Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims

R. Joseph Barton
DROWNING IN A SEA OF CONTRACT: APPLICATION OF THE ECONOMIC LOSS RULE TO FRAUD AND NEGligent MISREPRESENTATION CLAIMS

The economic loss rule is stated with ease but applied with great difficulty. . . . Lawyers and judges alike have found it difficult to determine when the rule applies and when an exception is appropriate.1

The economic loss rule is one of the most confusing doctrines in tort law.2 The rule defines the boundary between the overlapping theories of tort law and contract law by barring the recovery of purely economic loss in tort, particularly in strict liability and negligence cases.3 The rationale behind the rule is that contract law and the Uniform Commercial Code (UCC) are expressly designed to deal with disappointed economic expectations and, therefore, the recovery of economic losses.4 Confusion arises, however, when courts apply the economic loss rule to torts that expressly provide for the recovery of purely economic losses,5 such as misrepresentation.6

2. See Paul J. Schwiep, The Economic Loss Rule Outbreak: The Monster that Ate Commercial Torts, FLA. B.J., Nov. 1995, at 34, 34 (“It is clear that judges, lawyers, and commercial clients alike are all desperately struggling to define the parameters of the economic loss doctrine.”).
3. See infra notes 37-45 and accompanying text.
4. See infra notes 46-79 and accompanying text.
5. Torts that allow the recovery of economic loss include, but are not limited to, defamation, conversion, malicious prosecution, invasion of privacy, and tortious interference with business advantage. See W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 116A, at 843-44, § 119, at 887-88, § 130, at 1006 (5th ed. 1984); see also Tommy L. Griffin Plumbing & Heating Co. v. Jordon, Jones & Goulding, Inc., 463 S.E.2d 85, 88 (S.C. 1995) (“Purely ‘economic loss’ may be recoverable under a variety of tort theories.”). Unlike misrepresentation, courts readily conclude that the economic loss rule does not apply to other torts that permit the recovery of economic loss. See, e.g., Canal Elec. Co. v. Westinghouse Elec. Co., 973 F.2d 988, 998 (1st Cir. 1992) (explaining that the law permits recovery of economic loss for intentional torts, such as defamation); Pershing Indus. v. Sanz, 740 So. 2d 1246, 1248 (Fla. Dist. Ct. App. 1999) (finding the economic loss rule does not bar claims for conversion and civil theft); Facchina v. Mutual Benefits Corp., 735 So. 2d 499, 502-03 (Fla. Dist. Ct. App. 1999) (having “little trouble in concluding” that the economic loss rule did not bar defamation and invasion of privacy).
6. Throughout this Note the generic term misrepresentation includes both inten-
In states adopting the economic loss rule, courts struggle with the questions of if, when, and how the economic loss rule should apply to claims arising out of a defendant’s fraudulent conduct. Accordingly, courts have designed diverse rationales in determining when, and if, the economic loss rule should bar recovery in a misrepresentation claim.  

Illustrating the diverse application of the economic loss rule is the different treatment of similar claims involving the same defective product, fire-retardant treated (FRT) plywood. In the mid-1980s, the American Plywood Association notified its members that FRT plywood was subject to thermal degradation. Despite this warning and without disclosing the dangers, the manufacturers continued to promote and sell the product. As roofs deteriorated, they posed a risk of collapsing. Accordingly,
homeowners and builders sought to recover the cost to repair or replace the roof—a classic example of purely economic loss.\textsuperscript{12} In each case, the plaintiff(s) alleged that the defendants' misrepresentations as to the suitability of FRT plywood as roofing material induced the purchase of the product.\textsuperscript{13}

The Maryland courts dismissed the homeowners' negligent misrepresentation claims because the "plaintiffs [could not] recover in tort for . . . purely economic losses,\textsuperscript{14}" even when privity of contract barred the plaintiffs' contract claims.\textsuperscript{15} While Maryland law would permit recovery if the FRT-plywood roof had collapsed and damaged other property\textsuperscript{16} (e.g., the contents of the home), Michigan law does not provide such an exception.\textsuperscript{17} When a Michigan restauranteur's FRT-plywood roof collapsed and destroyed his business, the Michigan courts dismissed his fraud claim because "the UCC provide[d] the exclusive remedy."\textsuperscript{18} Because the defective FRT plywood did not deteriorate and destroy his business within the UCC's four-year statute of limitations, no remedy was available.\textsuperscript{19}

Although Maryland and Michigan courts afforded no recovery, Florida courts allowed a homebuilder's negligent misrepresentation and fraud claims that sought to recover the cost of replacing 

\textsuperscript{12} For further discussion of the meaning of economic loss, see infra notes 27-36 and accompanying text.

\textsuperscript{13} See Cintron, 681 So. 2d at 862; Morris, 667 A.2d at 629; Citizens Ins., 585 N.W.2d at 317; King-Bradwall Partnership, 865 S.W.2d at 20.

\textsuperscript{14} Morris, 667 A.2d at 631.

\textsuperscript{15} The homeowners had purchased homes that contained FRT-plywood roofs. Accordingly, the plaintiffs were not in privity with the manufacturer and the court held that a product sold as part of a constructed home did not constitute a consumer product. See id. at 637-38.

\textsuperscript{16} See id. at 630 (noting that under Maryland law, the economic loss rule does not apply where a defective product has damaged other property).

\textsuperscript{17} See Citizens Ins., 585 N.W.2d at 316 ("Unlike some jurisdictions, the economic loss doctrine applies in Michigan even when the plaintiff is seeking to recover for property other than the product itself.").

\textsuperscript{18} Id.

\textsuperscript{19} See id. at 317. Unless the restauranteur knew of the product defect prior to the roof crashing in, the statute of limitations would not have barred the tort claim because, unlike a contract claim in which the statute of limitations begins to run from the date of delivery, a tort claim's statute of limitations runs from the date on which the plaintiff discovered or should have discovered the defect. See infra notes 238-44 and accompanying text.
all the FRT plywood in homes the home builder had constructed. The Florida economic loss rule barred claims for strict liability and negligence, but did not apply to torts that were independent of the contract, such as fraud and negligent misrepresentation, even when warranty law also afforded recovery. Although the Florida plaintiff's claims were nearly identical to those of the Maryland homeowners, the economic loss rule did not apply. Similarly, Virginia law allowed homeowners' fraud claims, even though the condominium owners also had a viable contract claim. Unlike Florida, the Virginia economic loss rule would have barred negligent misrepresentation claims. Finally, Alabama allowed an architect's fraud and negligent misrepresentation claims seeking purely economic losses without any mention of the economic loss rule.

As the FRT plywood cases demonstrate, states do not apply the economic loss rule uniformly to nearly identical fraud and negligent misrepresentation claims. The first section of this Note

21. See id. at 742; see also id. at 738 n.13 (noting that Florida law treated the fraud and misrepresentation claims identically).
22. See id. at 742. The plaintiff's misrepresentation claims ultimately failed, because the court concluded that the plaintiff had failed to prove the misrepresentation claims, not because they were barred by the economic loss rule. See id.
23. See Providence Village Townhouse Condominium Ass'n v. Amurcon-Loudoun Corp., No. 12206, 1994 WL 740045, at *5 (Va. Cir. Ct. Jan. 19, 1994). Although the plaintiffs' fraud claims were dismissed for failing to plead with sufficient specificity, the dismissal was with leave to replead. See id.
24. See id. at *4. In contrast to the law in Michigan or Maryland, the Virginia UCC does not require privity between the plaintiff and the defendant for the plaintiff to recover under a breach of warranty theory, so long as the plaintiff is someone whom the manufacturer or seller might reasonably have expected to use, consume, or be affected by the goods. See id. (quoting VA. CODE ANN. § 8.2-318 (Michie 1991)).
provides a general overview of the economic loss rule and its rationale. The second and third sections examine the application of the economic loss rule to fraud and negligent misrepresentation claims respectively. The fourth section analyzes these rules and suggests a rule that is the most consistent with both the purpose of the economic loss rule and the tort of misrepresentation.

AN OVERVIEW OF THE ECONOMIC LOSS RULE

Defining an "Economic Loss"

Generally, the phrase "economic loss" is defined as losses other than those resulting from an injury to the plaintiff's person or other property. Economic loss is divided further into direct and consequential, or indirect, economic loss. Direct economic loss is the difference between the value of the contract or product as promised, and the actual value as delivered. In the context of products liability, direct economic loss occurs when a product is damaged and the buyer seeks to recover the price of the product. Direct economic loss can be measured in several ways. First, an "out-of-pocket" loss provides recovery for the difference in value between what is given and what is received. Second, "repair costs" provide the cost of replacement or repair to a product that is not delivered as promised. Third, the "benefit of the bargain" approach measures the difference between the value of what is received and the value as repre-

27. See Rich Prods. Corp. v. Kemutec, Inc., 66 F. Supp. 2d 937, 968 (E.D. Wis. 1999); see also Miller v. United States Steel Corp., 902 F.2d 573, 574 (7th Cir. 1990) (distinguishing the "economic loss" cost of "replacing a defective product ... from an injury to the plaintiff's person or property").


29. See Note, Economic Loss, supra note 28, at 918.


31. See Note, Economic Loss, supra note 28, at 918.

32. See id.
sented. Consensual or indirect economic loss consists of an injury extrinsic to the product and attributable to the product defect, such as lost profits resulting from the inability to make use of the product.

As Judge Posner has explained, the term "economic loss" is a misnomer: "It would be better to call it a 'commercial loss,' ... because personal injuries and especially property losses are economic losses, too—they destroy values which can be and are monetized. ..." Commercial losses are not confined to transactions involving business entities; rather, the term encompasses any contractual dispute involving disappointed economic expectations.

The Economic Loss Rule

The economic loss rule is a judicially created doctrine, first articulated by the California Supreme Court in Seely v. White Motor Co. In Seely, the plaintiff sought damages resulting from the purchase of a defective truck. The plaintiff suffered no

33. See id.
34. See Moorman Mfg., 414 N.E.2d at 1305; see also Seely v. White Motor Co., 403 P.2d 145 (Cal. 1965) (upholding the plaintiff's recovery of lost profits); Note, Economic Loss, supra note 28, at 918 ("Consequential economic loss includes all direct loss, such as loss of profits resulting from inability to make use of the defective product.").
35. Miller v. United States Steel Corp., 902 F.2d 573, 574 (7th Cir. 1990). The term "commercial loss" did not originate with Posner. The Seely decision described the damages sought by a plaintiff as "commercial losses" (and interchangeably "economic losses"), see Seely, 403 P.2d at 150, as have other courts adopting the economic loss rule, see, e.g., Nobility Homes, Inc. v. Shivers, 557 S.W.2d 77, 80 (Tex. 1977).
36. See Rich Prods. Corp. v. Kemutec, Inc., 66 F. Supp. 2d 937, 968 (E.D. Wis. 1999) (explaining that "commercial injuries are the type on which a breach of contract or breach of warranty suit is based.").
37. The "economic loss rule" is also referred to as the "economic loss doctrine." Whatever the name, the principle is the same.
38. 403 P.2d 145 (Cal. 1965); see also Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co., 652 F.2d 1165, 1169 n.12 (3d Cir. 1981) (identifying Seely as the leading case propounding the economic loss rule). Although Seely is the best known case, it was not the first case to find that a plaintiff could not "sue directly the manufacturer [in negligence] ... for damage limited to the allegedly defective product itself." Trans World Airlines, Inc. v. Curtiss-Wright Corp., 148 N.Y.S.2d 284, 287 (Sup. Ct. 1955).
39. See Seely, 403 P.2d at 147.
personal injury damages in the accident, but sought damages for the repair of the truck, the purchase price of the truck, and lost profits because of an inability to use the truck.\textsuperscript{40} Recognizing the overlap between products liability and contract law, the \textit{Seely} court held that in the absence of personal injuries or physical injury to property other than to the product, a buyer's sole remedy lay in warranty, not strict liability or negligence.\textsuperscript{41}

Today, courts routinely apply the economic loss rule to both strict liability and negligence claims.\textsuperscript{42} The economic loss rule, simply stated, is as follows:

"[W]here a purchaser's expectations in a sale are frustrated because the product he bought is not working properly, his remedy is said to be in contract alone, for he has suffered only 'economic' losses." \textit{This doctrine hinges on a distinction drawn between transactions involving the sale of goods for commercial purposes where economic expectations are protected by commercial and contract law, and those involving the sale of defective products to individual consumers who are injured in a manner which has traditionally been remedied by resort to the law of torts.}\textsuperscript{43}

The rule requires a purchaser to recover in contract for purely economic loss due to disappointed expectations, unless he can

\begin{itemize}
\item \textsuperscript{40} See id. at 147-48.
\item \textsuperscript{41} See id. at 150-51. Although a negligence claim was not before the court, the \textit{Seely} court nonetheless concluded that "[e]ven in actions for negligence . . . there is no recovery for economic loss alone." Id. at 151; see also David B. Gaebler, Negligence, Economic Loss, and the U.C.C., 61 IND. L.J. 593, 620-21 (1986) ("Ironically . . . \textit{Seely} reaches this question only in dictum. . . . In the twenty years since the \textit{Seely} decision, this dictum has been cited so frequently to deny tort recovery of economic loss in products cases that it seems almost to be the foundation of the rule.").
\item \textsuperscript{42} See, e.g., East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 871 (1986) (finding that, in admiralty law, no recovery exists under a negligence or strict products liability theory when a defective product only injures itself); Transport Corp. of Am., Inc. v. IBM, 30 F.3d 953, 956 (8th Cir. 1994) ("The economic loss doctrine in Minnesota bars recovery under the tort theories of negligence or strict liability for economic losses. . . ."); S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363, 1376 (9th Cir. 1978) ("Whether the complaint is cast in terms of strict liability in tort or negligence should make no difference.").
\end{itemize}
demonstrate harm above and beyond a broken contractual promise.\textsuperscript{44} Quite simply, the economic loss rule "prevent[s] the law of contract and the law of tort from dissolving one into the other."\textsuperscript{45}

\textbf{Rationale for the Economic Loss Rule}

The distinction drawn by the economic loss rule reaches to the heart of the differences between the underlying purposes of tort and contract law.\textsuperscript{46} The distinction between tort and contract law rests upon the source of the duty,\textsuperscript{47} the role that the parties' play in determining their rights and responsibilities,\textsuperscript{48} and the time at which duties and obligations are determined.\textsuperscript{49}

Contract law is individualistic because contractual duties and assignment of risk arise from agreements between the parties.\textsuperscript{50} Contract law operates on the premise that contracting parties, in the course of bargaining for terms of a sale, are able to allocate risks and costs of the potential nonperformance.\textsuperscript{51} The underlying assumption is that the contract is the result of an arms-length negotiated transaction.\textsuperscript{52} In a negotiated transaction, the buyer either may insist on additional warranties or may assume a greater risk in exchange for a lower price.\textsuperscript{53}

\begin{itemize}
\item \textsuperscript{44} See Redarowicz v. Ohlendorf, 441 N.E.2d 324, 327 (Ill. 1982); see also \textit{East River S.S.}, 476 U.S. at 873, 874 n.9 (explaining that, whereas contract damages generally protect the benefit of the bargain, tort damages are more analogous to reliance damages).
\item \textsuperscript{46} See \textit{Twin Disc, Inc. v. Big Bud Tractor, Inc.}, 772 F.2d 1329, 1332 (7th Cir. 1985).
\item \textsuperscript{47} See, e.g., \textit{Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.}, 652 F.2d 1165, 1169 (3d Cir. 1981).
\item \textsuperscript{48} See \textit{St. Denis v. Department of Hous. & Urban Dev.}, 900 F. Supp. 1194, 1202 n.11 (D. Alaska 1995); see also \textit{Neibarger}, 486 N.W.2d at 615 (explaining that tort law "protects society's interest in freedom from harm" while contract law protects "society's interest in the performance of promises" (quoting \textit{Spring Motors Dists.}, Inc. v. \textit{Ford Motor Co.}, 489 A.2d 660, 672 (N.J. 1985))).
\item \textsuperscript{49} See \textit{St. Denis}, 900 F. Supp. at 1202 n.11.
\item \textsuperscript{50} See \textit{id.}
\item \textsuperscript{51} See \textit{Neibarger}, 486 N.W.2d at 615.
\item \textsuperscript{52} See \textit{Detroit Edison Co. v. NABCO, Inc.}, 35 F.3d 236, 240 (6th Cir. 1994); see also \textit{Clark v. Rowe}, 701 N.E.2d 624, 626 (Mass. 1998) ("When the economic loss rule has been applied, the parties usually were in a position to bargain freely concerning the allocation of risk. . . .").
\item \textsuperscript{53} See \textit{Detroit Edison}, 35 F.3d at 240.
\end{itemize}
In contrast, tort law is paternalistic because tort duties arise from policy considerations with little or no regard to whether an agreement exists between the parties. As a general proposition, "[t]ort law . . . governs the relationship between a [buyer] and a [seller], where it is impractical or impossible . . . to negotiate either the terms of a sale or each party's duty to the other." Thus, tort duties arise to protect individuals unable to protect themselves from the unscrupulous actions of others and irrespective of the existence of a contract.

Both a contract claim and a tort claim, however, may arise from the same conduct. For example, when a defective product physically harms the purchaser or his property, recovery is provided in both tort and contract. To the extent that the legal theories overlap, they are said to be competing interests. The purpose of the economic loss rule is not to bar the recovery of economic losses but is to prevent parties from recovering in tort to extricate themselves from prior freely negotiated agreements.

The economic loss rule applies where the duties owed are created solely by contract. The focus of whether a plaintiff may maintain an action in tort for purely economic losses turns on the source of the duty that the plaintiff claims the defendant owed. If the duty arises merely out of the parties' agreement, then the proper remedy is in contract; if the duty arises inde-

54. See St. Denis, 900 F. Supp. at 1202 n.11; Neibarger, 486 N.W.2d at 616.
55. Detroit Edison, 35 F.3d at 239.
62. Framed another way, the conduct must be tortious despite the existence of a contract. See Hargrave v. Oki Nursery, Inc., 636 F.2d 897, 899 (2d Cir. 1980).
pendently of any contractual duties, then the proper remedy is in tort.\(^{63}\)

The economic loss doctrine relies on three rationales to preserve contract law as a generally superior remedy for breaches resulting solely in economic loss.\(^{64}\) An overview of these principles and rationales serves to illuminate when the doctrine should be applied to misrepresentation claims. First, contract law permits the parties to negotiate the allocation of risk.\(^{65}\) As parties to a contract are better suited to allocate risk and negotiate terms of the contract,\(^{66}\) courts should not interfere when equally positioned parties fairly negotiate a contract.\(^{67}\) In such situations, parties to a contract do not need the special protections of tort law.\(^{68}\) Indeed, permitting parties to sue in tort over a contract dispute allows the parties to rewrite the agreement by allowing a party to recoup a benefit that was not part of the bargain.\(^{69}\) By refusing to extricate parties from the bargains that

---

63. See id.
64. Some commentators and courts have criticized these underlying assumptions, or the application of the economic loss rule when the assumptions are not present, particularly in nonnegotiated or noncommercial cases. See, e.g., Moorman Mfg. Co. v. National Tank Co., 414 N.E.2d 1302, 1307 (Ill. App. Ct. 1980) ("[A] personal injury is not necessarily a more overwhelming misfortune . . . than is an economic loss."); aff'd in part, rev'd in part, 435 N.E.2d 443 (Ill. 1982); cf. Utah Int'l, Inc. v. Caterpillar Tractor Co., 775 P.2d 741, 744 (N.M. Ct. App. 1989) (applying the economic loss rule only "when there is no great disparity in bargaining power").
68. See South Carolina Elec. & Gas Co., 826 F. Supp. at 1557.

Commercial entities are capable of bargaining to allocate the risk of loss inherent in any commercial transaction. Courts should assume that parties factor risk allocation into their agreements and that the absence of comprehensive warranties is reflected in the price paid. Permitting parties to sue in tort when the deal goes awry rewrites the agreement by allowing a party to recoup a benefit that was not part of the bargain.

Id. at 1230.
they have struck, the economic loss rule encourages parties to consider the possibility that the product will not perform properly and either assign risk or negotiate the price accordingly. Consequently, contract damages are limited to those within the contemplation of the parties framing their agreement.

Second, in the event of a breach, the UCC and contract law are better suited to remedy disappointed economic expectations. The essence of the UCC is to provide a complete and independent statutory scheme to govern all commercial transactions resulting from a party's failure to perform a contract. Allowing a plaintiff a choice of recovery would undermine the need for contract law, because plaintiffs find tort remedies more attractive. Consequently, tort law would swallow the carefully construed rules of the UCC and contract law.

Finally, preventing parties from extricating themselves from freely bargained contracts also prevents unending liability. The economic consequences of any single accident are virtually limitless, and thus, "[i]f defendants were held liable for every economic effect of their negligence, they would face virtually uninsurable risks far out of proportion to their culpability, and far greater than is necessary to encourage . . . care in their endeavors." Such unending liability would decrease certainty and

70. See Detroit Edison Co. v. NABCO, Inc., 35 F.3d 236, 239 (6th Cir. 1994).
71. See Neibarger v. Universal Coops., Inc., 486 N.W.2d 612, 615 (Mich. 1992) ("Contract principles . . . are generally more appropriate for determining claims for consequential damage that the parties have, or could have, addressed in their agreement." (quoting Spring Motors Distribs., Inc. v. Ford Motor Co., 489 A.2d 660, 672 (N.J. 1985))).
72. See Hapka v. Paquin Farms, 458 N.W.2d 683, 688 (Minn. 1990). The UCC was not, however, designed to eliminate a cause of action for fraud or misrepresentation as the Code specifically contemplates additional causes of action for fraud and misrepresentation. See U.C.C. §§ 1-103, 2-721 (1999); infra notes 254-60 and accompanying text.
73. See Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1246 (Fla. 1993). Generally, plaintiffs prefer tort because it permits greater damages and avoids the restrictions of contract. See id.
76. Id. (alteration in original) (internal quotation marks omitted). It is debatable that such liability would be "unending" as tort law also requires that damages be
predictability in allocating risk, and thereby impede future business activity and contract negotiation. At the bottom of all the rationales is one simple principle: "The economic loss doctrine helps ensure that contract claims are resolved by contract law."

Status of the Economic Loss Rule Today

The U.S. Supreme Court first considered the economic loss rule in the context of admiralty law in *East River Steamship Corp. v. TransAmerica Delaval Inc.* In a unanimous decision, the Court recognized the importance of products liability in protecting people from dangerous products, but also emphasized that if products liability "were allowed to progress too far, contract law would drown in a sea of tort." Accordingly, the Court adopted the economic loss rule and held that a manufacturer in a commercial relationship could not be held liable "under either a negligence or strict products-liability theory" to the buyer for purely economic losses. The Court, however, explicitly refused to resolve whether the economic loss rule applied to all tort actions in admiralty. Clearly, the Court left open the question of whether the economic loss rule applied to misrepresentation.

Following *East River*, state courts increasingly adopted the economic loss rule. A few states have declined to follow the

proximately caused, or foreseeable. See infra text accompanying notes 250-53.


78. See id.


80. 476 U.S. 858 (1986). In Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875 (1997), the Court recently affirmed and explained further the holding of *East River* as it applies to other property. See id. at 876-82.


82. Id. at 871.

83. See id. at 871 n.6.

economic loss doctrine, but the overwhelming majority of jurisdictions have adopted the economic loss doctrine in one variation or another. These variations generally concern whether the economic loss rule applies (1) to "ordinary consumers," (2) to a

v. Ford Motor Co., 489 A.2d 660 (N.J. 1985), the New Jersey Supreme Court concluded that a commercial buyer's remedies for economic losses were restricted to those provided by contract law. See id. at 671-73. Then in Alloway v. General Marine Industries, L.P., 695 A.2d 264 (N.J. 1997), the New Jersey Supreme Court concluded that allowing a consumer to recover purely economic losses in tort was no longer necessary. See id. at 275.


86. See Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1246 n.2 (Fla. 1993).

87. Cf. East River, 476 U.S. at 869 n.4 (1986) ("Interestingly, the New Jersey and California Supreme Courts have each taken what appears to be a step in the direction of the other since Santor and Seely."). For an overview of states adopting a consumer exception, see, for example, Minnesota Forest Prods., Inc. v. Ligna Mach., Inc., 17 F. Supp. 2d 592, 902 (D. Minn. 1998) ("Minnesota law limits recovery for economic loss that arises from the sale of goods in a commercial setting."); Mainline Tractor & Equip. Co. v. Nutrite Corp., 937 F. Supp. 1095, 1104 (D. Vt. 1996) (holding that an ordinary consumer who suffers purely economic loss may recover under products liability theories of negligence or strict liability); Lloyd Wood Coal Co. v. Clark Equip. Co., 543 So. 2d 671, 672 (Ala. 1989) (adopting the economic loss rule for "a claim solely for damage to the product itself... which was for commercial use, as opposed to consumer use"); Lloyd F. Smith Co. v. Den-Tal-Ez, Inc., 491 N.W.2d 11, 17 (Minn. 1992) (recognizing a consumer exception); Rousseau v. K.N. Constr., Inc., 727 A.2d 190, 193 (R.I. 1999) (limiting the economic loss rule to commercial transactions that do not involve consumers).
defective product that poses an unreasonable risk of harm, but has caused only economic loss to the product itself, or (3) outside of a products liability context. Although the rule originated in the context of products liability, the current trend expands the rule to apply in other contexts, most notably in real property transactions and service contracts. As courts expand the economic loss rule outside of UCC transactions, the looming question is whether the economic loss rule applies to misrepresentation claims.

THE ECONOMIC LOSS RULE APPLIED TO FRAUD CLAIMS

Although the economic loss doctrine is now over thirty years old, its application to fraud claims is relatively recent. Prior to the adoption of the economic loss rule, courts routinely awarded purely economic damages when a defendant's misrepresentation induced a transaction.

88. See Alloway, 695 A.2d at 273. Although the RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 (1997) seemingly adopts the Seeley analysis to exclude recovery under tort theories for damage to a product itself, the comments explain that "[a] plausible argument can be made that products that are dangerous [in these respects (i.e. discovery of the defect prevented harm from occurring or the only harm was to the product itself, but not to other persons or property)] rather than merely ineffectual, should be governed by the rules governing products liability law." Id. cmt. d.


91. See, e.g., AFM Corp. v. Southern Bell Tel. & Tel. Co., 515 So. 2d 180 (Fla. 1987); Anderson Elec., Inc. v. Ledbetter Erection Corp., 503 N.E.2d 246 (Ill. 1986).


93. See, e.g., Haarberg v. Schneider, 117 N.W.2d 796 (Neb. 1962) (finding that the
The rules for recovery in fraud inherently conflict with the economic loss rule. Fraud expressly allows for the recovery of purely economic losses arising out of a defendant's misrepresentations in a sale of goods or other property. Conversely, the economic loss rule prohibits the recovery of purely economic losses in tort—particularly when the claim arises out of a contract. The courts' struggle with this conflict can be categorized into three approaches.

**Fraud: An Exception to the Economic Loss Rule**

The first approach exempts fraud, or fraudulent inducement, from the economic loss rule based on three rationales. The California Court of Appeals indirectly addressed this issue in *Kahn v. Shiley, Inc.*, when the recipient of a defective heart valve alleged that the manufacturer's misrepresentations about the quality and durability of the heart valve induced her to purchase the product. The court distinguished the other tort claims by explaining that, "[a]llegations of fraud . . . are in a

---

proper measure of damages in fraud is the difference between the value represented and the actual value); Stewart v. Potter, 104 P.2d 736 (N.M. 1940) (holding defrauded purchaser could recover the difference between the real and represented value of the automobile); Clouse v. Chaitown Motors, Inc., 195 S.E.2d 327 (N.C. Ct. App. 1973) (allowing recovery of purely economic loss in fraud). In order to prove fraud, a plaintiff must show (1) a misrepresentation (false statement, concealment, or nondisclosure), (2) scienter (i.e., knowledge of falsity), (3) intent to defraud (i.e., induce reliance), (4) justifiable reliance, and (5) resulting damage. See, e.g., Kahn v. Shiley, Inc., 266 Cal. Rptr. 106, 112 (1990); KEETON ET AL., supra note 5, § 105, at 728, § 106, at 736-37.

94. *See KEETON ET AL., supra note 5, § 110, at 766.*

95. *See supra text accompanying notes 37-45.*


97. 266 Cal. Rptr. 106, 112 (Ct. App. 1990). Clearly, under California law, fraud includes the ability to recover purely economic losses. *See Alliance Mortgage Co. v. Rothwell, 900 P.2d 601, 609 (Cal. 1995) (stating that the general rule in California is that a defrauded party is ordinarily entitled to "out-of-pocket" loss); Continental Airlines, Inc. v. McDonnell Douglas Corp., 264 Cal. Rptr. 779 (Ct. App. 1989) (allowing recovery of purely economic loss for fraud arising out of a commercial contract).*

98. *See Kahn, 266 Cal. Rptr. at 108.*
class by themselves. ... Unlike the other theories, in which the safety and efficacy of the product is assailed, the fraud claim impugns defendants' conduct. Rather, the Kahn court confirmed "that a manufacturer of a product may be liable for fraud when it" misleads potential users about material product information. Thus, the viability of a fraud claim rests on the defendant's conduct and not on the type of damage or on the existence of an underlying contract. Clearly then, fraud allows the recovery of purely economic loss because the presence or absence of physical injury makes no difference.

By analyzing the source of the duty, the Texas Supreme Court utilized a similar rationale to conclude the economic loss rule did not apply to intentional misrepresentation. In Formosa Plastics Corp. v. Presidio Engineers & Contractors, Inc., the Texas Supreme Court distinguished an action in contract as breaching a duty arising out of the parties' agreement from a tort action that arises from a breach of a duty imposed by law. Tort law "has long imposed a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations." As this duty is "separate and independent from the duties established by the contract itself," the economic loss

99. Id. at 112.
100. Id.
101. See id.; see also Continental Airlines, 264 Cal. Rptr. at 801 (allowing a fraud claim arising out of a contract between two commercial entities). The California Civil Code expressly declares unlawful "[a]ll contracts which ... exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another . . . ." CAL. CIV. CODE § 1668 (West 1985).
102. See Davis v. Shiley, Inc., 75 Cal. Rptr. 2d 826, 833 (Ct. App. 1998) (Sills, J., dissenting); see also id. at 828 n.3 (acknowledging the dissent's position on this issue as correct).
104. See Formosa, 960 S.W.2d at 45 (quoting International Printing Pressmen & Assistants' Union v. Smith, 198 S.W.2d 729, 735 (Tex. 1946)).
105. Id. at 46.
106. Id. Although the Texas Supreme Court has adopted an "independent injury" requirement for other torts, fraud is exempt from that requirement. See Eastman, 2000 WL 94931, at *5.
rule does not apply to fraud claims regardless of whether the
duties were subsumed later into the contract, or the losses were
purely economic.\textsuperscript{107}

In one of the earliest cases addressing the issue, \textit{Moorman
Manufacturing Co. v. National Tank Co.},\textsuperscript{108} the Illinois Supreme
Court expended one sentence in affirming the decision of the
court of appeals that intentional misrepresentations were out-
side the scope of the economic loss rule.\textsuperscript{109} Rather than focus on
the defendant's conduct, the court of appeals explained only that
the "loss of the bargain" \textit{is the measure} of damages for fraud:

\begin{quote}
Illinois courts have traditionally taken the position that "loss
of bargain" is the measure of damages for misrepresenta-
tion. . . . [O]ur Supreme Court [has] stated: "In an action on
the case for fraudulent representations in the sale of property,
the measure of damages is the difference between the value
of the property as it is and what it would be worth if the
representations had been true."\textsuperscript{110}
\end{quote}

Since the time of the \textit{Moorman} decision, the Illinois Supreme
Court has clarified that "the concept of duty" is the rationale for
this exception to the economic loss rule.\textsuperscript{111} This approach treats
fraud as an exception to the economic loss rule because (1) fraud
impugns the defendant's conduct, (2) the source of the duty arises
out of tort, not contract, and (3) the measure of damages for
fraud is purely economic "benefit of the bargain" damages. Ac-
cordingly, a plaintiff may maintain both a fraud and a contract
action simultaneously.\textsuperscript{112}

\textsuperscript{107} See Formosa, 960 S.W.2d at 46-47. Texas and Illinois are not alone in this
analysis. See, e.g., Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones &
Goulding, Inc., 463 S.E.2d 85, 89 (S.C. 1995) (recognizing that a breach of a duty
arising independently of contractual duties may support a tort action for economic
loss).

\textsuperscript{108} 435 N.E.2d 443 (Ill. 1982).

\textsuperscript{109} See id.

1980) (quoting Schwitters v. Springer, 86 N.E. 102, 103 (Ill. 1908)), overruled on
other grounds, 435 N.E.2d 443 (Ill. 1982).

\textsuperscript{111} 2314 Lincoln Park W. Condominium Ass'n v. Mann, Gin, Ebel & Frazier, Ltd.,

\textsuperscript{112} See Southwestern Bell Tel. Co. v. Delaney, 809 S.W.2d 493, 499 (Tex. 1991)
(explaining that even where a contract exists, "[i]f the defendant's conduct . . .
Fraud: A Limited Exception to the Economic Loss Rule

Despite the long-standing rule allowing recovery of purely economic loss damages in fraud cases, two states recently limited recovery in fraud cases to only those damages unrelated to an underlying contract. Indeed, the growing trend among courts is to craft a limited exception to claims for economic loss in fraud cases.113

The leading case advocating a limited exception for fraud is the Michigan Court of Appeals decision in Huron Tool & Engineering Co. v. Precision Consulting Services, Inc.114 Prior to Huron Tool, the Michigan Supreme Court adopted the economic loss rule in negligence cases115 and explained that "where a plaintiff seeks to recover for economic loss caused by a defective product purchased for commercial purposes, the exclusive remedy is provided by the UCC . . . ."116 In that context, the Michigan Court of Appeals addressed the application of the doctrine to actions for intentional torts, particularly fraud.117 Although the
Huron Tool court recognized that fraud in the inducement presented a special situation, because misrepresentations undermine the ability to negotiate freely,118 the court added an additional caveat: The fraud claim must be factually distinguishable.119 At first glance, this rule creates an exception for fraud claims. Yet the additional caveat requires that the misrepresentations be unrelated to the contract.120 If the defendant’s misrepresentations concerned the subject matter of the contract—the quality of the goods, for example—then they are said to be “interwoven” with the contract.121 If the fraud claim is “interwoven” with a contract claim, then no independent intentional misrepresentation exists. In such a case, the economic loss rule restricts the plaintiff to whatever contractual remedies exist.122

The result in Huron Tool is perhaps the best example of how the Michigan rule operates. The Huron Tool plaintiffs convinced the court of appeals that fraud was an exception to the economic loss rule, but the misrepresentations at issue in the case concerned the quality and characteristics of the goods. Although the defendant’s representations about the quality of the goods fraudulently induced the plaintiffs to contract, the court determined those claims to be indistinguishable from the terms of the contract.123 Accordingly, because the fraud claims were not “independent,” the economic loss rule barred the fraud claims.124

In formulating this rule, the Huron Tool court relied heavily on the parties’ ability to negotiate the terms of commercial transactions.125 Subsequent decisions have extended the rule to

118. See id. at 545.
119. See id. at 546.
120. See id. Even a fraud allegation concerning representations “made in connection with the making of a contract” has been interpreted to be “not extraneous to the contract.” Dinsmore Instrument Co. v. Bombardier, Inc., 199 F.3d 318, 321 (6th Cir. 1999) (emphasis added) (quoting from Dinsmore’s complaint).
121. See Huron Tool, 532 N.W.2d at 546.
122. See id.
123. See id.
124. See id.
125. See id. at 545. The court explained that the policy behind the doctrine “encourages parties to negotiate economic risks through warranty provisions and price.” Id. (quoting Florida Power & Light Co. v. Westinghouse Elec. Corp., 510 So. 2d 899, 901 (Fla. 1987)). The court also concluded that the quality and characteristics of the goods were not extraneous to the contract because the parties were still free to
nonnegotiated transactions\textsuperscript{126} and consumers.\textsuperscript{127} Moreover, the practical effect of the additional requirement has rendered the exception a nullity.\textsuperscript{128} No court correctly applying the \textit{Huron Tool} rule has found that a misrepresentation was independent of the contract.\textsuperscript{129}

Florida nominally adopts the \textit{Huron Tool} rule\textsuperscript{130} in barring the recovery of purely economic losses. The crucial difference between how Florida and Michigan handle the application of the rule in misrepresentation cases lies in the decision of when the economic loss rule should apply. Rather than apply a per se rule, the Florida courts determine whether the economic loss rule applies to a fraudulent inducement claim on a case-by-case basis.\textsuperscript{131}

The Florida Supreme Court recently acknowledged that its own "pronouncements on the economic loss rule have not always been clear."\textsuperscript{132} The lack of clarity of the Florida economic loss

\begin{itemize}
\item\textsuperscript{126} See \textit{Citizens Ins. Co.} v. Osmose Wood Preserving, Inc., 585 N.W.2d 314 (Mich. Ct. App. 1998) (finding no fraud in the inducement exception even when the buyer was not in a position to negotiate the terms of the sale); see also \textit{id}. at 318 (Kelly, J., dissenting) (suggesting that the economic loss rule should apply only when the plaintiff is in the same business as the defendant and may anticipate properly the foreseeability of the risks involved).
\item\textsuperscript{128} See \textit{Budgetel Inns, Inc.} v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1146-49 (E.D. Wis. 1998) (declining to adopt the \textit{Huron} rule).
\item\textsuperscript{129} See \textit{id}. at 1146 n.2.
\item\textsuperscript{131} See \textit{Force v. ITT Hardford Life & Annuity Ins. Co.}, 4 F. Supp. 2d 843, 852 (D. Minn. 1998) (applying Florida law and explaining that "Florida courts have not adopted a per se rule regarding whether the economic loss rule applies to claims of fraudulent inducement; rather, such a determination depends on the specifics of each case").
\item\textsuperscript{132} \textit{Comptech Int'l, Inc.} v. \textit{Milam Commerce Park, Ltd.}, Nos. 93,336, 93,126, 1999 WL 983857, at *5 (Fla. Oct. 28, 1999).
\end{itemize}
rule derives from conflicting statements in the supreme court decision in *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.* The Florida Supreme Court recognized that fraudulent inducement "occurs prior to the contract and the standard of truthful representation placed upon the defendant is not derived from the contract," and explained that the "economic loss rule has not eliminated causes of action based upon torts independent of the contractual breach." While the Florida Supreme Court recognized that fraudulent inducement was "an independent tort in that it requires proof of facts separate and distinct from the breach of contract," the court also adopted the analysis of *Huron Tool* and stated that a tort action exists only for "intentional or negligent acts considered to be independent from acts that breached the contract."

A number of lower Florida courts have interpreted these conflicting statements to require a bar similar to the one that the *Huron Tool* court imposed: "[W]here the alleged fraudulent misrepresentations are inseparably embodied in the parties subsequent agreement." Unlike Michigan courts, however, Florida courts recognize that a fraudulent inducement claim can coexist with a contract claim. Nonetheless, the decision of the oft-quoted statement from the Florida Third District Court of Appeals demonstrates the conflicting concerns and interests of applying the economic loss doctrine to fraud claims:

133. 685 So. 2d 1238 (Fla. 1996).
134. Id. at 1239 (quoting Woodson v. Martin, 663 So. 2d 1327, 1331 (Fla. Dist. Ct. App. 1995) (en banc) (Altenbernd, J., dissenting)).
135. Id.
136. Id.
137. See id. at 1239-40.
138. Id. at 1239 (citations omitted) (emphasis added).
139. Hotels of Key Largo, Inc. v. RHI Hotels, Inc., 694 So. 2d 74, 77 (Fla. Dist. Ct. App. 1997) (contending that certain fraudulent inducement claims are barred by the economic loss rule); cf. supra notes 114-24 and accompanying text (discussing the *Huron Tool* rule).
It makes sense that a truly independent cause of action for fraudulent misrepresentation, where the ability of one party to negotiate fair terms is undermined by the other's fraudulent behavior, is not barred by the economic loss rule. However, where the only alleged misrepresentation concerns the heart of the parties' agreement, simply applying the label of "fraudulent inducement" to a cause of action will not suffice to subvert the sound policy rationales underlying the economic loss doctrine.\(^{141}\)

These conflicting and unclear statements regarding application of the economic loss rule have led to a two-fold result. First, the Florida rule has sustained fraud as a viable cause of action, albeit through widely inconsistent results.\(^{142}\) Second, the Florida appellate courts have been deluged with a large number of cases on the applicability of the economic loss rule to fraud claims.\(^{143}\)

---


143. Florida easily has the largest number of judicial opinions discussing the application of the economic loss rule to fraud claims and quite often has conflicting opinions from the appellate courts on the issue.
To date, the Florida Supreme Court has not articulated a clear application of the economic loss rule to fraud claims.

**Fraud: No Exception**

A handful of courts have construed the economic loss rule to prohibit the recovery of purely economic losses in fraud. These courts conclude that because the economic loss rule bars recovery in tort, and because fraud is a tort, recovery of purely economic loss is therefore barred.\(^{144}\) For example, in *Flagg Energy Development Corp. v. General Motors Corp. Allison Gas Turbine Division*,\(^{145}\) a commercial plaintiff alleged that the defendant's misrepresentations about the quality of some engines fraudulently induced it to purchase them.\(^{146}\) Connecticut law afforded recovery for purely economic loss in fraudulent inducement claims\(^{147}\) and allowed a fraud claim in addition to a warranty claim.\(^{148}\) The *Flagg Energy* court nonetheless distinguished prior fraud cases because they did not involve the sale of goods.\(^{149}\) The Connecticut Supreme Court affirmed the trial court's reasoning that fraud claims cannot arise out of a transaction governed by the UCC.\(^{150}\)

\(^{144}\) See, e.g., Nigrelli Sys., Inc. v. E.I. Dupont de Nemours & Co., 31 F. Supp. 2d 1134, 1138-39 (E.D. Wis. 1999) (analyzing a plaintiff's strict liability and fraud claims together and concluding that the economic loss rule applied "equally" to all the claims); *In re Ford Motor Co. Bronco II Prods. Liab. Litig.*, MDL-991, 1995 U.S. Dist. LEXIS 18207, at *21-*22 (E.D. La. Dec. 4, 1995) (construing the New York economic loss rule to bar fraud claims). The court in *Bronco II* relied solely on New York's adoption of the economic loss rule to conclude that New York law barred the recovery of economic losses in fraud. See id. The *Bronco II* and *Nigrelli* decisions are perhaps limited to products liability, because the cases involved defective products. See id. More importantly, the *Bronco II* court probably misconstrued New York law in determining that the economic loss rule would bar a fraud claim. See Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 743-48 (2d Cir. 1979) (reversing district court's dismissal of a fraud claim that sought purely economic losses); see also Triangle Underwriters, Inc. v. Honeywell, Inc., 651 F.2d 132 (2d Cir. 1981) (allowing damages after a jury verdict).


\(^{146}\) See id.

\(^{147}\) See CONN. GEN. STAT. ANN. § 42a-2-721 (West 1999).

\(^{148}\) See id. cmt.


\(^{150}\) In *Flagg Energy Development Corp. v. General Motors Corp.*, 709 A.2d 1075
Although Flagg Energy involved a commercial purchaser in a fully negotiated transaction that was subject to the UCC, wholesale application of the economic loss rule to fraud is not limited to such cases. Courts have utilized similar rationales to apply the economic loss rule and bar fraud claims brought by consumer purchasers of defective products, and fraud claims unrelated to a sale of goods. The tacit directive of such decisions is to disallow fraud claims that do not seek damages for physical injury.

**THE ECONOMIC LOSS RULE APPLIED TO NEGLIGENT MISREPRESENTATION**

Unlike fraud, which has ancient roots in the common law, negligent misrepresentation is a more recent development.

(Conn. 1998), the Connecticut Supreme Court reviewed the trial court's decision regarding a dispute over the settlement agreement. In concluding the settlement agreement in Flagg Energy did not extinguish the terms of the original contract, the Connecticut Supreme Court determined that the economic loss rule applied to fraud and negligent misrepresentation claims—at least those that the UCC governed. See id. at 1088-89; Page v. Englander Millwork Co., No. CV9803329085, 1999 WL 311225, at *2 (Conn. Super. Ct. May 5, 1999) (explaining that the Flagg Energy decision held that claims of both negligent and fraudulent misrepresentation are inconsistent with "breach of contract and breach of warranty allegations under the [UCCI]"; see also Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 34 F. Supp. 2d 738, 750 (D. Minn. 1999) (concluding that the Minnesota economic loss doctrine does not treat fraud differently when alleged in connection with an Article 2 contract). But see Scap Motors, Inc. v. PEVCO Sys. Int'l, Inc., 1999 WL 643378, at *2 (Conn. Super. Ct. Aug. 12, 1999) (declining to apply the economic loss rule because the UCC did not govern the claims).

151. See Page, 1999 WL 311225, at *2-*3 (dismissing the homeowner plaintiffs' fraudulent and negligent misrepresentation claims based on Flagg Energy); see also Pryor v. Shiley, Inc., No. 89-3559, 1990 WL 159582, at *3 (9th Cir. Oct. 8, 1990) (affirming the dismissal of a consumer plaintiff's fraud claims because "Oregon treats all product liability actions the same, regardless of the theory asserted").

152. See, e.g., PPG Indus., Inc. v. Sundstrand Corp., 681 F. Supp. 287, 290-91 (W.D. Pa. 1988). The dispute in Sundstrand centered around a professional services contract. The plaintiff alleged that the defendant made misrepresentations during their precontractual negotiations, thus suggesting a fraud in the inducement claim. See id. (discussing the preliminary proposals and "the arm's length nature of the negotiations"); cf. Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 87 (S.C. 1995) ("[S]ome states use the 'economic loss' rule to prohibit all recovery of purely economic damages in tort.").


154. See id. § 32:76.
The three approaches to negligent misrepresentation all rest on the same basic principle, first explained by Justice Cardozo in *Glanzer v. Shepard.* In *Glanzer,* the New York Court of Appeals held a public weigher liable to a third-party buyer of beans, because the weigher knew that the buyer would rely on the weigher's representations when purchasing the beans from the seller. Justice Cardozo explained the court's reasoning:

> [The law imposes a duty toward buyer as well as seller. ...]
> [A]ssumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed. We do not need to state the duty in terms of contract or of privity. Growing out of a contract, it has none the less [sic] an origin not exclusively contractual. Given the contract and the relation, the duty is imposed by law.

Although a contractual relationship existed only between the buyer and the weigher, the law imposed a legal duty on the weigher to those who, like the bean buyer, would foreseeably rely on his misrepresentations. Thus, negligent misrepresentation imposes a legal duty on those who supply information in the

---

155. The Restatement (Second) of Torts § 552 (1977) adopts the holding of *Glanzer v. Shepard,* 135 N.E. 275 (N.Y. 1922), and provides in relevant part: One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Restatement (Second) of Torts § 552. The akin-to-privity approach defines and limits the scope of the defendant's duty according to the defendant's state of mind and agreed upon expectation of the parties. See Onita Pac. Corp. v. Trustees of Bronson, 843 P.2d 890, 908 (Or. 1992). The foreseeability approach is an expansive approach that allows recovery to third parties "to the extent that damages incurred by non-clients are reasonably foreseeable." First Nat'l Bank of Commerce v. Monco Agency Inc., 911 F.2d 1053, 1059 (5th Cir. 1990); see also Scottish Heritage Trust v. Peat Marwick Main & Co., 81 F.3d 606, 612 (5th Cir. 1996) (comparing the three approaches).

156. 135 N.E. 275 (N.Y. 1922).

157. See id.

158. Id. at 275-76. In a later decision, Justice Cardozo made it clear that negligent misrepresentation was not a substitute for fraud. See Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y. 1931).

159. See *Glanzer,* 135 N.E. at 275-76.
course of a business transaction in which they have a pecuniary interest.\textsuperscript{160}

A tension emerges between negligent misrepresentation, which allows for the recovery of pecuniary loss,\textsuperscript{161} and the economic loss rule, which forbids recovery of economic loss in tort.\textsuperscript{162} This tension has produced "substantial disagreement among the courts as to whether a claim for negligent misrepresentation should be recognized as an exception to the economic loss doctrine."\textsuperscript{163} As with fraud, this tension has produced a variety of approaches to determine when the economic loss rule should apply to negligent misrepresentation.

\textbf{Negligent Misrepresentation: An Exception Mirroring the Fraudulent Inducement Exception}

The first approach to negligent misrepresentation treats the cause of action like fraud. Florida, the leading proponent of this view,\textsuperscript{164} has fashioned its negligent misrepresentation exception

\begin{itemize}
\item \textsuperscript{160} See Sebago, Inc. v. Beazer E., Inc., 18 F. Supp. 2d 70, 95 n.10 (D. Mass. 1998) (citing section 552 of the \textit{Restatement (Second) of Torts}).
\item \textsuperscript{162} See McCarthy, Lebit, Crystal & Haiman Co. v. First Union Management, Inc., 622 N.E.2d 1096, 1103 (Ohio Ct. App. 1993) ("[P]ecuniary loss' is by its very definition 'economic loss.'").
\item \textsuperscript{163} Reeder R. Fox & Patrick J. Loftus, \textit{Riding the Choppy Waters of East River: Economic Loss Doctrine Ten Years Later}, 64 DEF. COUNS. J. 260, 268 (1997); see also Apollo Group, Inc. v. Avnet, Inc., 58 F.3d 477, 480 n.3 (9th Cir. 1995) ("There is no consensus among courts that have been squarely faced with this issue."); John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428, 434 (Tenn. 1991) ("[T]here is no clear majority; instead, we find a split of authority among the states.").
\item \textsuperscript{164} Other jurisdictions follow this approach as well. See, e.g., Arthur D. Little Int'l, Inc. v. Dooyang Corp., 928 F. Supp. 1189, 1204-06 (D. Mass. 1996); Niagra Mohawk Power Corp. v. Stone & Webster Eng'g Corp., No. 88-CV-819, 1992 U.S. Dist. LEXIS 7721, at *90 (N.D.N.Y. 1992) (finding that when parties seek "recovery for breach of a duty extraneous to the contract, the intentional tort and negligent misrepresentation claims . . . could stand regardless of the vitality of the contract claims"). Although the \textit{Dooyang} court rejected a claim that mirrored the breach of contract claim, it specifically did so because it was "not a claim for misrepresentation in the inducement of the contract." \textit{Dooyang}, 928 F. Supp. at 1205. It should be noted that the District Court of Massachusetts recently distinguished \textit{Dooyang}, finding that Massachusetts would not allow any negligent misrepresentation claims involving a defective product. See \textit{Sebago}, 18 F. Supp. 2d at 96. At least one Illinois case has applied a Florida-style rule, treating negligent misrepresentation cases similar to cases involving fraud in the inducement. See Budget Rent-a-Car Corp. v.
to the economic loss rule to match its fraudulent inducement exception. The most recent Florida Supreme Court decision on the issue, HTP, Ltd. v. Lineas Aereas Costarricenses, S.A. clearly established that the Florida economic loss rule did not apply to any torts independent of the contract: "Where a contract exists, a tort action will lie for either intentional or negligent acts considered to be independent from acts that breached the contract.

Just as the economic loss doctrine does not preclude all claims of fraudulent inducement, the economic loss doctrine does not bar a negligent misrepresentation claim if it centers upon an alleged inducement to enter into a contractual relationship, rather than performance of the contract. Because the economic loss rule applies identically to both fraudulent and negligent misrepresentation, widely inconsistent opinions have resulted—


165. See HTP, Ltd. v. Lineas Aereas Costarricenses, S.A., 685 So. 2d 1238, 1239 (Fla. 1996). It should also be noted that in Florida a claim of negligent misrepresentation "that resembles fraud in the inducement may support a claim for punitive damages." Burger King Corp. v. Austin, 805 F. Supp. 1007, 1025 n.31 (S.D. Fla. 1992).

166. 685 So. 2d 1238 (Fla. 1996). A brief per curiam opinion by the Florida Supreme Court in PK Ventures v. Raymond James & Associates, Inc., 690 So. 2d 1296 (Fla. 1997), confirmed the applicability of HTP to negligent misrepresentation. See id. at 1297.

167. HTP, 685 So. 2d at 1239 (emphasis added); see also McCarthy v. Southern States Utils., 698 So. 2d 590, 592 (Fla. Dist. Ct. App. 1997) ("[A]lthough HTP involved the tort of fraud, the high court was clear that any independent tort would satisfy the economic loss rule . . . .").

with some courts focused on whether the tort claims "mirror" breach of contract claims and others creating a nearly absolute exception for negligent misrepresentation claims. The recent Florida Supreme Court decision of Moransais v. Heathman suggests that the latter view is correct, however, some courts may still hold onto the former view. Until a more definitive pronouncement comes from the Florida Supreme Court on both fraudulent and negligent misrepresentation, the only clear directive is that the economic loss rule applies equally to both claims.

Negligent Misrepresentation: An Exception Limited to Defendants in the Business of Supplying Information for the Guidance of Others

Rather than extend identical exceptions for intentional and negligent misrepresentation, the Illinois Supreme Court in Moorman Manufacturing Co. v. National Tank Co. recognized a limited exception applicable solely to cases involving negligent misrepresentation. As one of the first states to discuss negli-
gent misrepresentation in the context of the economic loss rule, Illinois became a leading authority in the area.  

A claim for negligent misrepresentation in Illinois exists only against a defendant "who is in the business of supplying information for the guidance of others in their business transactions [and] makes negligent misrepresentations." Because "the concept of duty is at the heart" of the "Moorman doctrine," the Illinois Supreme Court analyzed whether the duty is extracontractual in resolving this question. An exception does not apply when the information is conveyed merely as part of a sale or contract. Thus, a misrepresentation is not actionable against a defendant who negligently supplied false information in the course of a transaction. The exception does not turn on the question of privity, but rather, depends on the profession of the defendant and the na-

the business of supplying information" requirement actually predates the adoption of the economic loss rule. See id. Thus, the Moorman court merely extended a preexisting exception to the economic loss rule to cases involving negligent misrepresentation.  


ture of the relationship between plaintiff and defendant. If the ultimate result of the relationship is something "intangible"—the value of the services rendered lies in the ideas behind the product and not the product itself—then the exception applies. Illinois courts have allowed claims against health care professionals, insurance brokers, accountants, and attorneys, but not against advertising firms, architects, or engineers. According to the Illinois Supreme Court, the distinguishing characteristic is that the former group have "long been held to be members of a skilled profession...liable for their negligent failure to observe reasonable professional competence."

Although once a certain profession is exempted it is clear that the Moorman doctrine no longer applies, this piecemeal determination of whether a particular profession owes some extra contractual duty has left lower courts in the "position of guessing which additional professionals [fall outside]...Moorman's economic loss doctrine." Determining that the importance of an accountant's duty is less tangible than an architect's provides lower courts with little guidance regarding when the exception is appropriate. In short, the Moorman doctrine's "in the busi-

181. See id. ("Application of the Moorman doctrine limiting recovery of purely economic losses to contract, therefore, is inappropriate where a relationship results in something intangible...").
182. See id. (allowing accountant malpractice claim); Collins v. Reynard, 607 N.E.2d 1185 (Ill. 1992) (finding that an attorney malpractice claim was not barred by the economic loss rule); 2314 Lincoln Park West Condominium Ass'n v. Mann, Gin, Ebel & Frazier, Ltd., 555 N.E.2d 346, 353 (Ill. 1990) (stating that the Moorman doctrine would not bar actions against attorneys or health care professionals); Lake County Grading, 589 N.E.2d at 1132 (allowing negligent misrepresentation claim against broker because the relationship between the parties was a fiduciary one).
183. See Cordiant MN, Inc. v. David Cravit & Assocs. Ltd., No. 96-C-4276, 1997 U.S. Dist. LEXIS 12803, at *44 (dismissing a negligent misrepresentation claim against an advertising firm); Fireman's Fund, 679 N.E.2d at 1201 (dismissing a negligent misrepresentation claim against an engineer); Lincoln Park, 555 N.E.2d at 353 (dismissing a negligent misrepresentation claim against an architect).
184. Congregation of the Passion, 636 N.E.2d at 515 (citation omitted).
185. Fireman's Fund, 679 N.E.2d at 1202 (Heiple, C.J., dissenting). The plethora of cases that the Illinois Supreme Court has resolved on this issue is a testament that the "distinguishing characteristic" has failed to provide any real guidance to the lower courts. See supra notes 175-78 and accompanying text (providing examples of the cases that the Illinois Supreme Court heard on this issue).
186. Cf. Fireman's Fund, 679 N.E.2d at 1202 (Heiple, C.J., dissenting) (contending
ness" requirement has failed to articulate a precise formula that will allow courts to apply the economic loss rule to negligent misrepresentation claims.

**Negligent Misrepresentation: An Exception Dependent on Whether the Parties Are in Privity**

A third approach recognizes the difference between negligent and intentional misrepresentation and avoids the piecemeal determination of the Illinois rule by focusing on the question of privity. Two of the leading cases advocating this approach, *South Carolina Electric & Gas Co. v. Westinghouse Electric Corp.* and *Duquesne Light Co. v. Westinghouse Electric Corp.*, involved factually similar claims. In each case, the plaintiffs negotiated contracts with the defendant to supply generators, with certain specifications, for use at their nuclear power plants. After the generators deteriorated, the plaintiffs filed breach of contract and negligent misrepresentation claims against the defendant.

In *Duquesne*, the Third Circuit utilized two rationales to apply the economic loss rule to the negligent misrepresentation
First, the court found that ordinary contract principles governed disputes between sophisticated business entities engaging in arms-length transactions. Second, the court explained that negligent misrepresentation governs liability only when contract remedies are unavailable. Accordingly, the Third Circuit concluded that privity of contract between two commercial parties eliminated the "need for an additional tort of negligent misrepresentation." The South Carolina Electric & Gas Co. court further distinguished negligent misrepresentation from intentional misrepresentation because fraud requires a "concomitant element of an actual intent to deceive." Both courts, however, suggested that the same rationale might not apply to "an unsophisticated consumer who is party to a sales contract." Under this approach, the economic loss rule bars the negligent misrepresentation claims of "business sophisticates . . . capable of protecting themselves by contractual agreement."

This rule suggests that it does not apply to foreseeable third parties. Accordingly, most courts adopting this rule recognize that the lack of privity by a third party renders "commercial law an inadequate framework" in which to resolve a third-party claim. First, the court found that ordinary contract principles governed disputes between sophisticated business entities engaging in arms-length transactions. Second, the court explained that negligent misrepresentation governs liability only when contract remedies are unavailable. Accordingly, the Third Circuit concluded that privity of contract between two commercial parties eliminated the "need for an additional tort of negligent misrepresentation." The South Carolina Electric & Gas Co. court further distinguished negligent misrepresentation from intentional misrepresentation because fraud requires a "concomitant element of an actual intent to deceive." Both courts, however, suggested that the same rationale might not apply to "an unsophisticated consumer who is party to a sales contract." Under this approach, the economic loss rule bars the negligent misrepresentation claims of "business sophisticates . . . capable of protecting themselves by contractual agreement." This rule suggests that it does not apply to foreseeable third parties. Accordingly, most courts adopting this rule recognize that the lack of privity by a third party renders "commercial law an inadequate framework" in which to resolve a third-party claim. First, the court found that ordinary contract principles governed disputes between sophisticated business entities engaging in arms-length transactions. Second, the court explained that negligent misrepresentation governs liability only when contract remedies are unavailable. Accordingly, the Third Circuit concluded that privity of contract between two commercial parties eliminated the "need for an additional tort of negligent misrepresentation." The South Carolina Electric & Gas Co. court further distinguished negligent misrepresentation from intentional misrepresentation because fraud requires a "concomitant element of an actual intent to deceive." Both courts, however, suggested that the same rationale might not apply to "an unsophisticated consumer who is party to a sales contract." Under this approach, the economic loss rule bars the negligent misrepresentation claims of "business sophisticates . . . capable of protecting themselves by contractual agreement."
2000] DROWNING IN A SEA OF CONTRACT 1821

plaintiff's claims.\(^\text{200}\) Thus, an exception to the economic loss rule allows tort liability when negligent misrepresentations induce third parties who justifiably rely on the information.\(^\text{201}\)

Despite the logic of this analysis—that third parties cannot transform a contract claim into a tort claim "to escape some roadblock to recovery"\(^\text{202}\)—some courts have applied the economic loss rule to negligent misrepresentation claims even when privity is absent.\(^\text{203}\) Although the parties may not be in privity, these courts require that the parties must resort to contract law to protect their economic expectations.\(^\text{204}\) Courts justify this approach by explaining that the "economic loss doctrine was designed to prevent such a strategy"\(^\text{205}\) whereby the plaintiff could recover benefits it was unable to obtain in contract negotia-

---

200. Apollo Group, Inc. v. Avnet, Inc., 58 F.3d 477, 480 n.4 (9th Cir. 1995) (applying Arizona law); see, e.g., Squish La Fish, Inc. v. Thomco Specialty Prods., Inc., 149 F.3d 1288, 1291 (11th Cir. 1998) (allowing recovery by a third party who indirectly relied on a negligent misrepresentation); Danforth v. Acorn Structures, Inc., No. 90C-JN-30, 1991 Del. Super. LEXIS 454, at *6-*7 (Nov. 22, 1991) ("It is clear that in order... to invoke a cause of action under negligent misrepresentation involving § 552, the plaintiff must show that the defendant supplied the information to the plaintiff for use in business transactions with third parties."); Bates & Assocs., Inc. v. Romei, 426 S.E.2d 919, 922 (Ga. Ct. App. 1993) ("Privity is not required to support an action for negligent misrepresentation.").


204. See supra note 203; infra note 205.

205. Palco Linings, Inc. v. Pavex, Inc., 755 F. Supp. 1278, 1280 (M.D. Pa. 1990); see also Ocean Ritz of Daytona Condominium v. GGV Assocs., Ltd., 710 So. 2d 702, 705 (Fla. Dist. Ct. App. 1998) ("[T]he premise of the rule is simply that a contract action is more appropriate for recovering economic losses [even when the parties are not in privity]... "). Given that the plaintiff in Seely was in privity with the defendant, the truth of this assertion is highly debatable. See supra text accompanying notes 38-41.
What these courts fail to explain is how a third party is supposed to protect itself through contract negotiation when it is not in privity to the contract.

Application of the economic loss rule to third parties bars negligent misrepresentation claims even in the absence of any contractual remedy or any other basis of recovery. In addition, some courts apply the economic loss rule to bar negligent misrepresentation claims by third parties and between commercial entities in privity. Dual application of this rule—to both commercial plaintiffs in privity and plaintiffs not in privity—would relegate negligent misrepresentation claims solely to noncommercial plaintiffs. Extension of this dual application to consumer plaintiffs would eliminate negligent misrepresentation altogether.

**Negligent Misrepresentation: No Exception**

The final approach to resolving the tension between the economic loss rule and negligent misrepresentation concludes that “negligent misrepresentation is a species of negligence.” Accordingly, no exception applies to negligent misrepresentation.

Although the Texas Supreme Court crafted an exception for fraudulent inducement without a requirement of independent injury in *D.S.A., Inc. v. Hillsboro Independent School District*,

---

206. See National Steel Erection, 899 F. Supp. at 274.

207. See, e.g., Palco, 755 F. Supp. at 1280 (“[Plaintiff’s] inability to recover in contract or warranty due to the lack of privity, although unfortunate, does not change the fact that . . . remedies in this matter are limited by law.”); Floor Craft Floor Covering, Inc. v. Parma Community Gen. Hosp. Ass’n, 560 N.E.2d 206, 212 (Ohio 1990) (“There is no nexus here that can serve as a substitute for contractual privity.”).

208. *Compare* Eagle Traffic Control v. ADDCO, 882 F. Supp. 417, 420 (E.D. Pa. 1995) (holding that the economic loss rule bars claims when the parties are in privity), with Palco, 755 F. Supp. at 1280 (holding that the economic loss rule bars claims when the parties are not in privity).


210. 973 S.W.2d 662 (Tex. 1998).
the Texas Supreme Court articulated three reasons why negligent misrepresentation did not require a similar exception. First, unlike fraudulent inducement, the measure of damages for negligent misrepresentation did not include the "benefit of the bargain."\(^{211}\) Second, the rationale for fixing a narrower scope of liability for negligent misrepresentation lay in the difference in the duty imposed—the duty of honesty versus the duty of care.\(^{212}\) Third, and finally, requiring only negligent inducement would "potentially convert every contract interpretation dispute into a negligent misrepresentation claim."\(^{213}\) Accordingly, merely negligent misrepresentations require an independent injury (e.g., actual physical harm) to overcome the economic loss rule.\(^{214}\) Thus, the rule articulated by the Texas Supreme Court mirrors the economic loss rule's application to negligence and strict liability.

DO FRAUD AND NEGLIGENT MISREPRESENTATION HAVE A FUTURE?

The adoption of the economic loss rule by a majority of the states and the Supreme Court indicates that the underlying rationale to maintain a dividing line between tort and contract is a sound policy with regard to unintentional torts.\(^{215}\) As the

\(^{211}\) See Hillsboro, 973 S.W.2d at 663.

\(^{212}\) See id. at 664.

\(^{213}\) Id.

\(^{214}\) See id. Although the Hillsboro court addressed the issue in the context of parties in privity, the Texas Court of Appeals has utilized the economic loss rule to bar negligent misrepresentation claims of a third party. See M.D. Thomson & Austin Banister Joint Venture v. Espey Huston & Assoc., 899 S.W.2d 415, 422 (Tex. Ct. App. 1995).

\(^{215}\) See Cathco, Inc. v. Valentiner Crane Brunjes Onyon Architects, 944 P.2d 365, 368 (Utah 1997); D’Angelo, supra note 74, at 595 ("After East River, courts continued to follow [the economic loss rule] . . . recognizing the sound policy reasons . . . ."). Despite the nearly universal acceptance of the economic loss rule by courts, debate still surrounds the merits of the rule, particularly outside the products liability context. Critics have suggested that because tort law reduces physical injury to monetary damages, the distinction between physical injuries and economic losses is a fiction and that the rule penalizes prudent conduct by requiring plaintiffs to await physical injury prior to recovery. See F. Malcolm Cunningham, Jr. & Amy L. Fischer, The Economic Loss Rule: Deconstructing the Mixed Metaphor in Construction Cases, 33 TORT & INS. L.J. 147, 148 (1997). It has also been suggested that the purpose of the
Supreme Court observed in *East River*, parties would be free to extricate themselves from freely bargained-for contracts, and the well-developed body of "contract law would drown in a sea of tort without such a rule."\(^{221}\)

A blind application of the doctrine, however, would eviscerate fraud and negligent misrepresentation claims.\(^{217}\) Failing to create a workable exception for misrepresentation claims ignores the reality that fraud and contract can coexist peacefully in the areas where the interests served by the two bodies of law merge.\(^{218}\) Although tort and contract represent separate bodies of law designed to deal with different functions, their purposes and roles are not mutually exclusive.\(^{219}\) The fundamental intersection of contract and misrepresentation is inevitable as misrepresentation arises in a contractual setting.\(^{220}\)

The potential for eliminating misrepresentation claims by overapplication of the economic loss rule is evidenced by the test commonly employed by courts to determine when the economic loss rule should apply. This test focuses on the "nature of the injury": If the damages are purely economic, the rule applies.\(^{221}\) The problem with applying this test to misrepresentation is that

---


\(^{217}\) See infra note 261 and accompanying text; see also Schwiep, *supra* note 2, at 42 ("[T]he economic loss rule, rotely applied, . . . [could] defeat what has been the common law for decades . . . .").

\(^{218}\) See supra text accompanying notes 56-59 (discussing the overlap of tort and contract law).


\(^{220}\) Indeed, the concept of warranty law, now a part of contract law, originated as a form of misrepresentation in the nature of deceit. See William L. Prosser, *The Implied Warranty of Merchantable Quality*, 27 MINN. L. REV. 117, 118-19 (1943); see also Williams v. Khalaf, 802 S.W.2d 651, 654 (Tex. 1990) (discussing the quasi-contractual origins of fraud claims).

\(^{221}\) See, e.g., Carmania Corp., N.V. v. Hambrecht Terrell Int'l, 705 F. Supp. 936, 938-39 (S.D.N.Y. 1989) (using the rationale that "[i]f the damages suffered are of the type remediable in contract, a plaintiff may not recover in tort" to bar plaintiff's fraud claims) (citations omitted); Grace Petroleum Corp. v. Williamson, 906 S.W.2d 66, 68 (Tex. Ct. App. 1995) ("[T]he nature of the injury most often determines which duty has been breached.").
misrepresentation affords contract-style economic loss damages. Unlike other tort claims that seek to compensate the injured party, fraud seeks to remedy the wrong by restoring to the plaintiff what the defendant has taken wrongfully. Consequently, the majority of American courts have adopted a “benefit of the bargain” rule for fraud claims. As in contract, this measure of damages gives the plaintiff the benefit of what he was promised and allows recovery of the difference between what was received and the value to which the plaintiff was entitled, based on the defendant’s representations. This measure of damages exists precisely because recovery in fraud seeks to restore to the plaintiff what the defendant has received.

The Advantages of Misrepresentation in the Recovery of Purely Economic Losses

Despite the apparent similarity between fraud and contract damages, the discussion of whether to allow recovery in misrepresentation versus contract is not purely academic. Allowing a plaintiff to recover under a tort claim of misrepresentation has several distinct advantages. First, contract law severely restricts who may recover by its privity requirement. Although a

222. See supra notes 94-95, 161 and accompanying text.
223. See KEETON ET AL., supra note 5, § 110, at 765-66 (“Since the purpose [of fraud] is not to compensate the plaintiff's loss, but to restore what the defendant has received, the courts look to the inequity of allowing him to retain it, rather than to the damage which the plaintiff has sustained.”). Indeed, the recovery allowed by fraud sets it apart from other tort claims that allow damages similar to reliance rather than benefit of the bargain. See supra note 44.
225. See ROBERT L. DUNN, RECOVERY OF DAMAGES FOR FRAUD § 2.2, at 21 (1988); KEETON ET AL., supra note 5, § 110, at 768. It is noteworthy that for negligent misrepresentation, the majority of states allow the recovery of “out-of-pocket” damages. See DUNN, supra, § 2.7, at 35.
226. This list merely illustrates the principal advantages of a fraud versus a contract claim and is by no means exhaustive. Tort law may permit recovery where a contract action will not normally lie due to lack of proof of a contract, want of consideration, illegality, limitations imposed by the statute of frauds, or the parol evidence rule. Tort law may also avoid defenses such as infancy or a discharge in bankruptcy and some counterclaims. See KEETON ET AL., supra note 5, §§ 92-93, at 655-71.
227. See William K. Jones, Product Defects Causing Commercial Loss: The Ascen-
number of states, through legislation or judicial decisions, have limited or dispensed with a privity requirement in warranty cases, the absence of privity still precludes warranty actions in many states.  

Second, both express and implied warranties can be disclaimed. The presence of a well-drafted merger clause can limit the contract to the written agreement and thereby disclaim any warranties made prior to the contract. Whereas a warranty disclaimer will be inoperative if it is inconsistent with the express warranties, the UCC explicitly encourages disclaimers of warranties. Section 2-316 of the UCC provides that, wherever reasonable, express warranties and disclaimers thereof will be “construed . . . as consistent with each other.” While a seller may unscrupulously try to disavow a false statement by disclaiming a warranty in the contract agreement, it will not be able to disclaim liability for fraud. Moreover, a court is more likely to dispense with a warranty limitation under a tort theory than under a contract claim.

---


228. See id.; see also Hubbard v. General Motors Corp., 95 Civ. 4362 (AGS), 1996 U.S. Dist. LEXIS 6974, at *15 (S.D.N.Y. May 22, 1996) (finding that, absent privity of contract, an indirect purchaser cannot recover mere economic loss under a breach of warranty claim unless the product is a thing of danger).


230. See ALCES & HANSFORD, supra note 229, § 5.02, at 361-62.


232. Id.


234. See Jones, supra note 227, at 790.
Misrepresentation claims are particularly superior to implied warranty claims. The implied warranty of merchantability does not guarantee that a plaintiff received the product as represented by defendant; rather, it requires only that the product serve the "traditionally recognized purpose" for which it is used.\(^{235}\) So long as the product has operated in a "safe condition" and substantially free of a manifest defect, the implied warranty of merchantability provides no remedy.\(^{236}\) In contrast, fraud allows recovery when a defendant has misrepresented the quality of the good or has substituted an inferior product, regardless of whether the product has actually failed.\(^{237}\)

Third, misrepresentation claims may have a longer statute of limitations. Typically, the statute of limitations for a contract claim is four years.\(^{238}\) A contract may reduce, but not lengthen, this statutory period to as little as a year.\(^{239}\) While tort claims typically have a significantly shorter statute of limitations than contract actions, the "discovery rule" allows plaintiffs a tort action long after the contract claim has expired.\(^{240}\) In contract, the statute of limitations begins at the time of the breach.\(^{241}\)

\(\text{235. See U.C.C. \& 2-314; see also Carlson v. General Motors Corp., 883 F.2d 287, 297-98 (4th Cir. 1989) (finding a car able to meet its "purpose" of providing "safe reliable transportation"); Hubbard v. General Motors Corp., 95 Civ. 4362, 1996 U.S. Dist. LEXIS 6974, at *9-*10 (S.D.N.Y. May 22, 1996) (explaining that a car that does not exhibit a design defect does not give rise to a breach of warranty claim).\}

\(\text{236. See, e.g., Carlson, 883 F.2d at 297-98; In re Air Bag Prods. Liab. Litig., 7 F. Supp. 2d 792, 803 (E.D. La. 1998) (discussing a warranty claim due to the plaintiffs' failure to allege that the air bags functioned improperly during their normal use); Yost v. General Motors Corp., 651 F. Supp. 656, 657-58 (D.N.J. 1986) (discussing an implied warranty of merchantability claim where plaintiff experienced no actual mechanical difficulties); Feinstein v. Firestone Tire & Rubber Co., 535 F. Supp. 595, 602 (S.D.N.Y. 1982) (dismissal of an implied warranty claim on tires with a latent defect where the plaintiff had not yet experienced product failure); Skelton v. General Motors Corp., 500 F. Supp. 1181, 1191-92 (N.D. Ill. 1980) (dismissal of a claim where there was no product failure despite an allegation that the manufacturer substituted less desirable transmissions than those represented).\}


\(\text{238. See U.C.C. \& 2-725(1).}\)

\(\text{239. See ALCES & HANSFORD, supra note 229, \& 4.06, at 333.}\)

\(\text{240. See Borello v. United States Oil Co., 388 N.W.2d 140, 146 (Wis. 1986).}\)

\(\text{241. See U.C.C. \& 2-725(2); ALCES & HANSFORD, supra note 229, \& 4.06, at 333; see also, e.g., Zhi v. Bell Helicopter Textron, Inc., No. 4:97-CV-494-Y, 1997 U.S. Dist.}\)
the statute of limitations begins to run only after the plaintiff knew or should have known of the injury.242 Even though the warranty provisions also contain a deferral clause, "its applicability is a rare exception."243 In addition, fraud itself may have a longer statute of limitations than a contract action or other tort actions.244 Thus, in the case of a misrepresentation that does not become known until after the contract statute of limitations expires, a plaintiff may still have a viable fraud claim.

Finally, fraud damages are more expansive than contract damages. Because fraud is a tort, nearly every state allows punitive damages for intentional fraud.245 Though punitive damages should not attach for mere negligent misrepresentation, one who intentionally perpetrates a fraud is "arguably a proper candidate for punishment."246

In addition, although both contract and tort law limit damages to those that are "foreseeable," the rules differ. The famous case of Hadley v. Baxendale247 established two rules limiting liability in contract cases. First, contract damages are limited to those that arise naturally as a result of the breach.248 Second, contract

LEXIS 20374, at *13 (N.D. Tex. Dec. 16, 1997) ("A cause of action for breach of warranty generally accrues at the time of the delivery, not at the time of discovery.").


243. ALCES & HANSFORD, supra note 229, § 4.06, at 335; see also id. at 334-35 (discussing cases and rules governing the applicability of the deferral provision).

244. See generally Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737 (2d Cir. 1979) (discussing the statutes of limitations for fraud (six years), contract (four years) and negligence (three years)).

245. See ALCES, supra note 224, § 2.02[G][b][iii], at 2-38; KEETON ET AL., supra note 5, § 110, at 769; see also Dinsmore Instrument Co. v. Bombardier, Inc., 999 F. Supp. 968, 972 (E.D. Mich. 1998) (dismissing a punitive damage claim because the Michigan UCC does not allow them).

246. ALCES, supra note 224, § 2.02[G][b][iii], at 2-38.


248. See id. at 151 ("[T]he damages which the other party ought to receive . . . should be such as may fairly and reasonably be considered . . . arising naturally, i.e., according to the usual course of things, from such breach of contract itself . . . .").
damages must "reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it." 249 Proximate cause in tort law does not focus on either the contemplation of the parties or on the extent of the injury. 250 Rather, a tortfeasor is liable for all consequences that follow from his impact on the plaintiff, except those that public policy limits. 251 Whereas fraud damages must also be foreseeable at the time of the misrepresentation, no case exists in which a defrauded party's proximately caused consequential damages were unforeseeable. 252 The foreseeability question highlights the necessity of a viable fraud claim for misrepresentation, as a defrauded purchaser cannot "reasonably be supposed" to contemplate that the other person is defrauding them at the time of the sale. 253

The advantages of misrepresentation claims do not merely illustrate the advantages of a tort versus a contract claim; rather, these advantages illustrate the fundamental differences between contract actions and misrepresentation claims. The scope of these differences concern the circumstances in which recovery is permitted and the extent of that recovery. As the purpose of the economic loss rule is to prevent tort law and contract law from dissolving into one another when they overlap, these differences suggest that while both contract and misrepresentation arise out of commercial transactions, each serves a complementary but distinct purpose. Accordingly, this recognition must inform the correct application of the economic loss rule to misrepresentation claims.

The rule of Hadley v. Baxendale is now codified in section 2-715(2) of the UCC.
250. See KEETON ET AL., supra note 5, § 42, at 273.
251. See Way, supra note 219, at 1173; see also Hap's Aerial Enters., Inc. v. General Aviation Corp., 496 N.W.2d 680, 683-84 (Wis. Ct. App. 1992) (remanding to the trial court with an allowance for the defendant to argue public policy grounds).
252. See DUNN, supra note 225, § 1.3, at 12-17.
253. "A party to a contract cannot rationally calculate the possibility that the other party will deliberately misrepresent terms critical to that contract. Public policy is better served by leaving the possibility of an intentional tort suit hanging over the head of a party considering outright fraud." Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1236 (W.D. Wis. 1997).
What Should Be the Rule for Fraud?

Formulating the rule for fraud requires an understanding of the interrelation between contract and fraud. In recognizing the complementary, yet distinct nature of fraud, the UCC expressly provides that principles of law and equity, including fraud and misrepresentation, apply unless specifically displaced by the Act. 254 This provision is not an innovation of the UCC; commercial law has long recognized that "fraud unravels everything."255 Despite the similarity between fraud and express warranty claims, warranty law does not supplant fraud because fraud requires additional elements. 256 Unlike warranty, proof of fraud requires an intentional act to deceive 257 and proof of actual reliance. 258 Moreover, warranty and fraud claims serve distinct purposes. Warranty claims arise from the existence of a contract and therefore may be disclaimed according to the negotiations of the parties in allocating risk of nonperformance. 259 In contrast, the duty not to engage in fraud to induce a contract is imposed by law, regardless of the contract and may not be disclaimed because parties cannot, and for public policy reasons should not, "reasonably contemplate" the risk of fraud, as compared to nonperformance. 260


255. ALCES, supra note 224, § 3.03[1], at 3-5; supra notes 92-93, 105 and accompanying text (explaining the long history of fraud in preventing misrepresentations that induce contracts).

256. See WHITE & SUMMERS, supra note 254, § 9-1, at 327.

257. See Formosa Plastics Corp. v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 46-47 (Tex. 1998); supra note 197 and accompanying text.

258. Compare Mirkin v. Wasserman, 858 P.2d 568, 570 (Cal. 1993) (reaffirming the need to show actual reliance to establish fraud), and RESTATEMENT (SECOND) OF TORTS § 533 (1977) (requiring justifiable reliance for fraud), and supra note 93 (discussing the elements of fraud), with Lennar Homes, Inc. v. Masonite Corp., 32 F. Supp. 2d 396, 399-400 (E.D. La. 1998) (finding that reliance is not required for a breach of express warranty claim).

259. See supra notes 50-53 and accompanying text (discussing the source of contractual duties); supra notes 64-73 and accompanying text (discussing the rationales of negotiation and risk allocation as underlying the economic loss rule); infra notes 274-79 and accompanying text (distinguishing fraud from contract actions).

260. See supra notes 54-55 and accompanying text (explaining the source of tort
Most courts recognize that fraud can be an exception to the economic loss rule. Indeed, without Michigan’s and Florida’s requirement that the allegations of fraud cannot be interwoven into the parties’ agreement, the rules in Michigan, Florida, California, Texas, and Illinois would be identical. All three rules would allow recovery of purely economic losses when the defendant’s misrepresentations fraudulently induced the plaintiff to enter into a contract. The only real differences between the rules are how and when to determine that the fraud is not merely a recasting of the breach of contract allegations.

Adopting the Flagg Energy court’s rule would eviscerate fraud claims. Under that rule, the UCC is the sole source of remedies in defective product cases, regardless of whether the contract to sell was procured by fraud. Not only does this rule ignore the explicit provisions of the UCC, the rule is unsound for policy reasons as well. For example, a seller held liable only for expectation damages—namely, the benefit of contractual performance or a functional product—would, at worst, expect recission of the contract. Because specific performance is rarely granted and punitive damages largely forbidden under contract law and the UCC, this approach fails to punish intentionally
fraudulent behavior. The possibility of such a limited remedy for
fraud would create an uncertain marketplace—where sellers
would not be held to their representations and buyers could not
rely on explicit representations by the seller. Judge Posner
recently explained that such a rule invariably would increase
costs for all commercial transactions:

If commercial fraud [is eliminated by the economic loss rule],
then prospective parties to contracts will be able to obtain
legal protection against fraud only by insisting that the other
party to the contract reduce all representations to writing,
and so there will be additional contractual negotiations, con-
tracts will be longer, and in short, transactional costs will be
higher. And the additional costs will be incurred in the maki-
ing of every commercial contract, not just the tiny fraction
that end up in litigation.267

Even if the buyer reduces all representations to writing and
recovers under an express warranty, the seller would not be
liable for inducing a contract that, but for the misrepresenta-
tions, would not have been made.268 Failing to hold the seller
liable for fraud does not provide the buyer with a full and
adequate remedy without any policy justifying the result.

The underlying problem with the Florida and Michigan limita-
tions on the fraudulent inducement exception is that they rest
on a misunderstanding of the tort of fraud in the inducement.269

266. See Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1236 (W.D.
Wis. 1997) (stating that a requirement that the economic loss rule bars intentional
misrepresentation claims “would not be conducive to amicable commercial relations”).
267. All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 867 (7th Cir. 1999) (em-
phases added); see also Armstrong World Indus., Inc. v. Robert Levin Carpet Co.,
that any representations, even those that fraudulently induced the transaction, if
material, must be “set forth in the parties’ integrated distribution agreements”);
Pressman v. Wolf, 732 So. 2d 356, 360 (Fla. Dist. Ct. App. 1999) (dismissing fraudu-
 lent inducement claims because of the existence of an “as is” contract).
268. See Dexter Corp. v. Shittaker Corp., 926 F.2d 617, 621 (7th Cir. 1991) (“If
plaintiff proves fraud, it can obtain all its compensatory damages and more and
can forget about the contract.”); see also Tourek et al., supra note 254, at 882 (ex-
plaining that it is “well-recognized that fraudulently obtained contracts are voidable
as a matter of law”).
269. See Budgetel Inns, Inc. v. Microsys, Inc., 8 F. Supp. 2d 1137, 1147-48 (E.D.
Wis. 1998).
Fraud in the inducement is defined as "[m]isrepresentation as to the terms, quality or other contractual relation, venture or other transaction that leads a person to agree to enter into the transaction with a false impression or understanding of the risks, duties or obligations she has undertaken." Whereas the fraudulent inducement is always interwoven with the contract, the tort itself is always independent of the contract. The Huron Tool court, then, was correct to distinguish the fact that fraudulent inducement claims, not fraudulent performance claims, are exceptions to the economic loss rule. By imposing the additional requirement, however, the court vitiated the exception and for all practical purposes created no exception at all.

Fraud in the inducement must always be interwoven with the contract because the tort of fraud is the inducement of someone to enter into a contract. The distinguishing determination is whether the fraud arises from inducement or performance; the former is a tort, the latter arises only under contract law. If the fraud took place prior to entering the contract, then it is fraud in the inducement; if not, it is breach of contract. Consequently, all fraud in the inducement claims should be exceptions

270. BLACK'S LAW DICTIONARY 661 (6th ed. 1990); see also RESTATEMENT (SECOND) OF TORTS § 530(1) (1977) ("A representation of the maker's own intention to do or not to do a particular thing is fraudulent if he does not have that intention.").

271. See Budgetel, 8 F. Supp. 2d at 1147; see also supra notes 99-107 and accompanying text (discussing the rationales for creating a true fraud exception to the economic loss rule).

272. See supra notes 117-22 and accompanying text (discussing Huron Tool).

273. See supra text accompanying notes 128-29; see also supra note 142 (discussing the varied application of the Florida economic loss rule). Compare supra notes 123-24 and accompanying text (discussing the application of the Huron Tool limitation), with supra notes 145-50 (discussing the results in Flagg Energy).

274. See supra notes 270-71 and accompanying text; see also supra notes 104-06 and accompanying text (discussing the origin of the duty for fraud).


276. See Budgetel, 8 F. Supp. 2d at 1147-48; see also supra notes 46-49, 62-63 and accompanying text (discussing the distinction between tort and contract).
to the economic loss rule. Both the California Court of Appeals and the Texas Supreme Court correctly recognized that fraud is separate and distinct from a contract because the duty imposed is the abstention from inducing another to enter into a contract through the use of misrepresentations. The duty not to lie in contract negotiations differs substantially from a broken contractual promise. In short, fraud consists of a promise never intended to be performed (i.e., a lie) while breach consists of a promise intended to be performed but is not performed (i.e., a broken promise).

The test to determine whether a plaintiff has properly asserted a tort claim does not rest on the determination of whether the damages are physical or economic. Purely economic loss is recoverable under a variety of tort theories, including fraud. Instead, the question of whether a plaintiff correctly asserted a fraudulent inducement claim depends on the source of the duty. If the duty arises solely from a provision contained within the contract, then the plaintiff has asserted a contract action. Conversely, if the plaintiff's allegations concern misrepresentations made during contract negotiations, then the claim is a tort. Mere failure to perform a contract does not constitute fraud, but a party can be held liable for fraud when that party makes a misrepresentation without the intent to perform and another party is induced into a transaction. So long as the

277. See Budgetel, 8 F. Supp. 2d at 1147-48; supra text accompanying notes 42-46 (defining the economic loss rule and explaining that the heart of the economic loss rule is to distinguish tort and contract claims).

278. See supra text accompanying notes 96-107.

279. See Budgetel Inns, Inc. v. Micros Sys., Inc., 34 F. Supp. 2d 720, 724 (E.D. Wis. 1999) (explaining that “the duty of honesty when negotiating a contract is not an obligation imposed by the contract, which does not yet exist, but instead by the common law”); Budgetel, 8 F. Supp. 2d at 1147-48.

280. See supra notes 5-6.

281. See supra notes 96-112 and accompanying text.

282. See supra note 50 and accompanying text (explaining that contract law arises from agreements of the parties); see also Budgetel, 8 F. Supp. 2d at 1149 (explaining that a representation made after the existence of the contract did not constitute fraudulent inducement); Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 88 (S.C. 1995) (same).

283. See Griffin Plumbing & Heating, 463 S.E.2d at 88; supra notes 103-07 and accompanying text.

284. See Royal Palm Sav. Ass'n v. Pine Trace Corp., 716 F. Supp. 1416, 1420 (M.D.
allegation concerns a misrepresentation made prior to the contract that induced the contract, it is a fraudulent inducement claim.

The economic loss rule clearly seeks to prevent the mere recasting of a contract claim sounding as a tort of fraud in the inducement, because tort law does not protect parties from breach of duties assumed only by agreement. Courts correctly recognize that "almost any contract claim can be framed as a fraud in the inducement." The test to determine whether a plaintiff has a fraudulent inducement action is not to examine "the gist of the action" by determining if the terms are "inseparably embodied in the parties’ subsequent agreement" nor the nature of the damages claimed. These indicators suggest only that there might be a recasting of the contract claim; they are the beginning, not the end, of the determination.

The true test of a claim rests on the duty involved and the significance of the representation: (1) Did the duty arise before the contract, and (2) if the misrepresentation had been known to the defrauded party, would there have been no deal? When a plaintiff does not allege merely that the defendant failed to keep

---

289. See, e.g., Hotels of Key Largo, 694 So. 2d at 77.
290. See DeWitt County Elec. Co-op., Inc. v. Parks, 1 S.W.3d 96, 105 (Tex. 1999) (explaining that the "measure of damages, standing alone, is not always determinative of whether a tort claim can co-exist with a breach of contract claim").
291. See 2314 Lincoln Park West Condominium Ass’n v. Mann, Gin, Ebel & Frazier, Ltd., 555 N.E.2d 346, 351 (Ill. 1990) ("[T]he concept of duty is at the heart of . . . the economic loss rule.”).
292. Cf. Douglas-Hanson Co. v. BF Goodrich Co., 598 N.W.2d 262, 270-71 (Wis. Ct. App. 1999) (determining that fraudulent misrepresentations that actually induce a contract create an exception to the economic loss rule, but declining to address whether the economic loss rule would bar misrepresentation claims that do not actually induce the contract).
its promise, but that either the defendant made a false statement that induced the contract or that the defendant never intended to keep the agreement, the plaintiff has properly claimed fraudulent inducement.\textsuperscript{293}

The validity of this test is evidenced by the fact that "[f]raud destroys all consent."\textsuperscript{294} If the defrauded party's reliance on the misrepresentation induced the contract, and the representation, if not true, was a deal-breaker, then the plaintiff has truly pled a fraudulent inducement claim. Unfortunately, such a determination must be made on a case-by-case basis; it cannot be applied in a simplistic fashion by merely looking to see if the misrepresentations are "interwoven" into the contract. The misrepresentations will necessarily concern the heart of the parties' agreement.\textsuperscript{295} A misrepresentation that is collateral to, or a minor part of, the contract is not a deal-breaker. If the misrepresentation is such that there would have been no contract if the truth were known, the party has been tricked into contracting.\textsuperscript{296} Because of the misrepresentation, the plaintiff entered into a contract to which he would not have otherwise agreed.\textsuperscript{297} In

\begin{flushleft}
\textsuperscript{293} \textit{See} City of Richmond v. Madison Management Group, Inc., 918 F.2d 438, 446-47 (4th Cir. 1990).
\textsuperscript{294} Ganley Bros., Inc. v. Butler Bros. Bldg. Co., 212 N.W. 602, 603 (Minn. 1927); see ALCES, supra note 224, §3.01, at 3-3.
\textsuperscript{295} Fraud in the inducement occurs when a party is induced to enter a contract "as when a seller misrepresents the quality of goods." E. ALLAN FARNSWORTH, CONTRACTS § 4.10, at 249 (2d ed. 1990); see also Armstrong World Indus., Inc. v. Robert Levin Carpet Co., No. Civ. A. 98-CV-5884, 1999 WL 387329, at *6 (E.D. Pa. May 20, 1999) (explaining that material factors to agreements are included in the subject matter of contracts); Eclipse Med., Inc. v. American Hydro-Surgical Instruments, Inc., No. 96-8532-CIV-RYSKAMP, 1999 WL 181412, at *5 (S.D. Fla. Jan. 20, 1999) (explaining that "if the representation was not important enough to make it into the comprehensive written agreement it must not have been material").
\textsuperscript{296} See Huron Tool & Eng'g v. Precision Consulting Servs., 532 N.W.2d 541, 545 (Mich. Ct. App. 1995) (explaining that fraud in the inducement undermines a party's ability to negotiate freely); \textit{Douglas-Hanson,} 598 N.W.2d at 268 (explaining that fraud undermines "one party's ability to negotiate fair terms and make an informed decision").
\textsuperscript{297} [A] material misrepresentation of fact may render a contract void or voidable. . . . The economic loss doctrine does not apply to fraudulently induced contracts because the person fraudulently induced. . . can affirm or avoid the contract, and . . . has the option of selecting tort or contract damages. That option is inconsistent with the economic loss doctrine, . . .
\end{flushleft}
essence, no agreement exists when the contract is based on fraud.

A case-by-case analysis requires that the court examine the evidence supporting the plaintiff's claims. The fact-intensive nature of a fraud claim suggests that the bottom line of this analysis rests not on the economic loss rule, but on whether the plaintiff has enough facts to support a fraudulent inducement claim. To survive judgment as a matter of law, a plaintiff must have sufficient facts to show (1) that the defendant intentionally misrepresented a material fact to induce the contract or the defendant's intent at the time prior to the contract was not to fulfill its promise, and (2) that had the plaintiff known that the representation was false, the plaintiff would not have entered into the contract.

This approach properly balances the interests of the economic loss rule and fraud claims. First, it preserves the essence of the fraudulent inducement claim, which responds to the concern of critics who allege that courts are using the economic loss rule as an "analysis-lacking short-cut" or merely as a tool of "judicial economy." Second, it suggests that fraudulent inducement requires not just reliance on the precontractual misrepresentation, but that without the misrepresentation, no contract would have been formed. By focusing both on the timing and significance of the representation, this approach responds to the concern that

which requires the contract to be affirmed.

Douglas-Hanson, 598 N.W.2d at 268-69 (citations omitted).

298. At least one court has explained that the nature and subtleties of a fraud claim are such that fraud requires a full explanation of facts and circumstances to permit a proper determination that seldom can be made without a full trial. See Nessim v. DeLoache, 384 So. 2d 1341, 1344 (Fla. Dist. Ct. App. 1980).


300. See supra note 215.
any contract claim can be converted into a fraudulent inducement claim. The similarity of claims for breach of an express warranty and fraud evidences that allowing simultaneous claims to proceed will not unnecessarily burden the defendant or the court. Finally, focusing on the timing and importance of the misrepresentation preserves fraud as a viable claim that co-exists with contract claims, as it developed in the common law and as contemplated by the drafters of the UCC.

What Should Be the Rule for Negligent Misrepresentation—Is It More Akin to Fraud or Negligence?

The disparate treatment of negligent misrepresentation by the courts demonstrates the true debate over application of the economic loss rule to negligent misrepresentation claims. The Florida rule treats negligent misrepresentation as if it were similar to a fraudulent inducement claim; Texas and Illinois treat negligent misrepresentation as more akin to negligence. Although negligent misrepresentation does not require fraud's concomitant intent to deceive, it "is founded on the breach of a duty separate and distinct from the duty abolished by the economic loss rule."

The duty imposed by negligent misrepresentation is "to exercise reasonable care or competence in obtaining or communicating information for the guidance of others in their business transactions." The goal of the economic loss rule is to prevent parties from extricating themselves from the bargains struck from freely negotiated transactions. Negligent misrepresenta-

301. See supra notes 274-79 and accompanying text.
302. Indeed, pleading fraud also comes with safeguards against false claims, such as the requirement of pleading fraud with particularity and, in most jurisdictions the burden of proving fraud by clear and convincing evidence, not merely a preponderance of the evidence. See All-Tech Telecom, 174 F.3d at 866; see also Tourek et al., supra note 254, at 919-21 (arguing that a host of provisions in the rules of procedure protect against improper allegations of fraud).
303. See supra notes 93, 215, 255 and accompanying text.
304. See supra notes 254-60 and accompanying text.
306. Id. at 303; see also supra note 155 (setting forth section 552 of the Restatement (Second) of Torts).
307. See supra notes 46-79 and accompanying text.
tion imposes a duty of care when the defendant supplies information intended for the guidance of others. In a negligent misrepresentation case, the plaintiff relies on that information and experiences business losses as a result.

Like fraud, negligent misrepresentation also expressly provides for the recovery of purely economic losses. Although the economic loss rule bars claims for disappointed economic expectations where commercial law provides an adequate remedy, the UCC clearly allows supplemental common law claims not only for fraud, but also for negligent misrepresentation. At least in the case of third parties, negligent misrepresentation does not protect the same interest that contract law and the UCC protect.

Adopting a view that negligent misrepresentation is so akin to negligence that the economic loss rule bars its application ignores the express intention of the UCC to allow fraud and negligent misrepresentation defenses to supplement the Code. The "in the business" requirement crafted by the Illinois courts raises several problems. First, the Illinois courts have failed to articulate a clear and concise test to determine who is "in the business of supplying information for the guidance of others, or to explain why certain professions are included and others excluded. The "in the business" requirement also ignores the plain language of the Restatement (Second) of Torts. The Restatement requires only that the supplier of information provide the information "in the course of his business... or employment" or supply information in connection with "any other

308. See John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428, 430-31 (Tenn. 1991); supra notes 159-60 and accompanying text.
309. See John Martin, 819 S.W.2d at 430-31.
312. See U.C.C. § 1-103 (1999); supra notes 254-55.
313. See supra notes 157-60 and accompanying text.
314. See U.C.C. § 1-103.
316. See supra notes 174-87 and accompanying text.
transaction in which he has a pecuniary interest." A proper defendant is one who either is paid to provide information, for example, an accountant or an attorney, or one who does not receive compensation for the information, but nonetheless has a pecuniary interest in the transaction.

All that a negligent misrepresentation claim requires is that the information be given in the course of the defendant's business, even if no consideration exists for the information itself, and that the defendant have a pecuniary interest in the underlying transaction. The Restatement also does not explicitly require that the plaintiff and the defendant not be in privity—only that the information be intended for the guidance of others.

Although . . . the bulk of the decisions stem from factual situations involving damage . . . [to] third parties . . . this alone does not compel a narrow reading of section 552 that limits its applicability solely to such situations or precludes its applicability . . . to parties . . . in which the providers of information are involved.

The Illinois "in the business" requirement is correctly applied when there is a direct relationship between the parties and an inequality of knowledge or bargaining power. Where the information supplier has a direct relationship with the relying party and the nature of the contractual relationship is based on the information supplier's superior knowledge, the aggrieved party should have a negligent misrepresentation claim. This reasoning is consistent with other jurisdictions that have specifically exempted the economic loss rule's application to professional negligence claims.

Allowing an exception for any party in privity, due merely to a negotiated contract, to seek redress through a claim of negligent misrepresentation has the potential to vitiate the economic loss

318. See, e.g., infra notes 331-36 and accompanying text (discussing Wassall v. Payne).
319. See RESTATEMENT (SECOND) OF TORTS § 552 cmts. c-d.
320. See id. § 552.
322. See, e.g., Moransais v. Heathman, 744 So. 2d 973 (Fla. 1999); Clark v. Rowe, 701 N.E.2d 624 (Mass. 1998).
rule. It is precisely for this reason that "[w]ith increasing frequency, plaintiffs are presenting their negligence claims"—or more accurately their contract claims—"in the form of negligent misrepresentation in an attempt to circumvent the economic loss rule." An action for negligent misrepresentation when the parties are in privity is indistinguishable from an action for breach of contract: "If one is unable to meet his [contractual] obligation . . . has he not 'negligently misrepresented' his ability to do so?" If this is truly the intent of allowing an exception for "independent torts" it would be better "to drive that final coffin-nail" into the economic loss rule. Because the economic loss rule permits and encourages parties to allocate risk through contract negotiations, a tort action for negligent misrepresentation where the parties are in privity of contract affords no alternative relief other than to allow the parties to extricate themselves from a fairly negotiated bargain. Thus, for sophisticated commercial entities who deal with each other at arms length in contract negotiations, the economic loss rule should prevent recovery in negligent misrepresentation.

The question of recovery for third parties presents an entirely different analysis. To apply the economic loss rule to bar negligent misrepresentation claims by third parties would restore the "citadel of privity" that insulated defendants from liability caused by misperformance of a contractual duty. Reviewing

323. Fox & Loftus, supra note 163, at 268.
326. Id.
the facts of *Glanzer*, it is easy to see how courts rejecting a third-party privity exception to the economic loss rule would prevent liability to the bean-weigher today.\(^{330}\)

*Wassall v. W.H. Payne*\(^{331}\) illustrates perhaps the best example of how the economic loss rule should apply to negligent misrepresentation. In *Wassall*, the defendant made representations to the plaintiff and a third party about the flooding propensity of a piece of property.\(^{332}\) The defendant knew at the time of negotiations that the third party intended to buy the land and then lease it to the plaintiff.\(^{333}\) Both the plaintiff and the third party relied on the misrepresentation in entering into their respective transactions.\(^{334}\) Similarly, the plaintiff in *Glanzer* was not in privity with the defendant and sought purely economic losses—damages incurred as a result of the weigher's negligent supply of information about the weight of the beans.\(^{335}\) Accordingly, both plaintiffs should be and were entitled to recover.

The outcome in *Wassall* demonstrates the sound reasoning of *Glanzer*, but an overbroad application of the economic loss rule, as some courts suggest, threatens to eliminate the reasoning of *Glanzer* altogether. Such an example establishes the correct application of the economic loss rule to negligent misrepresentation claims: When a foreseeable plaintiff, although not in privity, relied on the defendant's misrepresentations in entering into his transaction, the plaintiff should be entitled to recover from the defendant as a result of justifiable reliance on the defendant's misrepresentations.\(^{336}\) As Justice Cardozo recognized, potential pitfalls exist if the scope of negligent misrepresentation is unlimited.\(^{337}\) The extent of foreseeability of the plaintiff in relying

\(^{330}\) Compare *supra* notes 156-60 and accompanying text (discussing *Glanzer v. Shepard*, 135 N.E. 275 (N.Y. 1922)), with *supra* notes 207-08 and accompanying text (discussing the application of the economic loss rule to bar negligent misrepresentation claims by third parties).

\(^{331}\) 682 So. 2d 678 (Fla. Dist. Ct. App. 1997).

\(^{332}\) See *id*.

\(^{333}\) See *id*.

\(^{334}\) See *id*.

\(^{335}\) See *supra* notes 156-60 and accompanying text (discussing *Glanzer*).

\(^{336}\) See *Wassall*, 682 So. 2d at 681.

\(^{337}\) See *Ultramares Corp. v. Touche*, 174 N.E. 441, 445-46 (N.Y. 1931); *supra* note 158.
on the information is a question to be resolved by determination of the individual claim, it is not one to be resolved by a universal application of the economic loss rule to bar negligent misrepresentation claims by third parties.

CONCLUSION

The economic loss rule has become the rule of law in almost every jurisdiction. As application of the rule expands beyond the contours of products liability, applicability of the doctrine to torts other than strict liability and negligence has come to the forefront. The recent trend by courts in crafting an exception for intentional torts, including fraud, is correct. At least in part, states adopt the economic loss rule to promote predictable and uniform results in commercial transactions. Yet variation in methods of applying the economic loss rule to misrepresentation claims threatens to undermine that uniformity.

In applying the doctrine to misrepresentation claims, courts should be mindful of the basic purpose of the economic loss rule—to prevent the law of contract and the law of tort from dissolving into each other and the simple proposition that fraud unravels a contract. Just as overextension of products liability would drown contract in a sea of tort, so too would overapplication of the economic loss rule drown misrepresentation claims in a sea of contract. An analysis of the nature of damages and whether the misrepresentation is interwoven into the contract only suggests further analysis is required.

When fraudulent misrepresentations procure a contract, there is no agreement. In determining whether a contract truly was procured by fraud, courts should examine when the alleged misrepresentation was made and the significance of the misrepresentation. This analysis will ensure that the economic loss rule does not eviscerate a valid fraudulent inducement claim.

In contrast, creating an exception for a negligent misrepresentation claim between sophisticated commercial entities in privity does not protect an independent duty. Allowing those parties to escape their agreement merely by pleading negligent misrepresentation would vitiate the economic loss rule. The tort of negligent misrepresentation has its historic origins in protecting third parties. Accordingly an economic loss rule limitation on a third party's negligent misrepresentation claim serves no pur-
pose, other than to contradict the express reasons for the tort.

Unfettered application of the economic loss rule could potentially eviscerate fraud and negligent misrepresentation claims. Without workable exceptions for fraud and negligent misrepresentation, a judicial rule will eliminate a remedy where the policy justification is absent.338 As the Florida Supreme Court recently cautioned:

[T]he economic loss rule [has] . . . genuine, but limited, value [but it was] never intended to bar well-established common law causes of action. . . . Rather, the rule was primarily intended to limit actions in the products liability context, and its application should generally be limited to those contexts or situations where the policy considerations are substantially identical to those underlying the product liability type analysis . . . . The rule should not be invoked to bar well-established causes of action in tort.339

Prohibiting otherwise viable misrepresentation claims because of an improper expansion of the economic loss rule creates a system of recovery resting on the very ground that Justice Traynor sought to avoid in Seely: the "luck" of one plaintiff versus another.340 To permit such a result would contravene a fundamental duty of government to afford its citizens redress in the courts for injury, as "[t]he very essence of civil liberty certainly consists in the right of every individual to claim the protection of the laws, whenever he receives an injury."341

R. Joseph Barton

338. See, e.g., supra notes 8-19 and accompanying text (discussing the unavailability of remedies for the FRT-plywood plaintiffs).
339. Moransais v. Heathman, 744 So. 2d 973 (Fla. 1999); see also Comptech Int'l, Inc. v. Milam Commerce Park, Ltd., No. 93,336, 1999 WL 983857, at *6-*7 (Fla. Oct. 28, 1999) (reiterating this caution and quoting portions of it).
340. See Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965). More precisely, it rests on the luck of the defendant that the plaintiff will not discover its fraudulent misrepresentations within the UCC's statute of limitations.
341. Marbury v. Madison, 5 U.S. (1 Cranch) 137, 163 (1803); see also Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1248 (Fla. 1993) (Barkett, J., dissenting) (suggesting that the lack of a remedy due to the application of the economic loss rule violated the Florida constitution); Ned Miltenberg, The Revolutionary "Right to a Remedy," TRIAL, Mar. 1998, at 48 n.1 (listing the 38 state constitutions providing a right to a remedy).