Advanced Torts Syllabus
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Spring 2018
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Class: 4:30-5:45 MW Room 5

Office Hours: Tuesdays 4-5:30 or by appointment made through my assistant Judy Tayloe: tayloej@missouri.edu. Please don’t hesitate to schedule time with me. I’d rather have an open-door policy, but as dean my schedule is very packed from dawn until dusk, so the simplest way for us to talk is simply to contact Judy and set up a time. I really do want to get to know all of you over the course of this class.

Course Description:

The torts we will focus on in this course rarely involve physical injuries or even property damage, and they often arise in commercial or other settings in which the parties are not strangers to one another when the alleged tortious conduct arises. The topics we will address in Advanced Torts fall under four headings.

Intangible Harms to Family Relations. First, we briefly will address tortious injuries to family relations. We will examine loss of consortium claims brought by spouses and others and loss of companionship and society claims brought by parents and children. We will also consider defenses to those claims. We will examine survival and wrongful death claims (which are bar exam topics).

Intangible Harms to Economic Interests. Second, we will address the torts that sometimes arise when business relationships, such as partnerships, break down, or when competitive behavior is thought to exceed the bounds of what society considers fair or appropriate. The torts contained in this part of the course reflect assumptions about the role and limits of tort law in regulating competitive behavior. In this context, we will examine the Economic Loss Rule, Tortious Interference with Contractual Relationships and Economic Expectancies, Breach of Fiduciary Duties, Fraud, Misrepresentation, and Injurious Falsehood. Most of the torts studied here predominantly result in pecuniary losses, and we will inquire whether wrongful conduct that causes solely pecuniary losses should be governed by special principles not applicable in other tort contexts.

Intangible Harms to Dignitary Interests. Third, this course also includes torts that cause mainly “dignitary harms.” These torts include defamation, appropriation of name or likeness, intrusion, disclosure of private facts, invasion of privacy, and false light.
Torts That May Appear on the Bar Exam. Finally, my coverage choices in this course represent an attempt to cover Torts that may appear on the bar exam but were not covered in your introductory Torts course. Torts that may appear on the bar exam include assault, battery, false imprisonment, infliction of emotional distress, trespass to land, trespass to chattels, conversion, the defense of consent, self-defense and defense of others, defense of property, necessity, protection of public interests. Negligence, of course, is covered on the bar exam, though I assume all aspects were covered in your Torts course. Strict liability for abnormally dangerous activities and defenses to such claims as well as strict liability for defective products and defenses to such claims are subject to being covered on the bar exam. Nuisance and defenses, defamation and invasion of privacy and defenses, misrepresentation and defenses, and intentional interference with business relations and defenses may be covered by the bar, too. You should also know about survival and wrongful death actions and joint and several liability. I will conduct a survey of the class and will supplement the coverage sketched here with coverage of any tort that a majority of you may have missed or which a majority of you would like to review for the bar exam.

Text/Casebook: Peter B. Kutner & Osborne M. Reynolds, Jr., Advanced Torts: Cases and Materials (4th ed. 2013), plus edited cases I will hand out via email or TWEN (usually both).

Courtesy: Be courteous to me and to your classmates. Arrive on time. Pay attention. Turn off your cell phone. Don’t surf the net during class. Don’t distract your classmates. Because this class is small, I hope to get a chance to know all of you well, which means that I will be in a position to write an excellent letter of recommendation for you at the end of the class if your performance warrants it. Responsibility: Be prepared. It is your responsibility to prepare for class and to participate in class. I will call on you to participate at times. If you are unprepared, I expect you to be extremely well prepared the next day when I call on you. Attendance: Attendance is mandatory. You may miss 4 of our 28 total classes without penalty other than potentially missing a quiz (see below). If you miss more than four classes, I will drop you from the class absent extenuating circumstances. I will send the attendance sheet around during each class. Make sure you sign it. If you must miss class because of illness or for other legitimate reasons, please let me know. Supplemental Materials, Communications: Go to the TWEN site and register to receive class handouts, etc. Old Exams: Please see pp. 52-57 of this handout for copies of exams I have previously given to students taking Advanced Torts or Business Torts courses.
**Information Regarding Disabilities:** If you anticipate barriers related to the format or requirements of this course, if you have emergency medical information to share, or if you need to make arrangements in case the building must be evacuated, please contact Associate Dean David Mitchell as soon as possible. If disability related accommodations are necessary (for example, a note taker, captioning), please register with the Disability Center (http://disabilitycenter.missouri.edu), S5 Memorial Union, 573.882.4696, and then notify Dean Mitchell or Law School Registrar Denise Boessen of your eligibility for reasonable accommodations. For other MU resources for persons with disabilities, click on “Disability Resources” on the MU homepage.

**Academic Integrity:** Academic integrity is fundamental to the activities and principles of a university. All members of the academic community must be confident that each person’s work has been responsibly and honorably acquired, developed, and presented. Any effort to gain an advantage not given to all students is dishonest whether or not the effort is successful. The academic community regards breaches of the academic integrity rules as extremely serious matters. Sanctions for such a breach may include academic sanctions from the instructor, including failing the course for any violation, to disciplinary sanctions ranging from probation to expulsion. When in doubt about plagiarism, paraphrasing, quoting, collaboration, or any other form of cheating, consult the course instructor.

**GRADING:** Your grade in this course will be based on a three-hour in-class final exam consisting of essay questions combined with your scores on ten (10) quizzes administered throughout the course as described below. Your exam score will be worth a maximum of 100 points and your quiz scores will be worth a maximum of 10 points. The reason for the quizzes is that frequent low-stakes assessment is a powerful tool for learning and retention.

**QUIZ SYSTEM:** I will administer one quiz per week in Advanced Torts, for a total of 14 quizzes. Quizzes come in several forms. The quiz may consist of a single short question or hypothetical, a single multiple choice question, or I may ask you to summarize a case or hand in your written answer to a problem I’ve assigned as part of the day’s reading assignment. Each quiz is worth a maximum of 1 point (I may give half points occasionally). At the end of the class, I will drop your four lowest quiz scores. Then I will add the number of points you’ve earned on quizzes to your final exam score. I will grade quizzes leniently, and I expect most of you to get most of the points.

One purpose of this requirement is to reward students who diligently prepare for class, because such diligence is an essential part of being an excellent lawyer. Another purpose of this requirement is to allow me to give you feedback as you are learning the material and to let you know if you’ve “missed the boat.” Finally, the quizzes give me an opportunity to observe your written communication skills and to suggest ways to improve them if necessary.
If you’re interested in learning more about why I give quizzes and how to become a better learner, I highly recommend Make It Stick: The Science of Successful Learning, by Peter C. Brown, Henry L. Roediger III, and Mark A. McDaniel.

**Learning Outcomes:**
In this course you will learn to:

(1) identify and explain the substantive law governing the most common business torts and dignitary harm torts;
(2) identify and explain the substantive law involving intangible harms to family relations;
(3) apply the substantive law studied in this course to new factual scenarios in a comprehensive essay exam format;
(4) identify and explain the policy issues underlying the torts we study in this class;
(5) read torts cases carefully and identify important legal rules and policy issues;
(6) read pleadings in torts cases and assess the viability of the claims asserted;
(7) improve your ability to summarize torts cases clearly, succinctly, and accurately both orally and in writing.

**Guest Speakers:** Throughout the semester, I hope to bring in guest speakers. They may throw us off schedule at some point. Please know that we will simply go in the order of the assignments in the reading assignment list. I’ve built in some “free” days to accommodate the guest speakers. Thus, even though we will have 28 classes, I only have assigned 25 reading assignments.
Reading Assignments (28 Classes Total)

Class 1 (Loss of Spousal Consortium): Read pp. 3-22 in the Kutner Casebook

Class 2 (Loss of Child’s or Parent’s Companionship, etc.; Defenses): Read pp. 22-50 in the Kutner Casebook

Class 3 (Wrongful Death/Survival): Read pp. 50-76 in the Kutner Casebook

Class 4 (Economic Loss Doctrine): Read the materials in this handout on the economic loss rule, including the cases Rardin v. T&D Machine Handling, Inc. at p. 7 of this handout; East River Steamship at p. 12 of this handout.

Class 5 (Economic Losses and Breach of Fiduciary Duty): Read the Richard Posner article on Economic Torts at p. 17 of this handout; and work the problems at p. 24 of this handout. Your answers to the problems will constitute the quiz for this week. Then read Restatement (Third) of Agency §1.01, 2.04 (2006) (p. 26 of this handout); Curl By & Through Curl v. Key, 316 S.E. 2d 272 (1984) (p 26 of this handout).

Class 6 (Breach of Fiduciary Duty): Read Meinhard v. Salmon, 164 N.E. 545 (1928) (p.29 of this handout); Gibbs v. Breet, Abbott & Morgan, 271 A.D.2d 180 (2000) (p. 33 of this handout); Corporate Employees: Lamorte Burns & Co. v. Walters, 770 A.2d 1158 (2001) (p. 38 of this handout); Problem, p. 44 of this handout. Please write out the answer.

Class 7 (Fraud & Negligent Misrepresentation): Read Onita Pacific Corp. v Bronson Trustees at p. 44 of this handout. Also read the complaint in Worldview Entertainment Holdings v. Creative Artists Agency, available here: https://www.scribd.com/document/368950331/Worldview-v-CAA#from_embed

Class 8 (Interference with Contractual Relations): Read pp. 123-157 in Kutner Casebook.

Class 9 (Interference with Contractual Relations): Read pp. 143-164 in the Kutner Casebook.

Class 10 (Interference with Prospective Advantage): Read pp. 164-183 in the Kutner Casebook.

Class 11: (Interference with Prospective Advantage and Other Expectations): Read pp. 183-208 in the Kutner Casebook
Class 12: (Unintentional Interference with Economic Relations): Read pages 208-237 in the Kutner Casebook.


Class 14 (Passing Off): Read pp. 263-277 in the Kutner Casebook. Omit the remainder of the chapter and omit Chapter 4.


Class 16 (Intrusion): Read pp. 427-439 in the Kutner Casebook

Class 17 (Disclosure of Private Facts): Read pp. 440-473 in the Kutner Casebook

Class 18 (False Light and Review): Read pp. 473-490 in the Kutner Casebook

Class 19-24 (Defamation): We will read the defamation chapter in order without omitting materials for these 4-5 classes. We’ll strive for 30 pages per class. I’ll give you a rough guide at the end of each class.

Class 25 (Topic TBA)
What is the economic loss rule? What is the rationale underlying the economic loss rule? In what contexts does it arise?

RARDIN V. T & D MACHINE HANDLING, INC
890 F.2d 24 (7th Cir. 1989)

Before POSNER, COFFEY, and KANNE, Circuit Judges.

Opinion

POSNER, Circuit Judge.

Jack Rardin the plaintiff, bought for use in his printing business a used printing press from Whitacre-Sunbelt, Inc. for $47,700. The price included an allowance of $1,200 to cover the cost of dismantling the press for shipment and loading it on a truck at Whitacre’s premises in Georgia for transportation to Rardin in Illinois. The contract of sale provided that the press was to be “Sold As Is, Where Is,” that payment was to be made before the removal of the press from Whitacre’s premises, and that Whitacre was to be responsible only for such damage to the press as might be “incurred by reason of the fault or negligence of [Whitacre’s] employees, agents, contractors or representatives.” To dismantle and load the press, Whitacre hired T & D Machine Handling, Inc., which performed these tasks carelessly; as a result the press was damaged. Not only did Rardin incur costs to repair the press; he also lost profits in his printing business during the time it took to put the press into operating order. He brought this suit against Whitacre, T & D, and others; settled with Whitacre; dismissed all the other defendants except T & D; and now appeals from the dismissal of his case against T & D for failure to state a claim. (The facts we recited are all taken from the complaint.) The only issue is whether Rardin stated a claim against T & D under Illinois law, which the parties agree controls this diversity suit.

The contract indemnified Rardin against physical damage to the press caused by the negligence of Whitacre’s contractor, T & D, and the settlement with Whitacre extinguished Rardin’s claim for the cost of repairing the damage. The damages that Rardin seeks from T & D are the profits that he lost as a result of the delay in putting the press into operation in his business, a delay caused by T & D’s negligence in damaging the press. Rardin could not have sought these damages from Whitacre under the warranty, because consequential damages (of which a loss of profits that is due to delay is the classic example) are not recoverable in a breach of contract suit, with exceptions not
applicable here. Rarding had no contract with T & D, and his claim against T & D is a tort claim; consequential damages are the norm in tort law.

We agree with the district judge that Illinois law does not provide a tort remedy in a case such as this. We may put a simpler version of the case, as follows: A takes his watch to a retail store, B, for repair. B sends it out to a watchmaker, C. Through negligence, C damages the watch, and when it is returned to A via B it does not tell time accurately. As a result, A misses an important meeting with his creditors. They petition him into bankruptcy. He loses everything. Can he obtain damages from C, the watchmaker, for the consequences of C’s negligence? There is no issue of causation in our hypothetical case; there is none in Rardin’s. We may assume that but for C’s negligence A would have made the meeting and averted the bankruptcy, just as but for T & D’s negligence the press would have arrived in working condition. The issue is not causation; it is duty.

The basic reason why no court (we believe) would impose liability on C in a suit by A is that C could not estimate the consequences of his carelessness, ignorant as he was of the circumstances of A, who is B’s customer. In principle, it is true, merely to conclude that C was negligent is to affirm that the costs of care to him were less than the costs of his carelessness to all who might be hurt by it; that, essentially, is what negligence means, in Illinois as elsewhere. [ ]. So in a perfect world of rational actors and complete information, and with damages set equal to the plaintiff’s injury, there would be no negligence: the costs of negligence would be greater to the defendant than the costs of care and therefore it would never pay to be negligent. And if there were no negligence, the scope of liability for negligence would have no practical significance. But all this is a matter of abstract principle, and it is not realistic to assume that every responsible citizen can and will avoid ever being negligent. In fact, all that taking care does is make it less likely that one will commit a careless act. In deciding how much effort to expend on being careful-and therefore how far to reduce the probability of a careless accident-the potential injurer must have at least a rough idea of the extent of liability. C in our example could not form such an idea. He does not know the circumstances of the myriad owners of watches sent him to repair. He cannot know what costs he will impose if through momentary inattention he negligently damages one of the watches in his charge.

Two further points argue against liability. The first is that A could by his contract with B have protected himself against the consequences of C’s negligence. He could have insisted that B guarantee him against all untoward consequences, however remote or difficult to foresee, of a failure to redeliver the watch in working order. The fact that B would in all likelihood refuse to give such a guaranty for a consideration acceptable to A is evidence that liability for all the consequences of every negligent act is not in fact optimal. Second, A could have protected himself not through guarantees but simply by reducing his dependence on his watch. Knowing how important the meeting was he could have left himself a margin for error or consulted another timepiece. Why impose liability for a harm that the victim could easily have prevented himself?

The present case is essentially the same as our hypothetical example. T & D is in the business of dismantling and loading printing presses. It is not privy to the circumstances
of the owners of those presses. It did not deal directly with the owner, that is, with Rardin. It knew nothing about his business and could not without an inquiry that Rardin would have considered intrusive (indeed bizarre) have determined the financial consequences to Rardin if the press arrived in damaged condition.

The spirit of *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng.Rep. 145 (1854), still the leading case on the nonrecoverability of consequential damages in breach of contract suits, broods over this case although not cited by either party or by the district court and although the present case is a tort case rather than a contract case. The plaintiffs in *Hadley v. Baxendale* owned a mill, and the defendants were in business as a common carrier. The defendants agreed to carry the plaintiffs’ broken mill shaft to its original manufacturer, who was to make a new shaft using the broken one as a model. The defendants failed to deliver the broken shaft within the time required by the contract. Meanwhile, the plaintiffs, having no spare shaft, had been forced to shut down the mill. The plaintiffs sued the defendants for the profits lost during the additional period the mill remained closed as a result of the defendants’ delay in delivering the shaft to the manufacturer. The plaintiffs lost the case. The defendants were not privy to the mill’s finances and hence could not form an accurate estimate of how costly delay would be and therefore how much care to take to prevent it. The plaintiffs, however, as the court noted, could have protected themselves from the consequences of a delay by keeping a spare shaft on hand. See 9 Ex. at 355-56, 156 Eng.Rep. at 151. Indeed, simple prudence dictated such a precaution, both because a replacement shaft could not be obtained immediately in any event (it had to be manufactured), and because conditions beyond the defendants’ control could easily cause delay in the delivery of a broken shaft to the manufacturer should the shaft ever break. See also *EVRA Corp. v. Swiss Bank Corp.*, Rardin too, could have taken measures to protect himself against the financial consequences of unexpected delay. He could have arranged in advance to contract out some of his printing work, he could have bought business insurance, or he could have negotiated for a liquidated-damages clause in his contract with Whitacre that would have compensated him for delay in putting the press into working condition after it arrived.

As we noted in *EVRA Corp. v. Swiss Bank Corp.*, Illinois follows *Hadley v. Baxendale*. So if this were a contract case, Rarding would lose—and this regardless of whether the breach of contract were involuntary or, as he alleges, due to the promisor’s negligence. It is a tort case, but so was *EVRA*, where, applying Illinois law, we concluded that the plaintiff could not recover consequential damages. The plaintiff had instructed its bank to deposit a payment in the bank account of a firm with which the plaintiff had a contract. The bank telexed its correspondent bank in Geneva—which happened to be Swiss Bank Corporation—to make the transaction. As a result of negligence by Swiss Bank, the transaction was not completed, whereupon the plaintiff lost its contract because the other party to it declared a default. The plaintiff sued Swiss Bank for the lost contract profits, and lost. We held that the principle of *Hadley v. Baxendale* is not limited to cases in which there is privity of contract between the plaintiff and the defendant. Swiss Bank could not have estimated the consequences of its negligence and the plaintiff, like the plaintiffs in *Hadley*, could have averted disaster by simple precautions. This case differs from both *Hadley* and *EVRA* in that there is no suggestion that Rardin was imprudent in
failing to take precautions against damage or delay. But as in those cases the defendant was not in a position to assess the consequences of its negligence. In this respect the present case and EVRA are actually stronger for defendants even though these are tort rather than contract cases since neither case involves a defendant who is dealing face-to-face with the plaintiff. While it is generally true that consequential damages are recoverable in tort law although not in contract law, EVRA shows that the classification of a case as a tort case or a contract case is not decisive on this question.

. . . The doctrine is not unique to Illinois. Originating in Chief Justice Traynor’s opinion in Seely v. White Motor Co., 63 Cal.2d 9, 45 Cal.Rptr. 17, 403 P.2d 145 (1965), it has become the majority rule . . . . We need not consider the outer boundaries of the doctrine; it is enough that it bars liability in a suit for lost profits resulting from negligence in carrying out a commercial undertaking.

The doctrine (called in Illinois the Moorman doctrine) rests on the insight, which is consistent with the analysis in EVRA, that contractual-type limitations on liability may make sense in many tort cases that are not contract cases only because there is no privity of contract between the parties. The contractual linkage between Rardin and T & D was indirect but unmistakable, and Rardin could as we have said have protected himself through his contractual arrangements with Whitacre, while there was little that T & D could do to shield itself from liability to Whitacre’s customer except be more careful—and we have explained why a finding of negligence alone should not expose a defendant to unlimited liability.

The Moorman doctrine goes further than is necessary to resolve this case. Once a case is held to fall within it, the plaintiff has no tort remedy. In our hypothetical case about the watch, the plaintiff could not sue the repairer even for property damage. Moorman itself was a case in which there was a contract between the parties, so there was no reason to allow a tort remedy. The present case, like Anderson, is one where, although there is no contract, the policies that animate the principle which denies recovery of consequential damages in contract cases apply fully and forbid a tort end-run around that principle.

The “economic loss” doctrine of Moorman and of its counterpart cases in other jurisdictions is not the only tort doctrine that limits for-want-of-a-nail-the-kingdom-was-lost liability. It is closely related to the doctrine, thoroughly discussed in Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50 (1st Cir.1985), that bars recovery for economic loss even if the loss does not arise from a commercial relationship between the parties—even if for example a negligent accident in the Holland Tunnel backs up traffic for hours, imposing cumulatively enormous and readily monetizable costs of delay. See Petition of Kinsman Transit Co., 388 F.2d 821, 825 n. 8 (2d Cir.1968). Admittedly these doctrines are in tension with other doctrines of tort law that appear to expose the tortfeasor to unlimited liability. One is the principle that allows recovery of full tort damages in a personal-injury suit for injury resulting from a defective or unreasonably dangerous product—a form of legal action that arises in a contractual setting and indeed originated in suits for breach of warranty. Another is the principle, also of personal-injury law, that the injurer takes his victim as he finds him and is therefore liable for the full extent of the
injury even if unforeseeable—even if the person he runs down is Henry Ford and sustains a huge earnings loss, or because of a preexisting injury sustains a much greater loss than the average victim would have done. Both are doctrines of personal-injury law, however, and there are at least three differences between the personal-injury case and the economic-loss case, whether in a stranger or in a contractual setting. The first difference is that the potential variance in liability is larger when the victim of a tort is a business, because businesses vary in their financial magnitude more than individuals do; more precisely, physical capital is more variable than human capital. The second is that many business losses are offset elsewhere in the system: Rardin’s competitors undoubtedly picked up much or all of the business he lost as a result of the delay in putting the press into operation, so that his loss overstates the social loss caused by T & D’s negligence. Third, tort law is a field largely shaped by the special considerations involved in personal-injury cases, as contract law is not. Tort doctrines are, therefore, prima facie more suitable for the governance of such cases than contract doctrines are.

True, the “thin skull” principle illustrated by Stoleson is sometimes invoked to allow recovery of lost profits in cases where there is physical damage to property. The thinking here seems to be that the requirement of physical damage at least limits the number of plaintiffs. Rardin could appeal to that principle here—since title had passed to him before T & D began dismantling and loading the press—were it not that the Moorman line rejects it, as we explained in Chicago Heights Venture, a case in which there was some property damage. There is also liability (under an exception discussed in Chicago Heights Venture, see 782 F.2d at 726-29) when the injury is the consequence of a sudden, calamitous accident as distinct from a mere failure to perform up to commercial expectations. Consolidated Aluminum illustrates this exception, which is related to the principle that allows consumers injured by a defective product to sue the supplier in tort whether or not the consumer has a contract with him. There are other exceptions. The largest perhaps is the familiar principle that allows a suit for fraud against a person with whom the plaintiff has a contract, while the closest to the present case is the principle that allows a suit against an attorney or accountant for professional malpractice or negligent misrepresentation that causes business losses to the plaintiff. See Rozny v. Marnul, 43 Ill.2d 54, 250 N.E.2d 656 (1969); Pelham v. Griesheimer, 92 Ill.2d 13, 64 Ill.Dec. 544, 440 N.E.2d 96 (1982); Greycas, Inc. v. Proud, 826 F.2d 1560, 1563-65 (7th Cir.1987). These cases are distinguishable, however, as ones in which the role of the defendant is, precisely, to guarantee the performance of the other party to the plaintiff’s contract, usually a seller. The guaranty would be worth little without a remedy, necessarily in tort (or in an expansive interpretation of the doctrine of third-party beneficiaries) against the guarantor.

Although cases barring the recovery, whether under tort or contract law, of consequential damages in contractual settings ordinarily involve smaller potential losses than pure stranger cases do (such as the Lincoln Tunnel hypothetical discussed in Kinsman), this is not always so. In our watch hypothetical, in EVRA, and for all we know in Hadley and in the present case, the financial consequences of a seemingly trivial slip might be enormous. And it is in contractual settings that the potential victim ordinarily is best able to work out alternative protective arrangements and need not rely on tort law. Our
conclusion that there is no tort liability in this case does not, therefore, leave buyers in the plaintiff’s position remediless. Rardin could have sought guarantees from Whitacre (at a price, of course), but what he could not do was require the tort system to compensate him for business losses occasioned by negligent damage to his property.

A final example will nail the point down. The defendant in *H.R. Moch Co. v. Rensselaer Water Co.*, 247 N.Y. 160, 159 N.E. 896 (1928), had agreed to supply the City of Rensselaer with water of specified pressure for the city’s mains. There was a fire, the company was notified but failed to keep up the pressure, and as a result the fire department could not extinguish the fire, which destroyed the plaintiff’s building. In a famous opinion denying liability, Chief Judge Cardozo stated that even if the failure of pressure was due to negligence on the defendant’s part, the plaintiff could not obtain damages. The city was acting as the agent of its residents in negotiating with the water company, and the water company was entitled to assume that, if it was to be the fire insurer for the city’s property, the city would compensate it accordingly. Similarly, in dealing with T & D, Whitacre was acting in effect as Rardin’s agent, and T & D was entitled to assume that, if it was to be an insurer of Rardin’s business losses, Whitacre on behalf of Rardin could compensate it accordingly. Rardin in short could protect itself against T & D’s negligence by negotiating appropriate terms with Whitacre.

The protracted analysis that we have thought necessary to address the parties’ contentions underscores the desirability-perhaps urgency-of harmonizing the entire complex and confusing pattern of liability and nonliability for tortious conduct in contractual settings. But that is a task for the Supreme Court of Illinois rather than for us in this diversity case governed by Illinois law. It is enough for us that Illinois law does not permit a tort suit for profits lost as the result of the failure to complete a commercial undertaking.

*AFFIRMED.*

**EAST RIVER STEAMSHIP CORP. v. TRANSAMERICA DELAVAL, INC.**

106 S.Ct. 2295 (1986)

BLACKMUN, J., delivered the opinion for a unanimous Court.

In this admiralty case, we must decide whether a cause of action in tort is stated when a defective product purchased in a commercial transaction malfunctions, injuring only the product itself and causing purely economic loss. The case requires us to consider preliminarily whether admiralty law, which already recognizes a general theory of liability for negligence, also incorporates principles of products liability, including strict liability. Then, charting a course between products liability and contract law, we must determine whether injury to a product itself is the kind of harm that should be protected by products liability or left entirely to the law of contracts.
In 1969, Seatrain Shipbuilding Corp. (Shipbuilding), a wholly owned subsidiary of Seatrain Lines, Inc. (Seatrain), announced it would build the four oil-transporting supertankers in issue—the T.T. *Stuyvesant*, T.T. *Williamsburgh*, T.T. *Brooklyn*, and T.T. *Bay Ridge*. Each tanker was constructed pursuant to a contract in which a separate wholly owned subsidiary of Seatrain engaged Shipbuilding. Shipbuilding in turn contracted with respondent, now known as Transamerica Delaval Inc. (Delaval), to design, manufacture, and supervise the installation of turbines (costing $1.4 million each, see App. 163) that would be the main propulsion units for the 225,000-ton, $125 million, supertankers. When each ship was completed, its title was transferred from the contracting subsidiary to a trust company (as trustee for an owner), which in turn chartered the ship to one of the petitioners, also subsidiaries of Seatrain. Queensway Tankers, Inc., chartered the *Stuyvesant*; Kingsway Tankers, Inc., chartered the *Williamsburgh*; East River Steamship Corp. chartered the *Brooklyn*; and Richmond Tankers, Inc., chartered the *Bay Ridge*. Each petitioner operated under a bareboat charter, by which it took full control of the ship for 20 or 22 years as though it owned it, with the obligation afterwards to return the ship to the real owner. Each charterer assumed responsibility for the cost of any repairs to the ships.

The *Stuyvesant* sailed on its maiden voyage in late July 1977. On December 11 of that year, as the ship was about to enter the Port of Valdez, Alaska, steam began to escape from the casing of the high-pressure turbine. That problem was temporarily resolved by repairs, but before long, while the ship was encountering a severe storm in the Gulf of Alaska, the high-pressure turbine malfunctioned. The ship, though lacking its normal power, was able to continue on its journey to Panama and then San Francisco. In January 1978, an examination of the high-pressure turbine revealed that the first-stage steam reversing ring virtually had disintegrated and had caused additional damage to other parts of the turbine. The damaged part was replaced with a part from the *Bay Ridge*, which was then under construction. In April 1978, the ship again was repaired, this time with a part from the *Brooklyn*. Finally, in August, the ship was permanently and satisfactorily repaired with a ring newly designed and manufactured by Delaval.

The *Brooklyn* and the *Williamsburgh* were put into service in late 1973 and late 1974, respectively. In 1978, as a result of the *Stuyvesant*’s problems, they were inspected while in port. Those inspections revealed similar turbine damage. Temporary repairs were made, and newly designed parts were installed as permanent repairs that summer.

When the *Bay Ridge* was completed in early 1979, it contained the newly designed parts and thus never experienced the high-pressure turbine problems that plagued the other three ships. Nonetheless, the complaint appears to claim damages as a result of deterioration of the *Bay Ridge*’s ring that was installed in the *Stuyvesant* while the *Bay Ridge* was under construction. In addition, the *Bay Ridge* experienced a unique problem. In 1980, when the ship was on its maiden voyage, the engine began to vibrate with a frequency that increased even after speed was reduced. It turned out that the astern guardian valve, located between the high-pressure and low-pressure turbines, had been installed backwards. Because of that error, steam entered the low-pressure turbine and damaged it. After repairs, the *Bay Ridge* resumed its travels.
The charterers’ second amended complaint . . . seeks an aggregate of more than $8 million in damages for the cost of repairing the ships and for income lost while the ships were out of service. The first four counts, read liberally, allege that Delaval is strictly liable for the design defects in the high-pressure turbines of the Stuyvesant, the Williamsburgh, the Brooklyn, and the Bay Ridge, respectively. The fifth count alleges that Delaval, as part of the manufacturing process, negligently supervised the installation of the astern guardian valve on the Bay Ridge. . . . Delaval moved for summary judgment, contending that the charterers’ actions were not cognizable in tort.

The District Court granted summary judgment for Delaval, and the Court of Appeals for the Third Circuit, sitting en banc, affirmed. The Court of Appeals held that damage solely to a defective product is actionable in tort if the defect creates an unreasonable risk of harm to persons or property other than the product itself, and harm materializes. Disappointments over the product’s quality, on the other hand, are protected by warranty law. The charterers were dissatisfied with product quality: the defects involved gradual and unnoticed deterioration of the turbines’ component parts, and the only risk created was that the turbines would operate at a lower capacity. Therefore, neither the negligence claim nor the strict-liability claim was cognizable.

The intriguing question whether injury to a product itself may be brought in tort has spawned a variety of answers. At one end of the spectrum, the case that created the majority land-based approach, *Seely v. White Motor Co.*, 63 Cal.2d 9, 403 P.2d 145 (1965) (defective truck), held that preserving a proper role for the law of warranty precludes imposing tort liability if a defective product causes purely monetary harm.

At the other end of the spectrum is the minority land-based approach, whose progenitor, *Santor v. A & M Karagheusian, Inc.*, 44 N.J. 52, 66–67, 207 A.2d 305, 312–313 (1965) (marred carpeting), held that a manufacturer’s duty to make nondefective products encompassed injury to the product itself, whether or not the defect created an unreasonable risk of harm. The courts adopting this approach, including the majority of the Courts of Appeals sitting in admiralty that have considered the issue, e.g., *Emerson G.M. Diesel, Inc. v. Alaskan Enterprise*, 732 F.2d 1468 (CA9 1984), find that the safety and insurance rationales behind strict liability apply equally where the losses are purely economic. These courts reject the *Seely* approach because they find it arbitrary that economic losses are recoverable if a plaintiff suffers bodily injury or property damage, but not if a product injures itself. They also find no inherent difference between economic loss and personal injury or property damage, because all are proximately caused by the defendant’s conduct. Further, they believe recovery for economic loss would not lead to unlimited liability because they think a manufacturer can predict and insure against product failure.

Between the two poles fall a number of cases that would permit a products-liability action under certain circumstances when a product injures only itself. These cases attempt to differentiate between “the disappointed users ... and the endangered ones,” *Russell v. Ford Motor Co.*, 575 P.2d 1383, 1387 (1978), and permit only the latter to sue in tort. The determination has been said to turn on the nature of the defect, the type of risk, and the manner in which the injury arose. The Alaska Supreme Court allows a tort action if
the defective product creates a situation potentially dangerous to persons or other property, and loss occurs as a proximate result of that danger and under dangerous circumstances. *Northern Power & Engineering Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324, 329 (1981).

We find the intermediate and minority land-based positions unsatisfactory. The intermediate positions, which essentially turn on the degree of risk, are too indeterminate to enable manufacturers easily to structure their business behavior. Nor do we find persuasive a distinction that rests on the manner in which the product is injured. We realize that the damage may be qualitative, occurring through gradual deterioration or internal breakage. Or it may be calamitous. [ ] But either way, since by definition no person or other property is damaged, the resulting loss is purely economic. Even when the harm to the product itself occurs through an abrupt, accident-like event, the resulting loss due to repair costs, decreased value, and lost profits is essentially the failure of the purchaser to receive the benefit of its bargain—traditionally the core concern of contract law.

We also decline to adopt the minority land-based view espoused by Santor and Emerson. . . The minority view fails to account for the need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages.

. . . [W]e adopt an approach similar to Seely and hold that a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself.

“The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the ‘luck’ of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products.” When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong.

The tort concern with safety is reduced when an injury is only to the product itself. When a person is injured, the “cost of an injury and the loss of time or health may be an overwhelming misfortune,” and one the person is not prepared to meet. In contrast, when a product injures itself, the commercial user stands to lose the value of the product, risks the displeasure of its customers who find that the product does not meet their needs, or, as in this case, experiences increased costs in performing a service. Losses like these can be insured. Society need not presume that a customer needs special protection. The increased cost to the public that would result from holding a manufacturer liable in tort for injury to the product itself is not justified.

Damage to a product itself is most naturally understood as a warranty claim. Such damage means simply that the product has not met the customer’s expectations, or, in other words, that the customer has received “insufficient product value.” The maintenance of product value and quality is precisely the purpose of express and implied warranties. Therefore, a claim of a nonworking product can be brought as a breach-of-
warranty action. Or, if the customer prefers, it can reject the product or revoke its acceptance and sue for breach of contract.

Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies. In exchange, the purchaser pays less for the product. Since a commercial situation generally does not involve large disparities in bargaining power, we see no reason to intrude into the parties’ allocation of the risk.

While giving recognition to the manufacturer’s bargain, warranty law sufficiently protects the purchaser by allowing it to obtain the benefit of its bargain. The expectation damages available in warranty for purely economic loss give a plaintiff the full benefit of its bargain by compensating for forgone business opportunities. Thus, both the nature of the injury and the resulting damages indicate it is more natural to think of injury to a product itself in terms of warranty.

A warranty action also has a built-in limitation on liability, whereas a tort action could subject the manufacturer to damages of an indefinite amount. The limitation in a contract action comes from the agreement of the parties and the requirement that consequential damages, such as lost profits, be a foreseeable result of the breach. See Hadley v. Baxendale. In a warranty action where the loss is purely economic, the limitation derives from the requirements of foreseeability and of privity, which is still generally enforced for such claims in a commercial setting.

In products-liability law, where there is a duty to the public generally, foreseeability is an inadequate brake. Permitting recovery for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums. It would be difficult for a manufacturer to take into account the expectations of persons downstream who may encounter its product. In this case, for example, if the charterers—already one step removed from the transaction—were permitted to recover their economic losses, then the companies that subchartered the ships might claim their economic losses from the delays, and the charterers’ customers also might claim their economic losses, and so on. “The law does not spread its protection so far.” Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303, 309, 48 S.Ct. 134, 135, 72 L.Ed. 290 (1927).

And to the extent that courts try to limit purely economic damages in tort, they do so by relying on a far murkier line, one that negates the charterers’ contention that permitting such recovery under a products-liability theory enables admiralty courts to avoid difficult line drawing.

For the first three counts, the defective turbine components allegedly injured only the turbines themselves. Therefore, a strict products-liability theory of recovery is unavailable to the charterers. Any warranty claims would be subject to Delaval’s limitation, both in time and scope, of its warranty liability. The record indicates that Seatrain and Delaval reached a settlement agreement. We were informed that these charterers could not have asserted the warranty claims.
In the charterers’ agreements with the owners, the charterers took the ships in “as is” condition, after inspection, and assumed full responsibility for them, including responsibility for maintenance and repairs and for obtaining certain forms of insurance. In a separate agreement between each charterer and Seatrain, Seatrain agreed to guarantee certain payments and covenants by each charterer to the owner. The contractual responsibilities thus were clearly laid out. There is no reason to extricate the parties from their bargain.

Similarly, in the fifth count, alleging the reverse installation of the astern guardian valve, the only harm was to the propulsion system itself rather than to persons or other property. Even assuming that Delaval’s supervision was negligent, as we must on this summary judgment motion, Delaval owed no duty under a products-liability theory based on negligence to avoid causing purely economic loss. Thus, whether stated in negligence or strict liability, no products-liability claim lies in admiralty when the only injury claimed is economic loss.

While we hold that the fourth count should have been dismissed, we affirm the entry of judgment for Delaval.

Common-Law Economic Torts: An Economic and Legal Analysis
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I. Introduction

II. The Economic-Loss Doctrine

I begin with a concrete illustration that clearly exhibits the difference between economic and physical torts. The example will be my vehicle for discussing the “economic-loss” doctrine, the most discussed doctrine of the law relating to economic torts.

Suppose A owns a store and B is a builder who is using a crane to construct a building next to A’s store. Through B’s negligence, his crane falls on A’s store, damaging the store and injuring C, one of the store’s customers. A can sue for the property damage plus loss of profits while the store is closed for repairs, and C can sue for her pain and suffering and lost earnings even if she is an “eggshell skull” plaintiff who would not have been injured at all had her skull been of average thickness. The fact that C’s damages are unforeseeable is no bar to her recovering her full damages from B; likewise, the fact that the amount of A’s lost profits would have been completely unforeseeable.

But now suppose that the crane, instead of falling on A’s store, falls on the public sidewalk directly in front of the store, blocking the entrance and thereby forcing the store to close until the crane is removed and the sidewalk repaired, which might take several days. Assuming as before that the accident was caused by B’s negligence, should A be allowed to sue B for the profits lost while the store is closed?
The answer given by the economic-loss doctrine is “no.” The economic reasons—the only reasons I am interested in—are several. First, A’s lost profits are, in the language of economics, a “private” rather than a “social” cost. A social cost is a diminution in the total value of society’s economic goods; a private cost is a loss to one person that produces an equal gain to another. In other words, private costs result in a transfer of wealth but not a diminution of it. The property damage to A’s store and the physical injury to C are social costs because they are not offset by gains elsewhere. But A’s lost profits are offset elsewhere and are therefore merely a private cost. If A’s store is closed, his customers will shop elsewhere: A’s lost profits will be his competitors’ gain.

But we must consider whether his entire lost profit will be their gain or whether there will be some slippage, and therefore a diminution of aggregate wealth as well as a wealth transfer. There will be no significant slippage if but only if the average costs to the other stores of selling to additional customers do not increase. They will not increase if, for example, the stores do not have to add staff, or pay a premium to obtain the additional goods they need to cope with the surge in demand.

The “only if” (their costs do not rise) qualification is important. If a firm is at full capacity and therefore selling in a region of increasing marginal cost, the adjustments necessary to increase its output, especially in the short run, are apt to increase its marginal cost significantly. But not if it has some excess capacity. Although “excess capacity” sounds like waste, it need not be. Most retail establishments operate most of the time with a bit of excess capacity in order to handle peak demands. “Extra” would be a better term for it, because this “excess” capacity is really peak-load capacity, and so provided that the collapse of the crane does not occur at Christmas or some other peak selling period, the stores to which A’s customers switch when A’s store is closed will be able to handle the additional demand at no or very slight extra cost, especially if A’s customers spread out among a number of other stores rather than piling into just one. Assuming, therefore, that all of A’s lost profits are shifted to other store owners rather than being eaten up in higher costs incurred by those store owners, B has not caused a net social loss beyond the cost of repairing the sidewalk, for which it should be liable—but of course not to A, who does not own the sidewalk or have an obligation to pay for its repair.

A second reason not to impose liability for A’s lost profits is that it is very difficult for B, the crane company, to estimate its potential liability in advance of the accident. It would have a general idea of how many people it might hurt, or how much property damage it might do, if its crane collapsed; but it could not estimate the costs arising from the interruption that the collapse might cause in business activities and the inconvenience that the collapse might cause customers of those businesses. This uncertainty would prevent B from determining how much it should invest in precautions to prevent the collapse of its crane (that is, the investment that would equate the cost of precaution to the expected benefit in reduced legal liability). It would also make it difficult, and indeed probably impossible, for B to buy insurance against liability for such consequences. In general, insurance can be purchased only if the insurance company can calculate the risk of business loss from all accidents, as distinct from an accident caused by the fall of a crane. Business-loss insurance, it is true, is bound to be incomplete because of the moral-hazard problem of insuring a business against a loss of profits, that is, the tendency of insurance to cause the insured to relax his efforts to prevent the event insured against from coming to pass. But the limited liability of businesses that operate in the corporate form, and their ability to discharge their liabilities in bankruptcy, are, from a functional standpoint, forms of business-loss insurance.

In contrast to the debilitating uncertainty faced by the crane company, each business that might be affected by such an accident knows the value of its inventory and of its fixed assets, knows its customers’ behaviors, the pattern of demands, staff expense, and so forth, and can use that information either to take precautions (the commercial equivalent of fastening one’s seatbelt) that will minimize any business losses from an accident, or to buy insurance. For an insurance company should be able to calculate the risk of business loss from all accidents, as distinct from an accident caused by the fall of a crane. Business-loss insurance, it is true, is bound to be incomplete because of the moral-hazard problem of insuring a business against a loss of profits, that is, the tendency of insurance to cause the insured to relax his efforts to prevent the event insured against from coming to pass. But the limited liability of businesses that operate in the corporate form, and their ability to discharge their liabilities in bankruptcy, are, from a functional standpoint, forms of business-loss insurance.

In addition, however, if the victims of an economic tort are numerous (unlike my hypothetical case, where there was only one principal victim), and each incurs only a small loss, then letting the loss rest with them,
rather than shifting it to the injurer, is an automatic if highly imperfect form of insurance. It is in fact self-
insurance, with the victims constituting the insurance pool. Most people prefer to self-insure against risks of small losses—hence the deductibles found in most insurance policies—although, deductibles have the additional function of inducing the insured to exercise care, which reduces the moral-hazard problem inherent in insurance.

I have described two distinct methods by which potential victims can, in advance, minimize their losses from the collapse of the crane: preventing a loss from occurring in the first place (as by minimizing the amount of inventory kept in the store) and insuring against the loss. The second method may seem merely a way of shifting a loss, from the insured to the insurance pool, much like the shifting of profits from A to his competitors, rather than a way of reducing the loss. But that is incorrect. Risk is a real cost, in the sense of disutility, to anyone who is risk averse. Insurance reduces the risk by translating it into a certain cost (the insurance premium) borne by all the members of the insurance pool. One might doubt that business firms would be risk averse, since corporate shareholders can eliminate the risk of a plunge in the value of the individual stocks in their portfolio by diversifying their portfolio. But not all firms are corporations, let alone *739* corporations whose stock is publicly traded, and not all risk-averse investors hold diversified portfolios; they might like to, but it might be too costly for them. Moreover, corporate officers and employees may have firm-specific human capital, which is not diversifiable, and if so they will incur disutility from the risk that their corporation faces.

It is true that by reducing the disutility of a damages judgment, liability insurance may increase the number of accidents. But provided that compensation is full, an increase in the number of accidents need not reduce economic welfare.

The upshot of this analysis is that efficiency may be promoted by shifting the legal responsibility for an accident from the injurer to the victim. This is simply generalizing to tort law the contract-law rule of Hadley v. Baxendale; and indeed I did this many years ago in a case called Evra, which was much like Hadley except that there was no contractual relation between injurer and victim. The point in Hadley, as in my hypothetical case of the crane, was that the carrier could not estimate the loss that the customer would incur from a delay in the delivery of the repaired mill shaft to the customer, but the customer could estimate this cost and, therefore, was in a better position to avoid the loss by taking appropriate precautions or by buying insurance.

The third economic reason for the economic-loss doctrine is that the determination of damages is more difficult when there is no physical connection to the injury because it is much harder to delimit the victims. The collapse of the crane would undoubtedly interrupt more routines than merely that of the store it fell in front of. Owners of other stores on the block might complain that they had lost sales because of the obstructed sidewalk, though in fact their loss might have been due to other factors. A’s suppliers and employees would claim they had lost profits and wages respectively when the closing of the store eliminated its purchase of goods and caused it to lay off most of its workers. And many of these losses would generate offsetting gains to others—other buyers of the goods, other stores—exacerbating the first problem that I discussed that motivates the economic-loss doctrine. No doubt the losses incurred by customers inconvenienced by having to find another store to shop at could be disregarded as de minimis, but this approach could be carried only so far without liability unraveling altogether. Although litigation over such matters could be simplified by means of the class-action device, class actions present their own problems and have at best only limited value when members of the class incur different damages, which must be separately assessed.

Closely related is the fact that there are likely to be many fewer victims in a physical tort case than in an economic tort case. There have of course been a number of “mass tort” cases, but generally an accident that involves solely personal injury or property damage has only a few victims. In contrast, in a complex, integrated economy, an economic tort is apt to cause eddies of economic harm, encompassing a large number of victims incurring different levels of loss.

*740* There would also be a risk of double-counting. Suppose A’s store sold goods at wholesale rather than
retail. Its closure might force its wholesale customers to buy elsewhere at a higher price. They would try to pass on a portion of their costs to their customers in the form of a higher price. To the extent they succeeded, their loss from the closure would be shifted to the customers. Deciding in what proportions the loss had been split between the two tiers would present baffling problems of incidence analysis that caused the Supreme Court, in a related context, to forbid indirect purchasers (purchasers from purchasers) from a price-fixing seller to sue the seller for his antitrust violation.9

A final point is that liability for any personal injury or property damage caused by a negligent accident preserves at least some deterrence, making it less important to provide recovery to the additional victims, whose loss was purely financial. But this will not work in all cases: The crane might have fallen and blocked the entrance to A’s store without damaging the sidewalk, though even then the accident will not be completely costless to B, because it will interrupt his business as well as A’s.

Thus economic analysis supports the economic-loss doctrine, which denies tort liability for a purely economic tort. But remember the other victim in our first hypothetical case, C, who was physically injured yet is allowed to recover her purely “economic” losses, namely her lost earnings, and also the “unforeseeable” damages resulting from the fact that she is an abnormally vulnerable victim. Is not that result inconsistent with the economics of the economic-loss doctrine? It is in tension with it, certainly, but it is not completely inconsistent with it. The uncertainty is much greater in A’s case than in C’s case. In C’s case, the owner of the crane, or his insurer, will be able to estimate the damages, both economic (lost earnings) and noneconomic, of the average victim. This estimate will be correct on average and will enable the owner of the crane to determine the optimal precautions to take against the risk of its collapsing. It will also enable the insurance company to compute a premium. The variance in potential losses to a business is much greater and the mean much more difficult to estimate. Other differences between the cases are the greater ease of delimiting the victims when the basis of liability is a physical injury and the fact that there are likely to be many fewer victims.

To complete the economic analysis of the economic-loss doctrine, it is necessary to consider why in most jurisdictions the doctrine is no longer applied to cases of misrepresentation: Why, in short, Cardozo’s famous opinion in the Ultramares case10—which establishes the principle that an auditor who misrepresents the financial condition of the firm that he audited is not liable to the firm’s lenders for the consequences of the misrepresentation even though they reasonably relied on it in deciding to lend to the firm—is now a minority view.11

In fact, the considerations that support the economic-loss doctrine support the denial of liability in the auditor case and suggest that Ultramares was correctly decided. True, the victims are much better delineated: They are the firm’s lenders (or in some cases their other creditors, or their shareholders), whose identity is a matter of public record. And the auditor will have a better idea of the potential magnitude of a misrepresentation, since he will know a lot about the company he is auditing. But the gap between private and social cost, the first strut of the economic-loss doctrine, is at its widest. The auditor’s misrepresentation will ordinarily consist of concealing bad news about the company being audited. That bad news will eventually leak or otherwise become public, which means that the effect of the misrepresentation will have been to transfer wealth from one group of lenders or shareholders to another, rather than to bring about a net diminution of the lenders’ or shareholders’ wealth. Shareholders who sold their shares before the bad news emerged will benefit at the expense of those who bought the shares and were left holding the bag when the price of the stock crashed. The only net economic loss will be the injection of additional uncertainty into credit or securities markets, rendering these markets slightly less efficient. That is a loss different from and much smaller than the private losses of the lenders who decided to lend or not to lend to the firm, or the shareholders induced to buy its shares. In such a case, tort liability is an inferior remedy to a fine calibrated to the actual social loss caused by the misrepresentation.

If the misrepresentation is deliberate, it might seem that we should not worry about excessive damages; the threat of liability will deter. In contrast, when liability is strict or even when it is based on negligence, excess liability may deter excessively because it cannot be avoided simply by good behavior. The reason this is true in negligence cases as well as in strict liability cases is that negligence has, by virtue of the
“reasonable person” rule, a strict-liability component: Failure to employ average care is negligence even if the injurer is incapable of taking that much care.\textsuperscript{12}

III. Liability to Third Parties of Negligent Providers of Services

Ultramares belongs to a class of cases some of which, unlike the auditor cases, do not involve a large gap between private and social cost, or some other impediment to liability. These are cases in which a breach of contract injures a third party. Precisely because the victim is a third party (and, let me assume for the moment, not a third-party beneficiary of the contract, who would have the rights of an original party), his remedy if at all is in tort, and the question is whether such a person should ever have a tort remedy. The simplest such case is where the breach results in a mistaken wealth transfer. For example, a testator instructs his lawyer to include in the testator’s will a bequest to A, and by mistake the lawyer makes the *742 bequest to B and the testator signs the will without noticing the mistake.\textsuperscript{13} If B has the money when the mistake is discovered, A should be able to obtain restitution of it; mistake is a common ground for restitution. If B no longer has the money, or, having reasonably relied on the legitimacy of the bequest, would incur costs (beyond merely the loss of the use of the money) in returning it, the lawyer should be liable for the consequences of his negligent mistake.

But I want to revisit the assumption that the plaintiff, A, is not a third-party beneficiary of the contract between the testator and the lawyer. A person is a third-party beneficiary if the parties to the contract intended him to have the rights of a party; specifically the right to sue in the event of a breach and recover damages. The doctrine of third-party beneficiaries provides a superior approach to tort liability in the case of the erroneous bequest and probably in the auditor cases as well. If the intended legatees are third-party beneficiaries, the lawyer will be exposed to greater liability and as a result will presumably charge a higher price for preparing the will. The testator will then decide whether the increase in the price is worth incurring in order to reduce the risk that the wrong legatee will inherit. (The risk will be reduced because as a third-party beneficiary the intended legatee will be able to enforce the bequest.) It is better that the tradeoff be made by the parties themselves, namely the testator and his lawyer, than by a court in a tort suit. So here is another area where application of the economic-loss doctrine is efficient.

This recasting of tort as contract will not work in an important class of cases involving the negligent provision of services that harms a third party. These are cases in which the negligent performance of a contract between an employer and a third party causes the employee to be fired or incur other harm. Illustrative are cases in which an employer requires an employee to take a test for the presence of illegal drugs in his body and the lab to which the employer sends the employee’s urine specimen negligently conducts the test and reports a false-positive. It is unlikely that the contract parties--the employer and the lab--intended that the employee be empowered to enforce their contract, which expressly or by implication required the lab to use due care in evaluating the test results. So the employee is not a third-party beneficiary; but should he be allowed to bring a tort suit, even though it is an “economic-loss” case because there has been no physical injury to person or property? The courts are divided.\textsuperscript{14} The argument against tort liability is that the employer has an adequate incentive to enforce the contract, and if it learns of the erroneous result it will terminate the contract or insist on better care or a lower price and it will rehire the erroneously fired employee (presumably an employee at will, who therefore had no right to be rehired even though he had been fired without good cause). But this seems *743 implausible. Generally it is only lower-level employees who are required by their employers to submit to drug tests, and an occasional false positive will do little harm to the employer; he will easily find substitute workers. The principal victim and therefore logical enforcer of the lab’s duty of due care is the employee, and so he should have a right to bring a tort suit.

IV. Intentional Interference with Contract

The type of economic tort (or rather, what would be a tort were it not for the economic-loss doctrine) that falls within the scope of the economic-loss doctrine might be called the “pure” economic tort because it
does not arise from a contractual relation between injurer and victim, although there may be, as in the cases I discussed in Part III, a contract lurking in the background. The other major type of economic tort is supervenient on a contract in a more direct sense. One example, which is the subject of this part of the paper, is intentional interference with a contract (or with advantageous business relations that have not yet crystallized in a contract); another is bad-faith breach of an insurance contract; another is defrauding a customer.

If A and B have a valid contract, and C induces B to break it and recontract with him (C) instead, C has committed the tort of intentional interference with contract. At first glance this result seems contrary to the dictates of efficiency, and in particular to the important economic doctrine of “efficient breach.” Suppose that in the contract between A and B, A had agreed to pay B $100,000 for B’s performance, and that B’s breach of that contract (committed in order to recontract with C) would impose damages of $10,000 on A. Then B will not agree to break his contract with A and recontract with C unless C agrees to pay B at least $110,000 ($100,000 for the performance itself, $10,000 to compensate A for B’s breach of contract, for which B is liable), which C will not do unless B’s performance is worth at least $110,000 to him. That will therefore be the minimum price in the new contract, the contract between B and C. So at the end of the sequence of breach and recontracting, A will be no worse off and no better off than before, B will also be no worse off—he will have $110,000, or more if C agrees to pay him more, in which case B will be better off—and C will be better off by whatever the difference between what he agrees to pay B and what B’s performance is worth to him.

One party is better off and the other two are no worse off (and one of them, B, may be better off too), so the sequence is efficient and why should C be guilty of a tort? Of course, if barred from dealing directly with B—if forced instead to orchestrate a three-cornered deal in which A would voluntarily terminate his contract with B–C might achieve the same result. But the cost would be higher because of the complexity of the transaction. So C should not be liable.

But if the facts are changed, an economic rationale for liability for procuring a breach of contract heaves into view. Suppose that B is judgment-proof; then there is no longer a basis for confidence that the breach and recontracting will produce a net gain in economic welfare; A’s uncompensated loss might exceed the benefit to B and C. Or suppose there is no recontracting but merely a breach induced by mistaken information conveyed by C to B; maybe C, having agreed to guarantee B against certain business losses, mistakenly informs B that A is about to declare bankruptcy, and this causes B to terminate the contract, as C intended. Such a breach may well be inefficient, in which event C should be liable. None of the considerations, discussed earlier, that support the economic-loss doctrine argues against liability in such a case.

The law is not as clear as it could be in differentiating between “interferences” with contract that result in an efficient breach and should therefore not be deemed a tort and subjected to sanctions that would either prevent the efficient breach or require a roundabout recontracting, and interferences that induce breaches that reduce efficiency. In generally distinguishing between proper and “improper” inducements to breach, however, the law is not necessarily inconsistent with the economic approach. The Prosser treatise notes that “it is usually said that tort liability may be imposed upon a defendant who intentionally and improperly interferes with” the contract of another, but that “a defendant might intentionally interfere with the plaintiff’s interests without liability if there were good grounds for the interference.” This leaves it nicely vague.

But the Restatement’s treatment of the issue is hopelessly vague. On the one hand, “Even though A knows of B’s contract with C, he may nevertheless send his regular advertising to B and may solicit business in normal course. This conduct does not constitute inducement of breach of the contract.” On the other hand,

A writes to B: “I know you are under contract to buy these goods from C. Therefore I offer you a special price way below my cost. If you accept this offer, you can break your contract with C, pay him something in settlement and still make money. I am confident that you will find it more satisfactory to deal with me than with C.” As a result of this letter, B breaks his
contract with C. A has induced the breach.\textsuperscript{19} The first hypothetical case may be hinting at a mass mailing; A shouldn't be put to the bother of filtering out addressees who he knows already have a contract, but the example does not say this. The second hypothetical case may be hinting at the presence of predatory pricing (“a special price way below my cost”), though in fact sales below cost need not be predatory; they may be ways of marketing a new product or disposing of obsolete inventory. Again the example does not say. Stripped of equivocal overtones, the second case merely makes explicit what is implicit in the first. If B accepts the solicitation in the first case, he will break his contract, and the second case is just the same: He will break his contract if he thinks he will do better dealing with A even though he will have to compensate C for the damages to C from the breach. Of course if A’s solicitation in the second case is inaccurate in promising B a better deal, there may be liability; but that is not part of the Restatement’s example.

The sensible rule would be to refuse to impose tort liability unless the contract remedy is inadequate. The principal case in which this condition will be fulfilled is where the victim of the breach has no incentive to sue, for example because the contract breaker is insolvent (but the procurer of the breach--the interferer--is not), or because, as in my drug-testing example, the principal harm from the breach falls on a third party rather than on the contract victim of the breach (that is, the promisee).

V. Bad-Faith Breach of Contract

VI. Conclusion

To summarize briefly, viewed through the lens of economics, the area of tort law that I am calling “economic torts” is reasonably coherent and efficient, as we would expect of common law doctrine dealing with commercial transactions. Here as in many other areas of the common law, economics cuts beneath the semantic complexity of legal doctrine and renders law intelligible in practical, intuitive terms. The fit between economic theory and economic-tort doctrine is imperfect, however, and so my economic analysis has normative as well as positive implications. Because one is dealing here with commercial relations rather than personal injury or profound moral issues, the normative guidance that economics provides should be relatively uncontroversial. The economist’s hand on the tiller should enable the necessary mid-course corrections to be made.
The Restatement (Third) of Torts: Liability for Economic Harm (Tentative Draft No. 1) § 3 (April 4, 2012) states the general rule that “there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties.” The comments explaining this rule observe that “[i]f two parties have a contract, the argument for limiting tort claims between them is most powerful.” Id. at cmt. a. The comments explain the rationale for the rule:

When a dispute arises, the rule protects the bargain the parties have made against disruption by a tort suit. Seen from an earlier point in the life of a transaction, the rule allows parties to make dependable allocations of financial risk without fear that tort law will be used to undo them later. Viewed in the long run, the rule prevents the erosion of contract doctrines by the use of tort law to work around them. The rule also reduces the confusion that can result when a party brings suit on the same facts under contract and tort theories that are largely redundant in practical effect.

Id. at cmt. b.

Problems, The Economic Loss Rule

Problem 1: A truck carrying dangerous chemicals to Key West, Florida, overturned due to the driver’s negligence. No one was physically injured in the accident, but the resulting toxic spill resulted in closure of the only overland road to Key West for two weeks during the height of tourist season. Who, if anyone, can recover against the truck company for the negligence of its driver? Generally? In Florida? Explain your answer.

Problem 2: “Robert, a skilled electrical engineer, was employed by ABC Contractors, Inc. Robert was killed in an automobile accident caused by a defect in an automobile manufactured by XYZ. ABC suffered substantial economic loss as a result of Robert’s death because ABC was unable to complete a building contract in a timely fashion.” Taken from the Restatement. Can ABC recover in tort from the auto manufacturer? Generally? In Florida? Explain your answer.

Problem 3: “ABC Rubber Company sells a conveyor belt to XYZ Automobile Company. XYZ installs the belt in its engine assembly line. A defect in the conveyor belt causes it to break, damaging the assembly line. Until the assembly belt is repaired, no engines can be assembled. Because no engines are available, the production lines for automobiles shut down as well. XYZ loses many days of production at a critical time when its best-selling new model has just appeared in the showroom. Expert witnesses testify and the trier of
fact finds that as a consequence of this shutdown, XYZ not only lost the sales of the automobiles that would have been produced but for the shutdown, but also lost the crucial race to be the first in the market with its new model, thereby losing additional millions of dollars of sales to its arch rival MNO Motor Cars, which introduced its new model a week ahead of XYZ instead of a week behind it.” Can XYZ recover in tort against ABC? Generally? In Florida? Also taken from the Restatement.
Restatement (Third) of Agency

1.01 Agency Defined

Agency is the fiduciary relationship that arises when one person (a "principal") manifests assent to another person (an "agent") that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act.

2.04 Respondeat Superior

An employer is subject to liability for torts committed by employees while acting within the scope of their employment.

CURL by CURL v. KEY

311 N.C. 259 (S Ct.—N.C. 1984)

MARTIN, Justice.

In his role as fact finder, Judge John made, inter alia, [findings that the deed at issue was executed freely and voluntarily after “W. Marcus Short fully explained the effect of the execution of the deed to all grantors,” that “no facts were concealed,” that Walter Jack Key’s “forbearance” from suing the property owners constituted “actual consideration for the conveyance,” and that “there was no confidential or fiduciary relationship existing between the plaintiffs and the defendants, and all parties acted in good faith in the execution of the deed. It is further found that there was no attempt by either defendant to deceive or to breach any fiduciary or confidential obligation owed to the plaintiffs-grantors, nor was there any inequality of bargaining power. (Emphases added.)”] This appeal turns upon the question of whether there is evidence to support [the finding that there was no fiduciary relationship.] Our review of the transcript leads us to the conclusion that the finding (actually a conclusion of law) is unsupported by the evidence. All the evidence tended to show that a confidential or fiduciary relationship did exist between the plaintiffs and defendant Jack Key at the time the deed was executed. In part, the plaintiffs’ evidence disclosed:

After James B. Curl, Sr. died intestate in December 1975, his children inherited the family home in rural Guilford County. Living alone on the property after his death, the plaintiffs and Lottie Curl, common-law wife of the deceased, were subjected to harassment, threats, and occasional physical abuse from various “outsiders,” relatives with whom they did not get along. The situation is summarized in the words of James
Curl, Jr.: “Well, a bunch of people was coming down there beating on us, bossing us, just taking over the house ....” At the time of these events, the Curl children were 16, 17, 18, and 21 years of age, respectively.

The plaintiffs had been closely acquainted with Jack Key all of their lives. Known to them as “Uncle Jack,” Key had been their father’s best friend. They continued to regard him as “a special friend of the family.” Key offered to help plaintiffs with their problems in dealing with harassment from outsiders, claiming he could keep troublemakers away if each of the plaintiffs would sign a paper—“a peace paper giving him the right to kick anybody off the land that come there causing any disturbance.” Lottie Curl testified that Key would “have the rights ‘cause he’d be a man person. He said he could take care of it better than a woman. We was giving him the rights to help us out to have peace. He said we’d live happy, y’all can live happily after we sign these papers.”

It was only later, when she went to pay taxes on the property, that Lottie Curl first learned the truth about the “peace paper” they had each signed:

> [A]nd the lady that I went in front of-I don’t know her name-she said, honey, said you don’t have a place to pay taxes on. I said what are you talking about? She said you sold your place to Mr. Jack Key. I said for heaven’s sake, I haven’t sold anything. She said, well, I’m sorry, Honey, the deed, the paper is here stating you sold your property. So she wouldn’t let me pay no taxes.

Concerning the actual signing of the deed, each of the signatories recalled signing only “a blank piece of paper with six lines.” Other than the parties, there were no witnesses present. Attorney Marcus Short prepared the deed, which was signed in his office. When Short attempted to explain the procedure, he was silenced by defendant Key who, having transported plaintiffs to the lawyer’s office himself, claimed “we done talked it all over, explained it to each other, and we all know what we’re going through with.”

Jack Key told them they had signed a “peace paper” at Mr. Short’s office. Judy Curl Cummings, who was about twenty years old when the deed was signed, testified that Jack Key was a good friend of the family’s. She trusted Jack Key.

James Curl, Jr., who was about fifteen years old when the deed was signed, testified that he had known Jack Key as a friend and relied upon him for as long as he could remember.

The plaintiffs had confidence in Jack Key; he was their friend; they all trusted him and believed that he wanted to help them live in peace in their home.

Jack Key himself testified that he had known the Curl family for years. Mr. Curl had taught him to lay brick and they worked together. After Mr. Curl died, Jack Key lived for some time in the house with Lottie Curl and the children. He was a friend of the family’s.

We note that prior to the commencement of the trial, Judge John granted defense counsel’s motion to have all the witnesses excluded from the courtroom. Thereupon,
seven witnesses testified for the plaintiffs, rendering with virtual unanimity the foregoing summary of the evidence.

Evidence for the appellees tended to show that defendant Key lived for a period of time in the plaintiffs’ family home and while there was seriously injured as he descended the stairs to the basement. He thereafter informed plaintiffs that they were responsible for his injuries. According to Key, they resisted his demands for damages but later “volunteered” to convey their house to him in settlement of his claim.

Defendant Key testified, concerning the occasion of the execution of the deed, that attorney Short explained to plaintiffs and their stepmother that by signing the deed they would be conveying their house to Key in settlement of his claim for injuries sustained in July 1976, and the plaintiffs and Ms. Curl agreed that this was their desire. Thereupon, they executed a deed for their home to Key and his wife. The Keys shortly thereafter executed a deed of trust to William C. Ray, as trustee, to secure a $4,000 promissory note to Mr. Short in payment of his attorney’s fees.

None of appellees’ evidence contradicts the conclusion that there was a fiduciary or confidential relationship between plaintiffs and Jack Key.

The trial court erred in finding that no fiduciary or confidential relationship existed between plaintiffs and Jack Key.

The trial court erred in finding that no fiduciary or confidential relationship existed between plaintiffs and Jack Key. . . . The applicable law is as stated by Justice Lake:

Where a transferee of property stands in a confidential or fiduciary relationship to the transferor, it is the duty of the transferee to exercise the utmost good faith in the transaction and to disclose to the transferor all material facts relating thereto and his failure to do constitutes fraud.... Such a relationship “exists in all cases where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.” ... Intent to deceive is not an essential element of such constructive fraud.... Any transaction between persons so situated is “watched with extreme jealousy and solicitude; and if there is found the slightest trace of undue influence or unfair advantage, redress will be given to the injured party.”

The trial court failed to apply this standard to defendant Jack Key’s conduct. For this error, there must be a new trial.

Defendants also argue that the alleged release of Jack Key’s personal injury claim constituted consideration to plaintiffs for the execution of the deed. . . . [But] Key did not release his claim, either orally or in writing.

We hold that the evidence fails to support the conclusion of the trial court that forbearance to bring the suit constituted consideration for the execution of the deed. In fact, counsel conceded at oral argument that a suit for personal injuries against plaintiffs has been instituted by Jack Key.

At the heart of the matter is the universal principle that reality of assent is essential to the validity of a deed. A party must not only be mentally competent; he must exercise his
will freely and understandingly. Undue influence is the exercise of an improper influence over the mind and will of another to such an extent that the action is not that of a free agent. It is the unfair persuasion of a party who is under the domination of the person exercising the persuasion or who by virtue of the relation between them is justified in assuming that that person will not act in a manner inconsistent with his welfare. Confidential relationships are not limited to a purely legal setting but may be found to exist in situations which are moral, social, domestic, or merely personal. It is equally well settled that “[a] course of dealing between persons so situated is watched with extreme jealousy and solicitude; and if there is found the slightest trace of undue influence or unfair advantage, redress will be given to the injured party.”

Plaintiffs are entitled to a new trial. The decision of the Court of Appeals is reversed and the case is remanded to that court for further remand to the superior court for a new trial.

REVERSED AND REMANDED.

MEINHARD v. SALMON et al.
249 N.Y. 458 (N.Y. Ct. App. 1928)

CARDOZO, C. J.

On April 10, 1902, Louisa M. Gerry leased to the defendant Walter J. Salmon the premises known as the Hotel Bristol at the northwest corner of Forty-Second street and Fifth avenue in the city of New York. The lease was for a term of 20 years, commencing May 1, 1902, and ending April 30, 1922. The lessee undertook to change the hotel building for use as shops and offices at a cost of $200,000. Alterations and additions were to be accretions to the land.

Salmon, while in course of treaty with the lessor as to the execution of the lease, was in course of treaty with Meinhard, the plaintiff, for the necessary funds. The result was a joint venture with terms embodied in a writing. Meinhard was to pay to Salmon half of the moneys requisite to reconstruct, alter, manage, and operate the property. Salmon was to pay to Meinhard 40 per cent. of the net profits for the first five years of the lease and 50 per cent. for the years thereafter. If there were losses, each party was to bear them equally. Salmon, however, was to have sole power to ‘manage, lease, underlet and operate’ the building. There were to be certain pre-emptive rights for each in the contingency of death.

The were coadventures, subject to fiduciary duties akin to those of partners. As to this we are all agreed. The heavier weight of duty rested, however, upon Salmon. He was a coadventurer with Meinhard, but he was manager as well. During the early years of the enterprise, the building, reconstructed, was operated at a loss. If the relation had then ended, Meinhard as well as Salmon would have carried a heavy burden. Later the profits
became large with the result that for each of the investors there came a rich return. For each the venture had its phases of fair weather and of foul. The two were in it jointly, for better or for worse.

When the lease was near its end, Elbridge T. Gerry had become the owner of the reversion. He owned much other property in the neighborhood, one lot adjoining the Bristol building on Fifth Avenue and four lots on Forty-Second Street. He had a plan to lease the entire tract for a long term to someone who would destroy the buildings then existing and put up another in their place. In the latter part of 1921, he submitted such a project to several capitalists and dealers. He was unable to carry it through with any of them. Then, in January, 1922, with less than four months of the lease to run, he approached the defendant Salmon. The result was a new lease to the Midpoint Realty Company, which is owned and controlled by Salmon, a lease covering the whole tract, and involving a huge outlay. The term is to be 20 years, but successive covenants for renewal will extend it to a maximum of 80 years at the will of either party. The existing buildings may remain unchanged for seven years. They are then to be torn down, and a new building to cost $3,000,000 is to be placed upon the site. The rental, which under the Bristol lease was only $55,000, is to be from $350,000 to $475,000 for the properties so combined. Salmon personally guaranteed the performance by the lessee of the covenants of the new lease until such time as the new building had been completed and fully paid for.

The lease between Gerry and the Midpoint Realty Company was signed and delivered on January 25, 1922. Salmon had not told Meinhard anything about it. . . . The first that Meinhard knew of it was in February, when the lease was an accomplished fact. He then made demand on the defendants that the lease be held in trust as an asset of the venture, making offer upon the trial to share the personal obligations incidental to the guaranty. The demand was followed by refusal, and later by this suit. A referee gave judgment for the plaintiff, limiting the plaintiff’s interest in the lease, however, to 25 per cent. The limitation was on the theory that the plaintiff’s equity was to be restricted to one-half of so much of the value of the lease as was contributed or represented by the occupation of the Bristol site. Upon cross-appeals to the Appellate Division, the judgment was modified so as to enlarge the equitable interest to one-half of the whole lease. . . .

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

The owner of the reversion, Mr. Gerry, had vainly striven to find a tenant who would favor his ambitious scheme of demolition and construction. Beffled in the search, he
turned to the defendant Salmon in possession of the Bristol, the keystone of the project. He figured to himself beyond a doubt that the man in possession would prove a likely customer. To the eye of an observer, Salmon held the lease as owner in his own right, for himself and no one else. In fact he held it as a fiduciary, for himself and another, sharers in a common venture. If this fact had been proclaimed, if the lease by its terms had run in favor of a partnership, Mr. Gerry, we may fairly assume, would have laid before the partners, and not merely before one of them, his plan of reconstruction. The preemptive privilege, or, better, the preemptive opportunity, that was thus an incident of the enterprise, Salmon appropriate to himself in secrecy and silence. He might have warned Meinhard that the plan had been submitted, and that either would be free to compete for the award. If he had done this, we do not need to say whether he would have been under a duty, if successful in the competition, to hold the lease so acquired for the benefit of a venture than about to end, and thus prolong by indirection its responsibilities and duties. The trouble about his conduct is that he excluded his coadventurer from any chance to compete, from any chance to enjoy the opportunity for benefit that had come to him alone by virtue of his agency. This chance, if nothing more, he was under a duty to concede. The price of its denial is an extension of the trust at the option and for the benefit of the one whom he excluded.

No answer is it to say that the chance would have been of little value even if seasonably offered. Such a calculus of probabilities is beyond the science of the chancery. Salmon, the real estate operator, might have been preferred to Meinhard, the woolen merchant. On the other hand, Meinhard might have offered better terms, or reinforced his offer by alliance with the wealth of others. Perhaps he might even have persuaded the lessor to renew the Bristol lease alone, postponing for a time, in return for higher rentals, the improvement of adjoining lots. We know that even under the lease as made the time for the enlargement of the building was delayed for seven years. All these opportunities were cut away from him through another’s intervention. He knew that Salmon was the manager. As the time drew near for the expiration of the lease, he would naturally assume from silence, if from nothing else, that the lessor was willing to extend it for a term of years, or at least to let it stand as a lease from year to year. Not impossibly the lessor would have done so, whatever his protestations of unwillingness, if Salmon had not given assent to a project more attractive. At all events, notice of termination, even if not necessary, might seem, not unreasonably, to be something to be looked for, if the business was over the another tenant was to enter. In the absence of such notice, the matter of an extension was one that would naturally be attended to by the manager of the enterprise, and not neglected altogether. At least, there was nothing in the situation to give warning to any one that while the lease was still in being, there had come to the manager an offer of extension which he had locked within his breast to be utilized by himself alone. The very fact that Salmon was in control with exclusive powers of direction charged him the more obviously with the duty of disclosure, since only through disclosure could opportunity be equalized. If he might cut off renewal by a purchase for his own benefit when four months were to pass before the lease would have an end, he might do so with equal right while there remained as many years. He might steal a march on his comrade under cover of the darkness, and then hold the captured ground. Loyalty and comradeship are not so easily abjured.
Little profit will come from a dissection of the precedents. None precisely similar is cited in the briefs of counsel. What is similar in many, or so it seems to us, is the animating principle. Authority is, of course, abundant that one partner may not appropriate to his own use a renewal of a lease, though its term is to begin at the expiration of the partnership. The lease at hand with its many changes is not strictly a renewal. Even so, the standard of loyalty for those in trust relations is without the fixed divisions of a graduated scale. There is indeed a dictum in one of our decisions that a partner, though he may not renew a lease, may purchase the reversion if he acts openly and fairly. It is a dictum, and no more, for on the ground that he had acted slyly he was charged as a trustee. The holding is thus in favor of the conclusion that a purchase as well as a lease will succumb to the infection of secrecy and silence. Against the dictum in that case, moreover, may be set the opinion of Dwight, C., in Mitchell v. Read, where there is a dictum to the contrary. To say that a partner is free without restriction to buy in the reversion of the property where the business is conducted is to say in effect that he may strip the good will of its chief element of value, since good will is largely dependent upon continuity of possession. Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish. Certain at least it is that a ‘man obtaining his locus standi, and his opportunity for making such arrangements, by the position he occupies as a partner, is bound by his obligation to his copartners in such dealings not to separate his interest from theirs, but, if he acquires any benefit, to communicate it to them.’ Certain it is also that there may be no abuse of special opportunities growing out of a special trust as manager or agent. If conflicting inferences are possible as to abuse or opportunity, the trier of the facts must make the choice between them. There can be no revision in this court unless the choice is clearly wrong. It is no answer for the fiduciary to say ‘that he was not bound to risk his money as he did, or to go into the enterprise at all.’ ‘He might have kept out of it altogether, but if he went in, he could not withhold from his employer the benefit of the bargain.’ A constructive trust is, then, the remedial device through which preference of self is made subordinate to loyalty to others. Many and varied are its phases and occasions.

. . . Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation. He was much more than a coadventurer. He was a managing coadventurer. For him and for those like him the rule of undivided loyalty is relentless and supreme. A different question would be here if there were lacking any nexus of relation between the business conducted by the manager and the opportunity brought to him as an incident of management. For this problem, as for most, there are distinctions of degree. If Salmon had received from Gerry a proposition to lease a building at a location far removed, he might have held for himself the privilege thus acquired, or so we shall assume. Here the subject-matter of the new lease was an extension and enlargement of the subject-matter of the old one. A managing coadventurer appropriating the benefit of such a lease without warning to his partner might fairly expect to be reproached with conduct that was underhand, or lacking, to say the least, in reasonable candor, if the partner were to surprise him in the act of signing the new instrument. Conduct subject to that reproach does not receive from equity a healing benediction.
A question remains as to the form and extent of the equitable interest to be allotted to the plaintiff. The trust as declared has been held to attach to the lease which was in the name of the defendant corporation. We think it ought to attach at the option of the defendant Salmon to the shares of stock which were owned by him or were under his control. The difference may be important if the lessee shall wish to execute an assignment of the lease, as it ought to be free to do with the consent of the lessor. On the other hand, an equal division of the shares might lead to other hardships. It might take away from Salmon the power of control and management which under the plan of the joint venture he was to have from first to last. The number of shares to be allotted to the plaintiff should, therefore, be reduced to such an extent as may be necessary to preserve to the defendant Salmon the expected measure of dominion. To that end an extra share should be added to his half.

Subject to this adjustment, we agree with the Appellate Division that the plaintiff’s equitable interest is to be measured by the value of half of the entire lease, and not merely by half of some undivided part. A single building covers the whole area. Physical division is impracticable along the lines of the Bristol site, the keystone of the whole. Division of interests and burdens is equally impracticable. Salmon, as tenant under the new lease, or as guarantor of the performance of the tenant’s obligations, might well protest if Meinhard, claiming an equitable interest, had offered to assume a liability not equal to Salmon’s, but only half as great. He might justly insist that the lease must be accepted by his coadventurer in such form as it had been given, and not constructively divided into imaginary fragments. What must be yielded to the one may be demanded by the other. The lease as it has been executed is single and entire. If confusion has resulted from the union of adjoining parcels, the trustee who consented to the union must bear the inconvenience.

The judgment should be modified by providing that at the option of the defendant Salmon there may be substituted for a trust attaching to the lease a trust attaching to the shares of stock, with the result that one-half of such shares together with one additional share will in that event be allotted to the defendant Salmon and the other shares to the plaintiff, and as so modified the judgment should be affirmed with costs.

Gibbs v Breed, Abbott & Morgan

Mazzarelli, J.

Plaintiffs Charles Gibbs and Robert Sheehan are former partners of Breed, Abbott & Morgan (BAM) who specialize in trust and estate law. They withdrew from BAM in July 1991 to join Chadbourne & Parke (Chadbourne), and brought this action for monies due to them under their BAM partnership agreement. Defendants asserted various counterclaims alleging that plaintiffs breached their fiduciary duty to BAM. The counterclaims were severed and tried without a jury. Plaintiffs appeal from the trial
court’s determination that, in the course of both partners’ planning and eventually implementing their withdrawal from BAM, they breached their fiduciary duty to the partnership. Plaintiffs also appeal from the trial court’s determination that $1,861,045 in damages resulted from these transgressions.

From January 1991 until July 1991, plaintiffs were the only partners in the trusts and estates department (T/E) at BAM; plaintiff Gibbs was the head of the department. A third partner, Paul Lambert, had been the former head of the department, and he had obtained many, if not most, of the department’s clients. In 1989 he had left the firm to become the United States Ambassador to Ecuador and was still on leave in 1991. Lambert intended to return to the firm upon completion of his term as ambassador. The BAM trusts and estates department also employed three associate attorneys, Warren Whitaker (fifteenth year), Austin Wilkie (fourth year), and Joseph Scorese (first year); two accountants, Lois Wetzel and Ellen Furst; and two paralegals, Lee Ann Riley and Ruth Kramer.

Gibbs had become dissatisfied with BAM, and in January 1991 he began interviews to locate a new affiliation. He also approached Sheehan to persuade him to move with him. Sheehan and Gibbs subsequently conducted a number of joint interviews with prospective employers. In May 1991, Ambassador Lambert visited BAM, and Gibbs told him that he had been interviewing. Lambert relayed this information to the other partners. In early June, plaintiffs informed the executive committee that they had received an offer from two firms: McDermott, Will & Emory and Bryan Cave.

On June 19, 1991, both plaintiffs informed Stephen Lang, BAM’s presiding partner, that they had accepted offers to join Chadbourne. Lang asked Gibbs not to discuss his departure with any of the T/E associates, and Gibbs agreed not to do so. On June 20, 1991, Lawrence Warble, a BAM partner who was named temporary head of the T/E department, met with its associates and nonlegal personnel to inform them that plaintiffs were leaving the firm.

On June 24, 1991, Gibbs and Sheehan sent Chadbourne a memo listing the names of the personnel in the T/E department at BAM, their respective salaries, their annual billable hours, and the rate at which BAM billed out these employees to clients. The memo included other information about the attorneys, including the colleges and law schools they attended and their Bar admissions. This list had been prepared by Sheehan on April 26, 1991, months before the partners announced they were leaving. Sheehan specifically testified that the memo was prepared in anticipation of discussions with prospective firms, and both Gibbs and Sheehan testified at trial that the recruitment of certain associates and support personnel was discussed with different firms between March and May, as the partners were considering various affiliations. While Gibbs and Sheehan were still partners at BAM, Chadbourne interviewed four BAM employees that Gibbs had indicated he was interested in bringing to Chadbourne with him. On June 27, 1991, plaintiffs submitted their written resignations. Before Gibbs and Sheehan left BAM, they wrote letters to clients served by them, advising that they were leaving BAM and that other attorneys at BAM could serve them. These letters did not mention the fact that the two partners were moving to Chadbourne. Although the partnership agreement required 45 days’ notice of an intention to withdraw, BAM waived this provision upon plaintiffs’
production of their final billings for work previously performed. Gibbs left BAM on July 9, 1991, and Sheehan left on July 11, 1991, both taking various documents, including their respective “chronology” or desk files. With the assistance of his chronology file, Gibbs began to contact his former clients on July 11, 1991. On July 11th, Chadbourne made employment offers to Whitaker, Wilkie, Wetzel, and Riley. Wilkie, Wetzel, and Riley accepted that same day; Whitaker accepted on July 15, 1991. In the following weeks, 92 of the 201 BAM T/E clients moved their business to Chadbourne.

After hearing all the testimony and the parties’ arguments, the trial court determined that Gibbs’ actions in persuading his partner Sheehan to leave BAM, “and the way in which the leave was orchestrated, were done, at least partially, with the intention of crippling BAM’s trusts and estates (T/E) department and constituted a breach of loyalty to BAM. The court also found that Gibbs and Sheehan had breached their fiduciary duties to BAM by sending Chadbourne the April 26, 1991 memo detailing personal information about the individuals in the T/E department at BAM, because this gave Chadbourne a competitive advantage in offering employment to other members of the department. Finally, the court found that Gibbs and Sheehan breached their fiduciary duties to BAM by taking their chronology files with them to Chadbourne. Specifically, the court concluded that by taking their respective chronology files, the partners “to a large degree hobbled their former partners in their effort to rebuild the Trusts and Estates department, in order to maintain a viable department, and in their ability to serve clients without undue disruption.”

With respect to damages, the court concluded that both Gibbs and Sheehan were entitled to recover their share of BAM profits accruing until the end of July 1991, and that Sheehan was entitled to the remainder of his capital account with the firm. Although there was no evidence that the partners had improperly solicited former BAM clients, the court found that despite BAM’s efforts to mitigate damages by hiring a new partner and two associates into the T/E department, that department suffered financial losses as a result of plaintiffs’ conduct, and concluded that it was entitled to recover lost profits for a reasonable period following plaintiffs’ departure. The court directed that lost profits be calculated from July 1991, when the partners left the firm, to November 1993, when BAM dissolved. Gibbs and Sheehan were held jointly and severally liable for $1,861,045. The court also awarded defendants prejudgment interest and attorneys’ fees. The court’s liability finding should be modified, the damage award vacated, and the matter remanded for a determination of the financial loss, if any, occasioned by plaintiffs’ disloyal act of supplying competitors with BAM’s confidential employee data.

The members of a partnership owe each other a duty of loyalty and good faith, and “[a]s a fiduciary, a partner must consider his or her partners’ welfare, and refrain from acting for purely private gain” Partners are constrained by such duties throughout the life of the partnership and “[t]he manner in which partners plan for and implement withdrawals ... is [still] subject to the constraints imposed on them by virtue of their status as fiduciaries. According the trial court’s findings on issues of fact and credibility appropriate deference, we uphold that portion of the court’s liability determination which found that plaintiffs breached their fiduciary duty as partners of the firm they were about to leave by supplying confidential employee information to Chadbourne while still partners at BAM.
However, we find no breach with respect to Gibbs’ interactions with Sheehan, or with respect to either partner’s removal of his desk files from BAM.

Defendants did not establish that Gibbs breached any duty to BAM by discussing with Sheehan a joint move to another firm, or that Sheehan’s decision was based upon anything other than his own personal interests. In addition, while in certain situations “[A] lawyer’s removal or copying, without the firm’s consent, of materials from a law firm that do not belong to the lawyer, that are the property of the law firm, and that are intended by the lawyer to be used in his new affiliation, could constitute dishonesty, which is professional misconduct under [Model] Rule 8.4 (c)” (DC Bar Legal Ethics Comm Opn 273), here, the partners took their desk copies of recent correspondence with the good faith belief that they were entitled to do so.

Contrary to the finding of the trial court, and applying the principle that “[t]he distinction between motive and process is critical to a realistic application of fiduciary duties”, we find no breach of duty in plaintiffs taking their desk files. These were comprised of duplicates of material maintained in individual client files, the partnership agreement was silent as to these documents, and removal was apparently common practice for departing attorneys.

However, the record supports the court’s finding that both partners committed a breach of their fiduciary duty to the BAM partners by supplying Chadbourne, and presumably the other partnerships they considered joining, with the April 26, 1991 memorandum describing the members of BAM’s T/E department, their salaries, and other confidential information, such as billing rates and average billable hours, taken from personnel files. Moreover, a closer examination of the record does not support the dissent’s conclusion that these partners did not engage in surreptitious recruiting. The partners may not have discussed with firm employees the possibility of moving with them prior to June 20, 1991, but they indicated to Chadbourne the employees they were interested in prior to this date, and Gibbs specifically testified that he refrained from telling one of his partners, to whom he had a duty of loyalty, about his future plans to recruit specific associates and support staff from the partnership.

There is no evidence of improper client solicitation in this case, nor is it an issue on this appeal. Although the analogy could be useful in concluding that Gibbs did not breach his fiduciary duty to the partnership by working with Sheehan to find a new affiliation, the fiduciary restraints upon a partner with respect to client solicitation are not analogous to those applicable to employee recruitment. By contrast to the lawyer-client relationship, a partner does not have a fiduciary duty to the employees of a firm which would limit his duty of loyalty to the partnership. Thus, recruitment of firm employees has been viewed as distinct and “permissible on a more limited basis than ... solicitation of clients”. Prewithdrawal recruitment is generally allowed “only after the firm has been given notice of the lawyer’s intention to withdraw.”

However, here Sheehan prepared a memo in April of 1991, well in advance of even deciding, much less informing his partners of his intention to withdraw. There is ample support in the record for the trial court’s finding that the preparation and sending of the
April 26, 1991 memo, combined with the subsequent hiring of certain trusts and estates personnel, constituted an egregious breach of plaintiff’s fiduciary duty to BAM. Moreover, it is not speculative to infer more widespread dissemination given Sheehan’s trial testimony that the memo “was prepared in connection with talking to other firms,” and that “he was sure the subject of staffing was discussed at firms other than Chadbourne.” Sheehan’s disclosure of confidential BAM data to even one firm was a direct breach of his duty of loyalty to his partners. Because the memo gave Chadbourne confidential BAM employment data as well as other information reflecting BAM’s valuation of each employee, Chadbourne was made privy to information calculated to give it an unfair advantage in recruiting certain employees.

While partners may not be restrained from inviting qualified personnel to change firms with them, here Gibbs and Sheehan began their recruiting while still members of the firm and prior to serving notice of their intent to withdraw. They did so without informing their partners that they were disseminating confidential firm data to competitors. Their actions, while still members of the firm, were intended to and did place BAM in the position of not knowing which of their employees were targets and what steps would be appropriate for them to take in order to retain these critical employees. The dissent’s analysis, that once the firm was notified of the partners’ departure, there was no breach of fiduciary duty, is flawed. The breach occurred in April of 1991 and could not be cured by any after-the-fact notification by the fiduciary who committed the breach that he was withdrawing from the firm. Chadbourne still had the unfair advantage of the confidential information from the April 1991 memo, and still had the upper hand, which was manifested by its ability to tailor its offers and incentives to the BAM recruits.

The calculation of damages in cases such as this is difficult. “[B]reaches of a fiduciary relationship in any context comprise a special breed of cases that often loosen normally stringent requirements of causation and damages” This is because the purpose of this type of action “is not merely to compensate the plaintiff for wrongs committed ... [but also] ‘to prevent them, by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others, or to which their agency or trust relates’ ” However, the proponent of a claim for a breach of fiduciary duty must, at a minimum, establish that the offending parties’ actions were “a substantial factor” in causing an identifiable loss.

A reasonable assessment of lost profits has been deemed an appropriate measure of damages in cases where there was evidence that the fiduciary improperly solicited clients to move with him or her, or where the fiduciary’s acts could otherwise be connected to a subsequent loss of business Here, the court based its damage award on what it believed to be a series of disloyal acts. Defendants did not establish how the only act of plaintiffs which this Court finds to be disloyal, that of supplying employee information to Chadbourne, in and of itself, was a substantial cause of BAM’s lost [profits.] We therefore vacate the court’s award to defendants of the total profits lost by BAM between the time of plaintiffs’ departure in July 1991 and BAM’s dissolution in November 1993, and remand for consideration of the issue of whether plaintiffs’ disloyal act of sending Chadbourne the April 26, 1991 memorandum was a significant cause of any identifiable loss, and, if so, the amount of such loss.
LAMORTE BURNS & CO., INC.

v.

WALTERS

167 N.J. 285 (N.J. 2001)

LaVECCHIA, J.

In this case, we consider whether an employee has incurred liability for activities undertaken to plan and prepare for future employment in a newly created business entity established by the employee to compete directly with his current employer. Plaintiff, Lamorte Burns & Co. (Lamorte), filed suit against two of its former employees, Michael Walters and Nancy Nixon, in connection with their conduct in establishing a competing business. Plaintiff’s complaint charged that Walters breached the restrictive covenant clauses of his employment agreement, and that both Walters and Nixon breached their duty of loyalty, tortiously interfered with Lamorte’s economic advantage, misappropriated its confidential and proprietary information, and competed unfairly.

The trial court granted plaintiff’s motion for summary judgment as to liability only. After a hearing, the trial court awarded $232,684 in compensatory damages and an additional $62,816.23 in punitive damages covering counsel fees and costs. In an unpublished opinion, the Appellate Division agreed that Walters had breached his employment contract, but reversed that part of the decision that granted plaintiff summary judgment on its tort claims. The court reasoned that there were disputed facts concerning the confidential and proprietary nature of the information defendants had taken from plaintiff, as well as issues concerning whether defendants’ conduct was acceptable competitive behavior or malicious and in violation of the “rules of the game” of the parties’ business. We granted certification and now reverse, in part, and reinstate the trial court’s judgment sustaining plaintiff’s tort claims.

We regard the facts as not significantly in dispute. Where they are, we accord all inferences in favor of defendant as this matter is before us on an appeal from a motion for summary judgment. Lamorte has been in the business of investigating and adjusting claims for both marine and nonmarine liability insurers, their associations, and owners, in the United States and abroad since 1938. Incorporated in Delaware, Lamorte has its principal place of business in Wilton, Connecticut, and maintains a New Jersey office in Clark. The Clark office opened in 1986 chiefly to handle two types of marine insurance claims: protection and indemnity claims (P & I claims) consisting essentially of personal injury claims and federal longshore and harbor workers’ compensation claims.

Walters met Nixon in the Clark office, where they both worked on P & I claims. When
Walters arrived at Lamorte in 1990, Nixon had already established herself at the company. Walters, on the other hand, was recruited from out of state by Lamorte’s President, Harold J. Halpin, to manage the Clark office, handle P & I claims, and supervise other employees, including Nixon. Walters, an attorney, had experience in the field. He previously had been employed in the P & I division of St. Paul Fire & Marine Insurance Company in Ohio, and before that, in the admiralty department of a Florida law firm.

Lamorte entrusted Walters with substantial responsibility. Lamorte introduced Walters to many of its existing clients, but expected him to locate, establish, and maintain new clients. Because of his prior work, Walters knew many insurance carriers and P & I associations that offered P & I coverage. As it turned out, Walters proved successful at soliciting and establishing new business; he claims to have brought in thirty new clients to Lamorte.

Approximately one month after Walters’s arrival at Lamorte, Halpin asked him to sign an employment agreement. The relevant paragraphs of that agreement stated as follows:

2. You agree to devote your full time and best efforts to the performance of your duties for the Company and not to engage in any other business activities without the prior written consent of the Company.

4. You agree to maintain in confidence all proprietary data and other confidential information (whether concerning the Company, or any of its affiliated companies, or any of their respective clients or cases being handled for clients) obtained or developed by you in the course of your employment with the Company. Such information and data shall include, but not be limited to, all information covering clients and cases being handled for clients. All such information and data is and shall remain the exclusive property of the Company and/or affiliated companies. In addition you assign to the Company all right, title, and interest in and to any and all ideas, inventions, discoveries, trademarks, trade names, copyrights, patents and all other information and data of any kind developed by you during the entire period of your employment with the Company and related to the work performed by you for the Company.

You covenant and agree that upon termination of this Agreement for whatever reason, you will immediately return to the Company any and all files, documents, records, books, agreements or other written material belonging to or relating to the Company or its affiliated companies and any of their respective clients, together with all copies thereof in your possession or control....

Your obligation under this paragraph shall survive any termination of your employment.

5. Employee agrees that so long as you are an employee of the Company, and for a period of twelve (12) month after your termination, whether voluntary or involuntary, you will not solicit or accept any claim, case or dispute which is being handled or directed by the Company or any of its affiliated companies during the term of your employment with the Company. You agree that you will not solicit or accept any such
claim, case or dispute directly in your individual capacity, nor indirectly as a partner of
a partnership, and as an employee of any other entity nor as an officer, director, or
stockholder of a corporation, a joint venturer, a principal or in any other capacity.

You further agree not to solicit or induce any employee of the Company or any of its
affiliated companies to leave its employ, nor to hire or attempt to hire any such
employee....

Walters signed the contract, but he never believed it was enforceable against him. He
reasoned that because he was an at-will employee, the employment contract lacked
consideration for its restrictive covenant clauses. Also, the agreement was never signed
by Lamorte. A Florida attorney privately corroborated his view. Walters never expressed
his beliefs to anyone at Lamorte, however, out of fear that he would be fired.

In the Spring of 1996, Walters quietly began entertaining the idea of resigning and
starting a competing business. By that time, Halpin had informed defendants that
Lamorte would be de-emphasizing P & I work and increasing the workers’ compensation
area of the practice. . . . Walters spoke only with co-employees Nixon and John Treubig
about his idea of starting a competing business. Walters showed Nixon some financial
estimates he had developed, suggesting that she would improve her position if she were
to join in his enterprise. Eventually, Walters lost interest in Treubig. Soon after, Halpin
directed Walters to fire Treubig based on allegations that Treubig had tried to solicit a
Lamorte client for his private benefit.

(WNG). Thereafter, even while Walters and Nixon attended to their duties at Lamorte,
they secretly worked on the commencement of their new business venture. Each time
they worked on a Lamorte P & I claim file, they added to a target solicitation list they
were compiling using information from their employer’s client files. That information
included client names, addresses, phone and fax numbers, file numbers, claim incident
dates, claim contact information, and names of the injured persons. In total, the list
included approximately thirty of Lamorte’s clients, all but one or two of the company’s P
& I clients. As that information was gathered, it was transferred to Walters’s home
computer.

Walters testified that he did not believe the names of Lamorte’s clients and information
concerning pending claims was Lamorte’s proprietary and confidential information. He
reasoned that the information, although not generally available to the public, was not
secret. He asserted that the discrete information could be obtained by calling directly and
inquiring of insurance companies and vessel owners. Further, other than the reference to
“confidential and proprietary information” in his employment agreement that Walters
believed was unenforceable, he never had been told by Lamorte that any of the specific
information he was gathering in connection with his P & I work was confidential and
proprietary. Halpin, himself, never discussed the confidentiality of the information.
During Walters’s deposition, however, he answered “No” to the following question:

Would you have given that information to a competitor if he walked in the
door and said, I want to go after your customers [?]. Give me a complete listing of their files, reference numbers, adjusters and fax numbers and I will use that to solicit them. You would have given that information to them?

In September 1996, Halpin confronted defendants concerning rumors that they were thinking of leaving to start a competing business. They reassured Halpin the rumors were untrue. Walters testified that he feared he would be fired if Halpin knew the truth. The truth was that Walters and Nixon were well on their way to establishing a competing business. By October 1997, they signed a three-year lease to commence December 1, 1997 for office space in Cranford, New Jersey. As December approached, they purchased office equipment, leased computers, and obtained telephone and fax lines for the new WNG office. They agreed that they would resign on the weekend of December 20-21, 1997, a date selected so that each would be eligible to collect Christmas bonuses from Lamorte. They planned that over the same weekend they would send to Lamorte’s clients solicitation letters and forms directing the transfer of claim files.

. . .

On Thursday and Friday, December 18 and 19, 1997, Walters called in sick. In fact, Walters was at WNG’s office installing computers, setting up furniture, and preparing to activate the business solicitation plan over the coming weekend. Telephone records showed that on December 19, 1997, calls were placed to several of Lamorte’s clients from WNG’s office. . .

At 9 a.m. on Saturday, December 20, Walters and Nixon telephoned Lamorte’s Clark office and received no answer. They then drove to that empty office and spent two or three hours “putting away files and removing their personal belongings.” At 2:56 p.m., Walters and Nixon faxed their respective resignation letters to Halpin’s private office in Wilton, Connecticut.

. . .

On Sunday morning, December 21, Walters and Nixon began to fax solicitation letters and transfer authorization forms to all but one of Lamorte’s P & I clients, thirty-three in all. On that first day, defendants exclusively targeted Lamorte’s clients from whose files they had taken the client information noted earlier. A typical letter notified the client that defendants, who had been handling that client’s claim file, had resigned from Lamorte and started a new business. It stated “Our fee structure will be less than Lamorte Burns’ fee structure for 1998.” The client was told that it had absolute discretion in deciding whether to continue with Lamorte or to have its claim files in progress transferred to WNG or to any other firm. The letter was accompanied by a transfer request form. The form included “a list of open files we have been handling for you.” (emphasis added). In addition to the client’s file number, the transfer form included the client’s name, the name of the injured person, and the accident date. The client was instructed simply to mark an “X” next to each listed file that it wished to have transferred from Lamorte to WNG.

By Monday, December 22, 1997, ten of Lamorte’s clients returned to WNG signed
transfer authorization forms instructing Lamorte to transfer their active P & I claims to WNG. By January 7, 1998, all forms were returned and all thirty-three of Lamorte’s P & I clients requested transfer of their active claim files to WNG, totaling a transfer of 116 individual Lamorte P & I claims. By the time the summary judgment motion was heard, 153 of Lamorte’s 350 active P & I claim files had been transferred to WNG. According to Walters, the clients that had requested a transfer included clients he had brought into Lamorte, as well as clients that had been existing Lamorte clients when he arrived at the company. Walters conceded that “[he] had people faxing from up and down the Eastern Seaboard and from overseas within an hour or less of getting his sudden announcement.” Customers were sending their congratulations.

Upon consideration of the summary judgment record, the trial court concluded that defendants had breached their duty of loyalty, tortiously interfered with an economic advantage, misappropriated confidential and proprietary information, and competed unfairly. The court accepted for purposes of the motion that defendants had not solicited any of plaintiff’s clients prior to resignation. It also found that defendants removed only personal belongings from plaintiff’s office . . . . [but nonetheless held defendants had taken Lamorte’s confidential business information for their own purposes.]

On appeal, the Appellate Division determined that there were material facts in dispute and reversed. . . .

A threshold issue common to our analysis of plaintiff’s tort claims concerns whether the client claim information taken from Lamorte by defendants was legally protectable. Defendants admit to gathering, while employed, information from plaintiff’s P & I claim files, including clients’ names, addresses, phone and fax numbers, claimant names, accident dates, details concerning the accidents, and file numbers, for the sole purpose of soliciting, once they resigned, those very clients they had been handling for plaintiff. With respect to Walters, the gathering and use of that information was directly contrary to the terms of his employment agreement. Even in the absence of an agreement, however, the law protects confidential and proprietary information. The information surreptitiously gathered by defendants from plaintiff was not generally available to the public, but was shared between plaintiff and its clients. Defendants would not have been aware of that information but for their employment. The information went beyond the mere names of plaintiff’s clients. It included specific information concerning the clients’ claims, such as the name of the injured party, and the type and date of injury. Defendants admitted that that information gave them an advantage in soliciting plaintiff’s clients once they resigned. But, the information was available to defendants for their use in servicing clients on behalf of Lamorte only.

The record is clear that defendants also knew that Lamorte had an interest in protecting that information. Walters signed an agreement that so stated, and both Walters and Nixon declined to sign a later agreement that sought to afford further protection to the information. Walters acknowledged that he would not have given such information to a competitor if requested, and he would not have permitted a Lamorte employee to do so. Also, Walters and Nixon both were aware that their co-employee John Treubig had been
fired because of his attempt to privately solicit Lamorte’s customers. We conclude, therefore, that the client claim file information taken by defendants was confidential and proprietary information belonging to plaintiff.

Having concluded that plaintiff’s client claim file information is legally protectable, resolution of plaintiff’s breach of the duty of loyalty claim is relatively straightforward. Loyalty from an employee to an employer consists of certain very basic and common sense obligations. An employee must not while employed act contrary to the employer’s interest. And, during that period of employment, an employee has a duty not to compete with his or her employer. Consistent with our approach to this common-law duty, the Restatement (Second) Agency provides that “[u]nless otherwise agreed, an agent is subject to a duty not to compete with the principal concerning the subject matter of his agency.” An employee’s duty of loyalty to his or her employer goes beyond refraining from privately soliciting the employer’s customers while still employed. The duty of loyalty prohibits the employee from taking affirmative steps to injure the employer’s business. Defendants purloined protected information from plaintiff’s P & I claim files while still employed, for the sole purpose of effecting an advantage in competing with plaintiff immediately upon their resignation and the commencement of their new competitive business. Unlike the defendant in Auxton Computer Enterprises, Inc., supra, 174 N.J. Super. at 425, 416 A.2d 952, defendants here intentionally began a process of subverting their employer’s business while still employed. That process included gathering by stealth plaintiff’s legally protected information admittedly to seek an advantage in competing with plaintiff once they resigned. Obviously those actions were contrary to plaintiff’s interest, and in the case of Walters, directly conflicted with the terms of his employment agreement as well, as the courts below held.

We respect the principles of free competition, but defendants’ taking of plaintiff’s confidential and proprietary property and then using it effectively to target plaintiffs’ clients, is contrary to the notion of free competition that is fair. For the reasons expressed herein sustaining plaintiff’s claims of breach of the duty of loyalty and tortious interference with an economic advantage, and as expressed in the trial court’s opinion, we conclude that plaintiff is entitled to summary judgment on its other tort claims, namely that defendants misappropriated plaintiff’s confidential and proprietary information and committed unfair competition. Under the facts here, all proofs essential to those latter two claims are subsumed in the proofs required to support the claims for breach of loyalty and tortious interference with an economic advantage. Accordingly, the judgment of the Appellate Division is reversed, in part, and the judgment of the Chancery Division sustaining plaintiff’s tort claims is reinstated. For reversal in part and reinstatement—Chief Justice PORITZ and Justices STEIN, COLEMAN, LONG, VERNIERO, LaVECCHIA and ZAZZALI-7.
PROBLEM

Client seeks Lawyer’s advice about building a new shopping plaza at 123 Main Street. Lawyer provides legal advice about the development to Client and, without asking Client, purchases property at 125 Main Street, knowing that it will become more valuable once Client’s plans to develop 123 Main Street become public. Client learns that Lawyer has purchased the property and is furious. Client did not have the money to purchase 125 Main Street in addition to 123 Main Street; however, Client fears that Lawyer’s purchase may “tip off” others to Client’s contemplated purchase of 123 Main Street. Moreover, Client had hoped that her brother-in-law, a billionaire computer mogul, might want to purchase 125 Main Street, but had not mentioned the project to him yet. What claims, if any, may Client bring against Lawyer, and what remedies are available?

FRAUD AND NEGLIGENT MISREPRESENTATION

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ONITA PACIFIC CORPORATION v. BRONSON,
315 Or. 149 (Or. 1992)

PETERSON, Justice.

This proceeding stems from a dispute regarding the terms of a real estate development agreement. At trial, after the court directed a verdict in favor of defendants1 on plaintiffs2 fraud claim, the jury returned a verdict in favor of plaintiffs on their claim for negligent misrepresentation. The trial court thereafter granted defendants’ motion for a new trial on the ground that the jury instruction on damages was erroneous. Plaintiffs appealed, asserting that the trial court erred in granting a new trial, in awarding attorney fees, and in dismissing plaintiffs’ other claims for relief. The Court of Appeals reversed. It upheld the verdict on the claim for negligent misrepresentation, vacated the trial court’s order granting a new trial, and reinstated the jury’s verdict on the ground that the objection to the jury instruction had not been preserved and thus that the trial court erred in granting a new trial.

On defendants’ petitions for review, although we agree that damages may be recoverable for some negligent misrepresentations, a claim for negligent misrepresentation is not made out under the facts present here. Therefore, we reverse the Court of Appeals’ decision reinstating the verdict for plaintiffs on their claim for negligent misrepresentation.3 Because the Court of Appeals did not address plaintiffs’ contentions
that the trial court erred in directing a verdict on their fraud claim and in dismissing their claim for breach of the implied covenant of good faith, we remand the case to the Court of Appeals for consideration of those issues. The Court *153 of Appeals also should reconsider its decision concerning attorney fees in the light of its ultimate disposition of the appeal.

In 1973, Betty Camomile entered into a land sale contract (Camomile contract) with defendants to sell three large tracts of real property. The Camomile contract provided for a stream of payments over time to Camomile as the real property was developed and sold. In 1979, defendants sold their rights in two of the three parcels to Robert Hatch by a land sale contract (Hatch contract), which provided that a deed for each lot would be placed in an escrow with instructions for its release on resale. Hatch then assigned his interest to John Compton, with defendants’ and Camomile’s consent. Subsequently, Compton decided to sell his interest in the two parcels under the Hatch contract.

Plaintiffs were interested in purchasing Compton’s interest. Camomile refused to consent to Compton’s delegation of his obligations to her under the Hatch and Camomile contracts. In order to eliminate the need for Camomile’s consent, plaintiffs agreed to make a payment of $200,000 that would be used by defendants to pay the balance owing to Camomile. Plaintiffs transferred property worth approximately $850,000 to Compton for his interest in the Hatch contract and borrowed $200,000 in cash from Compton to make the $200,000 payment to defendants. Plaintiffs gave Compton a promissory note for $200,000 and security interests in their interest as assignees of the Hatch contract and in other property that they owned.

Defendants, plaintiffs, and Compton negotiated a “Modification of Agreement,” pursuant to which the parties agreed to change some of the restrictions on the development of the lots for resale. After setting forth the modifications to the development plan, the Modification of Agreement provided:

“In all other respects the contract between CHARLES D. BRONSON, CLYDE PURCELL, L.A. SWARENS and WARDE H. ERWIN, a joint venture, and ROBERT HATCH and JOHN COMPTON shall remain in full force and effect.

“Vendors-sellers [defendants] hereby consent to sale-assignment by JOHN COMPTON to DOUGLAS K. SIEBERT, and his WIFE, and to DR. and MRS. JOHN ‘JACK’ A. DANTE, and to the DOUGLAS CASCADE CORPORATION and ONITA PACIFIC CORPORATION, as tenants in common, each to be jointly and severally liable and responsible for performance of the contract above referenced and herein modified.”

The Hatch contract, to which the Modification of Agreement referred, included a clause that provided that “[t]here are no representations or warranties made by either party except as contained in this document.” There is no written memorandum in the record that reflects the details of the sale-assignment by Compton to plaintiffs.

Plaintiffs contend that they agreed to make the $200,000 payment because defendants told them that lots worth $200,000 would be released to them. Specifically, Douglas
Siebert testified that Lawrence Erwin, defendants’ attorney, had assured him that the $200,000 payment would be processed through the escrow that held the deeds and that the escrow would release lots worth $200,000 to plaintiffs. Siebert testified that he relied on Lawrence Erwin’s representations, because defendant Warde Erwin had told him that Lawrence Erwin would handle the negotiations on defendants’ behalf. Just before the transaction was to close, Lawrence Erwin informed Siebert that defendants wanted to use a different escrow to avoid a processing fee and that they proposed that plaintiffs’ payment be processed through Lawrence Erwin’s client trust account. Lawrence Erwin assured Siebert that the payment would be treated just as it would have been if processed through the original escrow and that the new escrow would have the same instructions as the previous one. Siebert, who believed that the existing escrow instructions permitted releases of lots without resale, agreed to this procedure on behalf of plaintiffs.

After making the $200,000 payment and executing the Modification of Agreement, plaintiffs requested the release of 16 lots worth $192,000. Defendants refused to release the 16 lots on the ground that the Hatch contract required releases of lots only upon resale. Lawrence Erwin then drafted instructions for the new escrow that clearly limited releases of lots to third-party resales. Further, in his cover letter accompanying the proposed new escrow instructions, Lawrence Erwin acknowledged that Douglas Siebert may have been confused about the availability of releases of lots without a resale. Without the released lots, plaintiffs had no collateral and were unable to obtain financing to develop the lots for resale, and they defaulted on their obligation to Compton. Compton foreclosed on the security, i.e., plaintiffs’ interests as assignees of the Hatch contract and plaintiffs’ other property that had been pledged as security for the $200,000 loan.

Plaintiffs brought suit against defendants seeking reformation of the Hatch contract and the Modification of Agreement to provide for the release of lots upon the payment of $200,000 by plaintiffs. Plaintiffs also sought damages for fraud, negligent misrepresentation, breach of the implied covenant of good faith, and intentional interference with contractual relations. The reformation claim was tried to the court first. The trial court denied reformation, stating that plaintiffs had failed to prove that defendants intentionally deceived plaintiffs regarding the release of lots and that Lawrence Erwin was not shown to have authority to bind defendants by his representations. The trial court also dismissed plaintiffs’ claims for breach of the implied covenant of good faith and for intentional interference with contract.

Plaintiffs’ fraud and negligent misrepresentation claims were then tried to the jury. At the close of plaintiffs’ evidence, the trial court granted defendants’ motion for directed verdict on the fraud claim. The jury thereafter returned a verdict in favor of plaintiffs on their negligent misrepresentation claim. Defendants moved for judgment notwithstanding the verdict, arguing that Oregon law does not recognize the tort of negligent misrepresentation and, even if it did, that it would not arise in these circumstances. Defendants also moved for a new trial, arguing that, assuming the legal sufficiency of plaintiffs’ claim for negligent misrepresentation, the trial court’s instruction on damages was incorrect. The trial court denied the motion for judgment notwithstanding the verdict.
and granted the motion for a new trial, stating that its instruction on damages was incorrect.

[Plaintiff appealed, and defendants cross-appealed.]

The Court of Appeals reversed. Concerning the tort of negligent misrepresentation, the Court of Appeals held that defendants’ conduct was actionable and that the jury’s verdict was supported by evidence in the record. . . .

Plaintiffs’ claim for negligent misrepresentation is based on Restatement (Second) of Torts § 552 (1977). They assert that “a party who supplies false information should be liable for misrepresentations that are made negligently.” Defendants contend that, as between parties to an arm’s-length transaction, one party should not be held liable to another party for economic losses caused by the latter’s reliance on the former’s negligent misrepresentations.

In Duyck v. Tualatin Valley Irrigation Dist., 304 Or. 151, 157–58, 742 P.2d 1176 (1987), this court traced the history of the tort of negligent misrepresentation.

“In England, though the English courts had long recognized the forms of action of deceit and negligence, the House of Lords, in 1889, held that an action for deceit could not be maintained by a plaintiff who had been induced to enter into a disfavorable commercial or financial venture unless the false statement upon which the plaintiff relied was made ‘(1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false.’ Derry v. Peek, 14 App Cas 337, 374 (1889). According to Prosser, the English rule was that, ‘in the absence of some fiduciary relation between the parties, there was no remedy for merely negligent misrepresentation, honestly believed, where the harm that resulted to the plaintiff was only pecuniary loss,’ Prosser, Misrepresentations and Third Parties, 19 Vand L Rev 231, 234 (1966) (footnote omitted).

“The best known statement for not recognizing liability for economic loss arising from a negligent misrepresentation causing only economic loss appears in Ultramares v. Touche, 255 N.Y. 170, 174 N.E. 441, 74 ALR 1139 (1931). In that case the New York Court of Appeals, fearing limitless liability, refused to hold an accounting firm liable for negligently certifying a firm’s balance sheet. The claimants were third persons who had suffered economic losses in reliance thereon. Judge Cardozo, for the court, stated:

‘If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.’

“Id. at 179–80, [174 N.E. 441] (emphasis added).
“The Ultramares court distinguished an earlier New York case, Glanzer v. Shepard, 233 N.Y. 236, 135 N.E. 275, 23 ALR 1425 (1922), in which a public weigher of beans was held liable to a buyer for an erroneous weight statement—even though the weighing was at the seller’s request—because the weigher knew that the buyer would rely on the weight statement. The Ultramares court distinguished Glanzer on the ground that the weight statement was ‘primarily’ for the benefit of the buyer, while the audit statement in Ultramares was ‘incidentally’ for the use of third parties.

“Today many American courts recognize the tort of negligent misrepresentation, but the scope of recovery for economic loss varies widely. The New York courts limit recovery to cases in which the nexus between the parties is direct or close. Credit Alliance Corp. v. Arthur Anderson [Andersen] & Co., 65 N.Y.2d 536, 551, 493 N.Y.S.2d 435, 483 N.E.2d 110 (1985) (‘there must have been some conduct on the part of the accountants linking them to that party or parties, which evinces the accountants’ understanding of that party or party’s reliance’). At the other extreme is the view that liability is only limited by the principle of reasonable foresight. See Craig, Negligent Misstatements, Negligent Acts and Economic Loss, 92 Law Q Rev 213 (1976). The Restatement (Second) appears to take an intermediate position.”

Because the Duyck court held that the statute of limitations had run, it was not necessary to decide whether the tort of negligent misrepresentation existed in Oregon; the court simply assumed the existence of the tort. The court concluded that an action for negligent misrepresentation was an action for negligence rather than deceit and, thus, that the plaintiffs’ action accrued on **896 the date that they knew or should have known that their reliance on the defendant’s representations had caused them a pecuniary loss rather than on the date on which they learned of the defendant’s culpability for causing that loss. *Id.* at 160–64, 742 P.2d 1176.

*159* We now state that, under some circumstances, one may be liable for economic loss sustained by others who rely on one’s representations negligently made. In Duyck, *id.* at 158, 742 P.2d 1176, this court observed that “many American courts recognize the tort of negligent misrepresentation, but the scope of recovery for economic loss varies widely.” The rule stated in *Restatement (Second) of Torts § 552* (see note 5, *ante*) is close to the mark. But, for the reasons that follow, rather than adopting a black letter “rule,” we opt to develop the scope of the duty and the scope of recovery on a case-by-case basis, in the light of related decisions of this court.

[2] [3] Our precedents establish that a negligence claim for the recovery of economic losses caused by another must be predicated on some duty of the negligent actor to the injured party beyond the common law duty to exercise reasonable care to prevent foreseeable harm. *Hale v. Groce*, 304 Or. 281, 284, 744 P.2d 1289 (1987), states:

“[O]ne ordinarily is not liable for negligently causing a stranger’s purely economic loss without injuring his person or property. It does not suffice that the harm is a foreseeable consequence of negligent conduct that may make one liable to someone else, for
instance to a client. Some source of a duty outside the common law of negligence is required.” (Citations omitted.)

Hence, where the recovery of economic losses is sought on a theory of negligence, the concept of duty as a limiting principle takes on a greater importance than it does with regard to the recovery of damages for personal injury or property damage.\(^7\)

Having recognized the existence of the tort, the central question in the present case becomes whether, during the parties’ arms-length negotiations, in addition to a duty of honesty, defendants owed plaintiffs a duty to exercise reasonable care in communicating factual information to prevent economic losses to plaintiffs. To resolve this, we examine the nature of the parties’ relationship and compare that relationship to other relationships in which the law imposes a duty on parties to conduct themselves reasonably, so as to protect the other parties to the relationship.

The law imposes a duty of care in the attorney-client relationship. \textit{Chocktoot v. Smith}, 280 Or. 567, 570, 571 P.2d 1255 (1977); \textit{Harding v. Bell}, 265 Or. 202, 204–05, 508 P.2d 216 (1973). That duty—to act as a reasonably competent attorney in protecting and defending the interests of the client—is owed not only to the client but, as well, to those who may be considered intended beneficiaries of the duty to the client. \textit{See, e.g., Hale v. Groce, supra,} 304 Or. at 284, 287, 744 P.2d 1289 (extending attorney’s duty to intended beneficiary of attorney’s promise to the client). If the professional breaches that duty, the client and the intended beneficiary can recover economic losses. Unlike parties who are negotiating at arm’s length, the attorney is engaged by the client to use his or her expertise for the benefit and protection of the client’s interests. The attorney generally does not and should not have any pecuniary interest that is adverse to the client. \textit{Schroeder v. Schaefer,} 258 Or. 444, 450–51, 477 P.2d 720 (1970), modified 258 Or. 444, 483 P.2d 818 (1971); \textit{see also Oregon State Bar, Code of Professional Responsibility, DR 5–101} (Conflict of Interest: Lawyer’s Self–Interest). The tort duty to exercise reasonable care in protecting the client’s economic interests is implied by law when the attorney contracts with the client to provide legal services. \textit{Georgetown Realty v. The Home Ins. Co.}, 313 Or. 97, 106, 831 P.2d 7 (1992).

Other professional or contractual relationships may also give rise to a tort duty to exercise reasonable care on behalf of another’s interests. \textit{Cf. Securities–Intermountain v. Sunset Fuel}, 289 Or. 243, 259, 611 P.2d 1158 (1980) (in “an *161 action for damages against one engaged to provide professional or other independent services,” the statute of limitations for negligence rather than for contract actions applies “[i]f the alleged contract merely incorporates by reference or by implication a general standard of skill and care independent of the contract, and the alleged breach would also be a breach of this noncontractual duty”).\(^8\) Engineers and architects are among those who may be subject to liability to those who employ (or are the intended beneficiaries of) their services and who suffer losses caused by professional negligence. \textit{Ashley v. Fletcher}, 275 Or. 405, 550 P.2d 1385 (1976) (architect); \textit{Bales for Food v. Poole}, 246 Or. 253, 256, 424 P.2d 892 (1967) (engineer).

Other examples may be cited. An agent owes duties of care and loyalty to his or her

In the above relationships, the professional who owes a duty of care is, at least in part, acting to further the economic interests of the “client,” the person owed the duty of care. In contrast, the present case involves two adversarial parties negotiating at arm’s length to further their own economic interests.

[10] The foregoing authorities are the most analogous ones that we can find to the present case. From them, we conclude that, in arm’s-length negotiations, economic losses arising from a negligent misrepresentation are not actionable. This conclusion is in accord with the opinions of some commentators. Professors Harper, James, and Gray have noted the desirability of limiting the class of persons to whom the duty of care is owed in the context of negligent misrepresentations causing economic losses.

“On the whole, as indicated above, courts have provided a remedy for negligent misrepresentation principally against those who advise in an essentially nonadversarial capacity. As against sellers and other presumed antagonists, on the other hand, the tendency of most courts has instead been either to rely on deceit with the requirement of scienter, however expanded, or to shift (by analogy to restitution or warranty) to strict liability * * *. “2 Harper, James & Gray, The Law of Torts 412–13, § 7.6 (2d ed 1986).

Similarly, Professor Alfred Hill distinguishes between misrepresentations made by an adversary in a sales transaction and by one who holds out to the general public that he or she supplies information and has noted:

“The situation is different in the case of ‘antagonists.’ When the aggrieved person is a buyer, who does not complain of the negligent performance of a service but rather of misrepresentation by a seller inducing the making of a contract, the conceptual mold has been different from the inception of modern contract law: the options have been to sue on the contract or to sue in deceit, without a middle ground consisting of actionable negligence.” Hill, *Damages for Innocent Misrepresentation*, 73 Colum L Rev 679, 688 (1973).

Hill also states that allowing recovery for negligent misrepresentations made in the bargaining process would undermine the law of contracts, especially rules of law concerning written contracts.

... Plaintiffs could have avoided the problems that gave rise to this case by insisting that the lot-release provisions be included in the written agreements. Arguably, permitting damages for negligent misrepresentation in arm’s-length transactions would
encourage contracting parties *not* to draft complete, integrated contracts. . . . Recognition of the tort of negligent misrepresentation in a case such as this, in which parties in a bargaining transaction contemplate a later written agreement, would undermine fundamental principles of contract law.

On the other hand, Prosser and Keeton argue that “there would seem to be very little justification for not extending liability to all parties and agents to a bargaining transaction for making misrepresentations negligently.” Prosser & Keeton, Torts 745, § 107 (5th ed. 1984). However, they do not explain or support that assertion; they merely state it. Prosser and Keeton do acknowledge that most courts have restricted liability for negligent misrepresentations causing pecuniary losses by “limit[ing] the group of persons to whom the defendant may be liable, short of the foreseeability of possible harm.” *Ibid.* Further, the situations that they describe involve suppliers of information, as distinct from parties in bargaining transactions, and the liability of the information suppliers is premised on the existence of a special relationship or by application of third-party beneficiary principles.

Our conclusion also is consistent with Restatement (Second) of Torts § 552. The text of section 552 and the comments and illustrations thereto suggest that the editors, in using the words “[o]ne 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,” had in mind relationships other than the relationship between persons negotiating at arm’s length. The comments provide no illustrations dealing with business adversaries in the commercial sense. . . .

We read Restatement section 552 as consistent with the rule that this court has adopted for negligence actions for the recovery of economic losses, *viz.*, nongratuitous suppliers of information owe a duty to their clients or employers or to intended third-party beneficiaries of their contractual, professional, or employment relationship to exercise reasonable care to avoid misrepresenting facts. In the case at bar, defendants and their representative did not owe any duty to plaintiffs during the negotiations by virtue of a contractual, professional, or employment relationship or as a result of any fiduciary or similar relationship implied in the law. Here, the relationship was adversarial. In an arm’s-length negotiation, a negligent misrepresentation is not actionable. Hence, plaintiffs cannot maintain their claim for negligent misrepresentation against defendants.

We recognize that some jurisdictions allow damages for negligent misrepresentation in contexts similar to the case at bar. However, those jurisdictions either treat the tort as a specie of fraud or are more willing to imply a “duty” than our precedents permit. Foreseeability alone is not a sufficient basis to permit the recovery of economic losses on a theory of negligence.

Plaintiffs cannot maintain their action for defendants’ allegedly negligent nonfraudulent misrepresentations, and the Court of Appeals’ decision reinstating the verdict is reversed. Because the Court of Appeals did not address plaintiffs’ contentions on appeal that the trial court improperly directed a verdict on their fraud claim and improperly dismissed
their claim for breach of the implied covenant of good faith, we remand this case to the Court of Appeals for consideration of those unresolved issues and for reconsideration of its decision concerning attorney fees in the light of its ultimate disposition of the appeal.

The decision of the Court of Appeals reinstating the verdict is reversed, and the case is remanded to the Court of Appeals for further consideration consistent with this opinion.

**FRAUD/Negligent Misrepresentation/Breach of Fiduciary Duty:**

**Complaint in Worldview Entertainment Holdings, LLC v. Creative Artists Agency LLC**

Please read the complaint here: file:///E:/Users/lidskyl/Downloads/368950331-Worldview-v-CAA.pdf I will also upload the complaint to TWEN.

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**Advanced Torts Exam 2007 (Prof. Lidsky)**

**Questions 1-10 are based on the following fact scenario. 14 questions total.**

Mike and Rob were business partners. Mike invested $200,000 into the opening of their restaurant, M&R Steakhouse. Rob was the chef at the restaurant, but did not invest any money in the venture. Their partnership agreement provided that they would share equally in the profits of the restaurant.

The restaurant opened about a month ago. Initially, it was packed with customers, but business dropped considerably after it received a negative review in *The Times*, a local newspaper. The reviewer from *The Times* wrote:

_I dined recently at M&R Steakhouse, and the only enjoyable part of the meal was the beer, which I drank straight from the bottle rather than pour into the dirty-looking mug my server brought to the table. The server, who wore seven earrings in one ear and had a tattoo of the Statue of Liberty on his bicep, appeared to be stoned, and he botched my order. When my steak finally arrived at the table, it was cold, and the steamed vegetables on the side were not “fresh from the garden” as the menu stated but were instead straight from a freezer bag._

Mike and Rob were very upset about the negative review, particularly since Mike was the server with the Statue of Liberty tattoo. As if this weren’t bad enough, a city health inspector arrived the day after the negative review and wrote M&R Steakhouse up for two violations: first, a freezer full of dairy products was one degree above the
temperature that the health code required, and second, the sign in M&R’s restroom telling employees to wash their hands was in a smaller type font than the health code required.

The day after the inspection, *The Times* published the following item.

*Unless food poisoning is high on your wish list, you might want to avoid M&R Steakhouse. A confidential source tells The Times that the steakhouse was written up by a city health inspector for several serious health code violations.*

When Mike and Rob read this item, they got into a terrible argument. Rob told Mike he could find himself a new business partner, and he walked out of the restaurant, taking all his secret recipes with him. The next day, Rob went to work as a salaried employee at Steaks “R” Us, a competing local restaurant. Evidently the owner of Steaks “R” Us had been urging Rob to come work for him some time.

A week after Rob went to work at Steaks “R” Us, *The Times* wrote the following small news item: Chef Rob has moved to Steaks “R” Us, apparently abandoning the doomed M&R Steakhouse. Mike, Chef Rob’s former business partner at M&R, was so despondent over the fate of M&R that he checked himself into a local psychiatric clinic to recover. [Incidentally, a year later, Rob published a very successful cookbook entitled, “Chef Rob’s Secret Recipes.”]

1. Evaluate the strengths and weaknesses of any potential libel action Mike may bring against *The Times* based on the first article (the negative review). Assume that Mike can prove he has never used illegal drugs in his entire life. Assume also that Mike did make a minor mistake in writing down the restaurant reviewer’s order. Discuss both the elements of Mike’s libel claim and any potential privileges or defenses *The Times* may plausibly assert.

2. Evaluate the strengths and weaknesses of any potential libel action M&R Steakhouse and/or Chef Rob may have based on the first article (the negative review). Assume that it can be established that the vegetables were in fact fresh rather than frozen. Discuss both the elements of the libel claim and any privileges or defenses *The Times* may plausibly assert.

3. If M&R Steakhouse sues *The Times* for libel based on the news article about the health inspection results, will *The Times* be able to avoid liability by asserting a privilege or privileges? Explain, making sure to identify the privilege or privileges *The Times* might plausibly assert.

4. Evaluate the strengths and weaknesses of any claim M&R Steakhouse might bring against *The Times* for injurious falsehood/commercial disparagement.

5. Evaluate the strengths and weaknesses of any claim Chef Rob might bring against *The Times* for false light invasion of privacy. Again assume the veggies were fresh, not frozen.
6. Evaluate the strengths and weaknesses of any claim Mike may bring against Rob for breach of fiduciary duty. Make sure and identify what remedies, if any, will be available to Mike.

7. Evaluate the strengths and weaknesses of any claim Mike may bring against the owner of Steaks “R” Us for intentional interference with contractual relations and/or economic opportunities.

8. Evaluate the strengths and weaknesses of any claim Mike may bring against Rob for conversion.

9. Evaluate the strengths and weaknesses of any claim Mike may bring against The Times for public disclosure of private facts. Assume that it is true that Mike checked himself into a psychiatric facility for treatment of severe depression.

10. Mike learns that The Times obtained the information about his psychiatric condition by bribing the security guard at the facility to reveal the names of any prominent people who checked themselves in. Evaluate the strengths and weaknesses of any claim Mike may bring against The Times for intrusion.

11. Paul sued Dale for breach of contract, seeking $1,000,000 in damages. Dale asserted a defense of fraud against Paul, though Dale knew this claim to be meritless; the fraud defense allowed Dale to delay the trial long enough to transfer his assets to his wife to shelter them from any judgment entered against him. Paul ultimately overcame the fraud defense and won a judgment against Dale, but the trial was much more difficult and costly than it otherwise would have been. Does Paul have any tort action(s) against Dale based on the assertion of the fraud defense? What damages, if any, would Paul be able to recover (assuming he can ultimately collect them from Dale)?

12. Client seeks Lawyer’s advice about building a new shopping plaza at 123 Main Street. Lawyer provides legal advice about the development to Client and, without asking Client, purchases property at 125 Main Street, knowing that it will become more valuable once Client’s plans to develop 123 Main Street become public. Client learns that Lawyer has purchased the property and is furious. Client did not have the money to purchase 125 Main Street in addition to 123 Main Street; however, Client fears that Lawyer’s purchase may “tip off” others to Client’s contemplated purchase of 123 Main Street. Moreover, Client had hoped that her brother-in-law, a billionaire computer mogul, might want to purchase 125 Main Street, but had not mentioned the project to him yet. What claims, if any, may Client bring against Lawyer, and what remedies are available?

13. Gainesville Seafood Company recently purchased an industrial freezer from Westinghouse. The freezer malfunctioned during the first week due to a wiring defect, causing $10,000 worth of Beluga caviar to spoil. What tort action can Gainesville
Seafood Company bring against Westinghouse, and what damages can it recover? Explain your answer.

14. XYZ Corporation’s computer servers have been inundated with spam sent by AdverCo. AdverCo’s spam has slowed XYZ Corporation’s computer system, forced its “computer guys” to spend countless hours trying to fix the problem, and has undermined the productivity of its workers by forcing them to read and delete unwanted spam from their email. What tort actions, if any, can XYZ Corporation bring against AdverCo? Evaluated the strengths and weaknesses of any potential actions XYZ Corporation may bring.

**Business Torts Exam 2012**

**Professor Lyrissa Lidsky, University of Florida Levin College of Law**

**Montpellier, France**

Thierry decides to start a business called the Gainesville Language Institute (the “Institute”); the purpose of the Institute is to make money by teaching American students how to speak French. Thierry solicits two friends, Clara and David, to invest $20,000 each in the Institute to rent business premises, develop advertising materials, and pay other necessary expenses. An agreement signed by Thierry, Clara, and David, provides that

(a) Thierry will provide all language instruction (teaching) at the Institute;
(b) David, who is a licensed accountant, will provide all accounting, marketing and administrative services to the Institute;
(c) Clara will have no role in the day-to-day management of the Institute;
(d) Thierry will receive 40 percent of the profits of the Institute, if any, for a period of ten years;
(e) David will receive 40 percent of the profits of the institute, if any, for a period of ten years;
(f) Clara will receive 20 percent of the profits of the institute, if any, for a period of ten years.

The Institute is successful, due in large part to the fact that Thierry is a gifted teacher of languages. David, however, is an incompetent administrator who alienates potential clients. Thierry and Clara converse with each other and decide that David needs to be fired because his incompetence diminishes the profitability of the Institute. The agreement, however, made no provision for terminating David as an administrator. So Thierry and Clara form a plan to get rid of David. They have a meeting with David in which they threaten to publicly accuse him of unethical accounting practices and theft from the Institute unless he agrees to receive only ten percent of the profits of the Institute and cease performing any services whatsoever for the Institute. David, afraid of losing his license and feeling betrayed by his friends, agrees.

Two years later, the Institute has become even more successful, making large profits for Thierry, David, and Clara.
Soon after, the Chief Executive Officer of Set-in-Stone Language Company ("the Company") learns of the success of the Gainesville Language Institute and approaches Thierry about joining the Company as a Master Instructor at a salary of $1 million per year, providing he shares the teaching methods he uses at the Institute and his database of clients. Thierry informs them that he has contracted with Clara and David to continue operating the Institute for a period of ten years. The CEO says, "Agreements were made to be broken."

Meanwhile, Arnold, a former client of the Gainesville Language Institute, threatens to sue Thierry and the Institute when he learns that Thierry is not a certified language instructor, as the advertising and promotional materials for the Institute claim. Arnold works for a company that does business around the world, and the company encourages its employees to learn foreign languages by reimbursing them for language courses they take from certified instructors. Although Arnold learned to speak French fluently after taking Thierry's courses at the Institute, the company Arnold works for refused to pay the $5,000 fee for the courses after learning that Thierry lied about his certification. Neither David nor Clara knew that Thierry was not certified.

1. (18 points) Evaluate the strengths and weaknesses of any potential claim or claims for breach of fiduciary duty that may be brought by David against Clara and Thierry.

2. (18 points) Evaluate the strengths and weaknesses of any potential claim or claims for breach of fiduciary duty that Clara and David may bring against Thierry.

3. (18 points) Evaluate the strengths and weaknesses of any claim or claims for intentional interference with contractual relations and/or economic opportunities that Clara and David may bring against Thierry.

4. (18 points) Evaluate the strengths and weakness of any claim or claims for fraudulent or negligent misrepresentation that Arnold may bring against the Institute.

5. (18 points) Assume you are a partner in the Trusts and Estates Department at the law firm of Mousseron, Cohn, and Lidsky. You become dissatisfied with the law firm and wish to leave and start your own new firm, and you would like to persuade the two other partners, three associates, and two paralegals in the Trusts and Estates Department at the Mousseron, Cohn, and Lidsky to leave with you. What should you do to maximize the success of your new law firm without creating tort liabilities to your partners in the firm of Mousseron, Cohn, and Lidsky? Explain your answer as fully as possible in time allocated, citing relevant cases as necessary to support your analysis.

6. (2 points) What are the rationales for limiting liability for those who negligently supply information to others?

7. (2 points) Client seeks Lawyer's advice about building a new shopping plaza at 123 Main Street. Lawyer provides legal advice about the development to Client and, without asking Client, purchases property next door at 125 Main Street, knowing that it will become more valuable once Clients plans to develop the property become public. Client learns of Lawyer's purchase and becomes furious. Client did not have the money to make purchase 125 Main Street in addition to
123 Main Street, but Client had hoped that her wealthy brother might purchase the property even though she had not yet mentioned it to him. What damages may Client recover if she sues Lawyer for breach of fiduciary duty?

8. (2 points) What was the rationale for denying recovery to the time charterers for the loss of the use of the ship negligently damaged by the dry dock in Robins Dry Dock & Repair Co. v. Flint?

9. (2 points) What criteria determine whether one person is acting as an agent of another?

10. (2 points) What is the standard used for determining whether a partner exercised her duty of care to her partners?