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Recovery for Economic Loss Under a Products Liability Theory: From the Beginning Through the Current Trend

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RECOVERY FOR ECONOMIC LOSS UNDER A PRODUCTS LIABILITY THEORY: FROM THE BEGINNING THROUGH THE CURRENT TREND

INTRODUCTION

Most courts relegate claims for purely economic loss to the realm of contract warranty law. However, when a court states that it does not allow a strict liability in tort recovery for a purely economic loss, it imparts information that, standing alone, is of little value. The manner in which courts distinguish economic loss from other damage must be scrutinized in order to give this generalization meaning.

The classification of an injury[1] into one of three categories is the first step in distinguishing actions which are recoverable in tort from those recoverable in contract. Defective products can cause three types of injury: personal injury, property damage and economic loss. Personal injury results when the defective product causes injury to a person. Property damage results when the defective product causes physical injury to other property.[2] Some courts[3] encompass damage to the product itself within the definition of property damage; other courts[4] relegate such damage to the category of economic loss.

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1. *See* Mead Corp. v. Allendale Mut. Ins. Co., 465 F. Supp. 355 (N.D. Ohio 1979); Sioux City Community School Dist. v. International Tel. & Tel. Corp., 461 F. Supp. 662 (N.D. Iowa 1978); Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc., 136 Ariz. 444, 666 P.2d 544 (1983).

2. *See Mead*, 465 F. Supp. 355; *Sioux*, 461 F. Supp. 662; *Arrow*, 136 Ariz. 444, 666 P.2d 544.

3. *See* Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165 (3d Cir. 1981) (applying Pennsylvania law); Corporate Air Fleet, Inc. v. Gates Learjet, Inc., 589 F. Supp. 1076 (M.D. Tenn. 1984); City of Clayton v. Gruman Emergency Prods., Inc., 576 F. Supp. 1122 (E.D. Mo. 1983); Cloud v. Kit Mfg. Co., 563 P.2d 248 (Alaska 1977); *Arrow*, 136 Ariz. 444, 666 P.2d 544 (applying Arizona law); Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, 306 S.E.2d 253 (1983) (applying Georgia law); Bagel v. American Honda Motor Co., 132 Ill. App. 3d 82, 477 N.E.2d 54 (1985).

4. *See* American Home Assurance Co. v. Major Tool & Mach., Inc., 767 F.2d 446 (8th Cir. 1985). Under Minnesota law, where a component part damages another component part of the same item, it is classified as damage to the product itself, and not as damage to "other" property. Only personal physical injury and damage to other property due to a defective product are compensable under a strict liability in tort theory in Minnesota. *Id.*; James v. Bell Helicopter Co., 715 F.2d 166 (5th Cir. 1983) (where damage to a helicopter that crashed was the only loss sustained by plaintiff, the plaintiff

Economic loss is "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."[5]

Economic loss, which includes items such as cost of repairs, cost of replacement and loss of profits, has two components, direct loss and consequential loss.[6]

> Direct economic loss may be said to encompass damage based on insufficient product value; thus, direct economic loss may be "out of pocket" — the difference in value between what is given and received — or "loss of bargain" — the difference between the value of what is received and its value as represented. Direct economic loss also may be measured by costs of replacement and repair. Consequential economic loss includes all indirect loss, such as loss of profits resulting from inability to make use of the defective product.[7]

Most courts[8] do not allow tort recovery for purely economic loss in the absence of any personal injury or property damage.

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could not recover under strict liability in tort). Under Texas law, "damage to the product itself is essentially a loss to the purchaser or [sic] the benefit of the bargain with the seller. Loss of use and cost of repair of the product are the only expenses suffered by the purchaser." *Id.* at 171 (quoting Mid Continent Aircraft Corp. v. Curry County Spraying Serv., 572 S.W.2d 308, 313 (Tex. 1978)); *Sioux*, 461 F. Supp. 662 (the court barred recovery under strict liability in tort for damage solely to the defective product itself unless evidence of unequal bargaining power exists or the product sustains a non-economic loss injury); State v. Mitchell Constr. Co., 108 Idaho 335, 699 P.2d 1349 (1984).

5. Comment, *Manufacturers' Liability to Remote Purchasers for "Economic Loss" Damages - Tort or Contract?*, 114 U. PA. L. REV. 539, 541 (1966).

6. *See* Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 918 (1966).

7. *Id.* at 918 (citations omitted).

8. *See American Home*, 767 F.2d 446; Henry Heide v. WRH Prods. Co., 766 F.2d 105 (3d Cir. 1985); *James*, 715 F.2d 166; Corporate Air Fleet v. Gates Learjet, Inc., 589 F. Supp. 1076 (M.D. Tenn. 1984); City of Clayton v. Gruman Emergency Prods., 576 F. Supp. 1122 (E.D. Mo. 1983); *Sioux*, 461 F. Supp. 662; Cloud v. Kit Mfg. Co., 563 P.2d 248 (Alaska 1977); Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc., 136 Ariz. 444, 666 P.2d 544 (1983); Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, 306 S.E.2d 253 (1983); *Mitchell*, 108 Idaho 335, 699 P.2d 1349; Bagel v. American Honda Motor Co., 132 Ill. App. 3d 82, 477 N.E.2d 54 (1985); National Crane Corp. v. Ohio Steel Tube Co., 213 Neb. 782, 332 N.W.2d 39 (1983). *But see* Cova v. Harley Davidson Motor Co., 26 Mich. App. 602, 182 N.W.2d 800 (1970) (The commercial purchaser of defective golf carts sustained loss of profit and cost of repair when the carts broke down due to deterioration of their parts. The court held the manufacturer liable in tort for the purely economic loss of the purchaser.); Santor v. Kargheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965); Iacono v. Anderson Concrete Corp., 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975) (Small holes appeared in the consumer's concrete driveway shortly after it

However, the method for categorizing a loss is so varied that a claim not recoverable in tort because it constitutes an economic loss in Idaho[9] may be recoverable in tort in Illinois[10] where it is classified as a claim for property damage.

This Comment will address four aspects of economic loss recovery. Part I will examine the landmark cases that form the basis for divergent views. Part II will look at the history of economic loss recovery. Part III will explore the modern trends in economic loss recovery. In conclusion, Part IV will suggest a unified approach to determine whether a purely economic loss should be compensable under a strict liability in tort theory.

I. THE BEGINNING OF THE CONTROVERSY: THE LANDMARK CASES WHICH FORM THE BASIS OF THE DIVERGENT VIEWS

The controversy over whether economic losses are recoverable under a strict liability in tort theory began with the landmark cases of *Santor v. Karagheusian, Inc.*,[11] and *Seely v. White Motor Co.*[12] In *Santor*, the plaintiff purchased carpeting for his home from a dealer.[13] The carpeting became unaesthetic in appearance due to certain defects,[14] causing Santor to suffer a purely economic loss.[15] Santor sued the manufacturer of the carpeting for breach of implied warranty, seeking the difference between the price he paid and the actual

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was poured. The court held that the manufacturer of the concrete was liable to the consumer under a strict liability theory for the purely economic loss.); Berg v. General Motors Corp., 87 Wash. 2d 584, 555 P.2d 818 (1976).

9. For an example of Idaho case law on this issue, see *Mitchell*, 108 Idaho 335, 699 P.2d 1349. The court held that where the only damage was to the roof itself, the plaintiff could not recover damages for the repair of the roof under a strict liability in tort theory.

10. Two of the leading Illinois cases in this area are Vaughn v. General Motors Corp., 102 Ill. 2d 431, 466 N.E.2d 195 (1984), and Moorman Mfg. Co. v. National Tank Co., 91 Ill. 2d 69, 435 N.E.2d 443 (1982). The approach taken by the Illinois court is in accord with the approach taken by the Pennsylvania court in Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165 (3d Cir. 1981); *see infra* notes 75-83 and accompanying text.

11. 44 N.J. 52, 207 A.2d 305 (1965).

12. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

13. *Santor*, 44 N.J. at 53, 207 A.2d at 307.

14. *Id.*

15. *Id.*

market value as damages. The Supreme Court of New Jersey held that the plaintiff could maintain a breach of warranty claim against the manufacturer despite the lack of privity between them.[16]

In dicta, the *Santor* court stated that the plaintiff also possessed a cause of action for strict tort liability.[17] In essence, the court said that strict liability in tort was applicable to a purely direct economic loss fact situation when the victim is the ultimate consumer. This tort doctrine, in the view of the court, was the long-awaited mechanism to overcome privity of contract requirements and for the ultimate consumer to gain relief from the manufacturer of an unsatisfactory product.[18]

> The obligation of the manufacturer thus becomes what in justice it ought to be — an enterprise liability, and one which should not depend upon the intricacies of the law of sales. The purpose of such liability is to insure that the cost of injuries or damage, either to the goods sold or to other property, resulting from defective products, is borne by the makers of the products who put them in the channels of trade, rather than by the injured or damaged persons who ordinarily are powerless to protect themselves.[19]

The *Santor* court espoused the view that this doctrine should not be limited to cases of personal injury, but should apply even where the damage from the defective product was to the product itself or to the possessor's other property.[20] Significantly, the court defined a defective product as one "not reasonably fit for the ordinary purposes for which such articles are sold or used,"[21] a contrast from the unreasonably dangerous[22] language of section 402A of the Restatement

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16. *Id.*

17. *Id.* at 63, 207 A.2d at 311.

18. *Id.* at 65, 207 A.2d at 311.

19. *Id.* at 64-65, 207 A.2d at 311-12.

20. *Id.* at 65, 207 A.2d at 312. The court reasoned: "[A]lthough the doctrine has been applied principally in connection with personal injuries sustained by expected users from products which are dangerous when defective . . . the responsibility of the maker should be no different where damage to the article sold or to other property of the consumer is involved." *Id.* (citation omitted).

21. *Id.* at 66, 207 A.2d at 313.

22. The New Jersey court rejected the "unreasonably dangerous" requirement of RESTATEMENT (SECOND) OF TORTS § 402A (1965), in Suter v. San Angelo Foundry & Mach. Co., 81 N.J. 150, 174-77, 406 A.2d 140, 149-51 (1979). The court stated that a jury in a strict liability action would be charged in terms of whether the product was

(Second) Of Torts.[23] In toto, the *Santor* court viewed the doctrine of strict liability in tort as having a wide breadth of applicability, spilling over into an area of damages once under the sole domain of contract law.

The *Seely* court took exception to this broad application of the strict liability in tort doctrine as espoused by the court in *Santor*.[24] In dicta, the *Seely* court stated that a strict liability in tort theory should never be used to recover for purely economic loss, as the failure of the product to perform to a party's expectations is a concept grounded in contract, not tort.[25] Judge Traynor, writing for the court, stressed the significance of the delineation between contract law and tort law:

> 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 designed to meet the consumer's demands. *A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury* when he buys a product on the market. *He can, however, be fairly charged with the risk that the product will not match his economic expectations* unless the manufacturer agrees that it will. Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone.[26]

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reasonably fit, suitable and safe for its intended or foreseeable purposes when inserted by the defendant into the stream of commerce and, if not, whether as a result damage or injury was incurred by the contemplated users or others who might reasonably be expected to come in contact with it. *Id.*

23. The decisions in both *Santor* and *Seely* pre-date the adoption of § 402A.

24. The court opined: "We are of the opinion, however, that it was inappropriate to impose liability . . . in the *Santor* case, for it would result in imposing liability without regard to what representations of quality the manufacturer made." *Seely*, 63 Cal. 2d at __, 403 P.2d at 151, 45 Cal. Rptr. at 23.

25. *Id.* at __, 403 P.2d at 151, 45 Cal. Rptr. at 23.

26. *Id.* at __, 403 P.2d at 151, 45 Cal. Rptr. at 23 (emphasis added).

On the basis of this reasoning, the Supreme Court of California held that the plaintiff could recover lost profits and the purchase price on the basis of the express warranty between the parties, but denied the plaintiff's strict liability in tort claim for these items.[27]

In *Seely*, the plaintiff purchased a truck manufactured by the White Motor Company for use in his heavy-duty hauling business.[28] White expressly warranted the truck to be free of defects.[29] The truck was afflicted with a condition known as "galloping," which caused it to bounce violently.[30] This defective condition was not corrected, despite many efforts by the dealer to do so.[31] About eleven months after the purchase date, the truck's brakes failed and the truck overturned.[32] The plaintiff was not injured, but the truck sustained physical damage.[33] The plaintiff brought suit for repair costs, loss of profits due to loss of normal use of the truck, and return of the purchase price.[34]

The court denied the plaintiff recovery for the cost of repairing the truck. Recovery was denied not because the damage was to the defective product itself and not because the repair costs were classified as a purely economic loss, but because the plaintiff failed to prove that a defect in the truck caused the accident.[35] Significantly, the *Seely* court stated that "[p]hysical injury to property is so akin to personal injury that there is no reason for distinguishing them."[36] Thus, the

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27. *Id.* at __, 403 P.2d at 148-49, 45 Cal. Rptr. at 20-21.
28. *Id.* at __, 403 P.2d at 147, 45 Cal. Rptr. at 19.
29. *Id.* at __, 403 P.2d at 148, 45 Cal. Rptr. at 20.
30. *Id.* at __, 403 P.2d at 147, 45 Cal. Rptr. at 19.
31. *Id.* at __, 403 P.2d at 147, 45 Cal. Rptr. at 19.
32. *Id.* at __, 403 P.2d at 147, 45 Cal. Rptr. at 19.
33. *Id.* at __, 403 P.2d at 147, 45 Cal. Rptr. at 19.
34. *Id.* at __, 403 P.2d at 147-48, 45 Cal. Rptr. at 19-20.
35. *Id.* at __, 403 P.2d at 152, 45 Cal. Rptr. at 24. Explaining its refusal to allow recovery in this instance, the court stated:

> Plaintiff contends that, even though the law of warranty governs the economic relations between the parties, the doctrine of strict liability in tort should be extended to govern physical injury to plaintiff's property, as well as personal injury. We agree with this contention. Physical injury to property is so akin to personal injury that there is no reason for distinguishing them. In this case however, the trial court found that there was no proof that the defect caused the physical damage of the truck.

Id. at __, 403 P.2d at 152, 45 Cal. Rptr. at 24 (citations omitted).
36. *Id.* at __, 403 P.2d at 152, 45 Cal. Rptr. at 24.

Seely court would have granted the plaintiff recovery of the cost of repairing the truck itself under a strict liability theory if the plaintiff had proved that a defect in the truck caused the accident.

The crux of the distinction between the decision in *Santor* and that in *Seely* thus rests in their disagreement over which *type* of risk is recoverable under a strict liability theory and not in the *item* for which a damage recovery is claimed. The plaintiffs in both *Santor* and *Seely* sought recovery for damages which are typically classified as economic losses[37] — loss of the bargain (*Santor*) and repair costs (*Seely*). The losses in both *Santor* and *Seely* occurred when the product itself was damaged. The *Seely* court was not adverse to allowing a strict liability recovery where only the product itself was damaged. The distinction, therefore, lies in the type of risk which the buyer of the product sustained. In *Seely*, the defect in the truck allegedly posed a sudden, unreasonable risk of physical injury to both the plaintiff and to the truck itself. In *Santor*, the carpeting was not defective or unreasonably dangerous, and did not pose a sudden risk of physical injury to the plaintiff or the carpeting itself. Rather, the plaintiff in *Santor* incurred the risk of unfulfilled economic expectations. The nature of the risk has played an important role in the developing case law.

II. THE OVERLAP OF TORT AND CONTRACT: THE RATIONALE FOR KEEPING THEM DISTINCT

The tort theory of products liability has its roots in contract law, growing out of the contract cause of action for breach of warranty.[38] The doctrine of strict liability in a products liability fact situation was formulated in *Greenman v. Yuba Power Products, Inc.*[39] The *Greenman* court held that a manufacturer is strictly liable when a defective product placed on the market causes personal injury.[40] The court stated that where strict liability is not assumed by agreement of the par-

37. *See supra* notes 5-7 and accompanying text.

38. *See* Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165, 1168 (3d Cir. 1981). *See generally* W. PROSSER & W. KEETON, HANDBOOK OF THE LAW OF TORTS § 97 (5th ed. 1984).

39. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

40. *Id.* at 60, 377 P.2d at 900, 27 Cal. Rptr. at 700.

ties but is imposed by law, the liability, even if arising out of an implied warranty, is governed by the law of tort.[41] Recovery under strict products liability was broadened to allow recovery for property damage by section 402A of the Restatement (Second) of Torts, which states: "One who sells any product in a defective condition unreasonably dangerous to the user or consumer *or to his property* is subject to liability for physical harm thereby caused to the ultimate user or consumer, *or to his property*."[42]

Prior to the *Greenman* decision,[43] in the absence of proof of the manufacturer's negligence, a person physically injured by a defective product had only a cause of action for breach of warranty.[44] As a result, a physically injured victim, who was not in privity of contract with the manufacturer or who failed to comply with the breach of warranty notice requirements, lacked a remedy against the manufacturer of the defective product.[45] Even where courts dropped the privity and notice requirements, "[o]nly by some violent pounding and twist-

41. *Id.* at 61, 377 P.2d at 901, 27 Cal. Rptr. at 701.

42. RESTATEMENT (SECOND) OF TORTS § 402A (1965) (emphasis added). Section 402A provides:

Special Liability of Seller of Product for Physical Harm to User or Consumer.

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if

(a) the seller is engaged in the business of selling such a product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of his product, and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

43. As a result of the decision in *Greenman* and the adoption of § 402A by most states, a plaintiff seeking damages caused by a defective product has three alternative causes of action against the manufacturer. These are negligence in tort, strict liability in tort and breach of warranty. W. PROSSER & W. KEETON, *supra* note 38, § 98.

44. *See* Santor v. Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965). *See generally* W. PROSSER & W. KEETON, *supra* note 38, § 98.

45. *See generally Greenman*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697; W. PROSSER & W. KEETON, *supra* note 38, §§ 97-98.

ing"[46] could the warranty doctrine be made to meet the plight of individuals injured by defective products.[47]

While breach of warranty and products liability evolved from common ground, they are premised on different public policy rationales. Tort law has traditionally been a means of compensation for injury to a person or property, with the obligation to compensate the victim being imposed by law.[48] Contract law is concerned with the bargain the parties enter into by mutual agreement; the obligation to comply with the agreement rests in the bargain itself.[49] Differing policies of risk allocation underlie the two theories.[50]

Contract warranty law protects the expectation interests that arise out of these bargains, providing a remedy where the product fails to perform as expected or is not of a quality fit for ordinary use.[51] Products liability law allows a consumer

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46. Seely v. White Motor Co., 63 Cal. 2d 9, __, 403 P.2d 145, 149, 45 Cal. Rptr. 17, 21 (1965) (quoting Patterson, *The Apportionment of Business Risks Through Legal Devices*, 24 COLUM. L. REV. 335, 358 (1924)). For affirmation of this view, see Ketterer v. Armour & Co., 200 F. 322, 323 (S.D.N.Y. 1912), where the court stated that "[t]he remedies of injured consumers ought not to be made to depend upon the intricacies of the law of sales." *See generally* Prosser, *The Fall of the Citadel*, 50 MINN. L. REV. 791 (1966); Prosser, *The Assault Upon the Citadel*, 69 YALE L.J. 1099 (1960).

47. The Uniform Commercial Code contains three provisions, § 2-715(2)(b), § 2-318 and § 2-719(3), which allow recovery for physical harm to purchasers under a warranty theory.

48. For interesting discussions of the differences between tort and contract law, see generally Dundee Cement Co. v. Chemical Laboratories Inc., 712 F.2d 1166 (7th Cir. 1983) (applying Illinois law); Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165 (3d Cir. 1981) (applying Pennsylvania law); Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp., 626 F.2d 280 (3d Cir. 1980) (applying Illinois law); Corporate Air Fleet v. Gates Learjet, Inc., 589 F. Supp. 1076 (M.D. Tenn. 1984); Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976).

49. *See* cases cited *supra* note 48.

50. The public policy rationale of strict liability in tort is to protect the consumer and allocate loss to the manufacturer, the entity most able to bear the risk. *See* Scandinavian Airlines Sys. v. United Aircraft Corp., 601 F.2d 425, 428 (9th Cir. 1979).

51. One court contrasted the policy distinctions between contract and tort law as follows:

> The gist of a products liability tort case is not that the plaintiff failed to receive the quality of product he expected, but that the plaintiff has been exposed, through a hazardous product, to an unreasonable risk of injury to his person or his property. On the other hand, contract law, which protects expectation interests, provides the appropriate set of rules when an individual wishes a product to perform a certain task in a certain way, or expects or desires a product of a particular quality so that it is fit for ordinary use.

Pennsylvania Glass, 652 F.2d at 1169 (footnotes omitted).

who is not in privity of contract with the manufacturer to recover for personal injury and property damage caused by a defective, unreasonably dangerous product.[52] Recovery for a reduction in the value of the product due to an inherent defect is classified as an economic loss and lies in contract law. Recovery for physical harm to a person due to a hazardous product lies in tort.

The basis of products liability is to place the cost of the injury from the defective product on the manufacturer, the entity best able to bear the cost and spread the risk.[53]

> The purpose of such liability is to ensure that the cost of injuries or damages, either to the goods sold or to other property, resulting from defective products, is borne by the makers of the products . . . rather than by the injured or damaged persons who ordinarily are powerless to protect themselves.[54]

In contrast, contract warranty law allows commercial parties of equal bargaining power to allocate the risk of a loss between themselves. A party to a commercial contract may choose to forego a remedy in exchange for a lower purchase price.[55] In any event, commercial parties of equal bargaining power are deemed able to protect themselves from economic loss due to a product that does not perform to their expectations.[56]

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52. *See generally* Wade, *Is Section 402A of the Second Restatement of Torts Preempted by the UCC and Therefore Unconstitutional?*, 42 TENN. L. REV. 123 (1979).

53. The price of the product thus reflects the manufacturer's absorption of this cost. As one court explained:

> The imposition on manufacturers of strict liability for defective products accomplishes the cost internalization that the price mechanism cannot achieve by placing the complete cost of the injuries on the manufacturer. In turn, the manufacturer can allocate a portion of that cost to the purchasers of its products in the form of higher prices.

Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp., 626 F.2d 280, 288 (3d Cir. 1980) (footnotes omitted).

54. Santor v. Karagheusian, Inc. 44 N.J. 52, ___, 207 A.2d 305, 312 (1965).

55. Uniform Commercial Code § 2-316 creates the seller's power to limit his liability. *See generally* Note, *supra* note 6, at 959-61, 965.

56. The mechanism for this self-protection lies in the fact that the price of the product will reflect the amount of protection bargained for. As one court explained:

> The original purchaser, particularly a large company . . . can protect itself against the risk of unsatisfactory performance by bargaining for a warranty. Alternatively, it may choose to forgo warranty protection in favor of a lower purchase price for the product. Subsequent purchasers may do likewise in bargaining over the price of the product. In any event, because persons other than the owner of the product will not incur economic losses resulting from the prod-

The tort theory of strict liability expressed in section 402A of the Restatement (Second) of Torts, and the contract theory of warranty articulated in sections 2-314 and 2-315 of the Uniform Commercial Code, do overlap.[57] However, most courts delineate those losses compensable under tort theory from those compensable under contract. Some courts justify this delineation on the ground that allowance of a recovery for a purely economic loss under a strict liability theory would not only infringe upon the Code, but emasculate it.[58] Essentially the doctrine of strict liability in tort, which does not permit a manufacturer to limit its liability by waiver or agreement, would infringe upon the principles of sales transactions set forth in the Code.[59] "The extension of strict liability to cover economic losses in effect would make a manufacturer the guarantor that all of its products would continue to perform satisfactorily throughout their reasonably productive life."[60]

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uct's poor performance, the costs associated with economic loss will likely be reflected in the price of the product.

Jones & Laughlin,, 626 F.2d at 288-89.

57. Even though the two modes of recovery overlap, the field of warranty has been zealously safe-guarded as a distinct area. As one court stated:

> Although strict liability in tort developed out of the law of warranties, the courts of most states have recognized that the principles of warranty law remain the appropriate vehicle to redress a purchaser's disappointed expectations when a defect renders a product inferior or unable adequately to perform its intended function. . . . These courts have classified the damages consequent to qualitative defects, such as reduced value, return of purchase price, repair and replacement, or lost profits, as economic loss, and have relegated those who suffer such commercial loss to the remedies of contract law.

Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, __, 306 S.E.2d 253, 256 (1983) (quoting Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165, 1169-73 (3d Cir. 1981)).

58. *See* American Home Assurance Co. v. Major Tool & Mach., Inc., 767 F.2d 446 (8th Cir. 1985).

59. See Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective Product Cases*, 18 STAN. L. REV. 974, 989 (1966), where the author states:

> It is striking that those who would use tort law to protect consumers in defective product cases do so with only the most cursory explicit recognition that there may already be a body of law directed toward regulating the rights of buyers and sellers, and a statutory body at that. The courts are operating at the border of an area considered by draftsmen at great length and framed in legislation arguably relevant to the cases before the courts. Yet, those judges appear either unaware of the merging of the tort and sales lines or else unwilling to consider the possible limitations legislation may impose on traditional judicial primacy in tort law.

Id.

60. *Jones & Laughlin*, 626 F.2d at 289.

In contrast, the Code allows parties to limit or eliminate their liability for economic losses, providing a comprehensive statutory scheme to fill the needs of commerce.[61] Based on the different policies underlying the two theories, some courts allow for recovery of purely economic loss under a strict liability in tort theory and others do not.

III. THE MODERN TRENDS IN ECONOMIC LOSS RECOVERY

A court that states it does not allow recovery for a purely economic loss imparts information which, standing alone, is of little value.[62] The largest discrepancy in what the term "economic loss" includes arises in a situation where the only harm alleged is to the product itself.[63]

Where the defective product alone is damaged, some courts classify this damage as economic loss. These courts bar recovery under a strict liability in tort theory unless there is personal injury or damage to property other than the product. According to these courts,[64] damage to the product alone is economic loss and not compensable under a strict liability in tort theory.

Other courts allow recovery under strict liability in tort where only the product itself is damaged. These courts ascertain whether the damage constitutes property damage or mere economic loss.[65] However, where the damage to the product falls within the constraints of property damage, the claim is compensable under a strict liability theory. Where the damage is classified as an economic loss, recovery in tort is barred.

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61. *Id.*

62. The question of what constitutes an economic loss is important because many courts do not allow for the recovery of economic loss in a product liability action. Whether courts construe RESTATEMENT (SECOND) OF TORTS § 402A (1965) broadly or narrowly often determines whether or not they allow recovery for economic loss. Thus, the issue of what constitutes property damage under § 402A is often before the courts.

63. The courts utilize three approaches to the economic loss issue. For a breakdown of the courts by category, see Jones & Laughlin Steel Corp. v. Johns-Mansville Sales Corp., 626 F.2d 280 (3d Cir. 1980).

64. See cases cited *supra* note 4 for a listing of courts which do not allow recovery in strict liability in tort for damage only to the product itself.

65. See cases cited *supra* note 3 for courts which do allow recovery under some circumstances, in strict liability tort, for damage only to the product itself.

In contrast, the New Jersey court permits strict liability in tort recovery for economic loss. Traditionally, the New Jersey court has not paid great attention to whether the damage sustained falls into one category or the other; recovery is permitted in either event.[66] Courts which bar recovery in tort for pure economic loss, however, devote a major portion of each strict liability decision to categorizing the loss.

Two cases decided by the Alaska Supreme Court illustrate the court's painstaking delineation of property damage from economic loss. In both cases the defective product was a mobile home and the only damage sustained was to the product itself. The Alaska Supreme Court, however, resolved the cases differently, rejecting the plaintiffs' strict liability theory in *Morrow v. New Moon Homes, Inc.*,[67] but allowing the plaintiffs to recover under a strict liability theory in *Cloud v. Kit Manufacturing Co.*[68]

In *Morrow*, the plaintiffs alleged that the mobile home they had purchased was defectively manufactured. The defects in the home, including a leaky roof, cracked windows and an inoperable furnace, became apparent over time.[69] The defects did not pose a risk of physical injury to the plaintiffs or their property, and the loss of the benefit of their bargain was the only damage suffered by the plaintiffs.

In *Cloud*, the plaintiffs purchased a mobile home that came equipped with polyurethane carpet padding. The mobile home was suddenly and calamitously destroyed by fire when the foam padding was ignited by a heating unit.[70] Although the plaintiffs did not suffer physical injuries, the nature of the defect posed a risk to their safety. The court classified the loss as property damage.

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66. *See* Cinnaminson Township Bd. of Educ. v. United States Gypsum Co., 552 F. Supp. 855 (D.N.J. 1982); Suter v. San Angelo Foundry & Mach. Co., 81 N.J. 150, 406 A.2d 140 (1979); Santor v. Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965).

67. 548 P.2d 279 (Alaska 1976).

68. 563 P.2d 248 (Alaska 1977).

69. *Morrow*, 548 P.2d at 281-82.

70. *Cloud*, 563 P.2d at 249. The plaintiffs alleged that the padding was defective due to its highly flammable nature. *Id.* Additionally, they alleged that the mobile home itself was defectively designed because it also was of a highly flammable nature. *Id.*

The distinction between the two cases is that *Morrow* involved a "lemon" and *Cloud* involved an unsafe product.[71] The *Cloud* court noted that deterioration and qualitative defects should be considered economic loss while sudden and calamitous damage should be recoverable in tort because it results in property damage.[72]

In *Cloud*, the sudden, violent nature of the damage was the determinative factor in classifying the loss as property damage. Several other courts also limit recovery for damage to the product itself to situations where the damage occurred as a result of a sudden, violent event.[73] These courts' rationale for this emphasis on accidents is based on the distinction authorities have drawn between property damage and economic loss:

> When the defect causes an accident "involving some violence or collision with external objects," the resulting loss is treated as property damage. On the other hand, when the damage to the product results from deterioration, internal

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71. *Cloud*, 563 P.2d at 251. While the mobile homes in both cases were alleged to be defectively manufactured, the defects resulted in different types of harm. *Id.*

72. *Id.*

73. A sudden, violent event has been a predominent consideration of the court in several cases. For interesting discussions on the significance of this factor, see Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, 306 S.E.2d 253 (1983). Under Georgia law, recovery for damage to the defective product itself is allowed under a strict liability theory only where the damage occurs through an accident. *Id.* at __, 306 S.E.2d at 254. "An 'accident' should be defined as a sudden and calamitous event which, although it may only cause damage to the defective product itself, poses an unreasonable risk of injury to other persons or property." *Id.* at __, 306 S.E.2d at 257. Another case, City of Clayton v. Gruman Emergency Prods., Inc., 576 F. Supp. 1122 (E.D. Mo. 1983), contains an informative discussion on violent occurrences. Under Missouri law, the seller of a defective product is liable for damage to the product itself only if the product was damaged by a violent occurrence. *Id.* at 1124-25.

In *Cloud*, 563 P.2d 248, the court identified factors relevant in drawing the line between property damage and economic loss: "We cannot lay down an all inclusive rule to distinguish between the two categories; however, we note that *sudden and calamitous damage will almost always result in direct property damage and that deterioration, internal breakage and depreciation will be considered economic loss.*" *Id.* at 251 (footnote omitted) (emphasis added).

In Moorman Mfg. Co. v. National Tank Co., 91 Ill. 2d 69, 435 N.E.2d 443 (1982), the court distinguished property damage from economic loss by focusing on the cause of the loss. "When the defect causes an accident 'involving some violence or collision with external objects,' the resulting loss is treated as property damage. On the other hand, when the damage to the product results from deterioration, internal breakage, or other non-accidental causes, it is treated as economic loss." *Id.* at 83, 435 N.E.2d at 449 (citations omitted).

breakage, or other non-accidental causes, it is treated as economic loss.[74]

A. The Pennsylvania Glass *Three-Factor Approach*

The occurrence of an accident is still a determining factor considered by courts when classifying damage. The modern trend, however, is moving away from a single factor analysis, such as examining how the damage occurred. Instead, the trend is toward analyzing the interrelationship of three factors: the manner in which the damage occurred, the nature of the defect, and the type of damage alleged.[75] This three-factor approach was first utilized in *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*,[76] and represented a radical departure from the traditional approach of classifying damage by the type of items (*e.g.*, repairs, loss of profit, replacement cost) for which recovery was sought. Each of the three *Pennsylvania Glass* factors should be examined separately to give meaning to the analysis.

FACTOR ONE: In analyzing the manner in which the damage occurred, courts distinguish damage sustained in a sudden, violent or calamitous occurrence from damage which develops over a period of time.[77] Damage from defects that cause accidents of "violence or collision with external objects" is more apt to create the traditional tort injuries of physical harm to persons and other property. A vehicular collision, a fire, an explosion and the collapse of a building have all been classified as violent, calamitous events,[78] whereas damage

74. Note, *supra* note 6, at 918.

75. These factors resolve the question of whether a defect renders a product unsafe or whether it makes a product ineffective. An unsafe product invokes the safety insurance policy of tort law while an ineffective product invokes the expectation bargain protection policy of warranty law. Pennsylvania Glass Sand v. Caterpillar Tractor Co., 652 F.2d 1165 (3d Cir. 1981) (applying Pennsylvania law).

76. *Id.*

77. Where the damage develops over a period of time, the resulting damage is categorized as an economic loss. In *Moorman*, a feed processor sued the manufacturer of a grain storage tank under a strict liability theory for damage resulting from a crack in the tank. The court found that the crack developed over a period of time and was an economic loss. *Moorman*, 91 Ill. 2d 69, 435 N.E.2d 443.

78. *See* Gibson v. Reliable Chevrolet, Inc., 608 S.W.2d 471, 473-74 (Mo. App. 1981) (the court defined a calamitous event as one likely to threaten traditional tort injuries of bodily harm or damage to other nearby property — such as occurs in a case involving unreasonably dangerous products).

caused by a tornado has not been classified as a violent occurrence. Tornado damage is inflicted by an outside force and not by an unreasonably dangerous defect inherent in the product.[79] In general, sudden and calamitous damage to the product itself is classifed as property damage; damage which develops over a period of time is considered an economic loss.

FACTOR TWO: A defect in a product can be qualitative or quantitative. A quantitative defect poses a dangerous, unreasonable *risk* of injury to persons or their property. The existence of a quantitative defect invokes the manufacturer's responsibility to guard against making a product which entails risk of personal injury or property damage — the principle underlying tort law.[80]

A qualitative defect, on the other hand, causes a product to deteriorate, suffer internal breakage or otherwise fail to perform its function due to a non-accidental cause.[81] A qualitative defect poses no risk of physical harm to persons or their property. It impacts upon the victim's pocketbook, disappointing his expectations, failing to live up to the bargain supposedly made,[82] invoking the "buyer beware" concerns which underlie contract law. Qualitative defects result in economic loss; quantitative defects result in property damage.

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79. *See* Clevenger & Wright Co. v. A.O. Smith Harvestore Prods., Inc., 625 S.W.2d 906, 909 (Mo. App. 1981) (The court denied the plaintiff recovery under a strict liability in tort theory where his silo was damaged by a tornado. The court suggested that while the tornado was violent, the concept of "violent occurrence" must be limited to the kind of damage caused in situations similar to cases of unreasonably or "imminently dangerous" products).

80. *"Accordingly, tort law imposes a duty on manufacturers to produce safe items, regardless of whether the ultimate impact of the hazard is on people, other property, or the product itself."* Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, __, 306 S.E.2d 253, 256 (1983) (emphasis in original).

81. A loss from a non-accidental cause occurred in City of Clayton v. Gruman Emergency Prods., Inc., 576 F. Supp. 1122, (E.D. Mo. 1983) where the plaintiff purchased a fire truck which inexplicably developed a lop-sided appearance. Soon after, the plaintiff discovered numerous cracks in the frame of the truck. *Id.* at 1123. The court characterized the cause of the damage as "mere deterioration or internal breakage due to a defect in the product" as the truck had not been damaged by a collision. *Id.* at 1125-26 (quoting *Gibson*, 608 S.W.2d at 474).

82. The issue of a qualitative defect was encountered in Bagel v.American Honda Motor Co., 132 Ill. App. 3d 82, __, 477 N.E.2d 54, 58 (1985), where the plaintiff purchased a used motorcycle. Two years later, the engine ceased to function while the motorcycle was idling in plaintiff's garage. The court barred a recovery under strict liability because the damage did not occur in a manner which posed an unreasonable

FACTOR THREE: The type of damage alleged may range from a solely pecuniary loss to pecuniary loss coupled with the risk of personal harm or physical damage to other property. Again, the underlying concepts of tort and contract come into play.[83] Where the resulting damage creates a safety risk, property damage is involved. Where the resulting damage creates only a risk to the victim's pocketbook, economic loss is involved.

The *Pennsylvania Glass* court draws the line between tort and contract by analyzing the inter-relationship of these factors. Where the factors indicate that safety or insurance issues are involved, the remedy lies in tort. Where the factors indicate that expectation of the bargain issues are implicated, the remedy lies in contract.

B. Hybrid Cases: Straddling the Tort-Contract Line

The *Pennsylvania Glass* three-factor approach has been utilized by courts in Illinois,[84] Arizona[85] and Georgia.[86]

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risk of injury to the plaintiff or his property. The only loss was to the plaintiff's disappointed commercial expectations. *Id.*

Other cases where a qualitative defect caused the plaintiff to suffer a benefit-of-the-bargain loss include: Morrow, 548 P.2d 279 (defects made trailer unsuitable; court disallowed tort recovery); Long v. Jim Lette Oldsmobile, Inc., 135 Ga. App. 293, 217 S.E.2d 602 (1975) (buyer may not recover in tort the reduced value of car which overheated); Nobility Homes v. Shiver, 557 S.W.2d 77 (Tex. 1977) (plaintiffs sought damages for the reduced value of a mobile home that proved uninhabitable because of a leaky roof, gaping floors and poorly installed door and windows).

83. The court in *Pennsylvania Glass* concluded that the type of damage alleged was not conclusive on the issue of whether a loss was recoverable in tort or in contract:

> In drawing this distinction, the items for which damages are sought, such as repair costs, are not determinative. Rather, the line between tort and contract must be drawn by analyzing interrelated factors such as the nature of the defect, the type of risk, and the manner in which the injury arose. These factors bear directly on whether the safety-insurance policy of tort law or the expectation-bargain protection policy of warranty law is most applicable to a particular claim.

Pennsylvania Glass, 652 F.2d at 1173.

84. *Bagel*, 132 Ill. App. 3d 82, 477 N.E.2d 54. The court inquired into the type of damage alleged, the nature of the defect and the manner in which the damage occurred. *Id.* at __, 477 N.E.2d at 58.

85. Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc., 136 Ariz. 444, 666 P.2d 544 (1983). The court stated: "Each case must be considered on its own facts bearing in mind the purposes of tort law recovery as contrasted with contract law." *Id.* at __, 666 P.2d at 548.

86. Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, 306 S.E.2d 253 (1983) (applying Georgia law).

While it represents a major step forward in drawing the line between tort and contract recoveries, it has already proved unwieldy in certain fact situations.

Some difficulty in applying the *Pennsylvania Glass* approach has been encountered by courts faced with "hybrid" cases where the fact situations straddle the line between economic loss and property damage. To date, four of these hybrid cases have been decided. Three cases[87] involve the use of asbestos products in school buildings, and the fourth[88] involves a compound contained in the mortar of a building.

In all three asbestos cases, the courts found that the use of asbestos products in the construction of schools posed a grave, unspeculative health hazard and thus raised the safety concerns underlying the tort theory of strict liability.[89] However, when the courts applied the *Pennsylvania Glass* three-factor test, the defect possessed qualities common to both tort and contract law. For instance, the only actual damage sustained was an economic loss, the cost of replacing the asbestos.[90] Additionally, the damage did not occur in a sudden or violent manner. On the other hand, the nature of the defect was quantitative in that the asbestos posed a dangerous, unreasonable risk of harm to persons.

The courts also noted that the defect in the asbestos not only rendered the product itself valueless, but also rendered other property worthless, as the repair process necessitated re-

87. Cinnaminson Township Bd. of Educ. v. United States Gypsum Co., 552 F. Supp. 855 (D.N.J. 1982); School Dist. of Lancaster v. ASARCO, No. 1414, slip op. (Philadelphia C.P. Dec. 6, 1983); Area Vocational Tech. Bd. v. National Gypsum Co., No. 119, slip op. (Lancaster C.P. Sept. 7, 1983).

88. Philadelphia Nat'l Bank v. Dow Chem. Co., 605 F. Supp. 60 (E.D. Pa. 1985).

89. The court in *Cinnaminson* stated:

> *In the instant case, the problem with USG's product is not that it did not perform its function in the ceiling plaster, but rather that it posed a grave risk of personal injury to those in contact with it. Thus, the manufacturer's responsibility to guard against making a product which entails risk of personal harm or property damage, a major concern underlying the doctrine of strict liability in tort, is involved in this case.* The case does not primarily involve a problem with the product which mandates its replacement or repair in order to perform its function, or a loss of profit stemming from a defect in the product's performance, but rather the replacement of the product because of a grave personal safety risk.

Id. at 859 (emphasis added).

90. *Cinnaminson*, 552 F. Supp. at 856; *ASARCO* No. 1414, slip op.; *National Gypsum*, No. 119, slip op.

moval of ceilings and walls.[91] The courts resolved this dilemma by moving away from adherence to the calamitous injury requirements and instead based their decisions on the policy underlying tort law, holding that plaintiffs could recover under the strict liability in tort theory.[92]

The court in *Philadelphia National Bank v. Dow Chemical Co.*[93] also based its decision on the policy underlying tort law. In *Philadelphia National*, the plaintiff alleged that the Dow product, Sarabond, which was incorporated into the mortar of the Philadelphia National Bank building, caused damage to the building's infrastructure and cracking of the masonry on the exterior of the building.[94] Again, the court was faced with a "hybrid" case. On one hand, the damage did not occur in a sudden or violent manner, and the only actual damage was the cost of repair and loss of use. On the other hand, the crumbling mortar and falling bricks posed a real *risk* of injury to passers-by and other property.[95]

Confronted with a dilemma because this case did not involve a sudden, violent occurrence, the *Philadelphia National* court questioned whether *Pennsylvania Glass* intended to maintain a calamitous injury as a prerequisite to a tort recovery.[96] The court noted that *Pennsylvania Glass* spoke of the *risk* of harm to people and property and the *exposure* of the plaintiff to such a risk.[97] Specifically, the defective product in

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91. *Cinnaminson*, 552 F. Supp. at 859; *ASARCO*, No. 1414, slip op. *National Gypsum*, No. 119, slip op.

92. *But see* National Crane Corp. v. Ohio Steel Tube Co., 213 Neb. 782, 332 N.W.2d 39 (1983). The Nebraska court held that replacement costs incurred to prevent a defective product from causing potential future physical harm were not recoverable in tort. The court noted that the plaintiff did not raise fifteen actual product failures, one which involved a death, in its complaint. *Id.* at __, 332 N.W.2d at 44.

93. 605 F. Supp. 60 (E.D. Pa. 1985).

94. *Id.* at 61.

95. Judge Newcomer, writing for the *Philadelphia Nat'l* court, drew a distinction between the risk sustained in the *Pennsylvania Glass* case and the risk sustained in the Pennsylvania asbestos cases:

> In the asbestos cases, as in the case before me, the product itself is inherently dangerous to people. No outside intervention is required to make the defective [product] hazardous. In [*Pennsylvania Glass*]. . . the defect became hazardous only upon the occurrence of some unrelated danger such as a sudden fire or a storm.

Id. at 64 n.5.

96. *Id.* at 62-63.

97. *Id.* at 63.

Pennsylvania Glass posed a serious risk of harm to people, even though no one was actually injured.[98] The court also noted that one Pennsylvania case[99] has rejected the requirement of a calamitous injury as an essential element of a strict liability in tort claim where only the defective product itself is injured. The court concluded: "Pennsylvania would permit recovery in tort where an allegedly defective construction project causes injury to other components used in construction and creates a real, unspeculative risk of harm to passers-by on the street below."[100]

When *Morrow*, *Cloud*, *Pennsylvania Glass* and *Philadelphia National* drew the line between property damage and economic loss, they were in essence redrawing the line between tort and contract. These decisions suggest that a new approach is required in evaluating whether an economic loss is compensable under a strict liability tort theory. When these decisions are coupled with the decisions in *Spring Motors Distributors, Inc. v. Ford Motor Co.*[101] and *Henry Heide, Inc. v. WRH Products Co.*,[102] the possibility of a new way out of the tort-contract maze becomes more apparent.

C. Santor *Revisited and Limited*

In *Spring Motors*,[103] the New Jersey Supreme Court sharply limited its decision in *Santor v. Karagheusian, Inc.*. The court held that a commercial buyer seeking damages for economic loss caused by a defective product could not recover under a strict liability in tort theory.[104] The court also abol-

98. *Id.*

99. The requirement of a sudden calamitous injury was rejected as an element of a strict liability in tort claim in Pennsylvania by the court in Area Vocational Tech. Bd. v. National Gypsum Co., No. 119, slip. op. (Lancaster C.P. Sept. 7, 1983).

100. *Philadelphia Nat'l*, 605 F. Supp. at 64.

101. 98 N.J. 555, 489 A.2d 660 (1985).

102. 766 F.2d 105 (3d Cir. 1985) (applying New Jersey law).

103. The plaintiff purchased a fleet of trucks which had defective transmissions. The plaintiff did not claim that the trucks were unreasonably dangerous or that they caused physical injury. *Spring Motors*, 191 N.J. Super. at __, 489 A.2d at 663-64.

104. *Id.* at __, 489 A.2d at 663. The New Jersey Supreme Court stated:

> We hold that a commercial buyer seeking damages for economic loss resulting from the purchase of defective goods may recover from an immediate seller and a remote supplier in a distributive chain for breach of warranty under the U.C.C., but not in strict liability or negligence. We hold also that the buyer need

ished the privity requirement in actions for breach of warranty.[105]

In *Henry Heide*,[106] the federal court of appeals, applying New Jersey law, agreed with the district court that New Jersey differentiates economic losses suffered by consumers from those suffered by commercial entities:

> For noncommercial entities, such as consumers, there is often no private allocation of the risk of loss, and if there were, it would be unfair to place the risk of loss on the consumer rather than the manufacturer given the unequal resources and bargaining positions of the parties. Thus, in those circumstances, public policy will allocate the risk of loss to the better riskbearer through the doctrines of strict liability and negligence. When commercial parties *of equal bargaining power* allocate the risk of loss by contract, however, there is a strong public policy to give effect to the private allocation. Under the U.C.C., commercial parties can allocate the risk of loss from defects through warranties, disclaimers and limitations on warranties.[107]

The importance of these two decisions does not lie in their limitation of a purely economic loss recovery to a non-commercial buyer.[108] After all, the *Santor* court itself applied its decision to a fact situation where the victim was an ultimate consumer. Rather, these decisions are significant because they

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not establish privity with the remote supplier to maintain an action for breach of express or implied warranties.

Id. at __, 489 A.2d at 663.

105. *Id.* at __, 489 A.2d at 663.

106. The plaintiff purchased plastic candy trays which did not suit the purpose for which he bought them. The allegedly defective product was not unreasonably dangerous. *Henry Heide*, 766 F.2d at 107-08.

107. *Id.* at 109 (emphasis added).

108. Justice Peters, concurring and dissenting in Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965), also suggested that the characterization of the buyer should be determinative in deciding whether damages were recoverable in tort or contract. *Id.* at __, 403 P.2d at 156-57, 45 Cal. Rptr. at 28-29.

> The majority recognize that the rules governing warranties were developed to meet the needs of "commercial transactions." If this is so, then why not look to the *transaction* between the buyer and the seller and see if it was a "commercial" transaction rather than a sale to an ordinary consumer at the end of the marketing chain? How can the nature of the damages which occur *later*, long after the transaction has been completed, control the characterization of the transaction? Any line which determines whether damages should be covered by warranty law or the strict liability doctrine should be drawn at the time the sale is made.

Id. at __, 403 P.2d at 156, 45 Cal. Rptr. at 28 (emphasis in original).

are based on the distinct policies underlying tort and contract law. Indeed, the *Spring Motors* court recognized the Uniform Commercial Code as "the *exclusive source* for ascertaining when a seller is subject to liability for damages if the claim is based on intangible economic loss not attributable to physical injury to person or harm to a tangible thing other than the defective product itself."[109]

In contrast, prior to these decisions, the New Jersey court applied the doctrine of strict liability in tort, rather than warranty law, to hold a manufacturer accountable for placing a defective product in the stream of commerce in situations where privity of contract was absent.[110] The New Jersey court, by abolishing the privity requirement in breach of warranty actions and by basing its latest decision on the distinction between the policies underlying tort law and the Code, has thus moved closer toward the approaches followed by courts adhering to *Seely v. White Motor Co.*[111]

The United States Supreme Court has not addressed the issue of economic loss recovery under a products liability theory in a land-based case. However, the Court has held that in admiralty law, a products liability claim does not exist where a commercial party alleges injury only to the product itself where the injury results in purely economic loss.[112]

In *East River S. S. Corporation v. Transamerica Delaval*,[113] the corporation chartered four ships, each one equipped with a turbine which Delaval designed, manufactured and installed.[114] When the ships were put into service, the turbines malfunctioned, causing injury only to the turbines themselves. The East River S. S. Corporation sought damages for the cost

109. *Spring Motors*, 191 N.J. Super. at __, 489 A.2d at 673 (quoting W. PROSSER & W. KEETON, *supra* note 38, § 95A (emphasis in original)).

110. The New Jersey Court "has consistently emphasized that the basis for the [strict liability] doctrine and the reason for holding the manufacturer liable to purchasers who are not in privity is simply that a manufacturer should be accountable for damages resulting from placing a product which is defective in the stream of commerce." *Spring Motors*, 191 N.J. Super at __, 465 A.2d at 540.

111. The plaintiffs in *Spring Motors* and *Henry Heide* would also have been denied tort recoveries under the *Pennsylvania Glass* approach. *Pennsylvania Glass* would allow a commercial buyer to recover under strict liability, but only where the product created an unreasonable risk to safety. *Pennsylvania Glass*, 652 F.2d at 1175.

112. East River S.S. Corp. v. Transamerica Delaval, 106 S. Ct. 225 (1986).

113. *Id.*

114. *Id.* at 2296.

of repairing the ships and for income lost while they were out of service.[115]

The Court held that admiralty jurisdiction applied.[116] The Court incorporated the principles of products liability into admiralty law as its threshold decision.[117]

Next, the Court addressed the issue of whether a commercial product injuring only itself is the kind of harm against which public policy requires manufacturers to protect, independent of any contractual duty.[118] The Court noted that in this case there was no damage to any property other than the turbines themselves.[119]

The Court found that the land-based approach to whether economic loss should be recoverable under a products liability theory encompasses a wide spectrum of positions.[120] The Court, exercising traditional discretion in admiralty,[121] adopted an approach similar to that espoused in *Seely*,[122] and held that a manufacturer in a commmercial relationship has no duty under a products liability theory to prevent a product from injuring itself.[123] However, the Court did not reach the issue of whether a tort cause of action can be stated in admiralty when the only damages sought are economic.[124]

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115. *Id.* at 2297.

116. *Id.* at 2298.

117. *Id.* at 2299.

118. *Id.* at 2300.

119. *Id.* While the components of the turbine damaged the turbine itself, the court stated that since each turbine was supplied by Delaval as an integrated package, each turbine is properly regarded as a single unit. *Id.*

120. *Id.* The Court chose not to adopt the minority or intermediate land-based positions, stating:

> The intermediate positions, which essentially turn on the degree of risk, are too indeterminate to enable manufacturers easily to restructure their business behavior. Nor do we find persuasive a distinction that rests on the manner in which the product is injured . . . . Even where the harm to the product itself occurs through an abrupt, accident-like event, the resulting loss due to repair costs, decrease values and lost profits is essentially the failure of the purchase to receive the benefit of its bargain — traditionally the core concern of contract law.

Id. at 2302.

121. *Id.*

122. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

123. *East River*, 106 S. Ct. at 2302.

124. *Id.* at 2302 n.6.

D. Wisconsin's Position on Economic Loss Recovery

While some courts have actively formulated a policy on economic loss recovery in strict products liability, the Wisconsin court has not yet formulated such a policy. The Supreme Court of Wisconsin established Wisconsin as a member of the majority of states which allow a strict liability in tort recovery for property damage existing without personal injury in *City of La Crosse v. Schubert*.[125] The city hired the Schubert architectural firm to design and construct a roof for an elementary school.[126] The roof leaked and subsequently blew off,[127] damaging the roof eaves.[128] The city sought the cost of replacing the roof itself and the cost of repairing the eaves as damage under a strict liability in tort action, alleging that the roof was defectively designed.[129]

The court held that the city was entitled to recover damages for both the roof and the eaves.[130] In dicta, the court, relying upon *Santor* as authority, espoused the opinion that Wisconsin would also allow recovery for a purely economic loss in a strict liability in tort action.[131]

In *Leadfree Enterprises v. United States Steel Corp.*,[132] the Court of Appeals for the Seventh Circuit ignored the dicta in *City of La Crosse* and concluded that Wisconsin law precludes recovery for purely economic loss in products liability.[133] Applying Wisconsin law, the court further held that plaintiffs who lacked a property interest in a product were barred from

125. 72 Wis. 2d 38, 240 N.W.2d 124 (1976). The Wisconsin Supreme Court allowed recovery for damages to property and its component part in a cause of action based on strict product liability. In City of Franklin v. Badger Ford Truck Sales, 58 Wis. 2d 641, 207 N.W.2d 855 (1973), a defective wheel on a fire truck caused the truck to topple, yielding damage to both the fire truck and the wheel itself. The court allowed recovery for repair and replacement of the defective wheel (the component part) and for damages to the fire truck (the property).

126. *City of La Crosse*, 72 Wis. 2d at 40, 240 N.W.2d at 125.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.* at 43, 240 N.W.2d at 127.

131. *Id.* at 45, 240 N.W.2d at 127.

132. 711 F.2d 805 (7th Cir. 1983).

133. *Id.* at 808. The court distinguished *City of La Crosse* as allowing recovery for economic loss only where there is damage to other property as well as to the product itself. *Id.* at 809.

a recovery under a strict liability in tort theory.[134] The court noted that section 402A of the Restatement (Second) of Torts, adopted by Wisconsin in *Powers v. Hunt-Wesson Foods, Inc.*,[135] limits liability for property damage "to property owned by the plaintiff."[136]

The economic loss issue was next addressed in *Twin Disc v. Big Bud Tractor, Inc.*,[137] where an intermediate manufacturer of tractors contracted to purchase tractor transmissions from Big Bud. Due to a delay in the delivery of the transmissions, Twin Disc incurred loss of profits. The federal district court denied Twin Disc a recovery for this purely economic loss.[138]

The Seventh Circuit Court of Appeals affirmed, stating that it was unable to predict what Wisconsin courts would do when presented with the fact situation of this case.[139] Significantly, this case dealt with two commercial entities who had the benefit of contractual remedies under the Uniform Commercial Code. The Wisconsin courts have not addressed the issue of whether a tort remedy should be available in a commercial transaction or whether recovery is available for damage to the product itself in the absence of personal injury or injury to other property.[140]

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134. *Id.* at 808.

135. 64 Wis. 2d 532, 219 N.W.2d 393 (1974); *see* Dippel v. Sciario, 37 Wis. 2d 443, 155 N.W.2d 55 (1967).

136. *Leadfree*, 711 F.2d at 808.

137. 772 F.2d 1329 (7th Cir. 1985).

138. Twin Disc v. Big Bud Tractor, Inc., 582 F. Supp. 208, 213 (E.D. Wis. 1984). The tort claim was dismissed because Big Bud was not an ultimate consumer, not because the alleged injury was of a purely economic nature. Significantly, the court said Wisconsin allows recovery for economic losses in tort. *Id.*

139. *Twin Disc*, 772 F.2d at 1333-34.

140. *Seely*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17. Whether Wisconsin courts allow for recovery in strict liability in tort where only the product itself is damaged is not clearly settled. The Wisconsin Supreme Court in *City of La Crosse* stated in dicta that a strict liability claim for pure economic loss involving the cost of repair or replacement of the product itself and loss of profits is not demurrable. *City of La Crosse*, 72 Wis. 2d at 40, 240 N.W.2d at 125. Further, it cited the case of Air Prods. and Chems. v. Fairbanks, 58 Wis. 2d 193, 206 N.W.2d 414 (1983), as standing for the proposition that economic loss damages, equal to the cost of repair and loss of profits of the product, are recoverable in a strict liability action. *City of LaCrosse*, 72 Wis. 2d at 38, 240 N.W.2d at 127. However, upon a thorough reading, the *Air Prods.* decision was not adopted as precedent in Wisconsin. The *Air Prods.* court stated: "The parties seek only that this court apply Pennsylvania law in determining the outcome of this question and, therefore, it would seem that any further extensions of the doctrine [of strict product

IV. RESOLUTION OF THE CONTROVERSY: A UNIFIED APPROACH

Most of the controversy over allowance of economic loss recovery surrounds the courts' attempts to draw the line between property damage and economic loss in cases where the plaintiff is seeking compensation for damage to the defective product itself. A unified approach has yet to be adopted by the courts in drawing this line.

Courts currently resolve four major areas of the economic loss question in diverse ways. The areas of greatest divergence include: whether to allow recovery for damage to the defective product itself; whether a calamitous event is required; whether tort remedies should be extended to commercial buyers; and whether recovery for damage to the product should include consequential losses.

The first factor to consider is whether recovery should be allowed under strict liability where the only damage is to the product itself. Notably, only a minority of courts[141] do not allow recovery under strict liability where the only damage is to the product itself. These courts have misinterpreted *Seely v. White Motor Co.* In *Seely*, Justice Traynor recognized that recovery under strict liability may apply to the product itself.[142] Additionally, Dean Prosser, in distinguishing between economic loss and physical injury, stated that "[t]here can be no doubt that the seller's liability for negligence covers any kind of physical harm, including not only personal injuries, but also property damage to the defective chattel itself, as

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liability] in Wisconsin will have to await consideration until another day." *Air Prods.*, 58 Wis. 2d at 216, 206 N.W.2d at 426.

The federal district court in *Twin Disc* cited A. E. Inv. Corp. v. Link Builders, Inc., 62 Wis. 2d 479, 490, 214 N.W.2d 764, 770 (1974), as standing for the proposition that Wisconsin allows recovery for economic loss in tort. *Twin Disc*, 582 F. Supp. at 213. However, *A. E. Inv.* was based on a negligence theory, not a strict liability theory.

141. *See* cases cited *supra* note 4.

142. The plaintiff in *Seely* was denied a tort recovery for the repair of his truck because he failed to prove that a defect in the truck caused the accident. Seely v. White Motor Co., 63 Cal. 2d 9, __, 403 P.2d 145, 152, 45 Cal. Rptr. 17, 24. For a subsequent decision where the California Supreme Court allowed recovery for damage to the product itself, see Gherna v. Ford Motor Co., 246 Cal. App. 2d 639, 55 Cal. Rptr. 94 (1966) (auto destroyed in fire caused by defective part).

where an automobile is wrecked by reason of its own bad brakes."[143]

The majority of courts[144] have already construedsection 402A of the Restatement (Second) of Torts to allow recovery for damage to the defective product itself as property damage in certain instances.[145] Hence, as a first step, all courts should consider allowing recovery where the only damage is to the defective product itself.

Next, where a defective product causes actual injury in a sudden, violent or calamitous manner to a person, to property or to the item itself, recovery should be available under strict liability in tort. Most courts do require the occurrence of an accident[146] where the only damage is to the product itself; even courts which have adopted the *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.* three-factor approach[147] consider a sudden, violent occurrence to be a determinative factor.[148] However, neither actual injury nor a sudden, violent, calamitous occurrence should be essential elements for a successful claim under a strict liability in tort theory.[149]

Not only should a calamitous occurrence be dropped as a prerequisite for tort recovery, but there should be no need to await the occurrence of actual physical damage to persons or

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143. W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 101, at 665 (4th ed. 1971).

144. *See* cases cited *supra* note 3.

145. *See, e.g.*, Kassab v. Central Soya Corp., 432 Pa. 217, 246 A.2d 848 (1968):

> The language of the Restatement, speaking as it does of injury to either the individual or his property, appears broad enough to cover practically all of the harm that could befall one due to a defective product. Thus, for example, were one to buy a defective gas range which exploded, ruining the buyer's kitchen, injuring him, and of course necessitating a replacement of the stove itself, all of these three elements of the injury should be compensable. The last, replacing the stove, has been sometimes referred to as "economic loss".... There would seem to be no reason for excluding this measure of damages in an action brought under the Restatement, since *the defective product itself is as much 'property' as any other possession of the plaintiff that is damaged as a result of the manufacturing flaw.*

Id. at __, 246 A.2d at 854-55 n.7 (citation omitted) (emphasis added).

146. *See* cases cited *supra* notes 73-79 and accompanying text.

147. *See* cases cited *supra* notes 84-86 and accompanying text.

148. *See* cases cited *supra* notes 73-79 and accompanying text.

149. *See* cases cited *supra* notes 87-99 and accompanying text.

property.[150] Proof that a product poses an unreasonable risk of harm, as in the asbestos cases,[151] should be sufficient.[152] To date, the issue of a defective product which poses an "unspeculative risk" of harm has only arisen in building component cases.[153] In these cases, a defective, unreasonably dangerous product, incorporated into the structure of a building, endangered lives and required removal of the product from the buildings.

Admittedly, allowing recovery for potential damage may open the door to spurious claims. However, courts should be able to formulate a reasonable stopping point using the "unspeculative risk" standard[154] set forth in *Philadelphia National Bank v. Dow Chemical Co.*.[155] Clearly, where there is no actual damage, recovery in tort must be limited to those cases

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150. Justice Traynor stated that whether the plaintiff is entitled to a recovery under a strict liability theory should not be based on the fortuitousness of his suffering a personal injury. *Seely*, 63 Cal. 2d at __, 403 P.2d at 151, 45 Cal. Rptr. at 23. Justice Peters, concurring and dissenting in *Seely*, stated,

> I cannot rationally hold that the plaintiff whose vehicle is destroyed in an accident caused by a defective part may recover his property damage under a given theory while another plaintiff who is astute or lucky enough to discover the defect and thereby avoid such an accident cannot recover for other damages proximately caused by an identical defective part. The strict liability rule should apply to both plaintiffs or to neither. They cannot be validly distinguished.

Id. at __, 403 P.2d at 154 n.2, 45 Cal. Rptr. at 26 n.2.

151. *See* cases cited *supra* note 87.

152. The requirement that an actual injury occur before a tort action arises is contrary to the principles underlying tort law. *See* Cinnaminson Township Bd. of Educ. v. United States Gypsum Co., 552 F. Supp. 855, 859 (D.N.J. 1982) (risk of latent defect placed on manufacturer, thus encouraging production of a safer product). *See generally* Note, *Comparative Contribution and Strict Tort Liability: A Proposed Reconciliation*, 13 CREIGHTON L. REV. 889 (1980) (consumer compensation, risk distribution and deterrence of defective products form the rationale of products liability). *Butsee* National Crane Corp. v. Ohio Steel Tube Co., 213 Neb. 782, 332 N.W.2d 39 (1983) (no recovery without physical injury).

153. *See* cases cited *supra* notes 87 & 93.

154. *See* cases cited *supra* notes 93-100 and accompanying text.

155. 605 F. Supp. 60 (E.D. Pa. 1985). The majority in *Seely* feared that if recovery were allowed in strict liability cases for economic loss, "the manufacturer would be liable for damages of unknown and unlimited scope." *Seely*, 63 Cal. 2d at __, 403 P.2d at 150-51, 45 Cal. Rptr. at 22. Justice Peters, concurring and dissenting in *Seely*, suggests that this fear is unwarranted as the term "defective" in the strict liability doctrine should be viewed as co-extensive with the well-defined and limitable concept of "unmerchantable" in the implied warranty cases. *Id.* at __, 403 P.2d at 156, 45 Cal. Rptr. at 28.

where the defect in the product manifests itself in a manner which imperils the *physical* safety of persons or property.

The next factor to consider is whether a commercial entity should be able to recover in tort for an economic loss incurred as a result of a defective product. In *Pennsylvania Glass*, the court was willing to permit a commercial consumer to recover in tort.[156] Many other courts have also permitted a commercial consumer to recover under a products liability theory for damage to the defective product itself.[157] However, the New Jersey court, which established the very liberal economic loss recovery policy in *Santor v. Karagheusian, Inc.*,[158] was not willing to extend this policy to commercial buyers.[159]

A commercial consumer who unknowingly buys a hazardously defective product should not be restricted to a contract remedy. A manufacturer has a duty to produce safe products, and one of the objectives of products liability is to place the risk of an unreasonably dangerous product on the manufacturer.[160] The underlying rationale is to encourage the manufacturer to produce safe products.[161] This rationale exists whether the purchaser is an ordinary consumer or a commercial entity.

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156. Pennsylvania Glass Sand Corp v. Caterpillar Tractor Co., 652 F.2d 1165, 1175 (3d Cir. 1981).

157. James v. Bell Helicopter Co., 715 F.2d 166 (5th Cir. 1983) (plaintiff, a corporation, provides helicopter services in U.S.); *Pennsylvania Glass*, 652 F.2d 1165 (plaintiff owns quarry); *Philadelphia Nat'l*, 605 F. Supp. 60 (plaintiff owner of bank building); Corporate Air Fleet, Inc. v. Gates Learjet, Inc., 589 F. Supp. 1076 (M.D. Tenn. 1984) (two corporations involved as plaintiffs); Mead Corp. v. Allendale Mut. Ins. Co., 465 F. Supp. 355 (N.D. Ohio 1979); Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc., 138 Ariz. 444, 666 P.2d 544 (1983) (plaintiff a corporation); Vulcan Materials Co. v. Driltech, Inc., 251 Ga. 383, 306 S.E.2d 253 (1983) (plaintiff owns and operates rock quarry); Moorman Mfg. Co. v. National Tank Co., 90 Ill. 2d 69, 435 N.E.2d 443 (1982) (plaintiff a commercial feed processor); Cova v. Harley Davidson Motor Co., 26 Mich. App. 602, 182 N.W.2d 800 (1970) (plaintiff a golf course owner).

158. 44 N.J. 52, 207 A.2d 305 (1965).

159. Henry Heide, Inc. v. Writ Prods. Co., 766 F.2d 105, 109 (3d Cir. 1985). The New Jersey Supreme Court stated that the extension of tort recovery to a commercial entity is justifiable only where the buyer lacks equal bargaining as the entity is then in the same hapless position as the ultimate consumer. Santor v. Karagheusian, Inc., 45 N.J. 52, 207 A.2d 305 (1965).

160. *See supra* notes 53, 56 & 80 and accompanying text.

161. *See supra* 38-61 notes and accompanying text; Ghiardi, *Two-Way Casualty Between Insurance and Liability*, 69 MARQ. L. REV. 33, 42-45 (1985) (insurance availablity impacts liability); Note, *supra* note 6 (insurance affects recovery).

Courts which bar commercial consumers from recovery in products liability need to shift the focus of their inquiry. Whether a plaintiff is entitled to a recovery under strict liability should be based on the nature of the claim and not on the nature of the plaintiff.

Finally, once a recovery is permissible under a strict liability in tort theory, traditional tort remedies should be available, even where the only damage is to the product itself. Where the fact situation comports with the policy reasons underlying tort,[162] the victim should be compensated for losses, no matter what type of damage is alleged.[163] There is no rational basis for allowing a person physically injured by a defective product to recover for consequential losses while not allowing a plaintiff with property rights in a defective product to recover for consequential losses.[164]

CONCLUSION

This Comment has traced the economic loss recovery controversy from the time of its inception to modern courts' most recent attempts at its resolution. It has examined what various courts mean when they bar recovery for a purely economic loss under a strict liability theory. Finally, it has proposed a unified approach to the determination of whether a particular loss should be recoverable under a strict liability theory.

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162. *See supra* notes 47-61 and accompanying text.

163. The courts which allow recovery for damage to the defective product itself are not in agreement on which items are recoverable. In Corporate Air Fleet, Inc. v. Gates Learjet, Inc., 589 F. Supp. 1076, 1081 (M.D. Tenn. 1984), the court allowed recovery for repair cost, but barred recovery for loss of use. In contrast, the Ohio court in *Mead* stated that indirect economic losses, such as loss of business, were compensable under a strict liability tort theory. Mead Corp. v. Allendale Mut. Ins. Co., 465 F. Supp. 355, 366 (N.D. Ohio 1979).

164. *See* cases cited *supra* notes 20, 35 & 137 and accompanying text; *Seely*, 63 Cal. 2d at __, 403 P.2d at 155, 45 Cal. Rptr. at 27 (Peters, J., concurring and dissenting). *But see* Note, *supra* note 6, at 964-66.