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Frank Charles Sabatino

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Economic Losses and Strict Products Liability: A Record of Judicial Confusion Between Contract and Tort

I. Introduction

Defective products may cause various types of harm, and no single theory of compensation can be designed for all cases. A successful products liability suit offers an injured individual three potential forms of recovery: (1) "personal" damages, which compensate for bodily harm; (2) "property" damages, which compensate for injury to property other than the defective product; and (3) "economic" damages, of which "direct" compensate for harm to the defective product itself and "consequential" for harm to business expectations, such as profits and goodwill. Presently, the majority of courts allow recovery for personal and property damages under the theory of strict liability in tort, but limit recovery for "economic" loss to cases involving breach of an express warranty.[1]

This note reviews the development and present status of the conflicting rules governing recovery of economic damages in products liability cases. It is contended that current judicial concepts are the result of the failure of courts to identify the proper policy considerations behind tort and contract theory. Different rules of compensation for economic harm should exist in consumer as opposed to commercial situations. This note distinguishes such principles on the basis of contractual bargaining power.

II. From *Henningsen* to *Seely*: The Evolution of a Theoretical Conflict

Modern products liability law developed as its theoretical foundation evolved from contract to tort. Originally, the doctrine of privity required that a plaintiff and defendant stand in a direct contractual relationship before the former could recover for injuries inflicted by goods produced by the latter. This rule legally insulated most manufacturers since the marketing of goods through retailers precluded privity between the producer and the ultimate consumer. The famous case of *MacPherson v. Buick Motor Co.*[2] led to abolition of privity as a factor in negligence cases, but the defense remained valid against claims which did not allege a lack of due care.[3] Beginning in 1960, however, a series of decisions rendered in California and New Jersey greatly accelerated the development of products liability law.

1 For a discussion of the case law involving these definitions see Note, *Manufacturer's Strict Tort Liability to Consumers for Economic Loss,* 41 St. John's L. Rev. 401, 405 (1967); Comment, *Strict Liability: Recovery of "Economic" Loss,* 13 Idaho L. Rev. 29, 40 (1976).

2 217 N.Y. 382, 111 N.E. 1050 (Ct. App. 1916).

3 Prior to the demise of privity, some courts took interesting approaches designed to allow recovery without explicitly rejecting contractual theory. A much-cited example of this strategy is Baxter v. Ford Motor Co., 168 Wash. 456, 12 P.2d 409 (Sup. Ct. 1932), *aff'd,* 168 Wash. 465, 15 P.2d 1118 (Sup. Ct. 1932), which held that mass advertising created sufficient contacts between manufacturer and consumer to overcome the common law privity requirement.

The New Jersey Supreme Court reached a momentous decision in *Henningsen v. Bloomfield Motors, Inc.*[4] Speaking for a unanimous court, Justice Francis declared that as a matter of law an implied warranty of fitness for every product placed in the stream of commerce extended from the manufacturer to the foreseeable user, notwithstanding the lack of a contractual relationship. Furthermore, the court's language indicated that the right to waive such a warranty would be extremely limited.

From a historical perspective, the underlying assumption of *Henningsen*—that the law of contract did not offer the consumer adequate protection—has proven more influential than the case's specific holding. The New Jersey Supreme Court clearly believed that under modern market conditions the disproportionate strength of the manufacturer made equitable bargaining, the foundation of contract law, impossible. According to Justice Francis:

> . . . . Manufacturers are few in number and strong in bargaining position. . . . From the standpoint of the purchaser, there can be no arm's length negotiating on the subject. Because his capacity for bargaining is so grossly unequal, the inexorable conclusion which follows is that he is not permitted to bargain at all. He must take or leave the automobile on the warranty terms dictated by the maker.[5]

Clearly, the court intended to design a new remedy for consumers. The *Henningsen* warranty was not a contract because it was imposed by law for policy reasons and did not require any promise on the part of the manufacturer. In all but name, the New Jersey Supreme Court created a remedy in tort. Justice Francis readily admitted this fact, reasoning that since warranty historically arose from "a curious hybrid" of contract and tort, the formalistic requirements of the former could be relaxed in the interest of equity.[6]

The judicial application of tort theory to products liability cases grew dramatically in the wake of *Henningsen*. In *Greenman v. Yuba Power Products, Inc.*,[7] the California Supreme Court specifically adopted the strict liability theory defined in Restatement (Second) of Torts § 402(A)[8] as the proper remedy for

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4 32 N.J. 358, 161 A.2d 69 (1960).

5 *Id.* at 403, 161 A.2d at 94.

6 *Id.* at 412-17, 161 A.2d at 99-101.

7 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962). It should be noted that the *Greenman* court's statements on strict liability were dicta. Yuba had based its entire defense on Greenman's failure to provide timely notice of his injuries. The court ruled that such notice was not necessary in a personal injury case. Thus, Chief Justice Traynor could have found for the plaintiff without even considering the concept of strict liability in tort. *See* text accompanying notes 27 and 28 *infra*.

8 Restatement (Second) of Torts § 402(A) (1965) states:

> (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to property, if
>
> (a) the seller is engaged in the business of selling such a product, and
>
> (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.
>
> (2) The rule stated in Subsection (1) applies although
>
> (a) the seller has exercised all possible care in the preparation and sale of his product, and
>
> (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

a plaintiff suffering bodily harm from a product produced and placed in the open market by a defendant. This decision noted that cases such as *Henningsen* had already reached much the same result in the guise of an implied warranty. Yet Justice (later Chief Justice) Traynor, speaking for the *Greenman* court, stated that strict liability in tort should be clearly adopted to demonstrate that consumer remedies did not rest solely on contract theory.[9]

The first major case involving strict liability in tort as applied to economic loss was decided in 1965. *Santor v. A and M Karagheusian, Inc.*[10] concerned a plaintiff who, through a retailer, had purchased a defective and virtually worthless rug produced by the defendant-manufacturer. On appeal, the defendant attempted to distinguish the case from *Henningsen* on the ground that economic rather than personal injury was at issue. The New Jersey Supreme Court, again through Justice Francis, rejected this distinction on the ground that no valid policy considerations justified a standard of recovery for economic injury less generous than that of the *Henningsen* warranty. The court could have decided the case on this narrow issue, but decided to expand the scope of the opinion significantly.

Justice Francis explained that the *Henningsen* implied warranty was simply a legal device fashioned to yield a desired result: recovery for the plaintiff without a wholesale incorporation of tort law into product cases. Citing Justice Traynor's opinion in *Greenman,* however, Justice Francis stated that the time had come to concede that consumer remedies did not hinge exclusively on the law of sales contracts. Accordingly, the New Jersey Supreme Court proclaimed strict liability in tort to be a proper remedy in products liability cases. Justice Francis ruled that since "responsibility of the maker should be no different where damage to the article sold or to other property of the consumer is involved,"[11] strict liability in tort would also apply to direct economic loss. Subsequent New Jersey case law has, albeit tentatively, extended *Santor* to consequential economic injury.[12]

The apparent harmony with which the California and New Jersey Supreme Courts refined the law of products liability eventually ended. In *Seely v. White Motor Company,*[13] the plaintiff, a small businessman, included a demand for lost profits incurred when a defective truck purchased from the defendant overturned. As in *Greenman* and *Santor, Seely*'s most significant pronouncements were dicta because the consequential damages were readily awarded at the outset of the opinion on the basis of a breached express warranty. Nevertheless, Chief Justice Traynor categorically refused to extend strict liability in tort to economic injuries, direct or otherwise. Due to their "commercial" nature, such losses were to remain under the jurisdiction of the law of sales as defined in the Uniform Commercial Code (U.C.C.). In effect, recovery for economic injury in California would be dependent upon the plaintiff's showing that the defendant had both granted and violated an express warranty.

9 59 Cal. 2d at 62-64, 377 P.2d at 900-902, 27 Cal. Rptr. at 700-702.
10 44 N.J. 52, 207 A.2d 305 (1965).
11 *Id.* at 66, 207 A.2d at 312.
12 *See* text accompanying notes 43 and 44 *infra.*
13 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

Most significantly, Chief Justice Traynor denied that strict liability in tort had been applied to cases of bodily harm in order to compensate for the consumer's slender bargaining power. Rather, he insisted that *Greenman* had turned entirely on the potential tragedy of personal injury and the ability of manufacturers to insure against it. Both of these factors were deemed lacking in all cases involving economic harm. Therefore, *Santor,* which according to the California Supreme Court saddled manufacturers with unlimited and unforeseeable liability, was rejected.[14]

Chief Justice Traynor did extend strict liability in tort to cover "property" damage, however, on the theory that such harm was "akin" to personal injury.[15] Significantly, the *Seely* court accepted a definition of property interests broader than the normal concept. In *Seely,* a defective part of the product (*i.e.,* the engine) caused damage to the rest of the product. Chief Justice Traynor considered such injury to be property damage even though the normal judicial definition would view it as direct economic harm.[16]

Justice Peters, who had concurred with the *Seely* ruling on the warranty issue, vigorously criticized the rationale as to economic loss. His dissent charged that the majority's distinction between economic harm and other types of injury was totally arbitrary. Furthermore, Justice Peters contended that the court should focus not on the classification of damage sustained, but on the relationship of the parties before the loss occurred. Thus, when the transaction was properly described as "commercial," contract law should be applied, and where the situation involved a consumer, the *Henningsen-Santor* strict liability rule ought to prevail. The dissent conceded that the term "consumer" is vague, but maintained that a definition could be developed on a case-by-case basis.[17]

In considering the differences between the *Santor* and *Seely* rules, it is important to realize that they are the products of an underlying theoretical dichotomy. Each springs from a substantive policy decision. *Santor* is derived from *Henningsen,* which assumes that the consumer is inherently unable to bargain with the manufacturer and therefore needs a tort remedy to safeguard his or her interests. *Seely,* conversely, rejects any analysis of bargaining power and, as a matter of law, insists that contract principles govern all cases of economic loss. Thus, the difference between the New Jersey and California rules reflects a fundamental conflict between contract and tort.

III. Practical Differences Between *Santor* and *Seely*

The conflicting theories behind the New Jersey and California rules translate into practical differences concerning the source of liability, the available defenses, the requirement of notice, the statute of limitations, and the standing of potential plaintiffs. Furthermore, an understanding of these distinctions is necessary for the jurist or legislator to determine which rule is superior.

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14 *Id.* at 15-19, 403 P.2d at 149-52, 45 Cal. Rptr. at 21-24.
15 *Id.* at 19, 403 P.2d at 152, 45 Cal. Rptr. at 24.
16 *Id.*
17 *Id.* at 19-29, 403 P.2d at 152-58, 45 Cal. Rptr. at 24-30 (Peters, J., concurring and dissenting).

A. *Source of Liability*

The *Seely* rule, since it is based on contract principles, views a breach of promise by the defendant as a condition precedent to the imposition of liability for economic damage. The controlling statutory provision is U.C.C. § 2-313,[18] which governs the requirements for express warranty. To recover such damages, a plaintiff must show that: (1) the defendant presented an "affirmation of fact or promise," "description," or "sample or model" of the product which became part of the "basis of the bargain"; (2) the resulting warranty was violated by the defendant; and (3) the plaintiff suffered economic loss as a result of the breach. Failure to prove one or more of the these elements will defeat recovery.

Santor, however, requires no such promise because its remedy is based on tort. Under the New Jersey rule, strict liability attaches as soon as the manufacturer places the product in the stream of trade and promotes its sale to the public.[19] *Santor's* scope of liability is therefore much broader.

This distinction is the greatest difference between the two rules. Under *Seely,* a manufacturer who, pursuant to the Magnuson-Moss Act,[20] the U.C.C., and the relevant case law, withholds an express warranty or limits liability resulting from a breach of such warranty can avoid responsibility for economic loss. *Santor,* however, offers no such opportunity because it adheres to the *Henningsen* principle that freedom to contract between manufacturers and consumers necessarily leads to oppression of the latter.[21]

B. *Defenses*

In a jurisdiction following the California rule, the manufacturer has access to the defenses available in a breach of contract action. For example, the plaintiff must not only show that the benefits envisioned in the defendant's express warranty never materialized, but also that the breaking of the promise, and not some other factor, proximately caused the economic injury for which relief is sought.[22] The manufacturer, moreover, cannot be held liable for damages beyond the

18 U.C.C. § 2-313 (1972 version) states:

(1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

19 32 N.J. at 384, 161 A.2d at 84.

20 The Magnuson-Moss Act, 15 U.S.C. §§ 2301-2312 (1977), enacted in 1975, is designed to give consumers warranty protection beyond that provided by the U.C.C.

21 Recently, one case has recognized the possibility that strict liability in tort may be open to waiver in contracts between commercial parties standing in equal bargaining positions. *See* text accompanying note 54 *infra.*

22 Heil v. Standard Chemical Mfg. Co., 301 Minn. 315, 223 N.W.2d 37 (1974).

amount contemplated by the parties at the time the warranty was made.[23]

Under *Santor,* on the other hand, a manufacturer can only rely on tort defenses which vary in form and potency according to jurisdiction. Representative examples include: (1) intervening cause of injury,[24] (2) defendant's expectation that the product will be inspected by a third party,[25] and (3) "state of the art," which gives special indulgence to innovation by denying strict liability in tort when the product is as safe as possible at its present stage of development.[26]

Under *Seely,* defenses are formalistic applications of contract law. The California courts look to what was promised and whether a breach occurred. The *Santor* principle, on the other hand, requires that judges consider each factual situation individually before they decide which defenses apply. In this area, therefore, the New Jersey rule is much more flexible.

C. *Requirement of Notice*

U.C.C. § 2-607(3)(a)[27] requires that a purchaser notify the warrantor of all product non-conformities within a "reasonable time" following acceptance of tender. Failure to adhere to this rule waives all remedies, including those provided by express warranty. This notification is mandatory under *Seely,* which holds that the U.C.C. and contract law control the right to collect economic damages. No corollary to U.C.C. § 2-607 exists under *Santor,* however, and thus notice is not a requirement.

The notice rule is well-suited to the business world because it discourages litigation by increasing the opportunity of sellers in breach to cure non-conforming tenders. No such justification, however, exists in the case of the consumer, who is often ignorant of the mandate. Indeed, the provision is so burdensome that some courts have carved out special exceptions to it. The *Greenman* decision, for example, included a holding that notification is not needed in personal injury cases.[28]

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23 *Compare* Head & Guild Equipment Co. v. Bond, 470 S.W.2d 909, 910-13 (Tex. Civ. App., 1971) (denying consequential damages for lost profits from collateral contracts when there was no evidence that the defendant had any knowledge of them) *with* Thomas v. Olin Mathieson Chemical Corporation, 255 Cal. App. 2d 806, 809, 63 Cal. Rptr. 455, 456-57 (1967) (sustaining a complaint seeking damages for "the loss of honor, prestige and victory involved in killing a Bengal tiger. . . .").

24 Balido v. Improved Machinery, Inc., 29 Cal. App. 3d 633, 105 Cal. Rptr. 800 (1973).

25 *Compare* Schneider v. Suhrmann, 8 Utah 2d 35, 327 P.2d 822 (1958) (allowing the defense when the third party agreed to finish processing the defective product) *with* Vandermark v. Ford Motor Co., 61 Cal. 2d 256, 391 P.2d 168, 37 Cal. Rptr. 896 (1967) (disallowing the defense when the product was entirely manufactured by the defendant).

26 *Compare* Lewis v. Baker, 243 Or. 317, 413 P. 2d 400 (1966) *with* Toole v. Richardson-Merrell, Inc., 251 Cal. App. 2d 689, 60 Cal. Rptr. 398 (1967). (Both cases involved prescription drugs.)

27 U.C.C. § 2-607 (3) (a) (1972 version) provides:

> (3) Where a tender has been accepted
>
> (a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy . . .

28 *See* note 7 *infra. See also* Pritchard v. Liggett & Myers Tobacco Company, 295 F.2d 292, 299 (3rd Cir. 1961) (ten-month delay in notification held "reasonable"); Ryderman v. Warner-Lambert Pharmaceutical Co., 23 Conn. 416, 184 A.2d 63 (1962) (held that the notification rule simply does not apply to consumers).

Significantly, both *Santor* and *Seely* handle the U.C.C. notice requirement incorrectly. A proper approach would enforce U.C.C. § 2-607 in commercial situations and abandon the duty in consumer cases to which the provision was not intended to apply. Yet both the New Jersey and California rules approach the issue without regard to this distinction.

D. *Statute of Limitations*

The conceptual distinction between contract and tort underlying *Santor* and *Seely* translates into another concrete difference in the applicable statute of limitations. A court applying the California rule would be constrained by U.C.C. § 2-725(1)[29] which requires that breach of warranty actions be brought within four years of the transaction. The parties may even agree to reduce this period to a minimum of one year. *Santor,* of course, is governed by the jurisdiction's personal injury limitation of actions.

Since the New Jersey rule is based on tort, it may also allow the plaintiff to take advantage of the practice adopted in many states of tolling the statute of limitations until the injury is actually discovered. In *Rosenau v. City of New Brunswick,*[30] for example, a strict liability action for damage incurred from a burst water meter was sustained even though installation of the equipment had taken place more than two decades before institution of the suit. Economic damages in such a case would be impossible under *Seely,* however, because this tolling of the statute of limitations does not apply to the law of sales contracts.

E. *Standing for Potential Plaintiffs*

A final distinction between contract and tort liability concerns the eligibility of injured persons to bring suit. Under common law warranty theory, a plaintiff first had to satisfy the demands of privity before a remedy would be awarded. The privity requirements that remain are codified in U.C.C. § 2-318, which allows a jurisdiction to choose among three options.[31] All of these alternatives

29 U.C.C. § 2-725 (1972 version) reads in relevant part:

(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

30 51 N.J. 146, 238 A.2d 177 (1968).

31 U.C.C. § 318 (1972 version) grants states the following choices:

Alternative A

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Alternative B

A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Alternative C

A seller's warranty whether express or implied extends to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends. As amended 1966.

protect the purchasing consumer. Additionally, injured third parties to whom damage is foreseeable are afforded protection under the following provisions: (1) (Option A) any "natural person" associated with the purchaser as a family relation, household member, or guest; (2) (Option B) any "natural person" injured by the goods "in person"; and (3) (Option C) "any person" injured by the goods.

A *Santor* jurisdiction, conversely, would employ the principles of standing used in general strict liability cases. This standard varies throughout the nation. The trend, nonetheless, is exemplified by *Elmore v. American Motors Corp.*,[32] which held that liability extends to bystanders as well as to actual purchasers. Although this distinction may not be particularly significant, the fact remains that a plaintiff's standing under *Seely* is determined by a jurisdiction's contract law, whereas under *Santor* the question is a matter of tort theory. A practitioner, therefore, must be careful to look to the correct body of law in determining the extent of liability in a particular case.

F. Santor *and* Seely: *Summary of the Comparison*

The theoretical foundations of the New Jersey rule lead to concrete advantages for plaintiffs who seek to recover economic damages. Undeniably, *Santor* is much more generous than *Seely* in assessing damages. The problem with both holdings is that they provide for no exceptions. New Jersey, apparently assuming that all purchasers are as disadvantaged as the *Henningsen* plaintiff in bargaining with sellers, grants the benefits of strict liability in tort to all who suffer economic harm. California, on the other hand, upholds the freedom to contract without ever considering the significance of bargaining power.

Neither rule recognizes that not all plaintiffs are alike. Rather than apply different remedies to different situations as may be appropriate, both *Santor* and *Seely* simply prescribe one norm for all economic damage litigation. The result in both cases is a set of inflexible standards.

IV. Beyond *Santor* and *Seely*: The Record

Since 1965, courts have faced two major tasks concerning economic injury. The first involves resolving theoretical issues not confronted in previous cases, such as the treatment of consequential business losses under the New Jersey rule. Second, the deceptively simple formulas adopted by the *Santor* and *Seely* courts have had to be applied to varied situations.

A proper examination of the post-*Seely* cases must consider rulings directly adhering to either contract or tort principles as applied to economic loss. Special attention, moreover, should be paid to Nebraska where an interesting variation of the California rule has emerged. Finally, a survey should be made of the Texas appellate courts which have adopted neither *Santor* nor *Seely* but have sought other solutions.

32 70 Cal. 2d 578, 451 P.2d 84, 75 Cal. Rptr. 652 (1969).

A. *The Nebraska Rule: An Extended Exercise in Formalism*

In *Kohler v. Ford Motor Co.,*[33] the Nebraska Supreme Court adopted strict liability in tort for product cases involving personal injuries. Property and economic damages, however, were not specifically considered until 1973. *Hawkins Construction Co. v. Matthews Co., Inc.*[34] involved a suit against the lessor and manufacturer of defective scaffolding which had collapsed while being used. The plaintiff urged the court to adopt the *Santor* principle.

Speaking for the majority, Chief Justice White agreed that the logic of the New Jersey rule seemed "irresistible,"[35] but he proceeded to distinguish injury to a product resulting from its own defect (*i.e.,* direct economic loss) from injury to other property resulting from the defect. The *Hawkins* decision readily accepted strict liability in tort as a valid remedy in the latter situation. Chief Justice White, however, insisted that in the case of economic injury the legislature had already provided the plaintiff with a cause of action under the U.C.C.'s warranty sections. To go beyond this remedy, the majority held, would "emasculate"[36] the Uniform Commercial Code. For no apparent reason, *Hawkins* assumed that the U.C.C. completely preempts the field of consumer protection. With this deference to perceived legislative intent, the court refused to accept *Santor* and denied the plaintiff recovery for the damaged scaffolding under strict liability in tort.

Chief Justice White's distinction between direct economic loss and property damage has the potential to affect many types of judgments and cause anomalous results. Under the Nebraska version of *Seely,* for example, an individual who purchases a defective furnace only to have it explode and incinerate his home could sue under strict liability in tort for damage to the house, but not to the furnace. The California rule, of course, would consider injury to both the house and furnace to be "property damage" and recoverable under strict liability in tort.

B. *The* Seely *Progeny*

One of Chief Justice Traynor's main arguments against the imposition of strict liability in tort for economic loss was that the *Santor* rule had the potential for authorizing unjustified and unforeseeable recoveries. Therefore, it is interesting to note how liberal the courts following the California principle have been in applying the *Seely* definition of property injury.[37] In *Wulff v. Sprouse-Reitz Co.,*[38] for example, a defective electric blanket ignited a fire that demolished the plaintiff's home. The Supreme Court of Oregon, which follows the California rule, authorized recovery for the full value of the house under strict liability in tort. The opinion did not question the plaintiff's definition of property damage.

An important extension of the property damage concept is *Bombardi v.*

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33 187 Neb. 428, 191 N.W.2d 601 (1971).
34 190 Neb. 546, 209 N.W.2d 643 (1973).
35 209 N.W.2d at 652.
36 *Id.*
37 *See* text accompanying note 15 *infra.*
38 262 Or. 293, 498 P.2d 766 (1972).

Pochel's Appliance and T.V. Company,[39] a Washington case involving the incineration of an apartment house. The destruction was caused by a defective television set purchased by the plaintiff-landlord. On appeal, the defendant argued that recovery for the building should be disallowed as an economic loss. The court, nevertheless, held that the injury constituted property damage and was fully recoverable under the California rule.

There is no reason to believe that the "property" damage suffered by the landlord in *Bombardi* is any more of a personal tragedy than the "economic" injury sustained by the small businessman in *Seely*. Furthermore, it is doubtful that the damages in *Bombardi* and *Wulff*, both of which far exceeded the $9,240.40 consequential loss[40] sought in *Seely*, were any more foreseeable than those feared by Chief Justice Traynor. The California rule, however, tends to be formalistic and apportions recovery on the basis of an almost mechanical application of the definition of the type of damage. Accordingly, Chief Justice Traynor's policy decisions, which form the entire basis of the *Seely* principle, are violated in cases such as *Bombardi* and *Wulff*, which theoretically adhere to the California position.

C. *In the Wake of* Santor

During the years following the *Santor* decision, the New Jersey courts expanded the scope of strict liability in tort applied to personal, property, and direct economic loss. Examples of this trend include extension of the theory to used car dealers[41] and to the mass-producers of homes.[42] Not until 1974, however, did a court approach the concept of consequential economic harm in a commercial context.[43]

Monsanto Company v. Alden Leeds, Inc.[44] arose from the sale of a large quantity of dry organic chlorine which exploded and caused extensive property destruction as well as consequential economic damage. When the plaintiff brought suit for non-payment for the chlorine, the defendant counterclaimed for all injury resulting from the blast, including lost business profits. In denying the plaintiff's motion for summary judgment on the counterclaim, Judge Dreier

39 9 Wash. App. 797, 515 P.2d 540 (1973).
40 63 Cal. 2d at 13, 403 P.2d at 148, 45 Cal. Rptr. at 20.
41 Realmuto v. Straub Motors, 65 N.J. 336, 322 A.2d 440 (1974).
42 Schipper v. Levitt & Sons, 44 N.J. 70, 207 A.2d 314 (1965).
43 Several cases from other jurisdictions involving consequential damages are occasionally cited as explicitly adopting the *Santor* theory of strict liability in tort. Many of these authorities are questionable or erroneous, including:

(1) Air Products & Chemical Inc. v. Fairbanks Morse, Inc., 58 Wis.2d 193, 206 N.W.2d 414 (1973). Although this case did accept *Santor*, it merely involved the Wisconsin Supreme Court interpreting Pennsylvania law. Recently, Plainwell Paper Company v. Pram, Inc., 430 F. Supp. 1386 (W.D. Pa. 1977) has cast doubt on the validity of the *Fairbanks Morse* ruling.

(2) Cova v. Harley Davidson Motor Company, 26 Mich. App. 602, 182 N.W.2d 800 (1970). This decision was remanded to a lower court with instructions to hear a claim for consequential economic loss. Since the issue had never been fully briefed, however, the court made clear that any judgment in the lower court would be reexamined. Michigan has not yet decided the question.

(3) Ford Motor Company v. Lonon, 217 Tenn. 406, 398 S.W.2d 240 (1966). This ruling permitted recovery of consequential economic loss, but the action was founded on misrepresentation.

44 130 N.J. Super. 245, 326 A.2d 90 (1974).

declared, "Even in these days of consumerism, economic interests are not out of favor. . . . Corporations are, in the last analysis, owned by people who rely upon them for their income, and thus commercial losses often are reflected in personal sorrow."[45]

Santor, especially when interpreted by *Alden Leeds,* certainly contains the elements of a theory that could allow consequential economic damages in a commercial setting. No case citing the New Jersey rule, however, has ever actually awarded such a recovery. Other than *Alden Leeds,*[46] moreover, no judgment has even acknowledged that the *Santor* holding should be so expanded. Perhaps the courts, including those of New Jersey, realize that public policy would not be enhanced by a wholesale incorporation of the *Henningsen* rationale into the world of commerce.

D. *Texas: Between* Santor *and* Seely

The Supreme Court of Texas has never officially chosen between the New Jersey and California rules. Thus, the lower appellate bodies of the state have been relatively free to innovate in the area of economic injury. Recent cases have shown contrasting approaches to the question.

In *Monsanto Company v. Thrasher,*[47] the defendant sold the plaintiff defective herbicide which allowed the plaintiff's fields to become overrun with weeds. Damages amounting to the difference in value of the crop expected and that actually harvested were awarded under strict liability in tort. Speaking for the court, Justice Joy conceded that consequential economic damages were being granted. He maintained, however, that no other standard was equitable in such a situation. On the matter of the tort remedy, Justice Joy described such strict liability as "separate and apart" from the U.C.C. and available when "the consumer is not adequately protected by the law of sales."[48]

Another progressive ruling occurred in *Nobility Homes of Texas, Inc. v. Shivers*[49] in which the plaintiff sued for the value of a flawed mobile home. Strict liability in tort was not adopted in this case because the court declined to expand upon Restatement (Second) of Torts § 402(A)'s limitation of coverage to "physical harm." The court in *Shivers* did, however, rule that the consumer is protected by an implied warranty of fitness similar to that established in *Henningsen* and expanded to cover economic injury.[50]

Some Texas courts adhere to the California rule, as can be seen in *Mid Continent Aircraft v. Curry County Spraying.*[51] This case superficially appears

45 *Id.* at 259, 326 A2d. at 97.
46 *Alden Leeds* explicitly extended *Santor* to cover consequential losses. *See id.*
47 463 S.W.2d 25 (Tex. Ct. Civ. App. 1971).
48 *Id.* at 27.
49 539 S.W.2d 190 (Tex. Ct. Civ. App. 1976).
50 Interestingly, the same court that decided *Shivers* has shown a tendency to be strict with regard to pleadings. Explorer's Motor Home Corp. v. Aldridge, 541 S.W.2d 851 (Tex. Ct. Civ. App. 1976) involved a substantially similar fact pattern, but the plaintiffs based their case entirely on a restitution theory. The court ruled that this claim brought the case within the realm of the U.C.C., and recovery was denied for failure to give notice of the warranty breach.
51 553 S.W.2d 935 (Tex. Ct. Civ. App. 1977).

to follow the New Jersey doctrine since the ruling affirmed an award based on strict liability in tort which included compensation for lost profits. On motion for rehearing, nevertheless, the court clearly stated that the consequential injury recovery would have been overturned had the defendant not failed to raise the appropriate objection on appeal. Thus, the *Mid Continent* ruling supports the California rule on economic loss.[52]

A review of these recent Texas decisions reveals some interesting results. First, in the absence of a uniform controlling rule, such as those mandated in *Santor* or *Seely*, some courts are, as in *Thrasher*, able to render equitable decisions based on the facts of the situation. Others, such as the *Shivers* tribunal, reach the same result through adoption of a *Henningsen*-like legal fiction. A final set of cases follow the *Mid Continent*[53] practice of seeking a uniform solution regardless of the situation.

V. Conclusion and Proposal

Both *Santor* and *Seely* are deeply flawed by failure to distinguish the commercial setting from the consumer situation. The California rule and its Nebraska variation are so formalistic that they often lose sight of original policy purposes and thus make anomalous results possible. The *Santor-Alden Leeds* theory, conversely, threatens to nullify the U.C.C. warranty provisions by extending strict liability in tort to *all* business circumstances. Neither rule attempts to apply appropriate remedies to different situations.

In his dissent in *Seely*, Justice Peters noted that "consumer" is a vague term. A definition, nonetheless, is needed to provide a rational policy, and its source lies in a reexamination of *Henningsen*. The individuals protected by the New Jersey rule should be defined with reference to the evil that strict liability in tort was intended to remedy: *disparate bargaining power*. When two parties stand in such a position that they are able to bargain fairly and thus equitably apportion the risks inherent in their transaction, the U.C.C. warranty provisions should be upheld. Yet when a comparison of the antagonists reveals that their "agreement" consisted of terms dictated by the stronger, "freedom to contract" is a sham, and strict liability in tort is the only valid remedy for all damages, whether personal, property, or economic. Matters of degree in bargaining power should be resolved on a case-by-case basis, as Justice Peters suggested.

Significantly, this proposed resolution of the *Santor-Seely* confrontation does not turn on a sterile categorization of occupations. The *Seely* plaintiff was most likely a "merchant" under the U.C.C. Certain large-scale farmers, on the other hand, might not traditionally be considered in a commercial context. Under this proposal, however, the former would be more likely to receive the protection of the New Jersey rule because the latter probably enjoy a stronger bargaining position in their commercial dealings.

Some courts have shown an attitude conducive to such a definition of

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52 *Id.* at 943.

53 For a similar holding, *see* Thermal Supply of Texas, Inc. v. Asel, 468 S.W.2d 927 (Tex. Ct. Civ. App. 1971).

"consumer." In *Keystone Aeronautics Corp. v. R. J. Enstrom Corp.*,[54] for example, the Third Circuit interpreted Pennsylvania law to allow parties standing on an equal contractual footing to limit damages usually recoverable under strict liability in tort. Furthermore, in *Iowa Electric Light and Power Co. v. Allis-Chalmers Mfg. Co.*,[55] the court explained that although Iowa law might accept the *Santor* rule in cases of disparate contractual strength, "[t]he doctrine of strict liability in tort, designed to aid the consumer in an unequal bargaining position who is injured, loses all meaning when a large public utility or other large company is the plaintiff and is suing solely for commercial loss."[56]

Common law precedents are designed to serve justice and the common good. When they become so rigid that they fail to further the purposes for which they were designed, they should be modified or eliminated. In *Henningsen*, Justice Francis wrote, "The task of the judiciary is to serve the spirit as well as the letter of the law."[57] *Santor, Seely,* and their progeny, however, have departed from the spirit of the law.

Frank Charles Sabatino

54 499 F.2d 146 (3d Cir. 1974).
55 360 F. Supp. 25 (S.D. Iowa 1973).
56 *Id.* at 32.
57 32 N.J. at 403, 161 A.2d at 94.