§ 3. Preclusion of Tort Liability Arising from Contract (Economic-Loss Rule)

Except as provided elsewhere in this Restatement, there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties.

Comment:

a. Terminology. Courts have used the expression "economic-loss rule" to refer to a variety of propositions. As noted in § 1, a minority have used it to mean that there is, in general, no liability in tort for causing pure economic loss to another. This Restatement does not endorse that formulation because its breadth is potentially misleading. This Section instead states an economic-loss rule that is narrower and more robust, and that is followed by a majority of courts. It is limited to parties who have contracts. This version of the rule hews closer than the broader one to the rationale that courts state for the rule in any of its forms: the need to separate matters best left to contract from those properly resolved by the law of tort. If two parties have a contract, the argument for limiting tort claims between them is at its most powerful. See Comment *b*.

The narrower scope of the rule stated here also ties it more clearly to its origins in cases that involve products liability. A buyer of a product disappointed by its performance cannot sue its maker in tort for negligence. Courts have long recognized that the law of warranty is better suited than the law of tort to address such cases, and that contracts between the parties determine the allocation of economic losses that arise from the transaction. See Restatement Third, Torts: Products Liability § 21. The rule recognized by this Section generalizes that principle to economic injuries arising from the breach of other sorts of contracts.

b. Rationale. An actor whose negligence causes personal injury or physical harm to the property of another can be held liable in tort regardless of whether the negligence occurs in the performance of a contract between the parties. The result is different, however, in cases of economic loss; if plaintiff and defendant have a valid contract, monetary harm caused by the defendant's negligent performance of it is generally not actionable in tort. Nor does tort law provide a remedy for economic loss caused by negligent statements that parties make during efforts to form a contract. When a party's negligence in performing or negotiating a contract causes economic loss to the counterparty, remedies are determined by other bodies of law: principally the law of contract, though sometimes also the law of restitution or relevant statutes.

The law of contract and the law of restitution have been developed for the specific purpose of allocating economic losses that result from the negotiation and performance of contracts. They provide a more extensive and finely tuned apparatus for the purpose than the law of torts, which has developed primarily to address injuries that occur outside contractual relationships.

The rule of this Section serves several purposes. 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. For more general discussion of the value of contract in allocating responsibility for economic loss, see § 1, Comment *c*.

c. Scope of preclusion. A contract precludes common-law tort claims for financial loss based on negligent conduct that the contract regulates. See Illustrations 1-3. It does not foreclose tort claims based on conduct outside the contract's scope. See Illustration 4. Close cases can arise when an act of negligence occurs at the fringe of a contract's coverage. The important question then is whether allowing the tort claim creates a risk of interference with an allocation of risk made by the parties. A contract can allocate a risk without mentioning it explicitly; silence may itself serve as an allocation if the risk falls within the scope of activity the contract governs. On the other hand, the purpose of this Section is to protect the bargain the parties made, not to penalize the plaintiff for failing to make a broader one. Navigating between these points may require study of the transaction and its logic. See Illustration 5. The extent to which a contract precludes liability in tort for economic loss is a question for the court.

Illustrations:

1. Town hires Firm to lay sewer pipe. Town later incurs costs of repair after finding that Firm laid the pipe negligently. Town's contract with Firm provided a one-year warranty, and Town discovered the defective work two years after the pipe was laid; Town therefore determines that it has no contract claim against Firm. Town instead brings a timely tort claim against Firm, alleging that Firm was negligent in laying the

pipe. Firm is not liable in tort to Town. Town's rights are determined by the contract and the law that governs it.

2. Developer makes a preliminary agreement to buy land from Seller. Before closing the sale, Developer hires Inspector to examine the property. Inspector informs Developer that most of the property consists of wetlands unsuitable for development. Developer declines to go through with the sale. Developer later observes another buyer extensively developing the same property; Developer finds on investigation that Inspector's earlier report was incorrect. Developer sues Inspector in tort. Court finds that Inspector's alleged negligence came in the performance of a contract with Developer, and that Inspector is not a professional within the meaning of § 4 of this Chapter. Inspector therefore is not liable in tort to Developer. Developer's remedies, if any, are those provided by his contract with Inspector.

3. Owner hires Mechanic to examine airplane. Mechanic negligently overlooks defects in the plane's landing gear. Owner sells plane to Buyer. Buyer discovers the problems in the landing gear, orders repairs, and sues Mechanic in tort to recover the costs. The rule of this Section is not an obstacle to Buyer's suit, because Mechanic and Buyer had no contract. Whether Mechanic is liable to Buyer is determined by the principles of §§ 5 and 6 (see, e.g., § 5, Illustration 9).

4. In the course of planning his retirement, Employee asks Employer when he must exercise stock options that he has accumulated. Employer negligently advises Employee that he has five years to exercise the options after leaving the firm. In fact, the options must be exercised within three years. Acting in reliance on Employer's statements, Employee retires, waits too long to exercise the stock options, and forfeits them. The court finds that while a contract of employment existed between the parties, Employer's statements were not a breach of it; the discussion about the stock options was outside the scope of Employer's contractual performance. Employer may be liable in tort to Employee for negligent misrepresentation under § 5 despite the contract between them.

5. Owner of a mineral lease makes a contract that gives Driller rights to extract oil. During a meeting at the office of Owner after the contract is formed, Driller asks whether Owner's insurance covers Driller's interests in the project. Owner negligently asserts that it has insurance against a blowout and that the policy covers Driller's

interests. Driller's oil well suffers a blowout. Driller then learns that its interests are not covered by Owner's insurance policy. After examining the parties' contract, the court concludes that their discussion about insurance did not overlap with their obligations of performance; permitting liability in tort would not interfere with any allocation of risk the contract made. Owner may be liable in tort to Driller for negligent misrepresentation under § 5 despite the contract between them.

d. Negligent inducement of contract. Some courts have used Restatement Second, Torts § 552—the predecessor to § 5 of this Chapter—to hold sellers liable for negligent misrepresentations that cause buyers to enter into contracts with them. The rule of this Section eliminates the tort claim in that circumstance. A seller's negligent misrepresentations are addressed sufficiently by the law of contract and restitution. Such misrepresentations may give the buyer a claim for breach of warranty, for rescission and incidental damages, or for breach of contract accompanied by a claim of estoppel. In other cases, the language of the contract and the parol-evidence rule may foreclose claims based on statements made before a contract was signed. In either event, adding a tort claim to the analysis interferes with the operation of those contract doctrines and creates confusion without offsetting gains. Liability under § 5 of this Chapter is thus limited to negligent misrepresentations that were not made in the performance or negotiation of a contract.

In a familiar instance of this pattern, the plaintiff buys a house and then discovers that the seller negligently vouched for a feature of it that turned out to be defective. The contract between the parties, coupled with the jurisdiction's parol-evidence rule, precludes any claim for contract damages based on statements the seller made before the contract was signed. Pressure to find a tort claim arises because the stakes are high and the plaintiff's position is sympathetic: if the contract contained an integration clause, it may have been boilerplate that the plaintiff did not read; and the contract itself might have been a form drafted by real-estate brokers. But if denying relief to the plaintiff seems to produce an injustice on those grounds, a better response is to reconsider the application of the parol-evidence rule or the other doctrines of contract law that are responsible for the result. Using tort law to bypass those doctrines weakens them and retards their development. It also interferes with the ability of others to make reliable agreements in the future. In the alternative, a result unappealing on its equities may call for a statutory solution.

Statutes can impose responsibility on sellers for certain risks without distorting widely applicable legal principles to reach the desired outcome.

Fraudulent inducement to enter a contract, unlike a claim of negligent misrepresentation, can in some circumstances give a plaintiff a viable tort claim. When two parties negotiate over a contract, the amount of care they are expected to show for each other's interests will often be unclear or significantly less than the care expected in a situation involving strangers or the risk of physical injury. That is among the reasons why the duties of care between parties who negotiate contracts are not governed by the law of tort. Expectations of honesty are more regular, however, and the disappointment of them may call for remedies not customarily available from the law of contract or restitution. Liability in tort may therefore be recognized in such circumstances, as discussed in Chapter 2 of this Restatement.

Illustration:

6. Purchasers enter a contract to buy a house from Seller. Seller negligently states that the septic system is in good working order. Acting partly in reliance on that assurance, Purchasers buy the house. Purchasers then discover that the septic system is not in good working order. Purchasers' remedies are determined by their contract with Seller and the rules of contract law that apply to it. Purchasers may, for example, have a claim for rescission and restitution based on mutual mistake or misrepresentation. They may have a claim for breach of warranty, depending on the relationship between the language in the contract, the Seller's statements outside the contract, and the jurisdiction's parol-evidence rule. Whatever the outcome may be under those theories, Purchaser has no tort claim against Seller.

Restatement Second, Torts § 552C recognized liability in tort for innocent misrepresentation. The liability applied when one party made a material but innocent misrepresentation to another in a sale, rental, or exchange transaction. For the reasons just discussed, this Restatement does not recognize tort liability under those circumstances. All such cases involve the negotiation and performance of a contract; if a plaintiff was induced to enter into an exchange with the defendant by the defendant's innocent misrepresentation, the plaintiff has recourse under the law of restitution, warranty, and estoppel. See Restatement Third, Restitution and Unjust Enrichment §§ 13 and 54.

e. Contracts never concluded. A party may be injured by reliance on another's negligent statements in the course of negotiating a contract that is never concluded. This Section treats the resulting claims for relief as matters for other bodies of law to resolve. It therefore eliminates tort claims based on a defendant's negligent statements of intent to make a contract, predictions about the likelihood of a contract, or mistaken suggestions that a contract has been formed. Detailed doctrines in the law of contract, of restitution, and of estoppel have developed to provide relief in such cases where necessary. If those bodies of law fall short, the appropriate response again is to reform them, not to use the law of tort to supply their deficiencies.

Illustration:

7. Agent for Firm negligently misinforms Applicant that Firm will award him a grocery-store franchise if he buys land where the store can be built. Applicant buys the land but never receives the franchise. The doctrine of promissory estoppel may give Applicant a remedy against Agent or Firm. Applicant has no claim in tort against either of them.

f. Parties indirectly linked by contract. Sometimes a plaintiff and defendant who had no contract with each other both had contracts with the same third party. In some cases of this type, it would have been possible for the plaintiff and defendant to work out their obligations to each other in advance by carefully writing their contracts with the party who stood between them. This Section does not extend its rule to those cases, however; it does not foreclose claims between plaintiffs and defendants who are only indirectly linked by contract. Whether the plaintiff has a good claim in such a case is determined by other rules of this Chapter.

Illustration:

8. City hires Engineer to test soil conditions at a site where it plans to erect a large building. City explains that Engineer's report will be distributed to prospective building contractors for use in estimating their costs. Engineer negligently submits an inaccurate report. Contractor wins the right to perform the construction, having relied on Engineer's report in preparing its bid. Engineer's errors cause Contractor to suffer losses in performing its contract with City. The contracts between Contractor and City, and between City and Engineer, do not preclude a claim by Contractor against Engineer under

§ 5 or § 6 of this Chapter. Engineer remains potentially liable to Contractor under either of those Sections.

In Illustration 8, a contract between Contractor and Engineer might not have been feasible. But Contractor could have insisted that City guarantee the soundness of Engineer's report, and City could have insisted that Engineer indemnify City for claims brought against it by Contractor. In effect, those contracts would have protected Contractor against the risk of errors by Engineer, and would have ensured that Engineer would bear the costs of its negligence. The pattern of Illustration 8 is thus one of many circumstances in which two parties might be able to settle their obligations to each other through a chain of contracts, and may or may not do so in practice.

The significance of such a missed opportunity to assign responsibility by contract bears clarification. Missed opportunities of that kind do not trigger this Section's rule against recovery in tort; only an actual contract has that effect. Missed opportunities to make contracts also do not bar a plaintiff from recovery under § 5 or § 6. Courts have concluded that in the circumstances addressed by those Sections, liability is appropriate even if the parties might have proceeded by contract but did not. But if a plaintiff argues for recognition of a duty outside the well-recognized categories stated in this Chapter, missed opportunities to seek protection by contract do become relevant. Where contracts might readily have been used to allocate the risk of a loss, a duty to avoid the loss is unlikely to be recognized in tort—not because the economic-loss rule applies, but simply because courts prefer, in general, that economic losses be allocated by contract where feasible. See § 1, Comment *e*.

g. Exceptions. Some well-established exceptions to the rule of this Section are addressed in subsequent parts of this Restatement. The most prominent is the tort liability of professionals to their clients despite (and alongside) any contract between them. See § 4. Fiduciaries likewise have duties recognized in tort notwithstanding the terms of contracts to which they may be subject. See § 16.

Common carriers and other bailees are sometimes said to have duties of care independent of their contracts, thus entitling an aggrieved bailor to recover against them in tort. Those statements typically are made, however, in the setting of claims to recover for damaged or lost property, not claims for pure economic loss. Economic loss alone, even in the setting of a bailment, may well be most appropriately allocated by contract, as is common. The extensive regulation of many bailments by the Uniform Commercial Code and other statutes provides additional reason to hesitate before recognizing a role for tort law in such a case. In view of the limited authority on the question, however, the right of a bailor to recover in tort for economic loss is left to developing case law.

h. Relation to other Sections. This Section precludes liability under §§ 5 and 6 when the defendant's negligent conduct occurs in the performance of a contract with the plaintiff. Sections 5 and 6 recognize liability when a defendant acts to provide a basis for reliance by the plaintiff, and the plaintiff in turn relies. The purpose of such liability is usually to provide a substitute for a contract where the parties have not made one and the appropriate allocation of risk between them is clear. Once parties do make a contract, it displaces the obligations of §§ 5 and 6; the contract alone determines the parties' responsibility for economic loss caused by negligence in performing it.

REPORTER'S NOTE

a and b. Terminology; rationale. As noted in Comment *a*, overbroad statements of an "economic-loss rule" easily can create confusion, and have. For discussion, see Eastwood v. Horse Harbor Foundation, Inc., 241 P.3d 1256 (Wash. 2010); Giles v. General Motors Acceptance Corp., 494 F.3d 865 (9th Cir. 2007); Moransais v. Heathman, 744 So. 2d 973 (Fla. 1999). A helpful overview of different versions of the economic-loss rule, with analysis of the rationales and risks associated with each, is Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523 (2009).

For representative cases recognizing the economic-loss rule as stated here, see Flagstaff Affordable Housing Ltd. Partnership v. Design Alliance, Inc., 223 P.3d 664 (Ariz. 2010); Indemnity Ins. Co. of North America v. American Aviation, Inc., 891 So. 2d 532 (Fla. 2004); Filak v. George, 594 S.E.2d 610 (Va. 2004); Grynberg v. Questar Pipeline Co., 70 P.3d 1 (Utah 2003); Saltiel v. GSI Consultants, Inc., 788 A.2d 268 (N.J. 2002); Town of Alma v. Azco Construction, Inc., 10 P.3d 1256 (Colo. 2000); Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85 (S.C. 1995). Isler v. Texas Oil & Gas Corp., 749 F.2d 22 (10th Cir. 1984), is a leading judicial discussion of the rationale for the rule, emphasizing the need to protect bargains against interference from the law of tort.

Comment *a* explains that the rule recognized by this Section generalizes from principles developed in the law of products liability. The logic of this extension is usefully discussed in *Azco Construction*, 10 P.3d 1256; *Moransais*, 744 So. 2d 973; and *Eastwood*, 241 P.3d 1256.

c. Scope of preclusion. Illustration 1 is based on Town of Alma v. Azco Construction, Inc., 10 P.3d 1256 (Colo. 2000); cf. Brookings Mun. Utilities, Inc. v. Amoco Chemical Co., 103 F. Supp. 2d 1169 (D.S.D. 2000).

Illustration 2 is based on Vesta Const. and Design, LLC v. Lotspeich & Assoc., Inc., 974 So. 2d 1176 (Fla. Dist. Ct. App. 2008).

Illustration 3 is based on Indemnity Ins. Co. of North America v. American Aviation, Inc., 891 So. 2d 532 (Fla. 2004).

Illustration 4 is adapted from Trytko v. Hubbell, Inc., 28 F.3d 715 (7th Cir. 1994).

Illustration 5 is adapted from Geosearch, Inc. v. Howell Petroleum Corp., 819 F.2d 521 (5th Cir. 1987).

Some courts have suggested that liability in tort exists despite a contract between the parties when a defendant has breached an "independent duty"—in other words, a duty that exists even without the contract, as distinct from those duties that exist solely because of it. That way of speaking is imprecise because it does not capture the preemptive effect of the economic-loss rule. Parties have independent duties—duties that exist in the absence of a contract—not to make negligent misrepresentations or provide negligent services in the circumstances covered by §§ 5 and 6. But, as explained in Comment *h*, those duties are displaced once they become the subject of a contract between the parties. To be sure, there are other cases where a party who breaches a contract remains liable in tort for the same conduct; claims of professional negligence are the most familiar example (see § 4). It may then be convenient to say that the duty in tort was independent of whatever duties the contract created. But it is misleading to suggest that liability in tort stays intact whenever the defendant's duty arises from outside the contract with the plaintiff.

d. Negligent inducement of contract. There is a division of authority on whether the economic-loss rule prevents a plaintiff from recovering in tort when induced to sign a contract by the other side's negligent misrepresentations. Authorities supporting the majority approach taken here include Alejandre v. Bull, 153 P.3d 864 (Wash. 2007), which forms the basis of Illustration 6; Snyder v. Lovercheck, 992 P.2d 1079 (Wyo. 1999); Onita Pacific Corp. v. Trustees of Bronson, 843 P.2d 890 (Or. 1992); Rio Grande Jewelers Supply, Inc. v. Data General Corp., 689 P.2d 1269 (N.M. 1984); Isler v. Texas Oil & Gas Corp., 749 F.2d 22 (10th Cir. 1984). A leading case for the minority view is Formento v. Encanto Bus. Park, 744 P.2d 22 (Ariz. Ct. App. 1987). For discussion of the difference between fraudulent and negligent statements as inducements to sign a contract, see Sound Techniques, Inc., v. Hoffman, 992 P.2d 1079 (Mass. 2000).

As Comment *d* notes, the analysis of inducement to enter a contract can be different when the defendant's statement is fraudulent rather than negligent. Courts also are reluctant to conclude that a contract allocated to the plaintiff the risk that the defendant was lying. They are more inclined to view fraud as an attack on the integrity of the bargaining process itself. Negligent misrepresentations are not comparable. They are honest mistakes. Allowing defendants to avoid liability for them, where the parties have so agreed, can make good commercial sense. Often potential plaintiffs will be in a better position than defendants to know how much they care about the subject matter of such a mistake, or to take other precautions of their own or against the risk of it. In some cases, of course, a court may conclude that the defendant should be held responsible after all for misstatements that induced the plaintiff to enter a contract; but in that case the remedial tools of contract law and the law of restitution provide sufficient remedies without adding a cause of action in tort.

e. Contracts never concluded. Illustration 7 is based on Hoffman v. Red Owl Stores, Inc., 133 N.W.2d 267 (Wis. 1965). For cases considering and denying tort liability in analogous situations, see Birt v. Wells Fargo Home Mortg., Inc., 75 P.3d 640 (Wyo. 2003); Consolidation Services, Inc. v. KeyBank National Association, 185 F.3d 817 (7th Cir. 1999). A case finding tort liability on similar facts, and thus disapproved here, is Giant Food, Inc. v. Ice King, Inc., 536 A.2d 1182 (Md. Ct. Spec. App. 1988).

f. Parties indirectly linked by contract. Forbidding tort claims between parties who are indirectly linked by contract would put pressure on them to specify their rights carefully in advance, thus sparing courts the need to inquire into them later. But that incentive is most likely to be noticed by sophisticated parties negotiating large projects, and for them the rule is unlikely to be of great importance. They will negotiate allocations of risk that look similar in the end notwithstanding the rule of tort law in the background. Meanwhile, less sophisticated parties would stand a good chance of being tripped up by a broad rule, as when they fail to provide for indemnification in some direction and inadvertently leave a party who has been wronged with no remedy. If unsophisticated A makes a contract with B, A can reasonably be expected to understand that the contract settles all rights between the two of them. It is something else, and less intuitive, for A to grasp that the contract also settles any rights A has against C because C and B have a contract of their own.

Applying the rule of this Section to parties indirectly linked by contract would also create a principle with uncertain reach. Claims of negligent misrepresentation, for example, often arise when a firm hires an accountant to provide an audit report; the firm then distributes the report to its investors, who rely on it in various ways. The structure of that situation resembles the construction case shown in Illustration 8: the accountant and the investors both have contracts with the firm in the middle, though not with each other. Yet all courts—even those that deny liability on the facts of Illustration 8—agree that investors often can sue accountants on whose negligent work they rely, despite the indirect contractual connection between them.

Illustration 8 is the same in substance as Illustration 9 to § 552 of the Restatement Second (AM. LAW INST. 1977). It is condensed here, with an additional party removed for clarity's sake and language added to emphasize the significance for this Section. For authorities following the Illustration, and supporting tort claims by contractors against architects and other design professionals with whom they are linked only indirectly by contract, see Bilt-Rite Contractors, Inc. v. The Architectural Studio, 866 A.2d 270 (Pa. 2005); Eastern Steel v. City of Salem, 549 S.E.2d 266 (W. Va. 2001); Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85 (S.C. 1995); Prichard Bros., Inc. v. Grady Co., 428 N.W.2d 391 (Minn. 1988); Forte Bros., Inc. v. National Amusement, Inc., 525 A.2d 1301 (R.I. 1987); Donnelly Construction Co. v. Oberg/Hunt/Gilleland, 677 P.2d 1292 (Ariz. 1984); A. R. Moyer, Inc. v. Graham, 285 So. 2d 397 (Fla. 1973); Craig v. Everett M. Brooks Co., 222 N.E.2d 752 (Mass. 1967). A leading case for the minority view, denying recovery on the facts of Illustration 8, is

Berschauer/Phillips Const. Co. v. Seattle Sch. Dist., 881 P.2d 986 (Wash. 1994). For a survey of case law both ways, see Annot., 61 A.L.R.6th 445 (2011). For an academic endorsement of tort liability on economic grounds, see ANTHONY NIBLETT, RICHARD A. POSNER, & ANDREI SCHLEIFER, THE EVOLUTION OF A LEGAL RULE (2010).

g. Exceptions. The liabilities of common carriers and other bailees are regulated by Article 7 of the Uniform Commercial Code as well as other statutes. As the text notes, most claims against such defendants involve lost or damaged property. The most likely way for a common carrier to cause pure economic loss would be through delays in delivery, but the Carmack Amendment to the Interstate Commerce Act preempts common-law tort and contract claims that arise from delays in interstate shipping. See 49 U.S.C. § 14706; Hall v. North American Van Lines, Inc., 476 F.3d 683 (9th Cir. 2007); New Process Steel Corp. v. Union Pacific R. Co., 91 F. App'x 895 (5th Cir. 2003); Consolidated Rail Corp. v. Primary Industries Corp., 868 F. Supp. 566 (S.D.N.Y. 1994).

For recent statements of the principle that a bailor has rights against a bailee in tort as well as contract, see Aimtek, Inc. v. Norton Co., 870 N.E.2d 1114 (Mass. App. Ct. 2007); Barker v. Eckman, 213 S.W.3d 306 (Tex. 2006); Yao v. Chapman, 705 N.W.2d 272 (Wis. Ct. App. 2005). For cases suggesting that the economic-loss rule precludes tort liability of a bailee to a bailor for lost or damaged goods when the parties have a contract, see American United Logistics, Inc. v. Catellus Development Corp., 319 F.3d 921 (7th Cir. 2003); Perfumeria Ultra, S.A. de C.V. v. Miami Customs Service, Inc., 231 F. Supp. 2d 1218 (S.D. Fla. 2002); Standard Fish Co., Ltd. v. 7337 Douglas Enterprises, Inc., 673 So. 2d 503 (Fla. Dist. Ct. App. 1996). These cases rely on expansive definitions of pure economic loss.