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The Preemption and Economic Loss Provisions of the Ohio Product Liability Code

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THE PREEMPTION AND ECONOMIC LOSS PROVISIONS OF THE OHIO PRODUCT LIABILITY CODE

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I. INTRODUCTION

In January 1988, Ohio passed legislation reforming its civil justice system and revising its insurance laws.[1] Within this omnibus measure was a package of provisions establishing a scheme of statutory rules of decision for product liability cases.[2] This collection of rules is referred to in this article as the "Code" or "Code scheme,"[3] and should be distinguished from the provisions of the Uniform Commercial Code (the "U.C.C.").[4]

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1. Ohio Civil Justice Reform Act, OHIO REV. CODE ANN. §§ 2307.71-.80, 2315.20-.21 (Anderson 1991).

2. The scheme was achieved through the enactment of sections 2307.71-.80 and 2315.20-.21 and by amendments to section 2315.19. OHIO REV. CODE ANN. §§ 2307.71-.80, 2315.19-.21 (Anderson 1991). As a civil action, a product liability claim would be subject to those provisions of the Ohio Civil Justice Reform Act relating to civil actions generally. *See, e.g., id.* §§ 1775.41, 2125.02, 2307.31, 2315.18-.19.

3. The product liability provisions in the Ohio Civil Justice Reform Act do not constitute a true code. They do not wholly displace existing law nor require the courts to construe matters anew, irrespective of prior interpretations. They operate in much the same fashion as the provisions of the Uniform Commercial Code in the sense that they are a collection of statutes providing comprehensive guidelines for a particular problem area. *See* Wade, *Tort Liability for Products Causing Physical Injury and Article 2 of the U.C.C.*, 48 MO. L. REV. 1, 5 (1983).

4. OHIO REV. CODE ANN. §§ 1301-1309 (Anderson 1979 & Supp. 1991).

Aside from fashioning a statutory remedy for certain products cases, the Code makes two major changes in the basic structure of Ohio's product liability law. First, the Code gives preemption status to its remedy for harm treated by the Code as personal injury and physical damage to property other than the product involved.[5] Second, the Code allows claimants who have suffered harm to use its strict tort provisions to recover compensatory damages for any economic loss proximately resulting from the product defect causing the harm.[6] Such economic loss is defined to include direct, incidental or consequential damages, which include damage to the product itself and nonphysical damage to other property.[7]

This article addresses the Code's preemption provisions and the economic considerations inevitably connected with giving commercial purchasers and users the ability to deploy the Code's strict tort apparatus to recover all the forms of economic loss possible where a defective product also has produced physical injury. The preemption issue is given brief, but favorable treatment. The Code's replacement of the

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5. Preemption is achieved through the directive in section 2307.72(A) that any recovery of compensatory damages based on a product liability claim is subject to sections 2307.71-.79. OHIO REV. CODE ANN. § 2307.72(A) (Anderson 1991). The definition of a "property liability claim" consists of six elements: (1) a civil action; (2) seeking recovery from a manufacturer or supplier; (3) for death, physical injury to person, emotional distress, or physical damage to property, other than the product in question; (4) arising from; (5) defects in; (6) a product. *Id.* § 2307.71(M). "Manufacturer" is defined as "a person engaged in a business to design, formulate, produce, create, make, construct, assemble, or build a product or a component of a product." *Id.* § 2307.71(I). "Product" means

> any object, substance, mixture, or raw material that constitutes tangible personal property and that satisfies all the following:
>
> (a) It is capable of delivery itself, or as an assembled whole in a mixed or combined state, or as a component or ingredient;
>
> (b) It is produced, manufactured, or supplied for introduction into trade or commerce;
>
> (c) It is intended for sale or lease to persons for commercial or personal use.

Id. § 2307.71(L)(1). Human blood, organs and tissue are not "products." *Id.* § 2307.71(L)(2). The conditions rendering a product actionable are production defects, design defects, warning and instruction defects, and nonconformance to manufacturer's representations. *Id.* §§ 2307.74-.77. Product liability claims for punitive damages are subject to sections 2307.72-.80 of the Ohio Revised Code. *Id.* § 2307.72

Individual attention must be given to product liability claims implicating products, including hazardous or toxic substances, capable of producing liability for actual or potential contamination or pollution of the environment under federal or state statutory or decisional law. Product liability claims brought under sections 2307.71-.80 do not supersede, modify or otherwise affect any state or federal statutory or common law that relates to liability for contamination or pollution of the environment. *Id.* § 2307.72(D)(1). The apparent intent of this provision is that where appropriate, a product liability claim may be brought under sections 2307.71-.80, but this coverage has no preemptive effect on environmental claims arising under any other provision of state or federal law. *See* S. DARLING, OHIO CIVIL JUSTICE REFORM ACT 53 (1987).

6. OHIO REV. CODE ANN. § 2307.79 (Anderson 1991).

7. *Id.* § 2307.71(B).

common law welter of doctrines and theories pertinent to personal injury and related cases with a single, integrated product liability remedy is a sensible reform.[8] This article, however, takes issue with the wisdom of giving commercial parties the authority to use strict tort remedies to recover all economic loss generated in a product liability episode.

The criticism of the Code's economic loss provision is presented in two articles. This article articulates the policy objections to the wholesale commitment of strict tort remedies for the recovery of economic loss in commercial cases. There are three layers of relationships variously involved in the marketing of commercial products. This article concludes that, when viewed from the perspective of each layer, the Code, with its strict tort approach to liability, achieves results contrary to those that would flow from a policy conscious application of tort and contract doctrine.[9] This feature of the Code reflects too little input from contract values and perspectives[10] and injects strict tort concepts into the economic area of product liability more deeply than is generally proposed in modern product liability reform.[11] The result is yet another instance of the erosion of the authority of contract.[12]

The second article addresses the mechanical problems which arise when remedies contrived to deal with the risk of physical endangerment are applied to economic disputes among commercial parties. It further

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8. *See infra* notes 13-20 and accompanying text.

9. *See infra* notes 210-23 and accompanying text.

10. *See* Shanker, *Strict Tort Theory of Products Liability and the Uniform Commercial Code: A Commentary on Jurisprudential Eclipses, Pigeonholes and Communication Barriers*, 17 WESTERN RES. L. REV. 5 (1965). As early as 1965, Professor Shanker was contending that because of the unjust results stemming from the U.C.C.'s privity and notice requirements, the strict tort theory was beginning to eclipse the warranty provisions of the U.C.C. He expressed the view that neither the U.C.C. warranty provisions nor the strict tort provisions were, by themselves, sufficient to cover the substantive area of products liability in its entirety. *Id.* at 11. In order to remedy this inadequacy, Shanker proposed that the courts should apply both contract and tort theories and establish a "blend" theory rather than merely pigeonholing the individual theories. *Id.* at 37. In his words, "[t]he main purpose of the article is to register a plea that the courts reject — while they may still do so—any doctrine urging the independence of one body of products liability law from the other." *Id.* at 11.

This article contends that a proper blend is not achieved by a massive extension of tort into the commercial products area through the use of the parasitic damage rule. Too many contract concepts are arbitrarily set aside by this process.

11. *See* MODEL UNIFORM PRODUCTS LIABILITY ACT § 102(D)-(F) (1979); UNIFORM PRODUCT SAFETY ACT OF 1988 § 214 (1988).

12. In *The Death of Contract*, Professor Grant Gilmore argues that the common law theories of tort law have been eroding the provisions of contract law since its outset. G. GILMORE, THE DEATH OF CONTRACT (1974). In his view, "[o]n its own terms . . . the theory of contract, as formulated by Holmes and Williston, seems to have gone into its protracted period of breakdown almost from the moment of its birth." *Id.* at 57. He argues further that "[c]lassical contract theory might well be described as an attempt to stake out an enclave within the general domain of tort. The dykes which were set up to protect the enclave have, it is clear enough, been crumbling at a progressively rapid rate." *Id.* at 87.

reveals that the strict tort concepts and systems arrayed in the Code cannot effectively be applied to disputes involving expectation and derivative losses. Significant deficiencies exist in standards both articulating seller wrongdoing and contouring seller defenses. The following are among the problems connected with this abortive effort: the awkwardness of supervising expectation disputes with physical risk standards; the inadequacy of tort damage concepts for economic shortfalls; the paucity of tort principles for orchestrating the voluntary transfer of the risk of economic loss; the inadequacy of strict tort affirmative defenses in economic matters; and the inappropriateness of tort statute of limitation techniques.

II. THE STRUCTURAL CHANGES

A. Preemption

The Code instructs that all product liability claims seeking recovery for harm are subject to its provisions.[13] While other interpretations can be made of this language, it is apparent that the General Assembly intended to give the Code remedy sole authority over the product liability circumstances to which it internally applies.[14] Any other reading would create a foolish and chaotic tangle of difficult to reconcile remedies.[15]

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13. OHIO REV. CODE ANN. § 2307.72(A) (Anderson 1991).

14. Positing that any recovery of damages based on a particular claim is subject to the substantive law requirements detailing the elements of that claim is a rather elliptical way of saying that any claim seeking particular damages must be based on a specific theory of recovery. Notwithstanding this indirectness, the evidence is that the Code remedy preempts all the theories that were viable remedies prior to the enactment of the Code. S. DARLING, *supra* note 5, at 52-53. For an illustration of a more straightforward expression of preemption, see MODEL UNIFORM PRODUCTS LIABILITY ACT § 103(A) (1979).

15. Prior to the enactment of the product liability code arrayed in sections 2307.71-.80 of the Ohio Revised Code, a plaintiff in privity with the defendant seeking damages for personal injuries caused by an intrinsic defect in a product could properly assert a claim under the theories of implied warranty, strict liability, and negligence. Lonzrick v. Republic Steel Corp., 6 Ohio St. 2d 227, 218 N.E.2d 185 (1975) (implied warranty claim); Temple v. Wean United, Inc., 50 Ohio St. 2d 317, 364 N.E.2d 267 (1977) (strict liability claim); Bowling v. Heil Co., 31 Ohio St. 3d 277, 511 N.E.2d 373 (1987) (negligence claim). Such a plaintiff also would be able to assert an implied warranty claim under the Ohio Revised Code. OHIO REV. CODE ANN. § 1302.27 (Anderson 1991) (breach of implied warranty of merchantability); *Id.* § 1302.28 (breach of implied warranty of fitness for a particular purpose). Plaintiffs not in privity would be limited to remedies based in tort. *See* United States Fidelity, 21 Ohio St. 2d 244, 251 N.E.2d 380 (1970). In privity cases involving the failure of a product to conform to the seller's representations, the plaintiff was able to assert the tort claims of implied warranty, strict liability, and negligence. He also was able to assert a breach of express warranty claim under the Ohio Revised Code. OHIO REV. CODE ANN. § 1302.26 (Anderson 1991). Non-privity plaintiffs were required to seek relief in tort. *See United States Fidelity,* 21 Ohio St. 2d at 244, 257 N.E.2d at 380 (1970).

In important respects, these remedies, as they might apply to a particular claim, were difficult to reconcile. Tort and warranty claims are controlled by different statutes of limitations which use

The Code applies to all claims for personal injury or physical damage to property, other than the product itself, caused by a product's failure to conform to the Code's design, manufacture, labelling and express warranty standards.[16] The Code preempts all competing state law remedies dealing with these matters whatever their conceptual character.[17]

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different standards for determining time of accrual. *See* Prokasy v. Pearle Vision Center, 27 Ohio App. 3d 44, 499 N.E.2d 387 (1985). Strict tort remedies are subject to only two affirmative defenses, misuse and assumption of the risk. *See Bowling*, 31 Ohio St. 3d at 277, 511 N.E.2d at 373 (1987). Liability for negligence claims can be avoided by proof of ordinary contributory negligence. While strict liability in tort claims cannot. The affirmative defense thicket is even more tangled where U.C.C. claims have been pleaded. In these matters, it is not settled whether careless user conduct is an aspect of proximate cause to be pleaded and proved by the plaintiff, or the basis of an affirmative defense to be raised and proved by the defendant. OHIO REV. CODE ANN. § 1302.29 comment 8 (Anderson 1979 and Supp. 1991) (refuse to examine goods); *Id.* § 1302.89 comment 5 (using goods with discovered defects or failing to reasonably examine for defects); *Id.* § 1302.27 comment 13 (possible defense if intervening action or event after delivery of goods).

User conduct is often the key issue in a product liability action. However, the divergent treatment of the kinds of user conduct necessary to defeat recovery clearly inhibits the coherent disposition of cases involving multiple theories of recovery. All of these dissimilarities within the tort family of remedies and between tort and contract are in addition to the textual and conceptual differences in the duty owed by sellers under the various theories of recovery. *Compare* OHIO REV. CODE ANN. § 1302.27 (Anderson 1979 & Supp. 1991) (standard of fitness for ordinary purposes and without objection in the trade) *with* RESTATEMENT (SECOND) OF TORTS § 402A (1977) (unreasonably dangerous standard for defective products). The circumstance created by the co-existence of tort and contractual-warranty theories has been described as involving "inordinate complexities." W. PROSSER & W. KEATON, THE LAW OF TORTS § 98 (5th ed. 1984 & Supp. 1988).

Piling an additional tort remedy atop those already mentioned would only exacerbate the problems existing prior to the adoption of the Code. For example, the availability of a common law negligence and a Code strict tort remedy would create the curious condition in which the plaintiff could circumnavigate the bar imposed in the Code's affirmative defense provisions by resorting to his negligence claim which would be subject to the comparative process provided in section 2315.19 of the Ohio Revised Code. OHIO REV. CODE ANN. § 2315.19 (Anderson 1991). Not only would this maneuver open the way for a grand triumph of form over substance, in that the Code's design and warnings formulas incorporate many negligence principles, it would provide an easy means for defecting many of the policies underpinning the Code remedies. Adding U.C.C. remedies to the concoction would only make it more conceptually and procedurally unpalatable.

16. "Product liability claim" is defined as a claim that is asserted in a civil action in order to recover from a manufacturer or supplier compensatory damages for death, physical injury to person, emotional distress or physical damage to property other than the product itself arising from the design, production, testing and marketing of the product, inadequate warnings and instruction and the failure of the product to conform to representations or warranties. OHIO REV. CODE ANN. § 2307.71(M) (Anderson 1991).

17. The preemption casualties include the common law remedies of implied warranty in tort, strict liability and negligence. *See supra* note 15. Also preempted are the warranty provisions posited in sections 1302.26-.28 of the Ohio Revised Code. Unaffected by the Code are claims arising from the contamination or pollution of the environment, including those implicating hazardous or toxic substances. *See* OHIO REV. CODE ANN. § 2307.72(D)(1) (Anderson 1991). Also untouched are remedies provided by federal law. *See, e.g.*, Consumer Product Safety Act, 15 U.S.C. § 2072 (1982). Since a tort claim for fraud involves a requirement not associated with a product liability claim, it should not be preempted. *See, e.g.*, U.C.C. § 2-721 (1982).

Preemption is a sensible reform. The prior practice of multiple remedies with assorted theoretical bloodlines pursuing one, single physical injury recovery was a disorderly and inefficient affair. The General Assembly's sense that the disarray should be replaced by a single product liability remedy was a wise and appropriate public policy response.[18] Whether its action achieves this goal turns on the merits of the strict tort claim delineated in the Code. Possible shortcomings within the Code's strict tort scheme do not detract, however, from the good judgment underlying the plan. Illustrations of the remedial circus which was replaced by the Code provide ample support for the reform.[19] The action also reveals legislative sensitivity to the need for efficiency and fairness in dispute resolution. The history of product liability development is a story of layering new remedies upon the old.[20]

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18. It should be noted that preemption does not totally purge the products area of problems. Frequently, a products case will involve defendants who, because of their status as manufacturer or supplier, will be subject to liability solely on the basis of a product liability claim. It also may involve non-seller parties whose negligence was a substantial factor in causing the plaintiff's injuries. In such a circumstance, the law must deal with two sets of relationships: the plaintiffs' relationship with the defendants and the defendants' relationship with one another.

Defendants subject to liability on the basis of a product liability claim can defeat recovery entirely by establishing that the plaintiff's express or implied assumption of the risk was the direct and proximate cause of the plaintiff's harm. OHIO REV. CODE ANN. § 2315.20(B)(1),(2) (Anderson 1991). Common law authority exists giving these defendants the additional affirmative defense of product misuse. *See Bowling*, 31 Ohio St. 3d at 277, 511 N.E.2d at 373; Onderko v. Richmond Mfg. Co., 31 Ohio St. 3d 296, 511 N.E.2d 388 (1987). Absent these defenses, the defendants may not defeat liability by establishing that the plaintiff was contributively negligent. OHIO REV. CODE ANN. § 2315.20(C)(1) (Anderson 1991). Moreover, product liability claims are not subject to the apportionment process arrayed in Ohio's comparative negligence statute. *Id.* § 2315.19. Product suppliers sued in negligence under section 2307.78 can deploy express and implied assumption of the risk and other forms of negligent conduct on the part of the plaintiff to defeat or diminish recovery according to the process provided in section 2315.19 of the Ohio Revised Code. *Id.* § 2307.78.

Non-product liability defendants are subject to liability on the basis of ordinary negligence principles. Compensation from them will be determined according to the process delineated in section 2315.19 of the Ohio Revised Code. *Id.* § 2315.19.

Three basic problems arise where a plaintiff has joined and seeks recovery from product liability and non-product liability defendants. The first concerns the extent to which the plaintiff's recovery should be diminished on account of his own negligence. Such conduct may be pertinent to some defendants, but not to others. The second involves the determination of each defendant's share of the liability. The third involves the determination of the common liability, a computation required for contribution purposes. A finding of common liability is difficult where some defendants are entitled to a diminishment of the plaintiff's damages and others are not. The inclusion of the phrase "legal responsibility" in the contribution among tortfeasor provisions of section 2307.31 suggests that different substantive law basis of liability to the plaintiff is not a barrier to contribution. *See id.* § 2307.31. However, practical and procedural problems may effectively prevent such equitable distribution where both product liability and other kinds of wrongdoers are involved.

19. *See supra* note 15.

20. *Id.*

This process inevitably forced lawyers into pleading and litigation excesses often counterproductive to principled decision-making.

B. Contingent Liability for Economic Loss

1. Background

a. The Code's Foray Into Areas of Economic Loss

The Code also gives to claimants successful in establishing a Code claim for physical harm the ability to recover all economic loss connected with the harm.[21] Preemption does not apply to this provision. The Code simply provides another remedy for the economic component of the loss.[22] One justification given for this provision is the asserted irrationality of requiring successful personal injury claimants to resort to some other theory for the property damage sustained as a result of the underlying event.[23]

This article does not quarrel with the grant of a Code remedy to personally injured plaintiffs for all their loss, even though elements of the recovery will be governed by economic considerations. Its concern is the Code's remedies for property damage, particularly where commercial products are involved.[24] To understand this feature of the Code

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21. The entitlement is that claimants otherwise meeting the subsection requirements may recover "compensatory damages for any economic loss that proximately resulted from the defective aspects of the product in question." OHIO REV. CODE ANN. § 2307.79(A) (Anderson 1991). It is provided that such claimants may recover compensatory damage for "any economic loss that proximately resulted from the negligence of that supplier or from the misrepresentation made by that supplier and the failure of the product in question to conform to that representation." *Id.* § 2307.79(B). "Economic loss" means "direct, incidental or consequential pecuniary loss, including, but not limited to, damage to the product in question and non-physical damage to property other than that product. Harm is not 'economic loss.' " *Id.* § 2307.71(B). Pecuniary loss is that which can be measured by money. BLACK'S LAW DICTIONARY 1131 (6th ed. 1991). Ohio Revised Code section 1302.88 provides a description of possible buyer damages from defective or non-conforming products under the U.C.C. OHIO REV. CODE ANN. § 1302.88 (Anderson 1979 & Supp. 1991).

22. In subsections 2307.79(A)-(B), a claimant satisfying the requisite requirements may recover compensatory damages for economic loss. OHIO REV. CODE ANN. § 2307.79(A)-(B) (Anderson 1991). These provisions do not require the claimant to seek such loss. Whether it would be wise for a claimant to withhold the use of this provision would depend upon the operation of the doctrine of res judicata. On this issue, it is ordinarily possible for a plaintiff to pursue in one action all of the possible remedies whether or not consistent, cumulative or alternative or legal or equitable. Therefore, it is fair to hold that after judgment for or against the plaintiff, the claim is ordinarily exhausted so that the plaintiff is precluded from seeking any other remedies deriving from the same group of facts. RESTATEMENT (SECOND) OF JUDGMENTS § 25(F) (1980). In short, legal principles outside the Code may compel plaintiffs seeking recovery for harm to join with that claim all other loss experienced in the product liability transaction. Of course, the plaintiff would not be confined to Code-based theories of recovery for such loss. *Id.*

23. S. DARLING, *supra* note 5, at 84.

24. A variety of loss consequences are possible where property is damaged. For example, these consequences may include:

and its impact on the damage to property dimension of commercial products cases, it is essential to define some potentially ambiguous terms.

b. Terminology

Any investigation of the boundary between tort and contract in property cases immediately encounters terminology difficulties. The natural tendency is to regard tort as generally concerned with physical injury and contract with economic loss. The problem is that the tort remedies dealing with physical injury to persons or property often extend to items of economic loss.[25] The U.C.C.'s contract remedies are just as ambitious in the other direction. They treat physical damage, both to person and property, as a form of consequential loss, a phrase typically associated with economic loss.[26] The modern tendency to regard physical damage to the product itself as economic loss exacerbates the potential for confusion.[27] Generally, the task often encompasses the separation of the loss that is typically associated with a physical injury event from the loss connected with the failure of the product to satisfy performance or value expectations. Even this is not routine. There are no bright lines due to the uncertainties connected with determining whether a product's condition is the consequence of a physical event or of a value or performance deficiency.[28]

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(1) reduction in value, (2) extra cost to replace, (3) cost of debris removal, (4) business interruption, (5) extra expenses to operate, (6) contingent business interruption, (7) contingent extra expenses, (8) loss of rental income, (9) loss of rental value, (10) loss of leasehold interest, (11) cost of financing, (12) loss of tuition fees, (13) inability to reconstruct accounts receivable or other records, (14) loss of use value in improvements and betterments, (15) demolition costs and increased cost of construction, (16) changes in condition, and (17) pair or set losses.

1 W. RODDA, J. TRIESCHMANN, & B. HEDGES, COMMERCIAL PROPERTY RISK MANAGEMENT AND INSURANCE 24 (1978).

25. For example, section 928 of *Restatement (Second) of Torts* provides that one entitled to a judgment for harm to chattels properly may include compensation for the diminished value of the chattels or for repair and restoration costs and compensation for loss of use. RESTATEMENT (SECOND) OF TORTS § 928 (1979). Moreover, section 927 contains companion principles appropriate for instances in which the chattel is destroyed. *Id.* § 927. Under the authority of the loss of use provision of these sections, recovery has been allowed in tort for items of damage properly describable as consequential loss, a phrase ordinarily associated with economic loss. *See* Hales v. Green Colonial Inc., 490 F.2d 1015 (8th Cir. 1974) (damages for cost of repairs, clean-up expenses and lost profits); Boone Valley Coop. Processing Ass'n v. French Oil Mill Machine Co., 383 F. Supp. 606 (N.D. Iowa 1974) (damages for property and inventory and loss of business profits). For the economic loss recoverable in tort personal injury actions, see LoSchiavo v. Northern Ohio Traction & Light Co., 106 Ohio St. 61, 138 N.E. 372 (1922).

26. U.C.C. §§ 2-714, 2-715 (1978).

27. *See, e.g.*, East River Steamship Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986); Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989).

28. See Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-*

It is clear that any description of tort and contract authority cast in terms of physical injury and economic loss is potentially troublesome.[29] On the other hand, the process of attempting to stake out the boundary between matters which are naturally inclined toward tort and those naturally inclined toward contract becomes especially cumbersome if all the exceptions and qualifications relating to each loss component constantly must be taken into account. Therefore, resorting to

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Product Cases, 18 STAN. L. REV. 974 (1966). The cases place considerable importance on the dynamics of the loss despite the problems involved in establishing bright lines. Harm is categorized as "physical property damage." It occurs when the defect in the product results in harm to other property such as an automotive electrical system defect which results in a short circuit and causes the automobile to burn. State Farm Mut. Auto. Ins. Co. v. Anderson-Weber, Inc., 252 Iowa 1289, 110 N.W.2d 449 (1961). "Economic loss" is the loss of the benefit of the user's bargain. Firemen's Fund American Ins. Co. v. Burns Electronic Security Serv., 93 Ill. App. 3d 298, 300, 417 N.E.2d 131, 133 (1981). "It is the loss of the service that the product was supposed to render, including loss consequent upon the failure of the product to meet the level of performance expected of it in the consumer's business." *Id.* The presence or absence of physical harm resulting from the defect is not the determining factor; "the distinguishing central feature of economic loss is not its purely physical characteristic, but its relation to what the product was supposed to accomplish." *Id.*

29. To illustrate this potential, the Model Uniform Product Liability Act developed to provide the states guidance in the formulation of a coherent pattern of product liability rules, elaborates a strict tort remedy for harm, defined to include damage to property. MODEL UNIFORM PRODUCTS LIABILITY ACT § 104 (1979). However, the Model Act defines harm to exclude direct or consequential loss. *Id.* § 102(F). Interpreting this refinement according to the U.C.C. concepts of consequential loss, set forth in section 2-715 of the U.C.C., would patently neutralize the property damage portion of the remedy because under the U.C.C. property damage is a branch of consequential loss. U.C.C. § 2-715 (1979). In *Chemtrol*, the Ohio Supreme Court summarized the damage area in products liability cases in the following way:

> Generally speaking, a defective product can cause three types of injury: personal injury, property damage and economic loss. 'Personal injury' is, of course, self-explanatory. 'Property damage' generally connotes either damage to the defective product itself or damage to other property. 'Economic loss' is described as either direct or indirect. 'Direct' economic loss includes the loss attributable to the decreased value of the product itself. Generally, this type of damages encompasses the difference between the actual value of the defective product and the value it would have had had it not been defective. It may also be described as 'the loss of the benefit of the bargain.' 'Indirect' economic loss includes the consequential losses sustained by the purchaser of the defective product, which may include the value of production time lost and the resulting lost profits.

42 Ohio St. 3d at 43-44, 537 N.E.2d at 629 (1989).

Even this explanation does not make altogether clear the difference between property damage and direct economic loss. Each involves injury measured by difference in value. One typically must look beyond the form of the loss to the dynamics of the loss for the remedies to be applied. Here, too, it is plain that the concept of consequential damages cannot be given the content provided in U.C.C. section 2-715, for under this view consequential loss includes "injury to person or property". U.C.C. § 2-715 (1979). The Code flirts with this ambiguity but avoids ultimate difficulty by the device of specific content. It defines "economic loss" to include consequential damage. OHIO REV. CODE ANN. § 2307.71(B) (Anderson 1991). However, it defines harm to include "physical damage to property other than the product in question." *Id.* § 2307.72(G). It also mandates that "harm" is not "economic loss," and "economic loss" is not "harm." *Id.* §§ 2307.71(G), 2307.72(B). Plainly, these instructions prevent any confusion of the Code's view of consequential loss with the U.C.C.'s sense of that requirement.

generally accepted notions in the discussion of policy questions seems reasonable, so long as the conclusions and assumptions on which they are based hold true for all the items of loss. Once the policy issues have been resolved, the precise authority of each doctrine, however, must be spelled out in specific terms.

The Code defines with particularity the items of loss immediately subject to its tort remedy. Together these are labelled harm and include personal injury and physical damage to property, other than the product itself.[30] It also defines economic loss to include "direct, incidental or consequential pecuniary loss, including, but not limited to, damage to the product in question and non-physical damage to property other than that product."[31] The Code uses the concepts of physical and non-physical damage as the basis for the boundary between its immediate remedy for harm and its contingent remedy for economic loss.

This article basically comports with these principles. In general discussions, the phrase "physical injury" refers to the threshold event for the application of tort remedies for personal injury or property damage. The general relationship of this approach to the Code's physical, non-physical basis for separating harm from economic loss is apparent. Where the damage is to property, the assumption is that the measure of damages for the physical loss would be the cost of repair or replacement.

This article uses the phrase "economic loss" to include those items of additional loss basically connected with non-physical damage. This category of loss includes the failure of a product to live up to value expectations, lost profits and extraordinary expenses. The article uses the phrase "consequential economic loss" to describe lost profits and extraordinary expenses. The assumption is that economic loss is genetically related to contract and should be a part of the family of remedies associated with that doctrine.

In the ongoing effort to maintain tort and contract in separate spheres, two issues take center stage in the product liability area. One is the extent to which consequential economic loss should be recoverable in tort under the principles relating to parasitic damages. The other is whether the repair cost of physical injury to property, either to the product itself or other property, should be treated in a particular circumstance as a form of direct economic loss, recoverable only in contract, or physical injury recoverable only in tort. This article analyzes

30. OHIO REV. CODE ANN. § 2307.71(G) (Anderson 1991). The items of damage which are regarded as economic loss also are defined. *Id.* § 2307.71(B).

31. *Id.* § 2307.71(B). Once again it is clear that the U.C.C.'s notion of consequential loss, as set forth in section 2-715, embracing as it does "injury to person and property," cannot be used to describe the loss recoverable under non-U.C.C. remedies. U.C.C. § 2-715 (1979).

these questions in the context of the layers of relationships involved in the marketing process. The choice of doctrine hinges on the policy considerations germane to each tier of relationship.

The second article on the Code's economic loss provisions recommends modifications to the Code.[32] These recommendations are based on the policy problems highlighted in this article and on the mechanical problems arrayed in the second article. They use the Code's physical, non-physical injury predicates for redistributing the Code's tort remedy. The recommendations in the second article are summarized at the conclusion of this article.

c. The Code in Operation

In the property area, the Code defines harm as "physical damage to property other than the product in question."[33] It treats economic loss as direct, incidental or consequential pecuniary loss, including damage to the product itself and non-physical damage to property other than the product.[34] By definition, economic loss is not harm.[35]

The Code's separation of physical from non-physical property damage creates the impression of a remedial format significantly different from the one typically applied in tort. The prototypical strict tort product liability remedy, as illustrated by Section 402A of the *Restatement (Second) of Torts*, covers physical harm to the user or his property.[36] Under the Restatement, harm to property includes "the destruction, physical impairment or wrongful taking of anything that is the subject of ownership."[37] The damages recoverable for such an event include both compensation for the difference in value caused by the harm, or the cost of repair, and compensation for loss of use.[38]

The concept of non-physical property damage found in the Code's definition of economic loss would seem to embrace the kinds of damages covered by the Restatement's loss of use provision[39] and by the

32. Raitt, *The Ohio Products Liability Code: The Mechanical Problems Involved in Applying Strict Tort Remedies to Economic Loss in Commercial Cases*, 17 U. DAYTON L. REV. (to be published, Feb., 1992).

33. OHIO REV. CODE ANN. § 2307.71(G) (Anderson 1991).

34. *Id.* § 2307.71(B).

35. *Id.*

36. RESTATEMENT (SECOND) OF TORTS § 402A (1977).

37. *Id.* §§ 7, 906 comment a (1977).

38. *Id.* § 928.

39. *See, e.g., id.* §§ 927 comment m and o, 928. For judicial interpretation of kinds of damage recoverable under the loss of use concept, see Hales v. Green Colonial, Inc., 490 F.2d 1015 (8th Cir. 1974) (lost profits, cost of repairs, extraordinary expenses); Boone Valley Coop. Processing Ass'n v. French Oil Mill Mach. Co., 383 F. Supp. 606 (N.D. Iowa 1974) (lost profits, damage to property, damage to inventory).

U.C.C.'s sections on consequential loss.[40] The Code's exclusion of these items from its harm equation would seem initially to move its remedial formula away from the Restatement's and align it with the Model Uniform Product Liability Act.[41] However, its addition of a provision contingently permitting the recovery of economic loss effectively moves its remedy back into line with the Restatement's formula.[42] The Code thus achieves a massive commitment of strict tort doctrine to all the loss possible in products cases. The Code covers all commercial transactions because of the breadth of the products and transactions subject to its authority and the damages recoverable under its remedies. Once physical harm has occurred, the Code traces back through the marketing chain adding a new system of remedies against commercial product manufacturers. Since the law of sales already occupies the area, the Code and the U.C.C. are brought into direct competition in these marketing relationships.[43]

The Code also assumes authority over the connection between product manufacturers and remote third-persons wholly outside the marketing chain who have detrimentally encountered the errant product.[44] In this dimension, the Code's economic loss provisions impose rough and arbitrary solutions for a difficult problem. Specifically, these

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40. U.C.C. § 2-715 (1978); *see supra* note 24 (variety of loss consequences).

41. The product liability claim provided in the Model Uniform Product Liability Act extends to harm, which includes damage to property but not direct or consequential economic loss. MODEL UNIFORM PRODUCT LIABILITY ACT §§ 102(D), (F) (1979).

42. The ability to recover under the product liability claim contoured in section 402A of *Restatement (Second) of Torts* requires the occurrence of physical harm to the ultimate user or consumer or his property. RESTATEMENT (SECOND) OF TORTS §402A (1977). Loss of use is then recoverable under the damages appropriate for harm to property. *Id.* §§ 927, 928 (1977).

43. The conditions required for the assertion of a claim under the U.C.C. are (1) sale (U.C.C. § 2-106), (2) of goods (U.C.C. § 2-105), (3) which fail to conform to tender requirements (U.C.C. §§ 2-313, 2-314, 2-714), (4) the failure is the proximate cause (U.C.C. § 2-714), (5) of damages (U.C.C. §§ 714, 715), (6) to persons entitled to warranty protection (U.C.C. § 2-318). U.C.C. §§ 2-105, 2-106, 2-313, 2-314, 2-318, 2-714, 2-715 (1979). A Code remedy is available to anyone who asserts a product liability claim. OHIO REV. CODE ANN. § 2307.72(A) (Anderson 1991). A product liability claim is a civil action against a manufacturer or supplier for harm caused by certain product conditions. *Id.* § 2307.71(M). Manufacturers include any person engaged in the business of designing, producing or assembling or rebuilding a product or its components. *Id.* § 2307.71(I). Product includes any object or material constituting tangible personal property manufactured or supplied for introduction into commerce and intended for sale or lease to persons for commercial or personal use. *Id.* § 2307.71(L)(1).

44. Privity is not an element of a Code claim for harm or a Code claim for economic loss resulting from harm. All that is required is a product liability claim, the essentials of which are (1) civil action, (2) against a manufacturer or supplier, (3) for harm, (4) arising for specified conditions, (5) in a product. OHIO REV. CODE ANN. § 2307.71(M) (Anderson 1991). Product is broadly defined but it must be tangible personal property produced for introduction into trade or commerce and intended for personal or commercial use. *Id.* § 2307.71(L)(1). The Code's economic loss provision comes into play for product liability claimants who have suffered economic loss resulting from the defective condition in the product. *Id.* § 2307.79.

provisions entitle third parties a very high grade tort equivalent of warranty protection.[45]

The Code does not become operative in the economic loss area until the requisite form of physical injury has occurred. Thus, it may be argued that the Code does nothing more than set forth the well-settled tort principle that once an actionable tort wrongdoing has occurred, the plaintiff is entitled to all the damage proximately caused by the primary wrongdoing.[46] This approach to economic loss liability is inconsistent in single-act negligence cases.[47] It is particularly troublesome where product liability cases confront manufacturers with liability from many sources.[48]

The courts have advanced an impressive array of reasons for keeping tort and contract separate in cases involving purely economic loss.[49] This article urges that in commercial cases dominated by consequential economic loss, the companion occurrence of physical injury or harm does not warrant the abandonment of the pure-loss liability principles, certainly not in the wholesale manner mandated in the Code.

This article is based on the premise that the extent to which the parties in commercial cases had an opportunity to bargain should play a critical role in establishing enforceable economic expectations, whatever the circumstances of loss. This approach leads logically to three categories of claims: (1) those by purchasers in privity with the manufacturer; (2) those by subpurchasers in the chain of distribution; and (3) those by parties totally outside the distribution process. The Code's operation is examined in each of these relationships.

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45. The complexities involved in establishing the parties entitled to warranty protection and the kinds of damages recoverable by those provided such protection is illustrated by the treatment given to these matters in section 2-318 of the Uniform Commercial Code. U.C.C. § 2-318 (1987). Under the U.C.C., remote parties are treated as third-party beneficiaries. *Id.* As such, they have the same protections and rights as the initial buyer. They are thus subject to any warranty disclaimers or remedy limitations properly made a part of the seminal transaction. *Id.*

46. The *Restatement (Second) of Torts* provides for strict tort remedy for physical harm to the ultimate user or consumer of the chattel and to his property. RESTATEMENT (SECOND) OF TORTS § 402(A) (1977). "Physical harm" denotes the physical impairment of the human body, or of land or chattels. *Id.* § 7. Sections 924, 927 and 928 of the *Restatement (Second) of Torts* prescribe the damages recoverable for harm to persons and to property. *Id.* §§ 924, 927, 928. Under these provisions, recovery may be had for the economic consequences of the impairment. *See, e.g.*, Hales v. Green Colonial Inc., 490 F.2d 1015 (8th Cir. 1974); Boone Valley Coop. Processing Ass'n v. French Oil Mill Mach. Co., 383 F. Supp. 606 (N.D. Iowa 1974) (economic loss connected to damage to property); LoSchiavo v. Northern Ohio Traction & Light Co., 106 Ohio St. 61, 138 N.E. 372 (1922) (economic loss associated with personal injury).

47. *See infra* notes 63-72 and accompanying text.

48. *Id.*

49. *See infra* notes 69-158 and accompanying text.

d. Tort and Contract: Their Orthodox Roles

A review of the orthodox roles of tort and contract and the policies underlying those roles will provide some background on the way in which the Code's economic loss provision impacts upon the liability relationships involved in the distribution of consumer and commercial products. Most courts which have undertaken to locate the proper boundary between tort and contract have agreed that while they sometimes run parallel, they originate from and express quite different public policy considerations.[50] Tort law is designed to protect the public from dangerous products.[51] It seeks to achieve this by burdening manufacturers, and sometimes other sellers, with the cost of accidental injuries.[52] This disposition draws support from the economic consideration that manufacturers can internalize and redistribute the cost of accidental injuries, and from the behavioral perspective that legal accountability provides an incentive for safer products.[53]

Not only have these values been instrumental in the extension of tort remedies to product sellers, they have been the force behind the development of tort remedies conceptually modeled after warranty standards and principles. Under these tort innovations, plaintiffs are freed from the burden of proving negligence.[54] Contract law, on the other hand, aims to preserve freedom of contract, thereby encouraging the free flow of commerce. It permits parties to bargain over and allocate particular risks, and binds them to the terms of their treaty, whatever the ultimate consequences.[55]

Viewed from a damage perspective, the policies underlying these doctrines translate roughly into a system in which tort provides the remedy for physical injury to persons and property while contract pro-

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50. *See, e.g.*, Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp., 143 Ariz. 368, 375, 694 P.2d 198, 205 (1984); Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Chemtrol Adhesives, Inc. v. American Mfr. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989).

51. *Salt River*, 143 Ariz. at 375, 694 P.2d at 205.

52. *See* East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986); W. PROSSER & W. KEETON, THE LAW OF TORTS § 98 at 693 (5th ed. 1984 & Supp. 1988).

53. For a discussion of values underlying tort and contract, see *East River*, 476 U.S. at 858; *Salt River Project*, 143 Ariz. at 368, 694 P.2d at 198; Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); Chemtrol Adhesives, Inc. v. American Mfr. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989).

54. In strict liability in tort, the plaintiffs' proof is directed to the content of the product or the representation made respecting the product, not the conduct of the defendant. If the content is actionable, the defendant is liable in strict tort even though he acted with due care. *See* RESTATEMENT (SECOND) OF TORTS § 402A-B (1979).

55. *See East River*, 476 U.S. at 858; *Spring Motors*, 98 N.J. at 555, 489 A.2d at 660.

vides the relief for unfulfilled economic expectations.[56] Problematically, circumstances will arise where damage will occur which implicates each remedial scheme. In these cases, the physical injury rule of tort comes into play. The rule is based on the belief that a plaintiff is entitled to all the damages resulting from the breach of a tort duty.[57] This rule is the conceptual instrument by which tort extends its authority from physical injury to economic loss. The wisdom of giving tort such free reign in commercial products cases requires a comparison of the policies underpinning the physical injury rule with those arguing for a clear and undisturbed division of authority between tort and contract doctrine.

e. The Reasons Behind the Physical Injury Rule

In the law of torts, interference with contractual relations or economic expectancies has remained almost entirely an intentional tort.[58] Negligent conduct, which makes contract performance impossible or more burdensome or prevents the plaintiff from obtaining a prospective pecuniary advantage, is not actionable in tort.[59]

The rules change dramatically where the economic injury flows from negligent conduct causing injury to the plaintiff or his property. In such an event, the plaintiff may recover all damage proximately resulting from the tort.[60] Recovery for the economic loss is permitted in this circumstance not because the interference with the economic interest was originally actionable, but because the economic loss is an item of damage resulting from some other tort. This principle in some of its more common applications has been described as follows:

> Recovery of lost wages is commonly permitted for negligent injury, not on the theory that there was a negligent interference with the worker's performance of his contract, but on the theory that the interference, and the wage loss, resulted from the tort to this person. The same principle permits recovery where the defendant interferes with contract performance by committing a public nuisance, as where he blocks a public road or fouls a waterway with the result that the plaintiff has special harm in the form of lost business opportunities or an increased cost of performing a contract. Damage to the plaintiff's own property, like damage to his person, is an obvious case for recovery of all damages proximately caused, including loss of profits if any can be adequately proven. All such cases of an independent physical tort to the plaintiff present

56. *See Seely*, 63 Cal. 2d at 9, 403 P.2d at 145, 45 Cal. Rptr. at 17.
57. *See* W. PROSSER & W. KEETON, *supra* note 52, § 129 at 997.
58. *Id.*
59. *Id.*
60. *Id.*

grounds for recovery and are not excluded by the rule against recovery for negligent contract interference.[61]

The *Restatement (Second) of Torts* arrays the tort principles involved in extending the reach of the physical injury rule from negligence to strict tort.[62] Compelling arguments can be raised against the unrestricted extension of this approach to liability in the products area. These arguments build from two sources. The first involves conceptual deficiencies in the physical injury rule itself. The second concerns the subversive effect that the use of the rule has on the ability to keep tort and contract in their separate spheres, a particularly critical need in commercial product liability cases.

2. The Policy Argument

a. Conceptual Flaws in the Physical Injury Rule in Products Cases

On the surface, the physical injury rule would seem to be a logical extension of tort's general endeavor to put an injured person in a position equivalent to the one existing prior to the tort.[63] This approach to reparations encounters three conceptual difficulties in commercial products cases involving both physical injury to property and ensuing consequential loss. First, the use of a single remedy for multiple kinds of loss is illogical when particular remedies have been crafted for particular losses. In such events, each loss should be entitled to the remedy specifically fashioned for it, irrespective of the way in which the loss occurred.[64]

Second, the equivalency principle has not always led to the development and application of tort remedies. For example, tort historically has not asserted authority over cases in which the conduct produced purely economic loss.[65] Countervailing concerns over "liability in an in-

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61. *Id.*

62. *See supra* note 46.

63. *See* RESTATEMENT (SECOND) OF TORTS § 901 comment a (1977) (placing injured in a position as nearly as possible equivalent to postion before tort).

64. By making an analysis and a comparison of the duties imposed on sellers by strict tort and by the warranty provisions of the U.C.C., Professor John W. Wade explained that it is customary to look to the gravamen of the action to determine whether tort or contract remedies should be applied. *See generally* Wade, *supra* note 3.

65. One court stated:

> There 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 where an automobile is wrecked by reason of its own bad brakes, as well as damage to any other property in the vicinity. 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 de-

determinate amount for an indeterminate time to an indeterminate class" has prompted the courts to withhold tort relief in this circumstance.[66] Moreover, under modern authority, tort remedies do not apply to products cases in which the product defect resulted only in damage to the product itself.[67] These shackles on tort make plain that the restoration of victims to their original state is a conceptual horse which cannot be ridden too far.

The third problem connected with the use of a physical injury approach to economic loss liability arises from conceptual deficiencies in the rule itself. The rule is not a policy-sensitive instrument for sorting out liability; rather, it is a rough device for clamping off liability.[68] In this capacity, the rule joins a variety of concepts, including proximate cause, intervening cause and duty, to help identify the limitations of liability.[69] The rule has particular utility because it eases the difficult task of isolating the point at which the defendant's conduct may be no more blameworthy than other causal events or at which the loss is too remote to be recoverable.[70]

As Dean Perlman has written, the laws of physics inherent in the rule provide natural liability boundaries:

> Friction and gravity dictate that physical objects eventually come to rest. The amount of physical damage that can be inflicted by a speeding automobile or a thrown fist has a self-defining limit. Even in chain reaction cases, intervening forces generally are necessary to restore the velocity of the harm creating object. These intervening forces offer a natural limit to liability.[71]

The problem in products cases is that manufacturers must account for more than one speeding car or thrown fist. In this context, a physical injury approach to liability paradoxically becomes more an instrument for extending liability than one for curtailing it. Moreover, this exten-

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nied the recovery.

Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 44-45, 537 N.E.2d 624, 630 (1989) (quoting W. PROSSER, LAW OF TORTS, § 101 at 665 (4th ed. 1971)).

66. Ultramares Corp. v. Touche, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931).

67. *See, e.g.*, East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986); Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); *Chemtrol*, 42 Ohio St. 3d at 40, 537 N.E.2d at 624. *But see* Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp., 143 Ariz. 368, 380-81, 694 P.2d 198, 210-11 (1984) (liability if unreasonably dangerous defect and the occurrence of the loss in a sudden, accidental manner).

68. *See* People Express Airline, Inc. v. Consolidated Rail Corp., 100 N.J. 246, 495 A.2d 107 (1985).

69. *See* Perlman, *Interference with Contract and Other Economic Expectations: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 61, 70 (1982).

70. *Id.* at 71.

71. *Id.* at 71-72.

sion is achieved randomly and without regard to the policies important to the allocation of liability.[72]

The following materials will show that most courts apply only contract rules to cases where the loss is connected with defective products which damage only themselves.[73] These decisions have undercut the premise that tort remedies are required to make victims whole. They provide compelling evidence that something more than mechanical, one-dimensional rules are needed to deal with the economic loss issues involved in products cases, particularly where commercial goods are involved. The nature of the economic loss, the character of the goods and parties, the risks inherent in the product and the nature of the relationship between the physical injury and the economic loss may warrant the use of a physical injury approach to some aspects of some items of economic loss liability. However, these limited instances do not warrant a blanket rule. The values and interests competing for recognition in the allocation of liability for economic loss deserve a system fine tuned by policy sensitive adjustments.

b. The Policies Counseling the Separation of Tort and Contract

Recent product liability cases reveal an ongoing effort by the courts to maintain tort and contract in separate spheres. The clear consensus is that instances of purely economic loss should be controlled by contract.[74] A variety of policy arguments have been marshalled for this position. The union of these arguments with the conceptual deficiencies in the physical injury rule form a powerful alliance against the knee-jerk use of this rule for the recovery of economic loss in products cases. These policy factors are organized according to marketplace relationships.

1. Claims by Purchasers

When a claim is made by the purchaser, the purchaser and the manufacturer will have been in privity. This condition does not negate the operation of the Code's economic loss provision. It simply assures that the plaintiff-purchaser will have available both Code and U.C.C. remedies for his economic loss.[75]

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72. *See People Express*, 100 N.J. at 254-55, 495 A.2d at 111.

73. *See infra* notes 75-82 and accompanying text.

74. *See, e.g.*, East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986); Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965); Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989).

75. *See* Avenell v. Westinghouse Elec. Corp., 41 Ohio App. 2d 150, 316, 324 N.E.2d 583 (1974), *cited with approval in Chemtrol*, 42 Ohio St. 3d at 50, 537 N.E.2d at 634 (1989).

The practical difficulties involved both in harmonizing the Code with the U.C.C. and in mak-

One of the first cases to address the issue of the allocation of authority between tort and contract in products cases was *Seely v. White Motor Co.*[76] *Seely* fashioned a partition between tort and contract based on an appraisal of the obligations undertaken by product sellers.[77] Foremost among these obligations is safety. Sellers properly may be held liable in tort for physical injuries caused by the failure of their products to conform to standards defined in terms of unreasonable risks.[78] Sellers have no duty except as acquired by agreement to provide products that will satisfy the consumer's economic expectations.[79]

Decisions since *Seely* have given considerable substance to the broad thesis advanced in that case. Leading among these is *East River Steamship Corp. v. Transamerica Delaval.*[80] *East River* was an admiralty case which raised the issue of whether a cause of action in tort is stated where a defective product purchased in a commercial transaction injures only itself.[81] The Court saw the claim as implicating purely economic loss. It concluded that whether alleged in negligence or strict liability, no product liability claim lies in such a circumstance.[82] The matter asserted in this context "is most naturally understood as a warranty claim."[83]

The decision in *East River* rests on a comprehensive examination of the divergent positions put forth in the land-based product liability cases. The Court expressly declined to follow the minority cases ex-

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ing the Code an effective remedy for economic loss problems is considered in a separate article. *See* Raitt, *supra* note 32. The present concern is the policy implications of deploying strict tort, even on a contingent basis, for the recovery of economic loss.

76. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

77. *Id.* at 18, 403 P.2d at 151, 45 Cal. Rptr. at 23.

78. *Id.*

79. The court in *Seely* clothed its reasoning in the following way:

> 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 personal 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 liable 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 personal injury when he buys the 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.

Id. at 18, 403 P.2d at 151, 45 Cal. Rptr. at 23.

80. 476 U.S. 858 (1986).

81. *Id.* at 859.

82. *Id.* at 870.

83. *Id.* at 872.

tending strict tort liability to instances of purely economic loss,[84] Acknowledging that these decisions raise legitimate questions about the reasons given for withholding tort relief in such cases, the Court concluded that the arguments against the minority position are more powerful.[85] The following arguments were among those recognized by the Court: the need to keep tort and contract in separate spheres;[86] the ability of product purchasers to insure against economic loss;[87] the lack of justification for categorically redistributing the costs of economic loss to the public;[88] the natural affinity between the protection provided by warranty law and economic loss;[89] the general preferability of allowing commercial parties to bargain over economic risks and expectations;[90] and the need for rules containing sellers' liability within reasonable limits.[91]

The Court rejected the line of land-based products decisions allocating remedies according to the nature of the risk inherent in the product defect, stating that this approach is "too indeterminate to enable manufacturers easily to structure their business behavior."[92] It similarly rejected the practice of assigning remedies according to the way in which the loss occurred.

> 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.[93]

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84. *Id.* at 870-71.

85. *Id.* at 870.

86. *Id.* at 870-71.

87. *Id.* at 871-72.

88. *Id* at 871-72. The categorical imposition on manufacturers of liability for the economic loss suffered by commercial purchasers and subpurchasers would encourage manufacturers to include within their price not only an increment for their potential liability for physical damage but also one for their potential liability for economic loss. The ultimate consumer would thus be required to pay for both such costs, including all the inefficiencies and guesswork involved in the liability estimates. *Id.*

89. *Id.* at 873-74.

90. *Id.* at 872-73

91. *Id.* at 874.

92. *Id.* at 870.

93. *Id.* (citing E. FARNSWORTH, CONTRACTS § 12.8, at 839-40 (1982)).

In its direct applications, the Code follows the contours recommended by the Court in *East River*. Its immediate concern is harm.[94] With respect to property, harm is physical damage to property other than the product itself.[95] By specific direction, economic loss, defined to include any damage or loss involving the defective product itself and non-physical damage to other property, is not harm.[96] Once harm in any form occurs, however, all the strict tort concepts in the Code are available to recover the economic loss sustained in the transaction.[97] They apply even though the parties were in privity.[98]

Since the claim in *East River* involved purely economic loss flowing from damage to the product itself, it must be determined whether the Court's reasoning can be translated, particularly in privity cases, to instances where the economic loss is connected with damage to other property. The solution depends on whether the occurrence of physical damage in this context outweighs the force of the arguments for keeping strict tort out of the economic area in the first instance. In making this assessment, it should be kept in mind that by denying tort recovery for the physical damage to the product itself, the Court in *East River* effectively repudiated major portions of the premise underlying the physical injury rule — that a plaintiff is entitled to all the damage caused by the primary wrongdoing.[99]

In *East River*, the Court underscored the need to keep contract and tort in their separate spheres.[100] The Code's economic loss scheme is particularly counterproductive of this goal in privity situations. Commercial parties in privity will have had an opportunity to bargain on all matters, including those touching economic concerns. All conceivable conditions of loss can be anticipated in their agreement. Where the parties fail to bargain, the Code supplies a tort remedy for economic loss in addition to those clearly provided by the U.C.C.[101] Where the parties actually negotiated, the existence of a Code remedy functions mainly to add tort problems and considerations to the bargaining agenda. Given the precision demanded by the courts for the surrender of tort remedies, the parties cannot be certain that their contract cove-

94. OHIO REV. CODE ANN. §§ 2307.72-.73 (Anderson 1991).

95. *Id.* § 2307.71(G).

96. *Id.* § 2307.71(B).

97. *Id.* § 2307.79.

98. The existence of a product liability claim in section 2307.73 of the Ohio Revised Code—the hook on which the ability to recover economic loss under section 2307.79 hangs—does not posit a privity relationship or the absence of such relationship as a condition of recovery. *Id* § 2307.73.

99. *See supra* note 63 and accompanying text.

100. *East River*, 476 U.S. at 870-71.

101. OHIO REV. CODE ANN. § 2307.79 (Anderson 1991).

nants will be effective to deal with tort-based claims.[102] By injecting tort remedies into the commercial area, the Code has further concealed the tort/contract confusion.

East River articulated its preference for a warranty remedy in the context of economic loss when damage was to the product itself.[103] Three factors support the extension of this preference to privity commercial cases in which the economic loss is bound up with physical damage to other property. The first of these factors rests on the parties' unfettered ability to bargain over all risks of loss whether associated with injury to the product itself or to other property. The circumstances surrounding the loss do not diminish this ability. The parties must foresee that defects in the product may cause problems extending beyond the product itself. The risk of damage to other property and ensuing consequential loss is not so uncommon in commercial cases as to be

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102. Sellers attempting to disclaim strict tort liability are confronted with an uphill struggle. The *Restatement (Second) of Torts* explicitly directs that plaintiffs' rights under section 402A are not governed by the U.C.C. and are "not affected by any disclaimer or other agreement." RESTATEMENT (SECOND) OF TORTS, § 402A comment m, at 356 (1977). Courts generally have emphasized the difference between attempts to disclaim contract-warranty liability and efforts to disclaim tort liability. *See* Sterner Aero AB v. Page Airmotive, Inc., 499 F. 2d 709, 712-13 (10th Cir. 1974). Some have held that tort disclaimers are per se unenforceable, but this rule probably applies only to personal injury. *See* Vandermark v. Ford Motor Co., 61 Cal. 2d 256, 391 P.2d 168, 37 Cal. Rptr. 896 (1964).

Although most courts would not be inclined to follow a *per se* rule in commercial cases involving economic loss, they likely would take the position that a proper and enforceable disclaimer of contract liability "would not mandate a finding that a similar limitation on tort liability in the same contract is effective." Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp., 143 Ariz. 368, 382, 694 P.2d 198, 212 (1984). The effectiveness of the attempted disclaimer of tort liability even where allowed must be considered separately. This consideration will be subject to its own rules. For example, the principle that the law does not look favorably on attempts to escape liability for duties imposed generally. Union Pac. R.R. Co. v. El Paso Nat. Gas Co., 17 Utah 2d 225, 259, 408 P.2d 910, 913 (1965). An additional rule is the rule of construction that the disclaimer or exemption provision will be strictly construed against the party relying upon it. Basin Oil Co. v. Baash-Ross Tool Co., 125 Cal. App. 2d 578, 594, 271 P.2d 122, 131 (1954). Even though commercial principles may warrant an ability within the parties to shift the risk of loss, "the parties must clearly intend to do so." M/V American Queen v. San Diego Marine Constr. Corp., 708 F.2d 1483, 1488 (9th Cir. 1983). The exception to the general rule that a party may not exempt himself from tort liability presupposes that the parties have thought about the risk-transfer issue "and have incorporated their conclusions into the contract." Jig the Third Corp. v. Puritan Marine Ins. Underwriters' Corp., 519 F.2d 171, 176 (5th Cir. 1975), *cert. denied*, 424 U.S. 954 (1976).

Exemptions from tort liability are given most generous treatment where the parties are business entities, but even in such instances, the courts are inclined to relax the prohibition against the disclaimer of tort liability only where four requirements are satisfied: (1) the parties must have dealt in a commercial setting; (2) they must possess relatively equal bargaining power; (3) they must have actually bargained over the specifications of the product; and (4) actually negotiated the risks of loss possible from product defects. *Salt River*, 143 Ariz. at 378, 694 P.2d at 214.

103. *East River*, 476 U.S. at 870-71.

beyond the range of ordinary contemplation. This risk is frequently addressed in commercial sales agreements.[104]

The second factor favoring the use of U.C.C. remedies for the economic loss resulting from damage to other property is the availability within the U.C.C. of a full complement of fair and evenly balanced concepts for structuring private agreement on liability matters. The U.C.C.'s disclaimer of warranty and limitation of remedy provisions are examples of these concepts.[105] The lack of comparable bargaining tools in tort makes it an inferior doctrine for regulating matters best left to disposition by private agreement.[106]

Finally, the U.C.C. provides clear and comprehensive damage provisions, many of which directly address economic loss problems.[107] These provisions not only allow full recovery for all types of loss possible from defective products, but their presence within the U.C.C. also delivers a clear message to commercial parties to resolve these liability questions during the bargaining process. The U.C.C.'s special competence in economic loss matters deserves particular weight in commercial transactions where the parties typically will be familiar with commercial law principles. For such cases, rule-making driven by a desire to keep tort and contract in separate spheres would not layer a troublesome and commercially incomplete tort remedy on top of the elaborate provisions organized in the U.C.C.

The presence within the U.C.C. of a well-crafted system for sorting out the substance of a commercial sales transaction, whatever the dynamics of the loss, is not the only basis for preferring contract over tort. In *East River*, the Court reasoned that the product buyer is best

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104. *See, e.g., Salt River*, 143 Ariz. at 368, 694 P.2d at 198; Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 43, 537 N.E.2d 624, 629 (1989).

105. U.C.C. §§ 2-316, 2-719 (1987). Tracking through the provisions of the U.C.C. reveals the conceptual equipment needed to sort out and solidify the obligations and expectations inherent in a sales transaction. Among the matters that must be addressed are: (1) the need for a writing to commemorate the agreement (U.C.C. § 2-201); (2) the admissibility of material outside the four corners of the written agreement (U.C.C. § 2-202); (3) reconciling conflicts within a warranty undertaking (U.C.C. § 2-316(1)) and among warranties (U.C.C. § 2-317); (4) the significance of course of performance, course of dealing, usage of trade and other practical considerations (U.C.C. § 2-208); (5) the role of unconscionability (U.C.C. §§ 2-302, 2-719(3)); and (6) the remedies available in event of default or the delivery of non-conforming goods (U.C.C. §§ 2-711 to-720).

106. The right of the parties as an abstract matter to strike a bargain exempting the seller from liability for economic loss has been noted. *See supra* note 103. Presumably, this right is conceptually rooted in the tort principle of express assumption of the risk. RESTATEMENT (SECOND) OF TORTS § 496B (1977). While the substantive dimensions of this concept are fully developed, the mechanics for arranging and expressing the concept are not. It would not be illogical for the courts to scavenge the U.C.C. for such detail. This, however, would paradoxically raise the danger that use of U.C.C. guidelines would be regarded as ineffective to dispose of tort duties and considerations. *See, e.g., Salt River*, 143 Ariz. at 382; 694 P.2d at 212 (1984) (stating that "U.C.C. rules for disclaiming warranty obligations have no bearing on a seller's tort liability").

107. U.C.C. §§ 2-714 to -720 (1987).

positioned to quantify the risks of economic loss from a defective product and to obtain insurance protection for these risks.[108] Such a view certainly accords with common sense. Who better than the buyer is able to gauge the potential adverse economic consequences from defective products used in his commercial operations? The cases verify the use of business interruption insurance at the product user level to protect against the possible economic loss from defective capital and commercial products.[109]

Insurance companies, on the other hand, are reluctant to provide insurance protection to product manufacturers for purchaser claims involving consequential economic loss.[110] Their concern is the difficulty associated with estimating the risk.[111] The importance of this concern in commercial cases is obvious.[112] Neither the presence of privity nor the nature of the conditions surrounding the economic loss alter these fundamentals. Commercial sellers remain the captive of the diverse and largely unknown needs, risks and requirements of their buyers.

If insurance is not available, manufacturers must self-insure. This alternative is not appealing. In the calculation of a loss reserve, self-

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108. *East River*, 476 U.S. at 872.

109. Product liability suits for economic loss often involve claims by the user's insurer against the product manufacturer for indemnification. *E.g.*, Mead Corp. v. Allendale Mut. Ins. Co., 465 F. Supp. 355 (N.D. Ohio 1979); Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989).

110. Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 953-58 (1966), *cited with approval in* Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); *see also* J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 11.6 (3d ed. 1988).

111. Note, *supra* note 110, at 955; *see* J. WHITE & R. SUMMERS, *supra* note 110, § 11.6 at 467 n.5.

112. Professor Fleming James, Jr. advances the thesis that liability for indirect economic consequences of negligence, generally defined as all indirect loss, such as loss of profits, resulting from inability to make use of defective products, should not be based upon fault. James, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43 (1972). He concedes that in whatever way the law assigns liability, the potential defendants may purchase liability insurance. He contends, however, that "[a] liability system based on fault is the most expensive way to administer accident losses." *Id.* at 52. He asserts that the estimated benefits received under a fault system amount to only about 44% of the system's cost. *Id.* This is to be contrasted with private loss insurance where benefits received are about 82% of the total cost and with social insurance programs where benefits are 98% of costs. *Id.* Professor James also contends that from the liability insurer's point of view, it is not practical to insure a liability which potentially could reach "catastrophic proportions, or to fix a reasonable premium on a risk that does not lend itself to an actuarial measurement." *Id.* at 53. On the other hand, first-party insurers have an ability to easily obtain insurance against loss from the subject source, and thus, can protect themselves adequately. *Id.* As "[m]any indirect economic losses fall upon businesses that are accustomed and able to make calculated provisions for losses of this kind," the duty to insure is aligned with the expectations of all the parties. *Id.* Professor James makes this further observation: "It is significant that insurers themselves often have recognized the waste entailed in the extra step of subrogation and voluntarily have foregone subrogation rights by knock for knock agreements, and that in some countries the loss insurer's rights against third-party tortfeasors, through subrogation or otherwise, are disallowed or curtailed." *Id.* at 55.

insurers must not err on the low-side, for this would expose them to the risk of crippling loss. Neither can they err on the high-side, for this would be an inefficient use of funds, particularly hazardous to marginal producers.[113] Using insurance principles as the basis for allocating liability means that the cost of the risk can be passed along to the firm's customers.[114] Price thus becomes a more accurate measure of the true cost of the product.[115]

A corollary of the insurance issue is the indiscriminate redistribution of the cost of economic loss to the public. A major policy objective of strict tort is the placement of the cost of personal injuries in products cases on manufacturers.[116] Manufacturers can then redistribute this cost across the entire product line. In *East River*, the Court saw no need for the imposition of such a categorical system for the reallocation of economic loss.[117] Bargaining within the marketing chain will lead to the efficient distribution of the actual costs of such loss.[118]

The Court's reasoning in *East River* is actually a condensation of the thesis that commercial parties in privity will negotiate voluntary exchanges of entitlements allocating liability more efficiently than the forced exchanges mandated by tort law. The economic basis of this position is the propensity of rational parties to make decisions that maximize efficiency.[119] This natural tendency toward rationality helps to assure the channeling of resources to their most valuable uses.[120]

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113. It is asserted that "[t]o the extent that a manufacturer cannot obtain insurance, he must become a self-insurer and his economic survival depends upon the accuracy with which . . . [he] anticipates future liability." Note, *supra* note 110, at 956. The difficulty in doing so threatens the survival of his enterprise. "There is no 'typical' economic loss; rather, the same defective product may cause varying amounts of consequential loss according to the nature of the ultimate purchaser." *Id.* For example, a manufacturer has an output of 100,000 units per year and anticipates that 100 units will be defective. He sells to a large distributor who, in turn, sells both to large factories and small retail establishments. A failure of his product in the factory will typically cause $300,000 consequential damages. In the retail establishment, it will cause only $20,000 damage. Should the manufacturer insure for $300,000 or $20,000? *Id.* Even if a subpurchaser's "typical" consequential damages could be computed, the manufacturer must be careful of "overfunding, to the detriment of his competitive position, and under-funding which would threaten him with financial disaster." *Id.*

114. *Id.* at 955.

115. *Id.*

116. Greenman v. Yuba Power Prod., Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963). *But see* Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 576, 489 A.2d 660, 671 (1985) (stating that a commercial buyer with sufficient bargaining power "may be better situated than the manufacturer to factor into its price the risk of economic loss caused by the purchase of a defective product").

117. *East River*, 476 U.S. at 872-74.

118. *Id.* at 873.

119. A. KRONMAN & R. POSNER, THE ECONOMICS OF CONTRACT LAW 1-7 (1979).

120. *Id.* at 1-2. "[I]f voluntary exchanges are permitted—if, in other words, a market is

Deployment on this basis ultimately benefits both the parties and society through resultant increases in wealth.[121] The U.C.C. is designed to enable these voluntary transfers.[122]

In the context of damage to the product itself, it has been argued quite sensibly that a voluntary system of risk allocation should not be replaced by one engineered in tort unless the voluntary process produces unfair or inefficient results.[123] Neither of these, it is asserted, is the experience in cases involving commercial parties in privity and claims for lost value, repair costs, and consequential damages.[124] The U.C.C. protects against unfairness by sheltering buyers from harsh agreements.[125] Its voluntary process provides a proper matrix for achieving efficient risk allocations because buyers may be as knowledgeable and well informed as sellers on the potential risks posed by defective products and the conduct required to minimize or avoid those risks.[126] They also may be just as able to absorb or spread costs.[127]

The voluntary risk allocation argument further contends that many of the values justifying strict tort relief have no place in commercial cases involving parties in privity. The deterrence principle, for example, lends nothing to the calculus required to separate acceptable from unacceptable risks. It simply assumes well-settled notions regarding the point at which a product is so bad as to be unmarketable.[128] Uncritical obedience to this value judgment could foreclose the marketing of commercial products with any appreciable danger.[129]

For risk allocation reasons, it has been concluded that tort remedies are out of place in self-inflicted damage cases.[130] Giving buyers a chance to retreat to the tort concept of property damage basically provides them with a means for evading what may be seen as troublesome

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allowed to operate—resources will gravitate toward their most valuable uses." *Id.*

121. *Id.* at 2.

122. U.C.C. § 1-102(2)(a)-(c) (1978).

123. Note, *Privity Revisited: Tort Recovery by a Commercial Buyer for a Defective Product's Self-Inflicted Damage,* 84 MICH. L. REV. 517, 530-31 (1985).

124. *Id.*

125. *Id.* at 534. For example, warranty disclaimers must be conspicuous and consistent with express warranties. U.C.C. § 2-316 (1978). Additionally, remedies given by the seller must be adequate. *Id.* § 2-719(2). Furthermore, courts can refuse to enforce warranty disclaimers based on unconscionability grounds. *Id.* § 2-302.

126. Note, *supra* note 123, at 535.

127. *Id.* at 537-38.

128. *Id.* at 536.

129. *Id.* at 536-37.

130. *See supra* notes 119-22 and accompanying text. The efficiency argument further contends that the U.C.C.'s voluntary system should be bypassed only where the courts are more qualified and better informed than the parties to make risk allocation judgments or where buyers chronically underestimate the risks. Note, *supra* note 123, at 537.

U.C.C. restrictions.[131] The obvious question is whether arguments pertinent to the self-inflicted damage area logically can be extended to cases involving loss resulting from damage to other property. Under the conventional view, tort remedies are available where the loss can be characterized as the consequence of an accidental event.[132]

Aside from the uncertainties naturally inherent in any test using accidents as its turnstile, sound arguments exist in commercial cases for submitting all risks from all sources to a voluntary apportionment process. To begin with, the presence of privity creates a circumstance in which bargaining is feasible because the potential victim and injurer are known.[133] If the parties have adequate information and comparable bargaining power, they presumably will reach risk agreements advancing all their respective interests.[134] Their ability and natural instincts are not limited to risks connected with a product's self-inflicted damage.

The other voluntary transfer arguments point in the same direction. Just as with self-inflicted product damage, commercial buyers logically are best positioned to avoid or minimize the risks resulting from damage to other property, particularly those items dominantly economic in nature.[135] They often are just as able as sellers to absorb resultant costs or to pass them along to succeeding purchasers or users.[136]

Finally, damage to other property does not necessarily resuscitate the tort values regarded as dormant in instances of self-inflicted loss. The deterrence value, for example, is equally ineffective in these cases to help identify the point at which products become too unsafe.[137] It is plain that from many perspectives, cases involving damage to property share the common ground of values affecting the apportionment of liability.

The main argument supporting the use of tort remedies for the subject loss appears to derive from notions of buyer expectations. Damage to the product itself directly implicates the product's performance abilities, which is the core concern of contract.[138] Damage to other property, on the other hand, smacks more of safety concerns. Where

131. Note, *supra* note 123, at 518-19.

132. *See* Seely v. White Motor Co., 63 Cal. 2d 8, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

133. Note, *supra note* 123, at 535. *See generally* Calabresi & Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral,* 85 HARV. L. REV. 1089, 1109 n.38 (1972) (stating that pre-accident negotiations between known potential injurers and victims are not expensive).

134. *See supra* notes 119-22 and accompanying text.

135. Note, *supra* note 123, at 531, 535.

136. *Id.* at 531, 537.

137. *Id.* at 536.

138. *See East River,* 476 U.S. at 871.

only property is involved, it is difficult to conceive of a buyer willing to concede a practical and financial difference between losses flowing from damage to the product itself and those connected with damage to other property. The remedial provisions of the U.C.C. do not regard this distinction as significant.[139] When labels and glib assumptions are put aside, it is apparent that transactions involving commercial parties in privity do not present the policy concerns that spawned the development of strict liability in tort. The property damage dimensions of these relationships are logical subjects for the voluntary risk transfer principles crafted in the U.C.C.

East River articulated other arguments for keeping the door closed to tort remedies in cases of purely economic loss. One was the size and inestimability of the liability to which sellers would be exposed were the economic loss area opened up to tort. The Court observed that, in contract, a limitation naturally derives from the agreement of the parties, the need for privity and the requirement that consequential damages be a foreseeable result of the breach.[140] It saw tort as lacking similar constraints.[141]

While the Court's immediate concern in *East River* was with economic expectations downstream, nothing assures that commercial sellers will have adequate information concerning the economic expectations and consequential loss hazards confronting their immediate buyers. The bargaining parties would have to expand the scope of their negotiations to include an analysis of the buyer's operations. Buyers would have to be forthcoming on the facts required for accurate risk assessments. They would have little inducement to do so if, through the medium of tort remedies, the law were otherwise poised to make sellers liable for all conceivable loss.

A curious trend appears to be developing in the products area. Manufacturers are being relieved of liability for the economic loss resulting from products which damage themselves but are burdened with

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139. U.C.C. § 2-715 (1978).

140. *East River*, 476 U.S. at 874.

141. *Id.* The Court argued that:

> In products-liability law, where there is a duty to the public generally, foreseeability is an inadequate brake. Permitting recovery for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums. It would be difficult for a manufacturer to take into account the expectations of persons downstream who may encounter its product. In this case, for example, if the charterers—already one step removed from the transaction—were permitted to recover the economic losses, then the companies that subchartered the ships might claim their economic losses from the delays, and the charterers' customers also might claim their economic losses and so on. 'The law does not spread its protection so far.'

Id. (citations omitted).

the loss associated with products which damage other property. This approach stands logic on its head. It saddles sellers with liability for the losses which they are least able to foresee.

The policies for treating damage to the product itself as wholly a matter of economic loss can be transferred without logical impairment to the consequential loss connected with damage to other property. Measured by such matters as the need to keep tort and contract in separate spheres, the ability of the parties to allocate the risks by private agreement, the superior ability of the buyer to insure for consequential economic loss, and the size and unpredictability of the potential liability confronting sellers, the two events are inseparable. In the final analysis, integrating economic loss claims into a system designed for physical injury binds together matters with vastly different policy aims and perspectives. The gulf is not bridged by conditioning liability on the way in which the economic loss occurred.

The introduction of tort into cases in which commercial parties were in privity is particularly troublesome. In this circumstance, the presence of privity assures a practical ability to bargain over the risk of economic loss. The presence of commercial parties assures parties the ability to act intelligently on this opportunity. The cases holding that damage to the product itself is economic loss not compensable in tort have weakened the intellectual foundations of the physical injury rule. The position that such damage concerns only buyer expectations does not further attenuate this weakening. It can be argued quite reasonably that all untoward economic consequences implicate buyer expectations.

This article concludes with specific recommendations. One urges the modification of the concept of "harm" to include damage to the product itself in consumer cases and the consequential damage connected with this event.[142] Another seeks the modification of the Code's economic loss provision to exclude the recovery of the consequential economic loss (non-physical damage) by purchasers of commercial products.[143]

This section of the article has contended that in suits by commercial parties in privity, a policy driven analysis would make all the loss in property cases, including consequential loss, physical damage to the product itself and even physical damage to other property, subject exclusively to the U.C.C. The article's recommendations do not go so far. They seek only to withdraw a Code basis of recovery for consequential economic loss and damage to the product itself in commercial product cases. Physical damage to property other than the product itself would

142. Raitt, *supra* note 32.

143. *Id.*

continue to be regarded as "harm" directly recoverable under the Code.

This concession rests on the perception that the tradition of allowing tort recovery for physical damage is too well established to be easily withdrawn.[144] Resistance would seem to be assured even though it reasonably can be argued that the duties imposed on product sellers are unique and implicate policy arguments quite different from those guiding tort. In any event, the major danger to commercial sellers created by the Code's incursion into areas of economic loss is the threat of liability for consequential loss. It is in this area that the Code works most perniciously to destroy the boundary between tort and contract.[145]

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144. The principal argument against withdrawing tort remedies for damage to other property is the coverage of such loss in comprehensive general liability policies. Arnold, *Products Liability Insurance*, 25 INS. COUNSEL J. 42, 44-46 (1958).

145. This article has presented the substance of the majority view that purely economic loss is not recoverable in negligence or strict tort. Such a loss must be pursued under the U.C.C. However, not all courts support this view. Significant among the contrary school is *Salt River Agricultural Improvement & Power District v. Westinghouse Electric Corporation.* 143 Ariz. 368, 694 P.2d 198 (1984). *Salt River* was a products liability action between commercial parties in privity. *Id.* at 372-73, 694 P.2d at 202-03. As a result of a fire and explosion accident, rotating blades in a gas turbine unit were destroyed. *Id.* at 374, 694 P.2d at 204. The total loss caused by the incident involved physical damage to the product itself, lost profits and additional expenses. *Id.* at 380, 694 P.2d at 208.

The Arizona Supreme Court saw the policy of tort as preventing accidents by deterring the distribution of unsafe products, and the policy of contract as promoting the free flow of commerce by allowing the recovery of expectation shortfalls. *Id.* at 375-76, 694 P.2d at 206. In its view, no all-inclusive rule governs the choice between tort and contract remedies. *Id.* at 375, 694 P.2d at 205. It reasoned that the determination must be made on a case-by-case basis in light of the purposes of the two doctrines. *Id.* Selection of a remedy involves the analysis of three interrelated factors: the nature of the product defect, the manner in which the loss occurred, and the type of loss. *Id.*

With respect to the "defect" factor, the court concluded that a defect posing an unreasonable risk of danger to the consumer or his property favors recovery in strict tort. *Id.* at 376, 694 P.2d at 206. Defects rendering a product substandard or making it incapable of performing its functions favor the use of a contract remedy for disappointed commercial expectations. *Id.* at 376-77, 694 P.2d at 206-07. The court conceded that the way in which the loss occurred is not determinative of the doctrine to be applied. *Id.* at 377, 694 P.2d at 207. However, it saw losses resulting from a sudden accident as pointing to the use of tort and losses from slow deterioration as pointing to the use of contract. *Id.*

With respect to the form of loss prong of the three-part test, the court viewed personal injuries and damage to other property as universally recoverable in tort. *Id.* at 378, 694 P.2d at 208. It concluded that damage to the product itself resulting from an unreasonably dangerous condition and occurring in a "sudden, accidental manner" should be recoverable in strict tort. *Id.* at 379, 694 P.2d at 209. Damage occurring gradually from a non-dangerous condition should be sought under the U.C.C. *Id.*

As to the loss sustained, the court held that repair costs, diminished value and lost profits occurring in a non-accident context must be pursued under the U.C.C. *Id.* However, where the product defect posed a risk of harm to persons or property and an accident occurred resulting in damage generally recognized in tort or where some combination of these factors preponderate, tort remedies should be available for personal injury, damage to other property, damage to the product itself and all consequential damage generally allowed in tort actions. *Id.* at 380, 694 P.2d at 210.

2. Claims by Subpurchasers

This category involves claims against sellers by non-privity parties in the distribution chain. Potential plaintiffs include both those who bought for resale and those who purchased for use. In *Spring Motors Distributors v. Ford Motor Company*,[146] the court addressed the problem of the remedies best suited for non-privity, commercial product cases.[147] The case involved a purchaser's economic loss claim against his immediate seller and a remote manufacturer.[148] Both parties were commercial entities. The loss consisted of injury to the product itself and consequential damages.[149] The court properly viewed the issues in the case as probing the boundary between strict liability in tort and the U.C.C.[150] It concluded that, in commercial circumstances, a non-privity buyer with purely economic losses may not recover in negligence or strict tort, but instead must look to the U.C.C. for a remedy.[151]

In its effort to delineate a suitable boundary between the damages recoverable in tort and those cognizable only under the U.C.C., the court sought first to isolate the fundamental policies underlying each doctrine. It, too, saw strict tort as a remedy that had evolved to protect consumers against the risk of personal injury. The following factors

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In *East River Steamship Corporation v. Transamerica Delaval, Inc.*, the United States Supreme Court rejected a choice of doctrine test resting on the nature of the risk. 537 U.S. 858, 870 (1986). It saw this approach as "too indeterminate to enable manufacturers to easily structure their business operations." *Id.* It also found unpersuasive any distinction based on the way in which the product injured itself, reasoning that all such damage, however sustained, involves a failure to receive the benefits of the bargain, the central concern of contract. *Id.*

It also can be argued that, in addition to its indifference to the policy arguments for confining purely economic loss to contract remedies, the Court's line of reasoning in *Salt River* puts excessive weight on injury deterrence, a value already recognized in the personal injury and related liability of manufacturers, and too little weight on freedom of contract values and benefits. Such reasoning tends not only to debase contract doctrine, it also invites increasing conflicts between the disciplines. The painstaking and absolutely essential examination in *Salt River* of the effect of the defendant's contract disclaimers on the plaintiff's tort remedies is but one example of the problems that can arise when tort is given extended authority in commercial disputes.

146. 98 N.J. 555, 489 A.2d 660 (1985).

147. *Id.* at 561, 489 A.2d at 663.

148. *Id.*

149. *Id.* at 560-61, 489 A.2d at 662-63. The plaintiff was in the business of selling and leasing trucks. *Id.* at 562, 489 A.2d at 663. It agreed to purchase a number of trucks made by the defendant, Ford Motor Company, and sold by the defendant dealer. *Id.* The transmissions in the trucks were made by defendant, Clark Equipment Company. For reasons unexplained, Ford and its dealer were treated in the litigation as a single entity. Ford provided to the plaintiff an express warranty covering repair and replacement of certain components for a specified time. *Id.* The warranty was in lieu of all other warranties; repair and replacement was the sole remedy. *Id.* The defendant, Clark, had extended to Ford an express warranty and limited remedies. *Id.* The plaintiff experienced a variety of transmission problems and sued for towing expenses, repair and replacement of parts, lost profits, and the decrease in market value of the trucks. *Id.*

150. *Id.* at 565, 489 A.2d at 665.

151. *Id.* at 561, 489 A.2d at 663.

were among those recognized as supporting this view: the superior ability of manufacturers to allocate and redistribute the cost of personal injuries; manufacturers' unique capacity to withhold defective products from the market; the unfavorable bargaining position generally occupied by consumers; and the conceptual and practical awkwardness of many U.C.C. provisions for consumer cases.[152]

The court saw the U.C.C. as providing a comprehensive system for determining the rights and duties of buyers and sellers in contracts for the sale of goods. Fundamental to this system is the policy that "parties should be free to make contracts of their own choice, including those disclaiming liability for breach of warranty."[153] Society's interest is that agreements once made should be fulfilled.[154] In the court's view, these considerations make the U.C.C. the appropriate source of law for resolving commercial disputes arising out of transactions between persons in the distribution chain.[155]

One of the factors urging this conclusion was the court's concern with imposing liability on the party best positioned to bear the risk of loss. It concluded that, with respect to economic loss, the commercial buyer may be better positioned than the manufacturer to assess the possible economic consequences from non-conforming or defective products and to factor these risks into price.[156] Transferring liability to the manufacturer could lead to price increases for all its customers.[157] This reasoning is consistent with the premise that sellers are less able than buyers to provide the protection or the reserves needed for the risk of economic loss and are correspondingly disadvantaged in making price determinations that will fairly reflect the true costs connected with the production of particular goods.[158] The court also was concerned that imposing the risk of economic loss on the manufacturer could give the buyer a better bargain than he originally made. The court reasoned that, as between commercial parties, "the allocation of risks in accordance with their agreement better serves the public interest than an allocation achieved as a matter of policy without reference to that agreement."[159]

The absence of privity does not require forsaking the U.C.C. in commercial cases. It does, however, raise two problems. The first con-

152. *Id.* at 567, 489 A.2d at 666.
153. *Id.* at 571, 489 A.2d at 668.
154. *Id.*
155. *Id.* at 578, 489 A.2d at 672.
156. *Id.* at 576, 489 A.2d at 671.
157. *Id.*
158. *See supra* notes 112-13.
159. *Spring Motors*, 98 N.J. at 577, 489 A.2d at 671.

cerns the range of remote interests to which the Code will extend warranty protection. The second involves the scope of such protection. The *Spring Motors* court resolved the range issue by abolishing the absolute need for vertical privity as a prerequisite to U.C.C. relief.[160] It saw this action as consistent with the position of the drafters of the U.C.C. that the matter of the parties' eligibility for warranty protection should be left to the courts.[161] *Spring Motors* did not address the scope issue. Its holding that the time-barred U.C.C. claims were the sole source of relief for the plaintiff mooted the matter.[162] While the court acknowledged that the application of certain U.C.C. provisions to remote parties raises some difficult and unsettled issues, it did not view these problems as sufficient to warrant the abandonment of the U.C.C. as the appropriate doctrine to apply.[163]

Spring Motors did not involve damage to property other than the product itself and ensuing consequential loss. It is submitted that the origin of the economic loss is irrelevant from a policy perspective. The factors guiding the *Spring Motors* court to the conclusion that the U.C.C. is the sole source of relief for the loss caused to remote parties by products which damage themselves reasonably extend to commercial cases in which the loss arises from damage to other property. The contrary position, which would see all such extra-product loss as "property damage" cognizable in tort, derives from an uncritical extension of general tort concepts to commercial products cases. The first factor recommending the use of contract remedies in non-privity commercial cases again involves the matter of insurance. Whether the economic loss is the consequence of damage to the product itself or damage to other property, the commercial subpurchaser remains the party best positioned to estimate the economic impact of defective products on his operations. This advantage translates into a better ability to obtain insurance and to factor its cost ultimately into price.[164] In contrast, remote sellers usually must guess on the extent of potential downstream liability. Their ignorance results in an impaired ability to obtain rea-

160. *Id.* at 583, 489 A.2d at 674.

161. *Id.* at 586, 489 A.2d at 676.

162. *Id.* at 588, 489 A.2d at 677.

163. *Id.* at 591, 489 A.2d at 678 (Handler, J., concurring). Justice Handler stated that:

> Although Spring Motors and Clark did not contract directly with each other, Clark was specified by Spring Motors to Ford as a supplier. Clark thus became a party to the transaction, in a sense acting with and through Ford, at the direction of Spring Motors. In such circumstances, the nexus or close relationship that is required by the privity rule might be reasonably satisfied.

Id. at 591, 489 A.2d at 678-79 (Handler, J., concurring).

164. *See supra* notes 107-10 and accompanying text.

sonable protection, particularly with respect to consequential economic loss.[165]

Other circumstances converge to make downstream damage more managable as economic loss under the U.C.C. All commercial subpurchasers will have had a commercial seller with whom they could bargain for warranty protection. Downstream economic loss liability is a contingency well within the foresight and bargaining ability of commercial parties. Nothing in the U.C.C. impedes the parties from bargaining over the liability risks emanating from these sources.[166] Moreover, the courts have the authority under the U.C.C. to extend warranty protection to remote parties in appropriate cases.[167]

These practical abilities are the logical products of the U.C.C.'s freedom of contract philosophy. Under that philosophy, risks are assigned according to the agreement of the parties. If each party behaves rationally, each risk will presumably fall ultimately on the party best able to manage it.[168] Consumers are better served by efficient methods of allocation.[169]

A physical injury, or tort, approach to allocating economic loss liability does not make thoughtful and principled dispositions of risk. It works mainly as a rough device for limiting liability.[170] Even in this aspect, it functions fitfully in the products area. The natural constraints provided by the laws of physics in single-events are considerably less effective where liability is possible from many products and each product user has his own unique requirements and loss potential.

Problems confronting sellers become particularly acute in commercial products cases. These cases point out that the cost of the actual physical damage done by errant products may be minor compared to the consequential loss.[171] Unlike personal injury cases, where the extent of the economic loss is circumscribed by the needs of a single person, commercial products cases implicate the needs of various business entities. The potential for consequential loss has no natural bounds.

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165. *Id.*

166. J. WHITE & R. SUMMERS, *supra* note 110, § 10-4, at 448 (3d ed. 1988).

167. U.C.C. § 2-318 comment 3 (1989); *see* J. WHITE & R. SUMMERS, *supra* note 110, § 11-3.

168. *See supra* notes 119-22 and accompanying text.

169. *Id.*

170. *See supra* notes 57-71 and accompanying text.

171. *E.g.*, Mead Corp. v. Allendale Mut. Ins. Co., 465 F. Supp. 355 (N.D. Ohio 1979) ($1,760,000 for total damages, including $250,000 for repair costs); Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989) ($225,047.43 for total damages, including $15,628.16 for repair costs); A.T.S. Laboratories, Inc. v. Cessna Aircraft Co., 59 Ohio App. 2d 15, 391 N.E.2d 1041 (1978) ($15,425.40 for total damages, including $242.55 for repair costs).

The position of non-privity sellers is made even more tenuous by their lack of involvement in and control over the conditions of use. Under these circumstances, the more the law makes manufacturers liable for remote losses, the less it functions to distribute incentives to the parties most able to avoid or minimize this loss.[172] The strict tort remedy contrived in the Code is a particularly inefficient distributor of incentives in economic loss matters because it imposes no sanctions on plaintiffs for ordinary contributory negligence.[173] It regards only express and implied assumption of the risk as effective to bar recovery.[174]

The result of these considerations is that courts are inclined to give the U.C.C. sole authority over commercial cases involving purely economic loss in the subpurchaser category. Under a policy driven analysis, the companion occurrence of physical injury is ineffective to alter this disposition of liability, particularly as concerns consequential loss. The commercial user's access to business interruption insurance, his ability to avoid or reduce the economic loss, and the availability of a commercial seller capable of providing U.C.C. warranty protection combine with all disadvantages confronting remote sellers to make the product user the party best able to manage risk, whatever the circumstances of loss. Any other approach misapplies the fundamental aims of tort and contract doctrine and mismanages the policies underlying those doctrines. The recommendations at the end of this article propose amendments to the Code's economic loss provision which would have the effect of withdrawing the ability to use the Code's remedy to recover consequential loss from commercial purchasers in the marketing chain.[175] Such claimants would continue to have a Code claim for physical damage to property other than the product itself. As was the case in the materials dealing with claims by immediate purchasers, the recommendations relating to claims by subpurchasers fall short of the arguments made in the text of this article. The justifications made earlier for this conservative response apply here. The tort tradition of providing a remedy for physical injury is well established, and the most critical threat confronting commercial sellers is liability for consequential loss.[176]

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172. *See* Posner, *Strict Liability, A Comment*, 2 J. LEGAL STUD. 205, 206-07 (1973).

173. OHIO REV. CODE ANN. § 2315.20 (Anderson 1991).

174. *Id.* Product misuse, either as an aspect of the plaintiff's prima facie case or as an affirmative defense is a factor in the recovery calculus. OHIO REV. CODE ANN. §§ 2307.75-.76 (Anderson 1991). Under these Code provisions, misuse would appear to be an aspect of whether the product was defective on account of design inadequacies or warning deficiencies.

175. Raitt, *supra* note 32.

176. With respect to the recovery of consequential loss by remote buyers, Professors James J. White and Robert S. Summers, present the following view:

> We agree with those courts that have refused to allow recovery of consequential economic loss by remote buyers. Even if relevant policies justify allowing non-privity consumers to

3. Third-party Claims

The range and diversity of possible economic loss claims from persons outside the marketing chain is virtually limitless.[177] As was the case with other commercial claimants, economic loss is not directly recoverable under the Code. The third-party claimant must also have suffered harm.[178] Many of the previous arguments favoring the assignment of economic loss liability to product purchasers apply to this tier of relationships. If anything, the absence in this category of linkage to the marketing network increases the number of possible claimants, the unforeseeability of their loss, and the dollar amount of the aggregate risk. It also means, however, that the plaintiff will be missing a commercial seller from whom he could have sought warranty protection. The seller's vulnerability to unrestricted loss liability must therefore be balanced against the third-party's unprotected and blameless circumstance.

The drafters of the U.C.C. were mindful of the need to deal with the problem of a warrantor's obligation to third persons outside the marketing chain. Their ability to devise a system free of the mechanical features of the physical injury rule warrants examination. The

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recover for direct economic loss, there can be no justification in the usual case for allowing non-privity consumer buyers to recover for consequential economic losses they sustain. Remote buyers may use a seller's goods for unknown purposes from which enormous losses might ensue. Since the remote seller cannot predict the purposes for which the goods will be used, he faces unknown liability and may not be able to insure himself. Insurers are hesitant to insure against risks they cannot measure. Moreover, here more than in personal injury and property damage cases, it is appropriate to recognize the traditional rights of parties to make their own contract. If a remote seller wishes to sell at a lower price and exclude liability for consequential economic loss to sub-purchasers, why should we deny him that right? Why should we design a system that forces him to bear the unforeseeable consequential economic losses of remote purchasers? Indeed, by forcing the buyer to bear such losses we may save costly lawsuits and even some economic losses against which buyers, knowing they have the responsibility, may protect themselves. In short, we believe that a buyer should pick his seller with care and recover any economic loss from that seller and not from parties remote from the transaction. Put another way, we believe the user is often the 'least cost avoider.' By placing the loss on him or by forcing him to bargain with his immediate seller about the loss, we may minimize the total loss to society. If the manufacturer is not the least cost avoider, but must, nevertheless, bear the loss, we may cause him to spend more of society's resources than are optimal to avoid the loss and may unnecessarily increase the cost of the commodity sold.

J. WHITE & R. SUMMERS, *supra* note 110, at 466-67 (1988).

177. *See, e.g.*, Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821 (2d Cir. 1968) (placing liability for incurred expenses upon ship owners and operators as a result of vessels being negligently set adrift in a river channel); Anderson v. Fairchild Hiller Corp., 358 F. Supp. 976 (D. Alaska 1973) (placing liability upon a helicopter manufacturer in negligence, warranty and strict tort for personal injuries suffered by an employee of a firm which was a non-purchaser of the helicopter).

178. OHIO REV. CODE ANN. § 2307.79 (Anderson 1991).

U.C.C. handles warranty obligations to remote third parties through the device of third-party beneficiaries.[179] The U.C.C. has three alternatives for extending liability, each progressively widening the range of interests eligible for third-party status, as well as the kinds of injuries compensable.[180] Whatever their dissimilarities, these alternatives have three common characteristics. First, eligibility for third-party status is limited in each of the alternatives. All remote parties must satisfy the requisite conditions.[181] Second, third-parties acquire no more warranty protection than that given initially by the seller being sued.[182] Sellers thus have considerable control over the extent of their warranty exposure. Third, in each, the third-party must be a person who reasonably could have been expected to "use, consume or be affected by the goods."[183] The occurrence of physical injury, the Code's predicate for the recovery of economic loss, does not in itself entitle the claimant to third-party beneficiary standing.

On the surface, the U.C.C.'s system for identifying the remote parties and claims deserving warranty protection is more sensitive to policy considerations than the rough judgments of the physical injury rule. Through its reliance on foreseeability, the U.C.C. paradoxically is more closely related to the traditional tort basis for determining liability than tort's own physical injury rule. In negligence, for example, foreseeability of the loss has been traditionally regarded as indispensable to liability.[184] The physical injury approach to liability tends to neu-

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179. U.C.C. § 2-318 (1989).

180. Alternative A of section 2-318 of the U.C.C. extends a seller's warranty "to any natural person who is in the family or household of his buyer or who is a guest in his home. . . ." U.C.C. § 2-318 Alternative A (1989). The practical effect of this provision is to extend only the warranty obligations of retailers as if they are the sellers dealing with buyers with households. *Id.* § 2-318 Alternatives A, B, C.

181. Under Alternative A, only natural persons who are connected with the buyer's household and who are injured in person may properly claim third-party beneficiary status. Under Alternative B, only natural persons may claim this status. Under Alternative C, sellers have the ability to exclude from this status all interests except natural persons with personal injuries. *Id.* § 2-318 Alternatives A, B, C.

182. The implied warranties that arise if the conditions posited in U.C.C. sections 2-314 and 2-315 are satisfied can be disclaimed under the authority of section 2-316. *Id.* § 2-316. Express warranties under the U.C.C. require affirmative conduct on the part of the seller. *Id.* § 2-313.

183. *Id.* § 2-318 Alternatives A, B, C.

184. One court has stated:

> Numerous principles have been suggested to determine the point at which a defendant should no longer be held legally responsible for damage caused 'in fact' by his negligence. Such limiting principles must exist in any system of jurisprudence for cause and effect succeed one another with the same certainty that night follows day and the consequences of the simplest act may be traced over an ever-widening canvas with the passage of time. In Anglo-American law, as Edgerton has noted, '[e]xcept only the defendant's intention to produce a given result, no other consideration so affects our feeling that it is or is not just

tralize this requirement.[185]

The operation of the physical injury rule in a third-party context was subjected to a detailed analysis in *People Express Airline Inc. v. Consolidated Rail Corp.*[186] In that case, the defendant's negligence had set in motion events leading to the plaintiff's economic loss. No personal injury or property damage was involved.[187] The court refused to apply the physical injury rule.[188] Although its analysis occurred in a context in which the rule worked to deny the plaintiff's claim for purely economic loss, the court's reasoning directly and comprehensively addresses the desirability of using physical injury as the touchstone for economic loss liability.[189]

The court conceded that under conventional tort doctrine, a defendant who negligently injures a plaintiff or his property is liable for all the proximately caused harm, including economic loss.[190] He is not liable if his conduct causes only economic loss.[191] Recovery in negligence for purely economic loss is traditionally denied because of concern over fraudulent claims, mass litigation, and limitless liability or liability out of proportion to fault.[192] Physical injury has been thought to solve these concerns by providing a causal link between the act and the injury while at the same time limiting liability.[193]

Even the occurrence of physical injury, however, has not always entitled the plaintiff to all the loss actually caused by the underlying

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to hold him for the result so much as its foreseeability.'

Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821, 824 (2nd Cir. 1968) (citations omitted).

185. The only brake on economic loss liability is the requirement that all the loss is the proximate result of the wrongdoing. The question of whether a traditional proximate cause requirement is an adequate clamp on consequential loss in products cases will be discussed later in this article. *See infra* notes 210-18 and accompanying text.

186. 100 N.J. 246, 495 A.2d 107 (1985).

187. *Id.* at 250, 495 A.2d at 109.

188. *Id.* at 263, 495 A.2d at 116.

189. *Id.* at 251, 495 A.2d at 109.

190. *Id.*

191. *Id.*

192. *Id.* at 252, 495 A.2d at 110.

193. The court in *People Express* contoured the rationale for a physical injury requirement for the recovery of economic loss in this manner:

> Some courts have viewed the general rule against recovery as necessary to limit damages to reasonably foreseeable consequences of negligent conduct. This concern in a given case is often manifested as an issue of causation and has led to the requirement of physical harm as an element of proximate cause. In this context, the physical harm requirement functions as a part of the causal relationship between the defendants negligent act and the plaintiff's economic damages; it acts as a convenient clamp on otherwise boundless liability. The physical harm rule also reflects certain deep-seated concerns that underlie courts' denial of recovery for purely economic losses occasioned by a defendant's negligence. These concerns include the fear of fraudulent claims, mass litigation, and limitless liability or liability out of proportion to the defendants' fault.

Id. at 252, 495 A.2d at 110 (citations omitted).

event. While the physical consequences of an act are finite, the remote results are seemingly limitless. Proximate cause and duty have functioned to limit liability.[194] These perspectives sparked the court to conclude that, in a negligence action, a duty and proximate cause analysis is just as appropriate for imposing liability as for limiting it.[195] It condemned the physical injury rule as one which "capriciously showers compensation along a path of physical destruction, regardless of the status or circumstances of the individual claimants."[196] It turned instead to a foreseeability test applied both to duty and proximate cause.[197]

Under this test, a defendant owes a duty only to plaintiffs "comprising an identifiable class with respect to whom defendant knows or has reason to know are likely to suffer such damages from its conduct."[198] The court stressed that an identifiable class of plaintiffs is not simply a foreseeable class of plaintiffs, but a class which is particularly foreseeable.[199] The measures of particular foreseeability are the type of persons or entities making up the class, the predictability of their presence, the numbers constituting the class, and the type of economic ex-

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194. The court in *People Express* defined the traditional role of proximate cause and duty in these terms:

> Even in negligence suits in which plaintiffs have sustained physical harm, the courts have recognized that a tortfeasor is not liable for *all* consequences of his conduct. While a lone act can cause a finite amount of physical harm, that harm may be great and very remote in its final consequences. A single overturned lantern may burn Chicago. Some limitation is required; that limitation is the rule that a tortfeasor is liable only for that harm that he proximately caused. Proximate or legal cause has traditionally functioned to limit liability for negligent conduct. Duty also has been narrowly defined to limit liability. Thus, we proceed from the premise that principles of duty and proximate cause are instrumental in limiting the amount of litigation and extent of liability in cases in which no physical harm occurs just as they are in cases involving physical injury.

Id. at 252-53, 495 A.2d at 110 (citations omitted).

Negligence doctrines are pertinent to strict liability in tort. Section 917 of *Restatement (Second) of Torts* posits the rule that one who tortiously harms the person or property of another is subject to liability according to the rules relating to legal cause. Tortious conduct includes "not only negligence but also conduct intended to inflict harm and that which entails strict liability under the rules stated in Restatement Chapters 20 and 21." RESTATEMENT (SECOND) OF TORTS § 917 comment b (1977). The rules relating to the liability of suppliers of chattel, which includes sections 402A and B of *Restatement (Second) of Torts*, are organized and promulgated in Division Two of the Restatement which sets forth the rules relating to negligence. It is thus reasonable to infer that rules appropriate to liability in negligence are pertinent to actions against suppliers of chattels under the strict tort product liability principles posited in sections 402A and B of the *Restatement (Second) of Torts*. RESTATEMENT (SECOND) OF TORTS §§ 402A-B (1977).

195. *People Express*, 100 N.J. at 253, 495 A.2d at 110.

196. *Id.* at 254, 495 A.2d at 111.

197. *Id.* at 262, 495 A.2d at 115.

198. *Id.* at 263, 495 A.2d at 116.

199. *Id.* at 264, 495 A.2d at 116.

pectancy affected.[200] Breach of duty to a member of a particularly foreseeable class is not enough, however, to impose liability. It must be joined with a proximate cause requirement. Proximate cause "is that combination of logic, common sense, justice, policy and precedent that fixes a point in a chain of events, some foreseeable and unforeseeable, beyond which the law will bar recovery."[201]

The court emphasized that its duty-proximate cause test of liability for economic loss reaches only losses particularly foreseeable.[202] Whether this test can be satisfied will turn on such matters as time and space relationships, the defendants' opportunity to "ascertain the identity and nature of the plaintiff's interests," the amount of litigation, and the extent of liability.[203] It defended its duty-proximate cause formula on the grounds that the imposition of liability for unforeseeable consequences not only punishes wrongdoers for harm that prudent conduct could not have avoided, but it undermines important policies affecting the allocation of liability.[204]

The line of reasoning advanced in *People Express* raises three interrelated product liability questions. First, is a duty and proximate cause approach to liability to third-parties more sensible than the mechanical processes of the physical injury rule? Second, if the approach passes this muster, does it extend the negligence concept of products liability to strict tort? Finally, should the approach, if it is otherwise sound, supplant or merely supplement the physical injury technique for controlling economic loss liability in the products area?

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200. *Id.* "An identifiable class of plaintiffs must be particularly foreseeable in terms of the type of persons or entities comprising the class, the certainty or predictability of their presence, the approximate numbers of those in the class, as well as the type of economic expectations disrupted." *Id.*

201. *Id.* at 264, 495 A.2d at 116 (quoting Powers v. Standard Oil Co., 98 N.J.L. 730, 734 (N.J. Sup. Ct. 1923), *aff'd o.b.*, 98 N.J.L. 893 (E & A 1923)).

202. *Id.* at 265, 495 A.2d at 118.

203. *Id.* at 265, 495 A.2d at 117.

204. *Id.* at 266-67, 495 A.2d at 117-18. The court argued that:

> The particular-general foreseeability axis is also accordant with the policies underlying tort law. For good reason, tortfeasors are liable only for the results falling within the foreseeability risks of their negligent conduct. Assigning liability for harm that fortuitously extends beyond the foreseeable risk of negligent conduct unfairly punishes the tortfeasor for harm that he could not have anticipated and taken precautions to avoid. This comports with an underlying policy of negligence doctrine: the imposition of liability should deter negligent conduct by creating incentives to minimize the risks and costs of accidents. The imposition of liability for unforeseeable risks cannot serve to deter the conduct that has eventuated in attenuated results, but instead arbitrarily assigns liability unrelated or out of proportion to the defendants' fault. If negligence is the failure to take precautions that cost less than the damage wrought by the ensuing accident, it would be unfair and socially ineffective to assign liability for harm that no reasonably-undertaken precaution could have avoided.
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> *Id.* (citations omitted).

In other words, should the physical injury rule remain a fixture of tort law permitting recovery in cases barren of "particular foreseeability"? In considering these questions, it must be kept in mind that under any rule, recovery of economic loss will be allowed in some cases and denied in others. The task is to isolate the test that assigns liability most sensibly.

It is clear that a duty and proximate cause test is conceptually closer to the U.C.C.'s method for distributing remedies to third-parties than the arbitrary dictates of the physical injury rule. The U.C.C.'s requirement that the third-party be one who reasonably could have been expected to use, consume, or be affected by the non-conforming goods[205] and its requirement that consequential damages relate only to loss resulting from those needs which the seller had reason to know at time of contracting[206] parallels a duty-proximate cause analysis. To the extent that foreseeability is the sensible predicate for allocating liability for economic loss, the physical injury rule suffers from two fundamental deficiencies. The first is its implicit assumption that the occurrence of physical damage to other property always results in economic loss fairly foreseeable to the remote manufacturer. This position is patently false, particularly in products cases where the defendant's products may find their way into places well beyond the foreseeability of even the most astute seller.[207] The second is its tendency to deny courts the opportunity to shape foreseeability principles that will help to fulfill the policies important to the assignment of liability. This shortcoming impairs the ability to assign risk to the party best able to manage it, the authority to use the law as a device for developing incentives, and the power to factor into liability the extent to which the substantive rules will result in liability unacceptably out of proportion to fault.[208]

The only limitation in the Code's economic loss scheme is the requirement that the loss proximately result from the defective aspect of the product in question.[209] This safeguard is inadequate on two grounds. First, it is devoid of a duty component. Under the Code's format, the occurrence of physical damage to other property creates the

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205. U.C.C. § 2-318 Alternatives A, B, C (1989).

206. Spring Motors Distrib., Inc. v. Ford Motors Co., 98 N.J. 555, 583, 489 A.2d 660, 674 (1985).

207. The court in *People Express* was particularly concerned that the physical injury rule scattered liability "capriciously." 100 N.J. at 254-55, 495 A.2d at 111 (1985). The rule was unworthy of use because of its ability to impose liability for unforeseeable risks. *Id.* at 266-67, 495 A.2d at 117-18. *See also* J. WHITE & R. SUMMERS, *supra* note 110, § 11-6.

208. *See e.g.*, East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 874 (1985) (regarding the tort approach to foreseeability as an "inadequate brake" on liability in circumstances, such as product liability, where the duty is owed to the public generally).

209. OHIO REV. CODE ANN. § 2307.79 (Anderson 1991).

duty.[210] The only issue open to a foreseeability analysis is the extent of the compensable injury. This rigidity strips the courts of intellectual authority over the critical question of whether the claimant was within a class to whom the manufacturer owed a duty.[211]

Second, tort's approach to proximate cause misses the mark when the target is liability for economic loss. It ignores the well-settled contract rule that a seller is liable only for indirect economic loss resulting from requirements of which at time of contracting he had reason to know.[212] *Restatement (Second) of Torts* section 917 sets forth the tort rule: "[o]ne who tortiously harms the person or property of another is subject to liability for damages for the consequences of the harm in accordance with the rules on whether the conduct is the legal cause of the consequences."[213] The comment to section 917 makes plain that, except where the duty is the result of a consensual arrangement, contract's rule of foreseeability of the harm is not a part of the tort formulation.[214]

Section 917's requirement that the conduct be the legal cause of the harm does not reduce the window of liability. The essence of legal cause is that the tortious conduct was a substantial factor in bringing about the harm and that no rule of law relieves the wrongdoer from liability because of the manner in which the wrongdoing resulted in the harm.[215] If the wrongdoer's conduct was a substantial factor in producing the harm, the fact that he neither foresaw nor should have foreseen the extent of the harm or the manner in which the harm occurred does not prevent liability.[216] Legal cause may be absent where, from a post-event perspective, it appears to the court "highly extraordinary" that

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210. *Id.*

211. *See supra* notes 191-204 and accompanying text.

212. U.C.C. § 2-715(2)(a) (1989). *See* Hadley v. Baxendale, 156 Eng. Rep. 145, 147 (1854).

213. RESTATEMENT (SECOND) OF TORTS § 917 (1977).

214. Comment d states in pertinent part:

> [A]lthough a contracting party who breaks his contract in failing to supply a machine would not be liable for the damages occasioned by shutting down a plant in which the machine was a necessary unit unless at the time of making the contract he knew or should have known the facts (see Restatement, Second, Contracts, Chapter 16 (Tent. Draft)), one who negligently destroys the machine may be responsible for the ensuing loss although he had no reason to know in advance of the machine's importance. The contractual rule, however, applies in cases in which the basis of the tort is the failure of the defendant to perform the obligations of a consensual relation with the other.

Id. comment d.

215. RESTATEMENT (SECOND) OF TORTS § 431 (1977). Although the rule stated in this section relates to negligence, such conduct covers the liability of suppliers of chattels. *See supra* note 184.

216. RESTATEMENT (SECOND) OF TORTS § 435(1) (1965).

the wrongdoer's conduct should have brought about the harm.[217] Given tort's express and specific abandonment of contract's requirement of seller awareness, it seems unlikely that courts would be inclined to regard economic loss in products cases as "highly extraordinary."

If a foreseeability test, styled along the lines of *People Express*, provides a sensible basis for measuring a seller's economic loss liability to third-parties, it must be determined whether that approach should replace or merely supplement the physical injury rule. The court in *People Express* was not confronted with a circumstance where physical harm had, in fact, occurred. However, the court's observation that liability tied to such a "requirement capriciously showers compensation along the path of physical destruction, regardless of the status or circumstances of individual claimants"[218] logically condemns the rule in all its applications. The sensible conclusion is that the physical injury rule should be abandoned in commercial cases and replaced with a process permitting a policy-sensitive allocation of economic loss liability built around the concept of particular foreseeability.

The foregoing materials together recommend the conclusion that if strict tort is to be extended to products cases involving economic loss by third persons outside the marketing chain, the physical injury approach to liability should be rejected in favor of a foreseeability analysis narrowed to take into account the enormous potential for liability in these cases. A duty-proximate cause approach would help to assure that remote sellers are not held accountable for events and losses which they could not foresee and thus could not prevent.[219] It also would help distribute liability fairly and rationally without exposing the law to baseless claims or torrents of litigation.[220]

This two-prong test for sorting out valid third-party economic loss claims is particularly suited to a strict tort theory of seller liability, especially where commercial products and economic loss are involved. The distribution of countless products into the hands of widely scattered persons with various business needs and methods of operation exposes sellers to boundless liability. Through manipulation of the requirements that the plaintiff be a member of an identifiable class and his loss a part of an identifiable risk, the courts will be able to isolate those claims in which the imposition of liability on the remote seller is fair and reasonable. Courts can effectuate this process by taking into account the following factors: the nature of the plaintiff's status; the

217. *Id.* § 435(2).
218. *People Express*, 100 N.J. at 254, 495 A.2d at 111 (1985).
219. *See supra* note 204 and accompanying text.
220. *See supra* note 191 and accompanying text.

kinds of economic expectancies and loss associated with that class; the likelihood of loss; the size of the individual loss; the aggregate risk; and the remote sellers practical contacts with the claimant.[221] Use of this process will enable the courts to identify within a complex marketing system the points where the imposition of liability is fair and reasonable and where parties can handle this burden by sound risk-management procedures.[222] The recommendations summarized at the conclusion of this article adopt this view and provide the modifications in the Code needed to effect it.[223]

c. Other Policy Considerations

Previously, this article examined the physical injury rule in the

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221. *See supra* notes 198-204 and accompanying text.

222. *See generally* Kinsman Transit Co. v. City of Buffalo, 388 F.2d. 821 (2nd Cir. 1968). The facts in *Kinsman Transit* illustrate the bizarre and unpredictable misadventures possible in a complex universe of relationships. *Id.* Although the case was decided under negligence principles, only modest imagination is required to convert the villain of the piece from careless conduct to defective mooring equipment such as a rope or a chain. In *Kinsman*, as a result of negligence, a vessel broke loose from its moorings and commenced to drift stern-first down a narrow S-shaped river channel. *Id.* at 822. In its travels it collided with another vessel breaking the latter loose from its moorings. The two continued to drift until they collided with a bridge, collapsing it. The wreckage from the bridge and the vessels formed a dam which caused extensive flooding and an ice jam which reached three miles upstream. As a result of these events, transportation on the river was disrupted for two months. The issue in the case was the liability of the negligent tortfeasors for the extra expenses suffered by other cargo owners as a consequence of the ice jam and associated difficulties. *Id.* The trial court had refused to confirm awards for such expenses reasoning that the loss was caused by negligent interference with contractual relations and that absent intentional interference or knowledge of the existence of such contract, recovery on this basis was not possible. *Id.* at 823. The court of appeals refused to rest the grounds for its decision on the principles pertinent to negligent interference with contractual relationships. *Id.* Instead, it invoked ordinary negligence principles. *Id.* at 823-24. Even after doing so, the court refused recovery for the claimed losses. *Id.* at 824. It held that they were "too 'remote' or 'indirect' a consequence of the defendant's negligence." *Id.* Admitting the potential breadth of the foreseeability concept, the court concluded that whether couched in terms of foreseeability, duty, proximate cause, or remoteness, the connection between the plaintiff's injury and the defendant's negligence was "too tenuous and remote to permit recovery." *Id.* at 825.

Although rationalized as ordinary negligence principles, it is rather apparent that the court in *Kinsman* followed a line of reasoning kindred to the one that would be pursued under the two prongs of the particular foreseeability test followed by the court in *People Express Airlines, Inc. v. Consolidated Rail Co.*, 100 N.J. 246, 495 A.2d 107 (1985). It is also apparent that the court in *Kinsman* would likely have allowed recovery for the subject economic loss if it was the proximate result of physical damage. The court's thinking on this approach to liability was not fully developed because the claimant did not seek recovery on this basis and because the fact of physical injury may not have altered or affected the damage issue. *Kinsman*, 388 F.2d at 825.

The disconcerting aspect of the physical injury rule is its one-punch ability to neutralize all the values, experience and wisdom implicit in the view that at some point a loss is too tenuous to be recoverable. The facts in *Kinsman* give particular color to the concern that the rule capriciously and arbitrarily scatters its jural consequences. Whether the subject economic losses occurred alone or in tandem with physical injury surely would be the product of the fickle conduct of fate.

223. Raitt, *supra* note 32.

context of each of the marketing relationships involved in the distribution of commercial products. It was shown that courts prefer U.C.C. remedies for instances of purely economic loss. This article presented the thesis that many of the values supporting this preference logically apply to cases in which the economic loss is the product of physical damage to property other than the product itself. This conclusion is particularly appropriate where the economic loss consists of consequential damage.

The views expressed in the cases draw support from other policy considerations. A variety of factors affect the allocation of liability. Among these are compensation of victims,[224] injury deterrence,[225] distribution of the costs of accidents,[226] allocation of resources,[227] cost of legal administration,[228] moral perspectives[229] and maximization of the joint value of interfering activities.[230] Indifference to these factors can lead to allocation decisions with a potential for undesirable results, including inhibition of socially useful activity, internalization of excessive costs, mismanagement of incentives, and excessive legal administration costs.[231]

Considerable modern scholarship has focused on the allocation of tort liability for physical loss in cases subject to negligence and strict tort remedies. Although general agreement exists on the factors impor-

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224. W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 129, at 938 (4th ed. 1971).

225. *Id.* § 4, at 23.

226. *Id.* § 4, at 22.

227. McKean, *Products Liability: Trends and Implications*, 38 U. CHI. L. REV. 3, 50 (1970).

228. W. PROSSER, *supra* note 224, § 4, at 22.

229. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151, 151-52 (1973).

230. Posner, *supra* note 172, at 207.

231. Perlman, *supra* note 69, at 61. Professor Perlman reviews the unfortunate consequences of improvident liability schemes:

> From an instrumentalist perspective the extension of liability increases the likelihood of at least three undesirable consequences. First, as the amount of potential liability increases, an actor must attach greater significance to the risk that the substantive legal rule will be applied erroneously or that he mistakenly will cross the line from no liability to liability. This increased cost of error may inhibit socially useful activity. The problem is most acute where liability is based in negligence, because the line between careless and careful behavior is ambiguous. Courts thus tend to delimit liability more strictly for negligence than for intentional torts, where in many instances the line between lawful and unlawful behavior is clear.
>
> Second, tort law may attempt to regulate the level of risky activity by internalizing its costs. As a loss becomes more remote from the defendant's act, the loss is more likely to be a cost attributable to intervening forces. Also, it is less likely that the defendant will regulate his activity to account for remote or unforeseeable losses. Third, as more losses are brought within the ambit of liability, the administrative costs of the legal system increase. On the other hand, limiting liability may reduce incentives to be careful.

Id. at 70-71.

tant to the allocation question, opinions divide on the rank and importance of each factor and the conclusions recommended by their interaction.[232] Two schools of thought dominate the allocation question. One views liability determinations as involving the "develop[ment of] a normative theory of torts that takes into account common sense notions of individual responsibility."[233] It contends that "the rules of liability should be based upon the harm in fact caused and not upon any subsequent determination of the reasonableness of the defendant's conduct."[234] The other follows the conviction that "economics is a powerful tool for analyzing a vast range of legal questions," including the assignment of legal liability.[235] As between these opposing positions, the common sense approach would hold manufacturers liable for the economic results connected with a physical injury to property. Proponents of this approach would follow a liability analysis organized around the belief that if the defendant's actions harm the plaintiff or his property, he should pay.[236] They would not view causation as a mask for assigning legal responsibility on the basis of social policies.[237] To them, causation, at least as it relates to personal injury and damage to property, "can be analyzed [and articulated] in a manner that both renders it internally coherent and relevant to the ultimate question [of] who should bear the loss."[238] They would agree, however, that causation and responsibility are separate questions and that proof of the former does not necessarily require the latter.[239]

It is unlikely that persons interested in a sensibly-structured system would wholly ignore the relevance of causation to the liability issue.[240] Nor would they dispute the ability of causation principles to

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232. *See, e.g.*, Calabresi, *Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr.*, 43 U. CHI. L. REV. 69 (1975) (promoting the use of causation as a device for apportioning liability); Epstein, *supra* note 229 (basing liability on a normative theory of torts which implements common sense notions of individual responsibility).

233. Epstein, *supra* note 229. This article is addressed primarily to the issue of whether strict liability in tort provides a fairer and more intelligent basis for assessing legal responsibility than negligence. It thus deals only indirectly with the damages that properly may be recovered once a basis for liability is established.

234. *Id.* at 189.

235. R. POSNER, ECONOMIC ANALYSIS OF LAW 3 (3d ed. 1986).

236. Epstein, *supra* note 229, at 165, 189.

237. *Id.* at 165.

238. *Id.*

239. *Id.* at 182. The school asserts, however, that the relationship between causation and responsibility is not clarified by per se rules arbitrarily severing the causal connection in particular circumstances. *Id.* at 182-83. Even with all of this, it would seem that the common sense school is primarily concerned with whether liability should be governed by strict tort principles where causation is the dominant element or by negligence concepts where perceptions of reasonableness play a controlling role. *See id.* at 189.

240. The products liability remedy contoured in the Code arguably does not allow an effi-

produce liability theorems in harmony with economic principles.[241] Excessive reliance on causation would, however, arguably produce an allocation system stunted by its indifference to resource allocation, cost-benefit comparisons, effect on incentives, the cost of legal administration and the role of private bargaining.

The assignment of liability for economic loss seems particularly and inherently suited to a system responsive to economic concerns. The school using economic concepts in its analysis posits that the economic objective of liability rules is to maximize the joint value of interfering activities.[242] The value maximization calculus involves a comparison of the costs of each party to reduce or eliminate the interference.[243] The outcome identifies the party upon whom liability should be imposed as an incentive to undertake the expense.[244]

The Code articulates a system which in its basic configurations allocates liability according to the principles of causation.[245] The marquee characteristics of this system are stringent product standards and constricted affirmative defenses.[246] An economic theorist likely would see this system as one built on the assumption that sellers are always best able to reduce or eliminate interferences in products cases.[247]

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cient application of the causation approach to responsibility. This deficiency derives from the failure of the Code to recognize many kinds of negligent conduct on the part of the plaintiff as effective to defeat or even diminish recovery. The only general affirmative defenses recognized in the Code are express and implied assumption of the risk. OHIO REV. CODE ANN. § 2315.20(B)(1) (Anderson 1991). Misuse of a defective product in an unforeseeable manner is also an affirmative defense. Bowling v. Heil Co., 31 Ohio St. 3d 277, 282, 511 N.E.2d 373, 377 (1987). Ohio's comparative negligence statute, section 2315.19 of the Revised Code, does not apply to product liability claims. *Id.* at 279, 511 N.E.2d at 375.

241. Professor Richard A. Epstein argues that the allocation of liability by the technique of common sense causation does not mean that the result will be antagonistic to economic principles. Epstein, *supra* note 229, at 187. He also contends that liability determined by this technique is preferable even on economic grounds because it reduces the administrative costs of decision. *Id.* at 188. With respect to the first point, to say that the result of a causation process may not offend economic principles is not to say that the result will always be consistent. On the second point, product liability concepts of strict tort, particularly in the design and warning area, implicate negligence principles. Recovery on this basis requires considerably more than a showing that the product injured the plaintiff. The common sense school would seem to be most comfortable in a universe dominated by a clear consensus of the conduct to be regarded as blameworthy. Even with respect to personal injury, liability standards in the product liability world are unsettled. The area must deal with the evolving issue of how safe is safe.

242. Posner, *supra* note 172, at 205.

243. *Id.* at 205-06.

244. *Id.* at 205-06.

245. OHIO REV. CODE ANN. §§ 2307.73, 2307.78 (Anderson 1991).

246. *Id.* §§ 2307.71-.80.

247. Posner, *supra* note 172, at 205-06. This conclusion follows from the Code's formula that product liability defendants must, absent rather narrow user conduct circumstances, pay for the damage caused by their defective products. OHIO REV. CODE ANN. §§ 2307.73, 2307.78 (Anderson 1991).

Through its economic loss provision, the Code extends causation constructs and assumptions to instances of economic loss. In so doing, it imposes on commercial cases an allocation scheme resting on moral and economic considerations thought to be appropriate for physical injury cases. The danger is that the values and perspectives appropriate for one class of cases are not suited for the other. It would be easier to accept the dramatic extension in the reach of strict tort as contemplated in the Code if more settled information were available on the costs of protection to producers, the benefits to users, the costs of legal administration, the effect on incentives, and the effect on the range of products available to cost-conscious consumers.[248] The economic loss resulting from defective products is a cost that cannot be ignored. The point is not to conceal this cost but to manage it wisely and efficiently. The allocation of liability is a critical element of the risk management process. Even if sound arguments could be raised for allowing economic loss claimants to trade on the high product standards developed to deal with the risk of physical endangerment, no sensible grounds exist for restricting, as the Code does, the affirmative defenses available against claims for economic loss.[249]

3. Recovery of Economic Loss Under Ohio Common Law

An examination of the position of the Ohio courts on the recovery of economic loss in products cases will provide yet another basis for assessing the merits of the Code's economic loss provision. The Code and the common law sources run parallel in some areas and take divergent paths in others. At the center of the common law canvass is *Chemtrol Adhesives Inc. v. American Manufacturers Mutual Insurance Co.*[250] In *Chemtrol*, the Ohio Supreme Court posited three rules

248. McKean, *Products Liability: Trends and Implications*, 38 U. CHI. L. REV. 3 (1970). What are the consequences of moving further toward producer liability—of reducing the chances that the purchaser will be held liable and of increasing the chances that the producer will have to bear the burden? This, to repeat, is what seems to have happened. The consequences of further moves in that direction would be to intensify the impacts noted above. One might expect more court cases and court costs, greater difficulty in bribing purchasers to be careful, more efforts to publish warnings and instructions (perhaps disclaimers, if they still gave producers some shelter), a greater tendency to produce safe products, a smaller range of product choice for poor consumers, and a partially offsetting tendency to neglect safety because of the more extensive use of liability insurance.

Id. at 50.

249. See *supra* note 240.

250. 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989). The parties in this case were commercial entities in privity with one another. The defendant contracted to design and build a dryer which was to include a heat recovery system. Because of alleged design defects in the dryer the product malfunction resulted in injury to itself. *Id.* The purchaser claimed damages for additional energy costs, other extra expenses, and repair costs. *Id.* at 42, 537 N.E.2d at 628. The purchaser brought an action against its insurer for these damages, and the insurer sought indemnification from the

respecting the common law division of authority between tort and contract in products cases. It also inserted a wild card into the remedies deck and deliberately left open a question going beyond the facts of the case.

The first of *Chemtrol's* rules is that in privity situations involving commercial parties, all the loss resulting from commercial products which damage themselves is economic loss.[251] The second is the companion principle that such loss by commercial parties must, absent certain wild card conditions, be sought under the warranty provisions of the U.C.C. rather than in tort.[252] The wild card concept adopts the notion that exclusive reliance on the U.C.C. is not required where the defective condition in the product posed a risk of unreasonable danger or harm to persons or other property.[253] Presumably, the presence of this condition opens the door to the use of strict tort remedies for the recovery of the damage to the product itself but not other items of economic loss.[254] In adopting the wild card principle, the court aligned itself with a minority position specifically rejected by the Supreme Court in *East River Steamship Corp. v. Transamerica Delaval.*[255]

The third rule of *Chemtrol* closes the economic loss triangle. In dictum, the decision endorsed the validity of tort's physical injury rule

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manufacturer of the product by direct action and third-party proceedings. *Id.* Since the insurance companies, as subrogees, acquired only the remedies available to the product purchaser, the court's inquiry focused on whether the purchaser would be entitled to recover from its seller. *Id.*

251. *Id.* at 50, 537 N.E.2d at 634-35.

252. *Id.* at 51, 537 N.E.2d at 635. The court also expressed the view that in consumer goods cases involving non-privity parties and loss from products which damage themselves, "an action in negligence may be an appropriate remedy to protect the consumers' property interests." *Id.* at 46, 537 N.E.2d at 631. Presumably, this thinking would be extended to consumer actions asserting strict tort relief.

253. *Id.* at 50, 537 N.E.2d at 635. It is impossible to accurately state the court's position on this matter. Since the court basically alluded to the minority cases' holdings that the presence of a defect posing an unreasonable danger to persons or other property gives rise to a strict tort remedy, it can be argued that the court in the name of completeness was merely presenting the range of views existing on the matter. On the other hand, it can be argued, probably with more weight, that the court's determination that the product defect in the subject case did not pose an unreasonable risk of harm to persons or other property is a clear signal of its acceptance of this principle. Such a reading would, however, put Ohio among the minority on this position. *See* East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 870-71 (1986). The court's comments on this topic make no distinction between consumer and commercial plaintiffs, but suggests that in property cases the wild card principle pertains only to the recovery of damage to the property itself and does not apply to the recovery of consequential loss. *Chemtrol,* 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635.

254. *Chemtrol,* 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635. Since only the threat and not the occurrence of harm would be involved, the Code's preemptive provisions would not come into play and the presence of privity would open the door to possible U.C.C. remedies. The wild card principle is pertinent only to instances in which the product has damaged itself. It allows recovery in tort for the repair or equivalent cost which otherwise would be recoverable only in contract as is held by Gorn recently.

255. 476 U.S. 858, 870-71 (1986).

and uncritically extended its use from negligence to strict liability in tort.[256] The issue deliberately left open in *Chemtrol* concerns the remedies available to non-privity parties, commercial and consumer, who suffer purely economic loss from a product condition posing no risk of physical harm. The court refused to decide whether these cases are subject to contract or tort.[257] The actual, as opposed to threatened, occurrence of personal injury or property damage as refined in *Chemtrol*, brings the Code into play.[258]

The reasoning in *Chemtrol* makes plain that the division of authority between tort and contract over economic matters in products cases involves the interrelationship of four factors: (1) the commercial or consumer character of the product; (2) the character of the defect; (3) the circumstances respecting privity; and (4) the direct or consequential nature of the economic loss. The combinations possible from these four variables create sixteen categories of product liability property damage situations with economic loss implications. The common law rules enunciated in *Chemtrol* and the rationale underlying those rules should be examined in all sixteen of these situations. If a study of the product liability area in all of its loss dimensions teaches anything, it is that alterations in one of these variables can change dramatically the remedies appropriate for a particular circumstance.

This category-by-category analysis will show where the Code and the common law meet and where they diverge. In this examination, direct economic loss clearly includes the loss of value not attributable to of physical injury. Whether a particular instance involving physical injury to property is to be regarded as property damage compensable in tort or direct economic loss cognizable only in contract is one of the

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256. *Chemtrol*, 42 Ohio St. 3d at 44, 537 N.E.2d at 629. Since the facts in *Chemtrol* were devoid of any personal injury or damage to other property, the opinion is dictum on the remedies available in such events. However, the absence of physical injury was the circumstance prompting the analysis undertaken by the court, and a condition essential to the determination limiting the plaintiff to contract remedies. *Id.* at 44, 51, 537 N.E.2d at 629-30, 635.

257. *Id.* at 50 n.7, 537 N.E.2d at 635 n.7. The court in *Chemtrol* acknowledged that its prior decisions of *Inglis v. American Motors Corp.*, 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965) and *Iacono v. Anderson Concrete Co.*, 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975) point in the direction of permitting non-privity plaintiffs to sue remote manufacturers in strict tort for the recovery of purely economic loss. *Chemtrol*, 42 Ohio St. 3d at 48-49, 537 N.E.2d at 633-34. Both *Inglis* and *Iacono* involved purchasers of consumer goods suing a remote manufacturer for the direct economic loss caused by defects in the goods. *Id.* at 45, 48-49, 537 N.E.2d at 630, 633-34. A variety of arguments can be made that giving non-privity purchasers of consumer goods a strict tort remedy for purely economic loss is sound policy. Among these arguments are (1) the practical lack of bargaining between these parties, (2) the economic disparity between consumers and manufacturers, and (3) the need for a theoretical device to negate the privity defense often available to manufacturers under the U.C.C.

258. *See supra* note 5 and accompanying text.

issues confounding the products area. The disposition of this question typically turns on two factors: (1) the property damaged; (2) the nature of the events leading to the loss.[259] Consequential loss refers to such matters as lost profits and extraordinary expenses.

a. Commercial Cases/Privity/No Wild Card Defect/Direct Economic Loss

The court in *Chemtrol* held that commercial parties in privity must seek relief under the U.C.C., rather than in tort, for all purely economic loss caused by product defects posing no risk of personal injury or physical damage.[260] Damage to the product itself in this circumstance is economic loss subject to the basic prescription.[261] On these matters, the Code and the common law stand on common ground.[262] Each treats actual physical damage to other property as physical injury recoverable in tort,[263] and each allows the recovery in tort for the consequential economic loss connected with the physical damage event.[264]

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259. The court in *Chemtrol* saw the damages possible from defective products as including the following: (1) personal injury, viewed by the court as self-explanatory; (2) property damage, seen as connoting either damage to the defective product itself or damage to other property; and (3) economic loss, categorized as either direct or indirect. *Chemtrol*, 42 Ohio St. 3d at 43, 537 N.E.2d at 629. Direct economic loss was regarded as including the loss connected with the decreased value of the product itself, measured by the difference between the actual value of the product and the value it would have had in a non-defective condition. *Id.* Indirect economic loss was seen to embrace "the consequential losses sustained by the purchaser of the defective product," including such matters as production time lost and lost profits. *Id.* at 43-44, 537 N.E.2d at 629.

Care must be taken to distinguish these perceptions and descriptions of loss from those delineated in the U.C.C. where injury to all property is regarded as a form of consequential damages. U.C.C. § 2-715 (1978). It also should be noted that while the court in its general assessment regarded damage to the product itself as property damage, it ultimately held that in commercial cases such loss, however sustained, is economic loss insofar as labels are indicative of the doctrine to be applied. *Chemtrol*, 42 Ohio St. 3d at 44, 537 N.E.2d at 629-30. With respect to property other than the product itself, whether the loss is property damage or economic loss, conventionally turns on the nature of the loss event—sudden and accidental failure versus slow deterioration.

260. *Chemtrol*, 42 Ohio St. 3d at 50, 537 N.E.2d at 634.

261. *Id.*

262. *Id. Chemtrol's* formulation that damage to the product itself is economic loss not recoverable in tort conforms to the Code's prescription that such damage is "economic loss" not recoverable under its remedy for harm. OHIO REV. CODE ANN. §§ 2307.71(B)(6), 2307.72 (Anderson 1991).

263. For the Code provisions pertinent to physical injury to property, *See* OHIO REV. CODE ANN. §§ 2307.71(G), 2307.72, 2307.73 (Anderson 1991). For the common law rule, see *Chemtrol*, 42 Ohio St. 3d at 43-44, 537 N.E.2d at 629.

264. The Code defines economic loss as direct, incidental or consequential pecuniary loss, including, but not limited to damage to the product itself and non-physical damage to other property. OHIO REV. CODE ANN. § 2307.71(B) (Anderson 1991). The common law basically subscribes to this approach. *Chemtrol*, 42 Ohio St. 3d at 43-44, 537 N.E.2d at 629.

b. Commercial Cases/Privity/No Wild Card Defect/Consequential Loss

Claims seeking consequential economic loss in this circumstance are governed by the rules and principles detailed in the first category. The character of the economic loss does not alter the remedial scheme pertinent to non-wild card cases involving commercial parties in privity.

c. Commercial Cases/Privity/Wild Card Defect/Direct Economic Loss

The presence of a defect posing a risk of physical injury, the wild card condition, apparently opens the door to tort relief even in privity cases.[265] The remedies available would be strict liability and negligence in tort, and possibly warranty in tort.[266] These would be in addition to the remedies available under the U.C.C.[267] Under the wild card concept, the tort relief would appear to reach only damage to the product itself.[268] In the typical products case, this would translate into the diminished value caused by the defect or, in an appropriate case, repair and replacement costs.[269] If the defect causes actual physical damage to other property, the remedial provisions of the Code preempt all other remedies.[270]

Chemtrol suggests that consequential economic loss does not fall within the wild card concept.[271] Relief for such loss will have to be sought under the U.C.C.[272] Presumably, the wild card liability of the seller in tort for economic loss is a matter that could be addressed during bargaining and the risk shifted to the buyer according to the tort principle of express assumption of the risk. Without a wild card condition, the rules in the first category apply. The Code does not embrace the wild card concept. It requires harm.[273] With harm, however, comes the ability to recover all the economic loss resulting from that event.[274]

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265. The parties in *Chemtrol* were in privity. Nothing in the court's attitude on the wild card question treats privity as a relevant consideration. *Chemtrol*, 42 Ohio St. 3d at 40, 50-51, 537 N.E.2d at 635.

266. For remedies available in circumstances in which the Code does not apply, see *supra* note 15.

267. *Id.*

268. *Chemtrol*, 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635.

269. *Id.* at 43-44, 537 N.E.2d at 629.

270. OHIO REV. CODE ANN. §§ 2307.71(G),(M), 2307.72(A), 2307.73 (Anderson 1991).

271. *Chemtrol*, 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635.

272. With Code and common law tort remedies unavailable to plaintiffs who have sustained purely economic loss, the remedies provided in the U.C.C. remain as the only viable predicates for relief. OHIO REV. CODE ANN. § 2307.72 (Anderson 1991).

273. *Id.* §§ 2307.72(A), 2307.79.

274. *Id.* §§ 2307.71(G),(M), 2307.72(A),(G), 2307.79.

d. Commercial Cases/Privity/Wild Card Defect/Consequential Loss

As explained in the discussion in the third category, the wild card concept does not extend to consequential economic loss. It is limited to damage to the product itself which, without the use of the concept, would be regarded as direct economic loss recoverable only in contract. Recovery for consequential economic loss must be pursued under the U.C.C.[275]

e. Commercial Cases/No Privity/Wild Card Defect/Direct Economic Loss

Although the court in *Chemtrol* specifically left open the issue of the remedies available to commercial parties in non-privity cases, the presence of a wild card defect would seem to open the door to recovery in tort for the damage to the product itself caused by the product defect regardless of privity.[276] The absence of direct dealing does not alter the reasoning underlying the wild card concept; it affects only the practical ability of the parties to negotiate the seller's tort liability.[277] Again, the existence of a wild card defect in the product does not activate the Code. Actual physical injury to property other than the product itself is required to bring it into play.[278]

f. Commercial Cases/No Privity/Wild Card Defect/Consequential Loss

Although the existence of a wild card condition allows for recovery in tort for the damage to the product itself, it does not provide the predicate for the recovery of consequential economic loss.[279] Privity is relevant only to whether the parties had a practical ability to bargain on the remedies question.

g. Commercial Cases/No Privity/No Wild Card Defect/Direct Economic Loss

The court in *Chemtrol* refused to go beyond the facts of that case in order to speculate on the remedies available to non-privity parties in non-wild card cases.[280] It noted that this issue would require a re-exam-

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275. *Chemtrol*, 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635; OHIO REV. CODE ANN. §§ 2307.71(G),(M), 2307.72(A),(C) (Anderson 1991).

276. *See Chemtrol*, 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635.

277. The focus in the wild card concept is solely on the character of the product condition causing the damage. The facts respecting privity are irrelevant to whether a wild-card condition was present in the product. *See, e.g., id.*

278. OHIO REV. CODE ANN. §§ 2307.71(G),(M), 2307.72 (Anderson 1991).

279. *See supra* note 268 and accompanying text.

280. *Chemtrol*, 42 Ohio St. 3d at 50 n.7, 537 N.E.2d at 635 n.7.

ination of its holdings in *Inglis v. American Motors Corp.*[281] and *Iacono v. Anderson Concrete Co.*[282] In each of these cases, the court authorized the use of a warranty in tort remedy against a non-privity manufacturer for the recovery of direct economic loss.[283]

Even before *Chemtrol* there was uncertainty in the non-privity area respecting the breadth of goods subject to tort remedies. *Inglis* and *Iacono* appeared to involve consumer products.[284] Arguments can be made that the U.C.C., with its freedom of contract philosophy, is ill-suited for consumer cases.[285] These contract deficiencies create a natural vacuum in the consumer area for tort to fill. However, any attempt to confine tort remedies to consumer cases must deal with *U.S. Fidelity and Casualty Co. v. Truck and Concrete Co.*,[286] ignored in *Chemtrol*, in which warranty in tort remedies were extended to a commercial case with no apparent restrictions on the damages recoverable under them.[287]

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281. 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965).

282. 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975).

283. In *Inglis*, a non-privity purchaser of an automobile was permitted to assert a warranty in tort theory of recovery against the remote manufacturer for the diminution in value resulting from the failure of the goods to conform to the manufacturer's representations concerning the quality of the product. 3 Ohio St. 2d at 140-41, 209 N.E.2d at 588-89. In *Iacono*, the court permitted a non-privity purchaser of concrete used for a residential driveway to recover against the remote producer for the defects in the driveway resulting from the failure of the concrete to be adequate for its intended purpose. 42 Ohio St. 3d at 92-93, 326 N.E.2d at 270-71. While the *Iacono* court characterized the loss as property damage, the better view, as the court in *Chemtrol* noted, would have been to treat such self-inflicted damage as a form of economic loss. *Chemtrol*, 42 Ohio St. 2d at 44, 537 N.E.2d at 630; *Iacono*, 42 Ohio St. 3d at 92-93, 326 N.E.2d at 270-71.

284. *Iacono*, 42 Ohio St. 2d at 88, 326 N.E.2d at 267; *Inglis*, 3 Ohio St. 2d at 133, 209 N.E.2d at 584. The character of the products was not made an issue in *Inglis* and *Iacono*. The holdings in each case were rendered in the context of a motion addressed to the sufficiency of the complaint to state a claim on a particular theory of recovery. *Iacono*, 42 Ohio St. 2d at 89, 326 N.E.2d at 268; *Inglis*, 3 Ohio St. 2d at 134-35, 209 N.E.2d at 584-85. Although an automobile (*Inglis*) and concrete (*Iacono*) have commercial applications, neither plaintiff sought damages for consequential economic loss, indicating actual commercial use. In *Inglis*, the plaintiff sought diminution in value damages resulting from the product's failure to conform to the seller's claims. 3 Ohio St. 2d at 133-34, 209 N.E.2d at 584. In *Iacono*, the plaintiff sought damages measured by the cost of repairing the product's self-inflicted damage. 42 Ohio St. 3d at 58-59, 326 N.E.2d at 268.

285. The problems involved in the use of the U.C.C. to govern the rights and remedies of consumers were reviewed in *Spring Motors Distributors, Inc., v Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985). Among the arguments militating against the use of the U.C.C. in consumer cases are: (1) the lack of bargaining in most such cases; (2) the disparity in power and ability between consumers and producers; and (3) the need for a theory able to navigate around the practical and legal barriers imposed by a privity requirement. *Id.*

286. 21 Ohio St. 2d 244, 257 N.E.2d 380 (1970).

287. *Id.* at 251-52, 257 N.E.2d at 384. *United States Fidelity* involved non-privity parties. *Id.* at 251, 257 N.E.2d at 384. In this case, a concrete mixer on a truck used for commercial purposes fell off the truck chassis damaging both the chassis and the mixer. *Id.* at 245, 257 N.E.2d at 381. Under the reasoning followed in *Chemtrol*, the damage today likely would be regarded as damage to the product itself. 42 Ohio St. 3d 40, 537 N.E.2d 624 (1989). The issue in

Chemtrol suggests that the court now would be inclined to limit the use of strict tort to consumer cases and to restrict the damages recoverable under that theory.[288] This article endorses such a limitation. The Code does not provide a remedy for purely economic loss even where only consumer products are involved. For all products, the recovery of economic loss depends upon the simultaneous occurrence of harm.[289]

h. Commercial Cases/No Privity/No Wild Card Defect/Consequential Loss

Inglis and *Iacono*, the decisions authorizing the use of a form of strict tort remedy in non-privity cases, involved consumers and limited recovery to direct economic loss.[290] In contrast to these decisions is the holding in *United States Fidelity* extending strict tort to commercial cases without express damage restrictions.[291] *Chemtrol* indicates the Ohio Supreme Court's reluctance to provide tort remedies for non-privity, non-wild card commercial cases involving purely economic loss.[292] It also implies that even if strict tort were available in such cases, the remedy would be limited to the recovery of diminution in value or the cost of repair of the product itself.[293]

i. Consumer Cases/Privity/No Wild Card Defect/Direct Economic Loss

Chemtrol is a commercial case and thus provides only limited and indirect guidance for consumer cases. The case suggests, however, that the Ohio Supreme Court currently would allow consumers a strict tort remedy against remote manufacturers for the direct economic loss or

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United States Fidelity was the appropriate statute of limitations for the claim. 21 Ohio St. 2d at 247, 257 N.E.2d at 382. The court held that the statutes of limitation appropriate for actions based on a contract were not pertinent because the absence of privity prevented the maintenance of contract claims. *Id.* at 251, 257 N.E.2d at 384. It further held that the plaintiffs' claim was one in tort based on the breach of an implied warranty arising from the duties assumed by a product seller relating to implied representations regarding the quality and safety of his product. *Id.* at 251-52, 257 N.E.2d at 384. As such, it was subject to and barred by the statute of limitations relating to actions for injuring property. *Id.* at 251, 257 N.E.2d at 384. The recognition of a viable tort theory of recovery in this damage to the product itself case was thus critical to the court's decision. *Id.* at 251-52, 257 N.E.2d at 384.

288. *See Chemtrol*, 42 Ohio St. 3d at 50, 537 N.E.2d at 635.

289. OHIO REV. CODE ANN. § 2307.79 (Anderson 1991).

290. *See supra* notes 283-84 and accompanying text.

291. *See supra* notes 286-87.

292. *Chemtrol*, 42 Ohio St. 3d at 50 n.7, 537 N.E.2d at 635 n.7. The court's recognition of the substantial criticism directed at the minority view giving non-privity commercial parties tort remedies for the recovery of purely economic loss would not seem to argue favorably for the survival of those remedies in Ohio, certainly not in a commercial context. *See id.*

293. This conclusion derives from the *Chemtrol* court's limitation of the wild card concept to recovery in tort for the damage to the product itself. *Id.*

product damage caused by the failure of consumer goods to conform to the manufacturer's representations or to be free of intrinsic defects.[294] As previously expressed, good arguments can be raised that the freedom of contract concepts in the U.C.C. do not supply sensible predicates for consumer remedies.[295] If this position is well founded, a case can be made for extending the remedy to consumers in privity with their seller.[296]

The most compelling argument for withholding tort relief to consumers in privity with their seller is the conflict that would arise between the tort remedy and those provided by the U.C.C. Elsewhere in this article it is contended that tort remedies should not be needlessly extended to commercial cases. This conclusion is premised in part on the belief that the U.C.C. is superior for resolving conflicts between commercial parties in privity.[297] That superiority does not exist in consumer cases.[298] It thus can be argued that in consumer cases, the availability of U.C.C. remedies, tilted as they are in favor of more commercially experienced sellers, is an inadequate basis for denying strict tort relief to consumer purchasers regardless of privity. The tort doctrine of express assumption of the risk would seem adequate to effectuate risk transfers actually contemplated in the bargain.[299] Where no bargaining occurred, the consumer buyer simply would enjoy both common law

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294. *See Chemtrol,* 42 Ohio St. 3d at 40, 537 N.E.2d at 624; *see also* East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986) (no tort liability where defective product causes only economic harm); Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985) (no strict liability for purely economic loss in defective product cases); Avenell v. Westinghouse Elec. Corp., 41 Ohio App. 2d 150, 324 N.E.2d 583 (1974) (no consequential damages awarded to buyer in breach of implied warranty action against seller). The basis of decisions in these cases rested in considerable part on particular appropriateness of U.C.C. remedies for commercial cases. The position and the arguments supporting them lose much of their moment in consumer goods cases, particularly where privity is absent.

295. *See supra* note 263.

296. Even though the presence of privity puts the parties in a position to bargain, consumers often will be poorly informed on the rights and abilities made available to buyers in the U.C.C. Much of the impetus for the creation of tort remedies for purely economic instances, the effect of which is to substitute freedom of contract principles with requirements resting on public policy considerations, has sprung from a practical assessment of the conditions confronting consumers in the modern market. *See, e.g.,* Seely v. White Motor Co., 63 Cal. 2d 9, 26, 403 P.2d 145, 156, 45 Cal. Rptr. 17, 28 (1965) (Peters, J., concurring in part and dissenting in part).

297. *See supra* notes 80-142 and accompanying text.

298. *See supra* note 247. This conclusion is further based on the belief that freedom of contract principles are designed to function in transactions in which both parties are alert to their respective rights and possess the market place power, knowledge, and experience necessary to effect those rights. The existence of these conditions in consumer transactions would be the exception and not the rule whatever the risk at issue. Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 389, 161 A.2d 69, 86 (1960).

299. *See* Anderson v. Ceccardi, 6 Ohio St. 3d 110, 114, 451 N.E.2d 780, 783 (1983) (stating the requirements of express assumption of risk).

tort and contract remedies.[300] The Code would not be involved as it does not provide a remedy for purely economic loss.[301]

j. Consumer Cases/Privity/No Wild Card Defect/Consequential Loss

The issue unique to this category is whether the reasoning outlined in the last category should be carried over to consequential economic loss. Depending on the range of products given consumer status, consequential economic loss ordinarily is not an element of loss associated with consumer cases.[302] The range of damages recoverable under a consumer strict tort remedy would seem to be an issue best left to development through the common law process. The key would be the way in which the policies justifying the use of tort in the first instance would apply to the damage question.[303]

k. Consumer Cases/Privity/Wild Card Defect/Direct Economic Loss

Under *Chemtrol*, the presence of a wild card defect presumably opens the door to the use of strict tort remedies against the product manufacturer for damage to the product itself irrespective of privity.[304] The presence of privity, however, would give the parties an opportunity to bargain away the tort remedy pursuant to the requirements of express assumption of the risk.[305] Although *Chemtrol* was a commercial case, nothing in the case logically compels a restriction of the wild card concept to commercial cases. If the principle is sound, its use is equally appropriate in consumer cases.

l. Consumer Cases/Privity/Wild Card Defect/Consequential Loss

One of *Chemtrol's* wild card conditions is that the tort remedy made available by the wild card circumstance apparently is limited to damage to the product itself.[306] As previously noted, the potential for

300. A major benefit of permitting the courts to tailor a strict tort remedy through the common law process would be the opportunity to develop affirmative defenses conceptually crafted for claims seeking recovery for purely economic loss. Misuse, express assumption, and implied assumption of the risk are too narrow to give effect to all the kinds of plaintiff conduct probative of ultimate liability for purely economic loss.

301. *See supra* notes 5-6 and accompanying text.

302. J. WHITE & R. SUMMERS, *supra* note 110, § 11-6 at 446 n.3.

303. The courts have articulated a variety of factors pertinent to the location of the boundary between tort and contract. *See supra* note 79-87 and accompanying text. The problem in each case would involve an application of these factors to the particular item(s) of loss sought by the claimant.

304. *Chemtrol*, 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635.

305. For an recitation of the requirements of express assumption of the risk, see Anderson v. Ceccardi, 6 Ohio St. 3d 110, 451 N.E.2d 780 (1983).

306. *Chemtrol*, 42 Ohio St. 3d at 50-51, 537 N.E.2d at 635.

consequential economic loss in consumer cases is limited and depends upon the breadth given to the concept of consumer product. In practice, a strict tort remedy addressed to damage to the product itself or direct economic loss should be adequate in most instances to compensate consumers. Where the remedy falls short of fair compensation, the courts should have the common law authority to extend its range on a case-by-case basis.

m. Consumer Cases/No privity/Wild Card Defect/Direct Economic Loss

The wild card approach to economic loss liability is conceptually most comfortable in non-privity consumer goods cases. The practical circumstances in this category parallel in many respects those existing in *Inglis* and *Iacono*.[307] Although *Chemtrol*, the source of Ohio's wild card jurisprudence, involved a commercial product, no sound arguments work against extension of the concept, if it is otherwise sound, to non-privity consumer cases.[308]

n. Consumer Cases/No Privity/Wild Card Defect/Consequential Loss

The central question in this category concerns the extent to which consequential economic loss is a significant problem in consumer cases. As argued previously, courts should have the power to deal with this issue on an evolving basis. If common law tort remedies for purely economic loss remain available to non-privity purchasers of consumer goods, the wild card concept will be irrelevant in any event.

o. Consumer Cases/No Privity/No Wild Card Defect/Direct Economic Loss

This is the category most closely approximating the conditions existing in *Inglis* and *Iacono*. Although *Chemtrol's* expression of a willingness to re-examine these cases raises a risk of their modification or

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307. In both *Inglis v. American Motors Corp.*, 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965) and *Iacono v. Anderson Concrete Co.*, 42 Ohio St. 2d 88, 326 N.E.2d 267 (1975), privity was absent. In the former, the purchaser sought damages for failure of an automobile to conform to the remote sellers claims. *Inglis*, 3 Ohio St. 2d at 133, 209 N.E.2d at 584. In the latter, the claimants sought damages to the product itself resulting from the failure of the product to conform to the standards required for its ordinary uses. *Iacono*, 42 Ohio St. at 88, 326 N.E.2d at 268. The key factor in such cases is the disabling effect that the absence of privity has upon the ultimate purchaser's ability to obtain adequate redress from the party responsible for the condition causing the loss.

308. The rationale for the wild card principle is the unwillingness to allow fortuities in the dynamics of the loss to control the remedies available for the event. *Chemtrol*, 42 Ohio St. 3d at 50, 537 N.E.2d at 635. The character of the goods, commercial or consumer, is quite unrelated to whether a particular loss was fortuitous.

even reversal, the evidence points away from such action in consumer cases.[309] The withdrawal of strict tort relief for non-privity consumers would restrict them to the remedies provided in the U.C.C., and problems exist concerning the U.C.C.'s conceptual ability to provide remote consumers adequate remedies.[310] Moreover, consumers often have been seen as requiring special protection, even in matters involving purely economic loss.[311] The Code does not provide a direct remedy for purely economic loss.[312]

p. Consumer Cases/Non-Privity/No Wild Card Defect/Consequential Loss

All the comments in the previous category are pertinent here. Additionally, this category raises the issue of whether the strict tort remedy, if it is to remain viable in Ohio, should extend to consequential economic loss. Consumer cases often are barren of such loss. Where it exists, courts should possess the freedom to raise sensible rules built on the principles of foreseeability.

Even with the adoption of the Code, the common law tort rules relating to the recovery of economic loss continue as important pieces in the mosaic of product liability rules. In some instances these rules will be available to recover purely economic loss, a matter falling outside the Code's plan. In others, they can be engaged under the Code's non-preemptive economic loss provision to recover the economic loss connected with damages subject to the Code's provisions.[313]

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309. Much of the impetus for the origin and growth of the concept of strict liability in tort comes from the need to provide consumers with adequate recourse against remote manufacturers for physical injuries. *See, e.g.*, Greenman v. Yuba Power Prod., Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963). Many of the disadvantages suffered by consumers in physical injury cases are present where their loss is purely economic. It can be argued that a common law strict tort remedy making remote manufacturers liable for consumers for the loss of value resulting from intrinsic defects in a product is simply a logical extension of the remedy given to consumers for the failure of the product to conform to the seller's express warranties. *See* Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301-(1)-(12) (1989).

310. *See supra* notes 179-84.

311. *See* Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301-(1)-(12) (1989).

312. OHIO REV. CODE ANN. § 2307.72(C) (Anderson 1991).

313. The Code does not apply to claims for purely economic loss. *Id.* § 2307.72(C). However, claimants who have suffered harm may recover compensatory damages for the economic loss resulting from the product condition causing the harm. *Id.* § 2307.79. Such claimants are not required by section 2307.79 to seek recovery under the Code. Presumably, this means that under liberal joinder of claims provisions, they may alternatively seek relief under common law remedies and those provided in the U.C.C. The facts respecting privity will affect considerably the range of alternative remedies available to the claimant.

4. Comparison of Code and Common Law Tort Remedies for Economic Loss

Both the Code and the common law employ the principle that the actual occurrence of personal injury or property damage enables the claimant to use tort remedies for the recovery of the economic loss caused by the product defect.[314] In the implementation of this principle, each takes the position that the damage to the defective product itself is economic loss and not property damage insofar as that distinction is pertinent to whether tort remedies are proper.[315] Each also accepts the position that the physical injury approach applies both to commercial and consumer products and that privity is irrelevant.[316] In instances of actual physical injury, the Code's preemption provision renders the common law rules academic on losses cognizable as "harm."[317] However, preemption does not prevent the use of common law tort remedies to recover the economic loss resulting from the defect causing the harm.

This article argues against the unrestricted use of the physical injury approach to economic loss liability in commercial products cases. It contends that liability on this basis often yields results at odds with those counseled by a policy-conscious application of tort and contract doctrine. While the Code and the common law share common ground on the physical injury aspects of product liability, they pursue divergent views on a variety of other matters touching upon the recovery of purely economic loss. The Code does not directly provide for the recovery of such loss. Even the existence of a product defect posing the risk of physical injury is inadequate to bring the Code's provisions into play. Harm also must have occurred.[318]

Unlike the Code, the common law embraces the notion that a product defect posing an unreasonable risk of physical injury is adequate to invoke strict tort relief, for damage to the product itself.[319] This notion is apparently operative whatever the character of the parties or the facts regarding privity[320] and opens areas otherwise off limits to strict tort. Most notable are claims involving commercial parties in

314. The Code rule is set out in section 2307.79 of the Revised Code. The most recent common law ratification of the principle is in dictum in *Chemtrol.* Chemtrol Adhesives, Inc. v. American Mfrs. Mut. Ins. Co., 42 Ohio St. 3d 40, 50-51, 537 N.E.2d 624, 634-35 (1989).

315. *Chemtrol,* 42 Ohio St. 3d at 51, 537 N.E.2d at 635; OHIO REV. CODE ANN. §§ 2307.71(B), (G), (M), 2307.73 (Anderson 1991).

316. *See supra* note 315.

317. OHIO REV. CODE ANN. § 2307.72(A) (Anderson 1991).

318. *Id.* § 2307.73.

319. *Chemtrol,* 42 Ohio St. 3d at 50, 537 N.E.2d at 635.

320. *Id.*

privity.

Before the introduction of the wild card concept, the common law had developed strict tort remedies for a variety of instances involving purely economic loss. Throughout this process, the focus seemed to be more on the problem of privity than on the character of the goods and parties.[321] Since *Chemtrol*, the common law economic loss rules are up for review. The preliminary signs indicate an increasing reluctance to deploy strict tort remedies for purely economic loss in cases involving commercial parties. A less restrictive attitude exists in consumer cases. The recommendations made at the conclusion of this article are consistent with these indications.

III. CONCLUSION

A. Summary of Policy Arguments Against the Code's Economic Loss Provision

This article has aimed at sorting out the policies underlying tort and contract in commercial cases and ascertaining the effect of the occurrence of physical injury on the deployment of those doctrines in products cases. The investigation was driven initially by a sense that if, from a policy perspective, tort and contract are properly aligned in cases of purely economic loss, the occurrence of physical injury generally should be ineffective to alter the economic aspects of commercial losses. The organization of the analysis was prompted by a belief that the extent to which the commercial parties had an opportunity to bargain over the risk of economic loss should be an important factor in determining whether the area should be governed by rules reflecting freedom of contract principles or by those resting on more broadly based notions of social responsibility. This mindset led logically to three categories of plaintiffs: (1) immediate purchasers; (2) subpurchasers in the marketing chain; and (3) persons outside the marketing chain.

With respect to immediate purchasers, this article concludes that their economic loss disputes with their sellers, certainly those involving consequential loss, should be governed exclusively by the U.C.C. The better ability of buyers to identify and quantify their economic risks, their access to insurance protection, and the availability of a commercial seller from whom warranty protection could have been obtained are among the factors prompting this conclusion.

The occurrence of physical injury to other property, the event most likely to trigger tort's physical injury rule in commercial products property cases, was determined to be ineffective to alter the pattern of rem-

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321. *See supra* note 32.

edies that would be applicable to instances of purely economic loss. Viewed practically, this risk was well within the contemplation of the parties at the time of bargaining and completely manageable under the U.C.C.'s risk allocation procedures. Moreover, nothing in the theoretical makeup of the physical injury concept warrants the intervention of tort in products cases. In fact, the theoretical arguments cut the other way. In these cases, the rule functions ineffectively as a clamp on liability, and its role as guarantor of fair compensation is largely subverted by the cases holding that damage to the product itself is only economic loss unrecoverable in tort.

Regarding economic loss claims by subpurchasers, the alteration in the marketing relationship does not bend the results of the analysis away from the exclusive use of the U.C.C. Every commercial buyer has a commercial seller from whom warranty protection could be obtained. Fixating on privity, however, misses the mark. From a policy perspective, manufacturers often will be unable accurately to foresee the economic loss risks confronting many of the subpurchasers in the marketing chain. This lack of vision translates into a severely impaired ability to provide or obtain protection for economic claims springing from these sources. On the other hand, subpurchasers are fully acquainted with their own particular circumstances and the measures needed for financial protection. They may be able to minimize the loss or even avoid it, and can factor protection costs into their price.

The most difficult category is the one involving economic loss claims by third persons outside the marketing chain. Both sides possess sound arguments. Manufacturers face inestimable liability. Third-parties may be blameless and bereft of warranty protections. Tort's answer to this difficult problem is the physical injury rule. This basis of liability derives not so much from the needs of victims as from the need for a technique containing liability. In the products area, the physical injury approach fails this function. Moreover, its lack of internal logic and indifference to policy make it a poor basis for selecting the party who will be required to bear the risk of loss.

The arbitrariness of the physical injury rule has prompted one jurisdiction to abandon it in favor of a test built on particular foreseeability. This approach gives courts the ability to balance all the factors involved in a principled allocation of risk of loss. Product cases are particularly needful of a policy conscious system for allocating liability. Manufacturers must account for many products subject to high quality and safety standards. In some instances the weight of the particular foreseeability arguments will fall against them. In others, the remoteness of the loss will militate against liability. At least liability will be determined by principle and not by chance. The Code's economic loss

provision, through its proximate cause requirement, gives courts some control over the range of a product seller's liability. However, no assurance exists that a sense of "particular foreseeability" will be blended into the Code's proximate cause element, borrowed as it was, from general tort principles.

This article also profiles the common law tort rules relating to economic loss liability. Because of the Code's preemption feature, these rules have lost their authority over cases involving harm. However, the courts of Ohio have been active in crafting common law remedies for purely economic loss. The Code and the common law should be rationally integrated not only to provide a coherent pattern of tort remedies, but also to assure the proper interaction of those remedies with those of the U.C.C.

B. Recommendations

The materials presented in this article make the economic arguments supporting a system under which all commercial parties in the distribution chain of commercial goods would be subject exclusively to the rights and remedies arrayed in the U.C.C. The only commercial parties who would be entitled to seek strict tort relief for any item of economic loss caused by commercial goods would be parties outside the marketing chain. Even in this instance, recovery would be limited to those items of economic injury particularly foreseeable to the remote seller.

These conclusions are supported in a second article which reveals the practical difficulties encountered when tort remedies designed to deal with the risk of physical endangerment are asked to broker expectation disputes among commercial parties. The second article concludes with specific recommendations and details the modifications of the Code needed to implement these recommendations. In summary form, the recommendations would give consumers who have suffered harm the ability to use their strict tort remedy to recover all the economic loss suffered in the harm-producing event, including the damage to the product itself. They would give commercial parties in the marketing chain the ability to invoke strict tort relief for the physical damage to other property caused by a defective product. Even those parties who may have suffered harm, however, would have to look to the U.C.C. for the recovery of all items of consequential economic loss. Finally, the recommendations give to commercial parties outside the marketing chain, who have suffered harm, the ability to employ strict tort to recover any economic loss connected with the harm which was particularly foreseeable to the remote product seller.

Since the recommendations continue to give to commercial parties in the distribution chain a strict tort remedy for the physical damage to

other property, they fall somewhat short of the full package of reforms urged in the two articles. This concession derives from a perception of general unwillingness on the part of the courts to deny commercial buyers tort relief for the actual physical harm to other property caused by defective products. At least in the cases affected by the concession, the theory and policy underlying the remedy will be consistent with the nature of the loss sought to be recovered under that remedy.