives to assist in their enlightenment.[196]

Product differentiation does not change the underlying analysis. Buyers might be ignorant, not only of the benefits of the improved warranty, but of other features of differentiated products in competition with one another. The burdens of buyer ignorance and the difficulties of seller enlightenment are increased if multiple product features must be compared. But in the end, buyers must meet the test of competition in their resale markets. Buyers choosing the best product (price, warranty, and other features considered) will succeed at the expense of rivals making less wise choices; purchasers of inferior products (price, warranty and other features considered) will find themselves threatened in their resale markets. These purchasers (and their suppliers) will be subjected to market pressures to achieve improved price/product combinations, including improved warranty protection when justified by a comparison of costs and benefits.

It might be argued that product development could proceed at a pace so rapid as to preclude market evaluation and acceptance of a superior price/product combination. Assume, as before, that an improvement yielding benefits of $150 is priced at $125 and that ignorant buyers shun the new offering in the mistaken belief that the improvement is not worth the higher price. If the improvement is then superseded by further product developments in a relatively short time, the interval might not be long enough to permit completion of the process of learning and adaptation leading to the domination of the superior price/product combination over inferior price/product

196. One perverse impact may be the attraction of poorly-situated buyers ("lemons") by sellers making more expansive warranties. This problem of adverse selection, however, assumes buyer knowledge. If poorly situated buyers know wherein their interests lie, better situated buyers may be at least as well informed. Moreover, sellers can anticipate, or react to, adverse selection by buyers, and write their warranties so as to minimize or preclude such buyer behavior.

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combinations. Anticipating such a rapid succession of products, a producer might choose not to offer the improvement for fear that the expected life of the product would be insufficient to permit a level of market acceptance necessary to make the strategy of innovation a profitable one.

This is a serious problem in the case of improvements involving changes in the physical characteristics of the product.[197] But the concern about potentially short product life is largely inapplicable to decision-making about improved warranties applicable to particular products. A producer incurs very little cost, and runs almost no risk, in introducing an improved warranty. Unlike changes in the physical characteristics of the product, which almost invariably involve a substitution of the new product for the old, the introduction of a new warranty need not exclude the old one. The producer can offer the old (inferior) warranty at the old price and the new (improved) warranty at the appropriate price increment ($125 in the example given). If buyers respond favorably within the effective life of the product, the improved warranty will gain acceptance in the market. If the product life proves too short to permit such acceptance, the producer incurs a negligible loss (and probably realizes some gain) and buyers who choose the improved warranty clearly derive a benefit. In sum, the producer has everything to gain, and almost nothing to lose, in adopting improved warranties—even in dynamic markets in which the life cycle of the product might be relatively short. For any given product, improved warranties will be offered to buyers whenever a producer perceives that they confer a benefit on the parties in excess of anticipated costs.

ii. Monopolistic Markets

If the seller is an enlightened monopolist, the result is the same—the improved warranty will be provided. Assume, as before, that the initial profit-maximizing price (without the improved warranty) is $1,050. Under the assumptions previously made, the monopolist would impose the improved warranty at a price of $1,175. (At worst, assuming extreme inelasticity of demand, the monopolist would not charge more than $1,200.) At any price below $1,200, the monopolist has the power to ram the improved warranty down the throats of unwilling buyers.[198] The buyers have nowhere else to go; moreover,

197. On the significance of timing in product innovations, compare Winter, *Economic "Natural Selection" and the Theory of the Firm*, 4 YALE ECON. ISSUES 225, 261-67 (1964) with Alchian, *Uncertainty, Evolution and Economic Theory*, 43 J. POL. ECON. 211, 217-21 (1950).

198. Implicit in this observation is the assumption that those who buy from a monopolist,

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they will not be driven out of business nor constrained to buy less product because, whatever their original ignorance, buyers will find that the benefits of the new warranty exceed its costs (by $25 under the assumptions previously made). As long as the monopolist is knowledgeable, both parties will be better off under the improved warranty; warranty responsibility will be efficiently distributed.[199]

Buyer ignorance is a problem only if the buyer is a monopolist in the market in which it engages in resale activity[200] and the seller is *not* a monopolist and cannot unilaterally impose the improved warranty on the buyer. Because the buyer is not subject to competition in its own sales, it cannot be compelled by market pressure to accept the improved warranty; in fact, it might persist in refusing to do so. It should be emphasized that it is contrary to the self-interest of the buyer-monopolist to refuse the improved warranty and to forego the opportunity to reduce the net costs of its operations. A reduction in the costs of a monopolist enables it to reduce price, increase output, and increase profits (assuming a constant demand).[201] This is an example of a "slothful monopolist"—one that engages in inefficient operations but is not subject to market correction as long as its monopoly position is maintained. Nonetheless, because it is in the self-interest of the buyer-monopolist to accept the improved warranty, and because sellers have an interest in achieving the same result, there is good reason to expect that the forces of enlightenment will prevail.

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having some significant investments in their businesses, will not cease operations on the announcement of a new price/product combination, but will continue to operate as long as revenues exceed variable costs. Accordingly, they will have an opportunity to learn of the true costs and benefits of the improved warranty and will not thereafter cease operations.

199. There are two variations on the monopoly theme. First, the monopolist may be facing a highly elastic demand curve. Purchasers might switch to other products rather than pay a higher price for the monopolist's product with the improved warranty. This problem of the "weak monopolist" is indistinguishable from the problem of product differentiation. As previously indicated, purchasers achieving the best price/product combination will succeed at the expense of their rivals in resale markets, putting pressure on these rivals to patronize the "weak monopolist" and to accept the improved warranty if that is in fact the best price/product combination available. *See supra* text following note 196. Only ignorance of market-wide dimensions would preclude such an outcome.

Second, monopoly power may be exercised by several firms acting in concert. This poses no distinctive problems. If the leading firm is knowledgeable, it will adopt and impose on its rivals the most efficient warranty term. *See supra* note 193.

200. "Resale activity" is intended to encompass not only situations in which the buyer incorporates the seller's product in the buyer's product, but also situations in which the seller's product is used by the buyer to provide a commercial service.

201. Assume that the buyer is a profit-maximizing monopolist with an output of 6,000 units, a price of $1,050 per unit, a unit cost of $600, and a total profit of $2,700,000. *See supra* Section IV(C)(1). Assuming the demand schedule there described and a cost reduction of $50 per unit, the results are as follows:

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b. Seller Ignorance

If sellers are ignorant of the advantages of offering an improved warranty, none will do so. In competitive markets, however, this ignorance must be massive in order to pose an impediment. Once a competitor recognizes the advantages, it will become an innovator and offer the improved warranty to knowledgeable buyers. To return to the original example, the innovating seller can offer an improved warranty for $125, providing benefits of $25 to its buyers (the warranty's benefits are worth $150) and benefits of $25 to itself (the cost of the warranty is $100). Other sellers must emulate the innovating seller or lose market share. The process can also be triggered by the entry of an enlightened seller or by the initiative of an enlightened buyer, who offers a "bribe" of $125 to an ignorant seller and explains the mutual advantages of the improved warranty. It is doubtful that massive ignorance among sellers will persist for a prolonged period of time in competitive markets.

Product differentiation presents no distinctive problems. Seller ignorance, whether about one or more product features, will be penalized if buyers are knowledgeable.

If the seller is a monopolist, we are confronted once again with the problem of the "slothful monopolist"—a firm that, because of ignorance or indifference, refuses to introduce an improved warranty that would prove beneficial both to itself and to its customers. (Under assumptions previously made, a monopolist could increase profits from $2,700,000 to $3,010,075 by introducing the improved warranty.) There is no simple solution to this problem except the hope of eventual enlightenment—the monopolist awakens, an enlightened firm enters, or the monopolist responds to the proposals of customers (presumably, a powerful customer could insist on an improved war-

Output	*Price*	*Unit Cost*	*Unit Profit*	*Total Profit*
5800	1,065.00	550	515.00	2,987,000
5900	1,057.50	550	507.50	2,994,250
6000	1,050.00	550	500.00	3,000,000
6100	1,042.50	550	492.50	3,004,250
6200	1,035.00	550	485.00	3,007,000
6300	**1,027.50***	**550**	**477.50**	**3,008,250**
6400	1,020.00	550	470.00	3,088,000
6500	1,012.50	550	462.50	3,006,250

*** Approximate profit-maximizing price.**

At the new profit-maximizing price of $1,025 (arrived at by interpolation), output is 6,337 units (an increase of 337 units), and total profits are $3,010,075 (an increase of $310,075).

Even a monopolist will profit from attaining the lowest net costs of operation. *See* F. SCHERER, *supra* note 192, at 15-16.

ranty).[202] The problem of the slothful monopolist cannot readily be solved in any other manner. This is one of the reasons monopolies are opposed as a matter of public policy. The important thing to recognize is that this is not a problem unique to warranties; the ignorant monopolist may produce the wrong goods, charge the wrong price, use the wrong production techniques, or make any number of errors. The solution is to encourage new entry and to provide competition at the monopolist's level. One redeeming feature of this general configuration is that the more slothful the monopolist, the greater the inducement to new entry. (Of course, if the monopolist is regulated, the regulatory agency can regulate warranty matters along with any other aspects of price and service.)

c. Universal Ignorance

If neither buyers nor sellers are knowledgeable about the advantages of an improved warranty, the warranty will not be offered. Nonetheless, it is difficult to fashion a response to this phenomenon because it is hard to imagine that courts or legislatures will be more enlightened about optimal warranty provisions than competitors, customers, and prospective entrants, all of which focus their energies and risk their fortunes in the market.[203] This scenario is impervious to solution, either public or private, but it is also unlikely to occur in any form other than as an innovation waiting to be discovered.

3. SUMMARY

Contractual allocations of risk between commercial entities are not rendered inefficient because of disparities in bargaining power. In

202. Resistance to change may be aggravated if monopoly power is shared rather than exercised by a single firm. If collusion is overt, there are no additional problems; once the efficient warranty is identified, all firms would agree to adopt it in order to increase aggregate monopoly profits and thereby increase each firm's respective share. But if the firms are pursuing a course of tacit collusion with no explicit communications among them, it is conceivable that an improved warranty could be withheld—even after its beneficial features are recognized by one of the firms participating in the tacit collusion—if variation of product features (including warranty terms) poses a threat to industry-wide adherence to a supracompetitive price. A concern for consensus could therefore delay introduction of an improved warranty. Nonetheless, a number of conditions must be met in order for this impact to be felt, including disparity in the knowledge of the colluding firms and a general fear of the breakdown of consensus pricing. In any case, the industry leader would not be deterred by such considerations because it can impose its price/product combination on its rivals. *See supra* note 193.

203. It is perhaps plausible that a specialized regulatory agency might devise a solution more efficient than any prevailing in the market. Even this contingency seems remote, but in any case the outcome is not troublesome. Market participants have strong incentives to adopt superior solutions, and the non-coercive provision of information by an agency would achieve appropriately efficient results.

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this context, warranty practices are very likely to be efficient whether they are individually negotiated between parties of equal bargaining power or unilaterally imposed by a monopolist or other powerful seller.

Either buyers or sellers may lack knowledge of pertinent risks, and thus fail to appreciate the benefits of an efficient warranty arrangement. But this is not likely to pose a problem if: (1) the buyer's market and the seller's market are both competitive; (2) the seller's market is monopolistic and the seller is knowledgeable; or (3) the buyer's market and the seller's market are both monopolistic and at least one participant is knowledgeable. Ignorance poses a problem in only two cases: both buyers and sellers are ignorant (universal ignorance); or one of the market participants (either seller or buyer) is a "slothful monopolist" and the other participant lacks market power. The first case is unlikely to yield to any solution, either public or private. The second is more properly viewed as a monopoly problem rather than a warranty problem, but even here, the prospects for eventual enlightenment seem promising.

In sum, there are no substantial reasons—whether grounded in concerns over market power or over the ignorance of market participants—for refusing to enforce contractual allocations of risk in sales transactions between commercial entities. To the contrary, there is every reason to expect that market participants will be better informed and more highly motivated than any government agency in efforts to identify and adopt efficient warranty terms.

D. *Fraud, Concealment, and Sharp Practices*

While legislatures and courts are not well suited to determine whether particular warranty provisions are sound or unsound, it is possible to generalize about contracting practices. Fraud, for example, has no redeeming virtues. Resources are consumed in the creation of fraudulent schemes and in the development of measures to protect against them. Society would be better off with no fraud at all, and it is appropriate to react forcefully to fraud. The only restraining influences are: (1) adjudication costs incurred in proving fraud; and (2) possible errors in finding fraud where none exists, thereby undermining legitimate transactions.[204] Courts appear to adopt the appropriate attitude: require clear proof of fraud, but then attack fraud with vigor.[205]

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204. *See* Darby & Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & Econ. 67 (1973).

205. *See, e.g.*, St. Joseph Hosp. v. Corbetta Constr. Co., 21 Ill. App. 3d 925, 316 N.E.2d 51

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