Non-Consensual Liability of a Contracting Party: Contract, Negligence, Both, or In-Between?

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This article makes a comparative examination of the widening spectrum of cases in which both tort law and contract law are employed, jointly or separately, to impose non-consensual liability on a contracting party. The article focuses on liability imposed on a contracting party either toward another contracting party or toward a third party for failure to perform an obligation that, on the one hand, is predicated on and arises from the contract, but, on the other hand, does not genuinely originate in the consent of the liable party because it is external to her genuine intention. The primary objective of this article is to propose general guidelines for either choosing between tort law and contract law when imposing non-consensual liability on a contracting party or else allowing liability under both headings. These guidelines for the classification of non-consensual liability also bear on the preliminary question of whether to impose non-consensual liability at all and on the delicate interplay between contract and tort in general and particularly when the two lead to conflicting legal outcomes.

INTRODUCTION

It is now common knowledge that the traditional distinctions between tort law and contract law have been eroded and have lost their descriptive

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power.[1] In many respects, the blurring of these distinctions is the result of the development and expansion of tort law. For quite some time now, tort law has transcended its traditional role of protecting against physical damage to body or property and now protects, as does contract law, a wide range of economic interests, including lost profits and pure economic loss. In this regard, the observation that "contract law is productive, tort law is protective,"[2] or that contract concerns the improvement of the claimant's position whereas tort is concerned with its worsening,[3] seems to have lost its vigor. The same can be said of another traditional distinction, that which concerns the nature of obligations under these two fields of law. Tort law is no longer limited to negative obligations, i.e., the obligation to refrain from endangering and damaging the interests of others. Like contract law, it also imposes certain affirmative duties to protect others against risks created by third parties or by natural causes, thereby imposing liability for pure *omission*, as well as for the failure to provide benefits.[4] Another distinction that seems to be losing its differentiating power is that between fault-based liability, the core of tort liability, and strict liability, the core of contract law. More and more areas of tort law are now governed by strict or even absolute liability regimes,[5] while contractual liability can also be fault-based.

Finally, another traditional distinction between tort and contract that appears to be disappearing relates to the source of the prospective obligation. Under the traditional common law distinction, contractual liability is

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1 On the traditional distinctions, analysis and criticism, see André Tunc, *Introduction, in* XI International Encyclopedia of Comparative Law (Torts) ch. 1, at 19 (André Tunc ed., 1971); Tony Weir, *Complex Liability, in* XI International Encyclopedia of Comparative Law (Torts), *supra*, ch. 12, at 3. *See also* W.V.H. Rogers, Winfield & Jolowicz on Tort 5-11 (15th ed. 1988); Dan B. Dobbs, The Law of Torts 5-7 (West 2000). Yet Grant Gilemore's announcement of The Death of Contract (1974), asserting that contract law as an independent category has lost its viability and has actually been reabsorbed into tort law, has been disputed by many. *See, e.g.*, Jeffrey O'Connell, *The Interlocking Death and Rebirth of Contract and Tort*, 75 Mich. L. Rev. 659 (1977).

2 Weir, *supra* note 1, at 5.

3 *See* Peter Cane, *The Basis of Tortious Liability, in* Essays for Patrick Atiyah 351, 352-53 (Peter Cane & Jane Stapleton eds., 1991).

4 This is exemplified by the recognition of liability in tort of public authorities for failure to protect the public against risks created by others or for failure to provide benefits. In *Phelps v. Hillington L.B.C.*, 3 W.L.R. 776 (H.L. 2000), the public authority was held liable for failure to provide proper dyslexia diagnostic services.

5 Road accidents, products liability, workplace injuries. Moreover, even fault-based liability has strict liability features such as objective and demanding standards of due care or rules that shift to the defendant the burden of proving absence of fault.

consensual: it originates in the consent of the contracting parties, whether explicit or implicit, and is imposed for failure to perform an obligation that was undertaken voluntarily and willingly. Tort liability, in contrast, traditionally has been perceived as non-consensual, an obligation imposed by law regardless of whether the liable party consented. With the evolution of contract law and tort law, these simple equations — "contract = consensual" and "tort = non-consensual" — have blurred into confusion.[6] Contract law has become a source of non-consensual obligations that the parties may or may not have stipulated, while tort law has become a source of obligations predicated on or related to consensual or quasi-consensual relations.[7] One may get the impression that in some countries, tort and contract have become so entangled that it is difficult to characterize a given obligation (such as an attorney's professional liability toward a client or malpractice in general) as being contractual, tortious, or both.[8] In France and Germany, for example, major civil law jurisdictions, the imposition of non-consensual liability on a party to a contract under contract law has never been perceived as an anomaly.[9]

This article takes a comparative view of the widening spectrum of cases in which both tort law and contract law are employed, jointly or separately, to impose non-consensual liability on a contracting party. The article focuses on liability imposed on a contracting party either toward another contracting party or toward a third party for failure to perform an obligation that, on the one hand, is predicated on and arises from the contract, but, on the other hand, does not genuinely originate in the consent of the liable party because it is external to her genuine intention. Such liability is non-consensual not only when the liable party opposes it, but also when the liable party may agree to it *ex post* although it was not part of her genuine intention *ex ante*.

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6 *See e.g.*, Rogers, *supra* note 1, at 5, 6.

7 Contractual or close-to-contract relations establish proximity or "special relations" necessary to establish duty of care for pure economic loss caused by negligent misrepresentation. *Id.* at 367-68. Contractual or close-to-contract relations may also affect the recognition of "assumption of responsibility," another element of such duty of care. *Id.* at 124-32. This ambiguous notion is discussed at *infra* note 39. Dobbs, *supra* note 1, at 6, concludes that "the contract cousins, consent and expectation, play a very large role indeed in shaping tort duties."

8 On the classification of malpractice suits, see Thomas C. Galligan Jr., *Contortions along the Boundary between Contract and Tort*, 69 Tul. L. Rev. 457, 476-81 (1994).

9 *See infra* Section III. The French Civil Code provides in article 1135 that "contracts oblige their parties not merely to what has been expressed, but also to all the consequences which equity, custom or the law give to the obligation according to its nature." *See* Simon Whittaker, *Privity of Contract and the Tort of Negligence: Future Directions*, 16 Oxford J. Legal Stud. 191, 229 (1996).

The primary objective of this article is to propose general guidelines for either choosing between tort law and contract law when imposing non-consensual liability on a contracting party or else allowing liability under both headings. These guidelines for the classification of non-consensual liability also bear on the preliminary question of whether to impose non-consensual liability at all and on the delicate interplay between contract and tort.

Section I opens with a prefatory question: Does it really matter whether non-consensual liability is imposed under the heading of tort or under the heading of contract? I argue that the classification is important. To achieve its goals, the legal system functions through "intermediaries" such as tort and contract, each of which has a different agenda, different characteristics, and built-in limitations. Liability must, therefore, be characterized as tortious, contractual, or both. There should not be "liability in the air," liability that has no defined origins.

Section II addresses another preliminary issue, namely, the legal environment in which our discussion of non-consensual liability takes place. Civil law jurisdictions differ from common law jurisdictions in many aspects, including the characteristics and domains of torts and contracts. Moreover, differences may exist among different jurisdictions belonging to the same legal family. To establish a common denominator for this discussion, I suggest that the idiosyncrasies of certain national laws that unjustifiably impede the evolution of law be disregarded and that more flexible and malleable tort law and contract law be assumed.

Section III offers guidelines for either sanctioning or allowing the imposition of non-consensual liability upon a contracting party under contract law. It begins with the basics, looking into the core, the essence, of contract law: the promotion and protection of the contract as a social and economic institution. I argue that this core sets the boundaries of contractual liability, the inner territory where contract law *should* apply, and then the outer perimeters where contract law *could* apply without conflicting with the objectives of contract law. Given these borders, three criteria are presented to determine when non-consensual liability can and should be allowed in contract. Against the background of these general criteria, three types of cases of non-consensual liability are examined from an abstract, "extra-territorial" perspective. This analysis focuses on cases of non-consensual liability that involve liability for pure economic loss, as this type of loss presents the most acute dilemma of torts/contracts classification. The three cases are: liability between contracting parties for contract-related misconduct; liability of a producer to a third party, a remote purchaser, for loss caused by a shoddy product not tailored to a specific user; and liability

of a contracting service-provider to a third party for loss caused by improper provision of the service.

Section IV examines the tort perspective on non-consensual liability imposed on a contracting party, focusing on the general tort of negligence. Unlike contract law, non-consensual liability is typical in tort law and harmonious with the essence of tortious liability. Negligence law, by its nature, governs vast contractual territories. However, negligence law has traditionally tended to refrain from imposing liability on contracting parties for pure economic loss. This self-restraint has its roots in fears of the dangers of indeterminate liability in general, as well as in concerns that the intervention of tort law in contractual relations may have a damaging effect on contractual value. Whenever these fears and concerns are in decline, there is a consequent relaxation of self-restraint, and *vice versa*, so that tort liability expands and contracts in accordance with the weight attached to these considerations.

Section V presents an overview of these developments in tort law, focusing on the legal tools employed by the courts to control the scope of tort liability in this context. These legal tools in fact serve as guidelines for when to impose tort liability. The three paradigmatic cases of non-consensual liability are analyzed in light of the present state and degree of self-restraint.

Section VI integrates the guidelines of contract and tort with regard to imposition of non-consensual liability on contracting parties, using the three-case analysis as a framework. The conclusion arrived at is that in imposing non-consensual liability on a contracting party, these guidelines indicate in which cases courts should apply contract law, in which cases tort rules should be preferred, and when both contract law and tort law can be applied. In the overlapping region, where both apply, an effort can and should be made to adjust and even harmonize the seemingly conflicting rules of each field of law.

Section VII concludes that a combination of contract law and tort law, with their different menus of liability and remedies, constitutes the best method for contending with non-consensual liability of contracting parties, with each branch supporting and supplementing the other.

I. TORT OR CONTRACT — DOES IT REALLY MATTER?

The search for a proper basis for non-consensual liability presumes that it matters whether such liability is imposed under contract law or under tort law. There are those who may argue, in opposition, that it is of little consequence whether non-consensual liability is contractual, tortious, or hovers in the

gray in-between areas. The real question, under this latter view, is whether such liability should be imposed in a given case or type of cases and, if so, to what extent. This question should be decided on the basis of policy considerations, such as justice and efficiency, that cut across all legal fields.[10] If these considerations justify liability to a given extent, it should not really matter under which title liability is imposed. Classification into different fields of law, although serving methodological and practical purposes, should not dominate legal reasoning or arbitrarily decide the outcome of a dispute.[11]

The counter-argument to this approach is that even if there exists an agreed set of goals to be promoted by law — and let us assume that the best balance of justice and efficiency is this goal — this "remote" general notion cannot serve as a practical, workable means for the individual judge to adjudicate specific disputes. The abstract, first-order formula of justice and efficiency must be transformed into a more specific and concrete set of goals. If, for example, justice and efficiency will be promoted when people keep their mutual promises, enforcing promises becomes a second-order goal derived from the first-order formula. Different fields of law, contracts and torts in our example, specialize in promoting derivative second-order goals. They do so by establishing different derivative lower-order goals and by formulating different standards and rules designed to attain these lower-orders goals by guiding and directing the decision-making process.[12] Indeed, the many "intermediaries" between the first-order goals and an actual rule or standard that eventually decides a case may sometimes obscure the links between the two. Moreover, in a given case, a specific rule may lead to a decision that conflicts with the first-order goal. Yet, this is how the system works. Doctrinal classification, despite its complexities,[13] is vital to legal reasoning and the proper functioning of the legal system.[14]

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10 For a unified concept of law when viewed from the economic analysis perspective, see Robert D. Cooter, *Unity in Tort, Contract and Property: The Model of Precaution*, 73 Cal. L. Rev. 1 (1985).

11 Galligan, for example, concludes that "categories into which we law professors place disputes are, at best, artificial. As such, our categories must and do give way when necessary. The risk we run is that we take ... categories far too seriously." Galligan Jr., *supra* note 8, at 534.

12 For a discussion of the differences between tort and contract in this regard, see Galligan Jr., *supra* note 8. It appears, however, that the author goes too far in arguing that the two categories are "philosophically diverse areas of law." *Id.* at 461. Justice and efficiency are philosophical sources both categories have in common.

13 On problems of classification in the contract/tort context, see Jay M. Feinman, *Classification*, 41 Stan L. Rev. 661 (1989).

14 The classification of legal doctrine also serves certain purposes. The first purpose is instrumental — to achieve certain ends through the classification process ... .

Let us return to non-consensual liability. Since different, specializing fields of law may pursue different second-order goals; or develop different rules and standards; or attach different weights to the same factors; or have different built-in limitations and scope of application, it is necessary for the non-consensual liability of a contracting party to be classified. It should be identified as falling into a recognized territory of either contract law or tort law, or into both territories in the overlapping zone, where causes of actions concur. The non-consensual liability may also fall within the territories of fields of law that will not be dealt with here — unjust enrichment, for example. The extraterritorial, "beyond-classification" approach may be most valuable for legal theory and analysis, as well as for methodological purposes, but with regard to the actual functioning of the legal system, it may become a source of uncertainty and confusion.

II. GUIDELINES FOR NON-CONSENSUAL LIABILITY — UNDER WHICH LAW?

Any proposed guidelines for choosing between tort law and contract law in imposing non-consensual liability must relate to the given legal environment. It is common knowledge, however, that civil law jurisdictions differ from common law jurisdictions in their treatment of non-consensual liability and that even within a given common law or civil law legal tradition, national laws may differ. This is illustrated by the case of non-consensual liability imposed on a contractual party toward a third-party for pure economic loss caused to the latter by the former. While German law applies contractual doctrine (protective contracts) because its law of delict does not allow tortious liability for pure economic loss, English law has traditionally resorted to tort law because the requirements of consideration and privity exclude contractual claims in such cases.[15] These differences in classification between legal systems and the history and traditions behind these

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> The second purpose is analytic ... classification creates and maintains a rational doctrinal structure ... . Contract and tort as distinct categories facilitate a legal system which is relatively nonarbitrary, objective, principled and just.

Jay. M. Feinman, *Doctrinal Classification and Economic Negligence*, 33 San Diego L. Rev. 137, 139 (1996). "It is unlikely that any legal system can ever cut loose from general conceptual classifications such as 'contract' and 'tort'." Rogers, *supra* note 1, at 5.

15 The common law rule of privity is now subject to the Contract (Rights of Third Parties) Act, 1999 (Eng.), which established a wide-ranging exception to privity. French law resorts to the doctrine of "implied" obligations for the benefit of third

differences have been discussed extensively.[16] To lay a common ground for border-crossing theoretical analysis, one must disregard the idiosyncrasies of some national laws and assume flexible and malleable laws of tort and contract, unburdened by the hardly defensible idiosyncrasies of certain national laws. The following analysis therefore ignores such domestic limitations on liability, limitations other legal systems do not share. To be more specific, it is assumed, on the one hand, that contract law is not bound by rigid requirements of consideration and strict privity[17] and, on the other hand, that under the general tort or principle of negligence, pure economic loss is not excluded in principle from the domain of tort liability. Israeli law may serve as a suitable background for such an analysis, as it is characterized both by an expansive, common-law-oriented tort law[18] and by a civil-law-oriented contract law unbound by the requirements of consideration and strict privity.[19]

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parties. Simon Whittaker, *Privity of Contract and the Law of Tort: The French Experience*, 15 Oxford J. Legal Stud. 327, 337-43 (1995).

16 Werner Lorenz, *Some Thoughts about Contract and Tort, in* Essays in Memory of F.H. Lawson 86 (Peter Wallington & Robert M. Merkin eds., 1986); Basil S. Markesinis, *An Expanding Tort Law — The Price of Rigid Contract Law*, 103 Law Q. Rev. 354 (1987); Hein Kötz, *The Doctrine of Privity of Contract in the Context of Contracts Protecting the Interests of Third Parties*, 10 Tel Aviv U. L. Rev. 195, 196-200 (1990) [hereinafter Kötz, *Privity of Contract*]; Basil S. Markesinis, *Doctrinal Clarity in Tort Litigation: A Comparative Lawyer's Viewpoint*, 25 Int'l Law. 953 (1991); Hein Kötz, *Economic Loss in Tort and Contract*, 58 Rabels Zeitschrift fur Auslandisches und Internationales Privatrecht 423 (1994) [hereinafter Kötz, *Economic Loss*]; Peter Cane, *Economic Loss in Contract and Tort*, 58 Rabels Zeitschrift fur Auslandisches und Internationales Privatrecht 430 (1994); Whittaker, *supra* note 9.

17 Whittaker, *supra* note 9, at 192, calls "for English law to develop true exceptions to the privity of contract where these can be justified as a matter of policy." Yet, he refrains from commenting on the possibility of admitting exceptions to the doctrine of consideration as well; *id.* at 223. See also the The Privity of Contract: Contracts for the Benefits of Third Parties, Law Comission Consultation Paper Number 121 (H.M.S.O. 1991), recommending the creation of rights for third parties under a contract, contingent on the contractual intention that the third party should have such rights.

18 For example, the rule that denies liability for pure economic loss subject to exceptions — the "exclusionary rule" (*infra* note 32) — is hardly ever mentioned by courts as a general limitation on negligence liability.

19 Sections 34 to 38 of the Contracts (General Part) Law, 1973, 27 L.S.I. 117, 122-23 (1972-73), establishes contractual liability toward third party beneficiaries.

III. NON-CONSENSUAL LIABILITY — CONTRACT LAW PERSPECTIVE

The search for guidelines for sanctioning and allowing the imposition of non-consensual liability on a contracting party begins with contract law. The first step is to go back to the basics — to contract law's agenda and the second-order goal underlying this agenda. From this core, the characteristics, standards, rules, and inherent limitations and boundaries of contract law are derived. The next step is to introduce, against this background, guidelines as to when non-consensual liability can or should be imposed on a contracting party. Finally, the proposed guidelines are applied to three paradigmatic types of cases, followed by a discussion of chains of contracts and intervening contracts complexities.

A. The Essence and Outer Perimeters of Contractual Liability: The Contractual Value

At the core of contract law lies the notion that contracting parties are obliged to fulfill their voluntary obligations. Contractual liability is designed and shaped in accordance with this basic notion. The parties are liable to each other for failure to perform their assumed obligations, with this liability being either strict (failure to secure a given result) or fault-based. The major remedies are enforcement of the breached obligation and/or damages that compensate for the protected lost expectations or reliance losses.

Contract law insists upon the fulfillment of obligations and the protection of corresponding expectations, because promises should be kept and because it is through contractual relations that people express and exercise their autonomy and their right to personal fulfillment. Additionally, the contract serves a major goal closely related to the protection of expectations. Namely, it is through contractual exchange that the value of factors of production, products, and services is increased. In such an exchange, the transferee derives greater utility from these factors than the transferor does. The contract, as a social-economic institution, is the mechanism that enables and facilitates this beneficial exchange, increasing the welfare of both parties.[20] Moreover, assuming that the overall effects of contracts on the welfare of third parties (externalities) are not negative, the contract

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20 In basic economic terms this major role of the contract is expressed by the "contract curve," a term introduced by F.Y. Edgeworth. This is the curve of exchange between two parties along which their marginal rates of substitution are the same in relation

not only increases the welfare of the contracting parties through a bilateral Pareto-efficient transaction, but also increases the overall welfare — utility — of society. In other words, the contract as an institution is undoubtedly one of society's major producers of added utility. It is, by nature, an efficient institution.

Indeed, it may be argued that not all contracts are efficient. A contract between *A* and *B* may have negative effects on the welfare of a third party, *C*, that exceed its value to the contracting parties. Yet, the existence of negative externalities *per se* does not undermine the concept of the contract as an efficient institution. First, the loss caused to *C*, in being a negative externality, may often be offset or overtaken by a positive externality, a benefit that third party *D* derives from the contract between *A* and *B*. In other words, the loss to *C* is often a private, not social, cost and, therefore, can be disregarded.[21] Second, under the Coase theorem, the loss to *C* may be internalized through contracting between *C*, on the one hand, and *A* and *B*, on the other, where *C* "bribes" a contracting party to quit or modify the activity that is inflicting loss upon her. Third, even if some contracts are inefficient, it certainly appears that the contract as an institution is efficient and, therefore, should be protected on the ground of "rule utilitarianism" rather than "act utilitarianism."

This combination of the honoring of commitments, the promotion of autonomy and self-fulfillment, and the assumed efficiency of the contract as an institution constitutes "the contractual value." If the ultimate first-order goal of law is to achieve the best combination of justice and efficiency, the contractual value is the derived second-order goal entrusted to the law of contracts to promote and protect. Contract law should not weaken and undermine its underlying goal, except for a very good cause. This defines the territory of contract law. At its core, inner-territory contract law protects and promotes the contractual value. Contractual liability that does not protect and promote the contractual value lies at the outer perimeters of contract law. Such liability has to be justified on the basis of other first-order or second-order goals, even when it does not conflict with the contractual value. When it does conflict, such liability requires most compelling justification.

Let us now examine how non-consensual liability fits into this analysis.

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to the commodities traded. Any rate of exchange other than one on the contract curve can be improved by moving to the contract curve.

21 Victor P. Goldberg, *Recovery for Economic Loss following the Exxon Valdez Oil Spill*, 13 J. Legal Stud. 1 (1994); Israel Gilead, *Tort Law and Internalization: The Gap Between Private Loss and Social Cost*, 17 Int'l Rev. L. & Econ. 589 (1997).

B. The Boundaries of Non-Consensual Liability under Contract: Grounds and Guidelines

1. Non-Consensual Liability and the Contractual Value: An Inherent Tension?

At first glance, there seems to be an inherent tension between non-consensual liability, on the one hand, and the protection and promotion of the contractual value, on the other. If liability is imposed on a party to a contract against her will, this appears to derogate from the benefits that that party derives from the contract, rendering the contract less attractive due to these additional costs of contracting. Liability that conflicts with the interest of that party has a negative effect on the incentives to contract. As a result, there may be a reduction in the overall added benefits that contracting parties and society at large derive from contracts and there may be a negative effect on the ability of contracting parties to express and exercise their autonomy and right to self-fulfillment. Yet despite these seeming tensions, contractual non-consensual liability may be justified on three grounds, with each constituting a guideline for sanctioning or allowing such liability.

2. The First Ground of Justification and Guideline: Non-Consensual Liability Conducive to the Promotion of the Contractual Value

Non-consensual liability is obviously justified when derived from non-consensual liability arrangements that are designed to protect and promote the contractual value.

To start with, contracts, for various reasons, may fail to reflect the real will and preferences of contracting parties. Enforcement and execution of such a malformed contract may not only fail to promote the contractual value, but may even contradict it. Non-consensual arrangements imposed by law, therefore, should be employed either to deny the validity of such a contract or to remedy its distortion. Statutory rules dealing with standard contracts, rules rendering contracts void or voidable, and rules strengthening the position of the weaker party on the assumption that such party failed to express real preferences are, therefore, justified under this first ground.

Second, non-consensual contractual rules may well help the contracting parties derive greater benefits from the contract by facilitating the contracting process, by providing default arrangements, by filling in gaps, by disallowing opportunistic behavior, and the like. To the extent that such arrangements supplement the parties' agreements, they are perceived as consistent with the will of the parties.

In sum, when contractual non-consensual liability serves and promotes the contractual value, such liability should not only be allowed, it should be

sanctioned. This is the first guideline that justifies non-consensual liability in contract.

3. The Second Ground of Justification and Guideline: Non-Consensual Liability Not Affecting Incentives to Contract but Serving Other Goals

Non-consensual liability that does not positively contribute to the contractual value may, nevertheless, be allowed when it does not increase the costs of contracting borne by the parties, does not derogate from the benefits derived from the contract, and does not negatively affect incentives to contract. Yet, there should be a positive justification extrinsic to the contractual value for using contract law to impose such liability. The promotion of goals other than the contractual value may serve as just such a justification, providing the second ground and guideline for non-consensual liability in contract.

This "promotion of other goals" justification and guideline becomes less convincing, however, when attaining these goals falls within the territory of other fields of laws. If tort law pursues justice and efficiency, for example, there is no compelling justification to resort to contract law to attain these goals, through non-consensual liability, unless the latter is better equipped or more fit to attain them.

4. The Third Ground of Justification and Guideline: Non-Consensual Liability that Conflicts with the Contractual Value but Serves Other Prevailing Goals

Non-consensual liability that negatively affects the contractual value may, nevertheless, be imposed on the ground that it promotes values or goals that predominate the contractual value. If the contractual value is a second-order goal derived from the first-order goals of justice and efficiency, it should take a backseat when it obviously conflicts with these first-order goals.[22] But non-consensual liability adverse to the contractual value should not be imposed by contract law when other fields of law provide better means for attaining the proper balance between these goals and the contractual value. This guideline is illustrated by the following example.

A, a party to a contract with *B*, makes a contract-related negligent misrepresentation that negatively affects *C*, a third party, causing her economic loss that *A* could have avoided at a cost lower than the loss. Lacking any incentives, *A* failed to do so. According to basic economic

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22 "The parties' agreement to the contract should be seen as a trigger to a relationship whose ambit as well as whose incidents may be set by the law as well as by the parties." Whittaker, *supra* note 9, at 215.

analysis, the externalized loss to *C* should be internalized to *A* to induce him to avoid it. Considerations of efficiency, and possibly justice as well, warrant the imposition of non-consensual liability on *A* toward *C* even though such liability may have negative effects on incentives to contract. Yet such non-consensual liability obviously lies within the territory of tort law, and there is no compelling and convincing reason to employ contract law to this end. On the contrary, the use of contract law is out of context and artificial, creating uncertainties that may lead to inefficiencies. Assume, for example, that not only *C* but also *D* is negatively affected by *A*'s misrepresentation, but liability to *D* is neither efficient nor just. Tort law is undoubtedly better qualified to distinguish between these different claimants, using, for example, notions of proximity and remoteness of third parties. Contract law, lacking this specialization and operating in remote territories, may end up imposing on *A* unjustified non-consensual liability in favor of *D*.

In sum, the third justification and guideline for allowing non-consensual liability in contract is the attainment through contract law of goals that take precedence over the contractual value, provided that these prevailing goals cannot be attained by more fitting fields of law.

C. Case Analysis

1. Liability between Contracting Parties for Contract-Related Misconduct

Non-consensual liability imposed on contracting parties toward each other for contract-related misconduct may take the form of mutual duties of good faith. In Israel, such liability is statutory. The Contracts (General Part) Law, 1973, provides: "An obligation or right arising out of a contract shall be fulfilled or exercised in customary manner and in good faith."[23] "Good faith" has been interpreted by the courts as an objective standard of behavior.[24]

It appears that this kind of non-consensual liability may well be justified according to the first guideline: liability conducive to the promotion of the contractual value. Duties of good faith and reasonable behavior imposed by law on the contracting parties toward each other prevent opportunistic behavior, thereby saving the costs of protecting against such behavior. Additionally, they add a sense of certainty and security enjoyed by the contracting parties. Indeed, such duties may frustrate the expectations and reduce the benefits a given party derives from a contract, but that does not

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23 Contracts (General Part) Law, 1973, § 39, 27 L.S.I. 117, 123 (1972-73).

24 H.C. 59/80, Pub. Transp. Services Be'er Sheva v. Nat'l Labor Court, 35(1) P.D. 828.

necessarily derogate from the total value of the contract, because in such a case, the loss of one party is often the gain of the other. Moreover, these duties are mutual: imposed on and enjoyed by all parties. All in all, if all parties to contracts were to be asked whether they favor or object to rules of good faith and reasonableness, it stands to reason that the answer would be in the affirmative.

The same can be said about rules of interpretation and supplementation that, by facilitating the contracting process, providing default arrangements, and filling in gaps, help the contracting parties to derive greater benefits from their contract. These rules may also remedy contracts that fail to reflect the real will and preferences of the weaker party.

2. Non-Consensual Liability to Third Parties — In General

Non-consensual liability imposed on a party to a contract toward a third, non-contracting party appears to be much more problematic than liability toward a contracting party. Assuming that the third party has no reciprocal obligations and pays no consideration, such liability, *prima facie*, increases the costs of contracting to the liable party, thus reducing contractual benefits and negatively affecting incentives to contract. Such liability appears to conflict with and weaken the contractual value.[25]

Applying the above analysis, this kind of non-consensual liability can nevertheless be justified on the following grounds. First, such liability may originate in rules of interpretation and supplementation that reflect the common interest of the contracting parties. If, for example, the liable party has received a fitting remuneration from the other party to the contract in order to protect or promote the interests of the third party, even though such obligation was not explicit, it is justified under the first guideline. It may also be allowed where liability to *C* does not negatively affect the incentives of *A* to contract with *B* (the second guideline) or where liability to *C* is sanctioned by other conflicting goals that prevail over the contractual value with no better alternative (the third guideline).

3. Liability of a Producer to a Third Party, a Remote Purchaser, for Pure Economic Loss Caused by a Shoddy Product Not Tailored to a Specific User

Applying the above analysis, it appears that for products not tailored to a

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25 This is why Whittaker, *supra* note 15, at 193, suggests, following French law, that "in certain cases, liability to third parties for defective performance of contractual obligation should find its correlative in a liability in that third party to payment for that performance."

specific consumer or user, imposition of non-consensual liability in contract upon producer *A* toward remote purchaser *C* does not exceed the outer perimeters of contract law. Such liability is justified under the second guideline to the extent that it does not increase the costs, or reduce the benefits, of the contracting parties. When a shoddy product not tailored to a specific consumer is sold to one consumer and then causes loss to a remote purchaser, liability imposed on the producer toward this third party would not generally increase the producer's costs of contracting. This is because the risk basically remains the same — liability toward an unknown consumer for loss caused by a given defect. Indeed, such liability exposes the producer to a larger class of potential claimants, but eventually only one claim will be brought and for the same type of transferred loss.[26] Moreover, such liability renders the product more valuable to remote purchasers and, therefore, to immediate purchasers as well, thereby serving the interests of the contracting parties.[27] When a product is tailored to a specific user, contractual liability to a remote user may well increase the risk faced by the producer.

4. Liability of a Service Provider to a Third Party for Pure Economic Loss Caused by an Improper Service

Services, unlike products, usually are not transferable. Moreover, a service is, by nature, a more personal thing. While a producer is often indifferent as to who buys his product, a service provider may be more selective. It therefore follows that non-consensual liability imposed on a service provider for pure economic loss caused to a third party by improper service will often increase the costs of the contract and negatively affect incentives to contracting. Such contractual liability, being incompatible with the contractual value, cannot be warranted by the first and second guidelines, but only by the third guideline — when such liability serves prevailing goals that cannot be attained by more fitting fields of law.

Should non-consensual liability in contract nevertheless be justified when the party to the service contract and the third party are indirectly connected through a chain of contracts? One example: a sub-contractor, *A*, performs under contract for the principal contractor, *B*, work ordered from *B* by the employer, *C*, under another contract, and *C* sues *A* for improper

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26 On the doctrine of "transferred loss" in Germany and England, see Kötz, *Economic Loss, supra* note 16, at 425-26; Kötz, *Privity of Contract, supra* note 16, at 208-11; Peter Cane, *supra* note 16, at 435-37.

27 Contractual liability to a remote purchaser may be imposed through laws of sale or warranties attached to the product or by assuming that the contractual rights of the immediate purchaser are transferred by him to subsequent purchasers.

performance.[28] Another example: each of two independent contractors, *A* and *C*, performs a different component of work done for the same employer, *B*, under different contracts, and the poor performance of *A* negatively affects the performance of *C*, who sues *A*. Does the existence of a chain of contracts provide justification for imposing non-consensual liability toward the remote link in this chain? It is argued that the answer, in principle, should be negative. As long as such liability increases the costs of contracting and is justified by neither the second nor the third guidelines, the chain of contract *per se* provides no independent justification for imposing non-consensual liability.

There may be cases, however, in which the second guideline justifies or allows such liability toward a third party. In the sub-contractor/principal contractor example, it may often be that the loss suffered by the principal contractor due to the poor performance of the sub-contractor is exactly the loss suffered by the employer, that is, exactly the loss for which the principal contractor is liable to the employer. In such cases, a shortcut that will allow a direct contractual claim by the employer against the sub-contractor would not increase the costs of the sub-contractor. As with the shoddy products discussed above, this is a case of transferred loss, not of an extended risk, so that liability may be compatible with the second guideline.[29] The same reasoning may apply, even absent a contractual chain, with regard to a third party, *C*, whose loss is the same as and does not exceed the loss of the other party to the contract, *B*. Yet given the personal nature of services and the additional burden imposed on *C* if held liable to both *B* and *A*, such non-consensual liability in contract should be the exception rather than the rule.

D. Intervening Contracts

With a chain of contracts, where the above criteria justify or allow as an exception the liability of contracting party *A* to third party *C*, the question arises whether this liability should be restricted by the contract between *C*

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28 See the landmark English case *Junior Books v. Veitchi Co. Ltd.*, [1983] 1 A.C. 520, where a sub-contractor was held liable in tort to a building owner for installing a defective floor. For a comparative survey of the classification of these cases, see Kötz, *Privity of Contract, supra* note 16, at 203-08.

29 The Israeli Bailees Law, 1967, § 7 (a), 21 L.S.I. 49, 50 (1966-67), a mixture of tort and contract law, states: "Where a bailee has delivered the property to a sub-bailee, ... the sub-bailee is liable to the owner of the property to the same extent that he is liable to the bailee."

and *B*. Assume, for example, that *A*'s liability under the contract with *B* for a given breach that affects *C* is 100, but *C*'s entitlement for the same breach under the contract between *B* and *C* is only 80. Should *C* be entitled to claim from *A* a remedy of 100 in accordance with *A*'s contract with *B* or only a remedy of 80 in accordance with his contract with *B*? On the one hand, why should *C* be entitled to more than his expectations under his contract with *B*? Is this not a windfall? Why, on the other hand, should *A*, who is held liable under his contract with *B*, benefit from a contract between *B* and *C*?

One option is that the effect of intervening contracts should be determined according to the circumstances of the case. If, for example, *B* and *C* agreed on liability of 80 because this is what *C* expected his loss to be, *C* should not be entitled to receive from *A* any more than his expected loss. The intervening contract quantifies *C*'s loss. If, however, *B* and *C* agreed on 80 rather than 100 in order to set off a former claim of *C* against *B*, *A* should not benefit from such an agreement. It is also relevant whether *A* knew about the limitation of liability between *B* and *C*. If he knew and relied on reduced liability toward *A* of 80, this expectation should not be frustrated by an award of 100. Certain circumstances may also justify a double limiting approach, where *A*'s liability to *C* would be limited under both *A*'s contract with *B* and under *B*'s contract with *C*.[30]

IV. NON-CONSENSUAL LIABILITY OF PARTIES TO CONTRACT: THE NEGLIGENCE LAW PERSPECTIVE

Assuming, as we have, that the ultimate aim, the first-order goal, of law is to achieve the best combination of justice and efficiency and that the derived second-order goal of contract law is to promote the contractual value, what are the second-order goals of tort law? The answer to this depends on the relevant tort. The tort of interference with contractual relations, for example, protects the contractual value against third parties. Our discussion, however, is concerned with the general and abstract tort of negligence. This abstract principle of liability is neither confined to a specific second-order goal nor limited to protecting specific kinds of interests. Its major characteristic and built-in limitation are the requirement of fault. Liability is to be imposed only

30 In French law, these limitations on the liability of *A* toward *C* are related to a concept of "contractual groups." Whittaker, *supra* note 15, at 354-57.

when the defendant has misbehaved. The second-order goal of negligence law, then, is to promote the first-order goal of justice and efficiency in cases where misconduct brought about loss. Negligence law, it follows, has a much broader agenda than contract law in terms of goals to be promoted, but is restricted by the precondition of misconduct for the imposition of liability.

Given its broad mandate, it is natural for tort law to recognize non-consensual liability. Indeed, this is the very type of liability that tort law is supposed to impose. Should the case be different, however, when non-consensual liability is imposed on contracting parties and is closely related to the performance of their contractual obligations? In principle, when such liability meets the preconditions of negligence liability (i.e., the defendant was at fault) and promotes the first-order goals of tort liability (justice and efficiency), the mere fact that the loss occurred within the context of contractual relations and is imposed on a contracting party does not, in and of itself, remove this loss from the natural scope of negligence law.

Traditionally, however, where pure economic loss was involved, negligence law acted with a great deal of self-restraint, essentially distancing itself from the contractual realm. The driving forces behind this traditional self-restraint were concerns with indeterminate liability and the "bull in the china shop" problem. As these concerns subsided over the years, the self-restraint policy was relaxed accordingly, and negligence law in common law countries gradually expanded into contractual territories. Yet this expansion has been carefully monitored by the courts, applying the liability limiting concept of "duty of care" and related requirements of reliance, special relations, and assumption of responsibility. These monitoring devices discussed below, despite their shortcomings,[31] should serve as the guidelines for imposing tortious non-consensual liability on contracting parties, as later explained by the analysis of the three illustrative cases from the tort perspective.

A. Non-Consensual Liability and Tort Law's Traditional Self-Restraint

1. Self-Restraint: Indeterminate Liability and the Exclusionary Rule

A major consideration underlying the policy of non-intervention in contractual relations where pure economic loss is involved has been the

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31 *See infra* note 39 (regarding criticism of the "assumption of responsibility" concept).

general concern, not limited to contract-related cases, over the possibility that such liability would result in indeterminate liability, which, in turn, would lead to overdeterrence, huge social costs of litigation, and overburdening of the judiciary (the floodgate argument). These concerns, which reflect pragmatic considerations, took the form of an exclusionary rule, that is, a rule denying liability for pure economic loss under the general tort (or principle) of negligence. The exclusionary rule actually kept tort law and contract law apart with regard to pure economic loss until the second half of the twentieth century.[32]

2. Self-Restraint and the "Bull in the China Shop" Problem: Protecting the Contractual Value

The other major reason for restraining tort law in imposing liability for pure economic loss on contracting parties has been the concern that tort law would impinge on the realm of contract law and thus disturb the balance struck by the contracting parties and contract law and frustrate the parties' expectations. This is the "bull in the china shop" problem — namely, the concern that the bull of tort law will destroy the porcelain china in the contract shop. The French doctrine of *non cumul des obligations* represents a firm insistence on a clear-cut protective separation between tort and contract.[33]

It should be noted that the interest protected by this self-restraint approach is the contractual value, the same value that both lies at the core of contract law and determines its inner and outer perimeters. It is a kind of negative protection, protection of the contractual value by default.[34]

Another, related argument against interventionism is that when tort and contract concur, a claim that falls into both territories is governed by conflicting inner rules from each territory, for example, by different remedies and defenses or different rules of limitation of actions or of conflict of laws. It is feared that such a conflict may create confusion and uncertainties.

In fact, the "bull" problem is a major argument raised by those who

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32 *See* Bruce P. Feldthusen, Economic Negligence (4th ed. 2000).

33 *See* Weir, *supra* note 1, at 27-30; Whittaker, *supra* note 15, at 330-36.

34 "Affirmative" protection of the contractual value through tort law is provided where contract law is "handicapped" by the disabling requirements of consideration and strict privity, and tort law fills in. Active protection is also provided by torts such as fraud and negligence (regulating pre-contractual relations) and interference with contractual relations (protecting the contract against third parties).

oppose the imposition of tortious non-consensual liability on contracting parties for pure economic loss.[35]

B. The Expansion of Tort Law: Controlled Invasion into Contract

During the course of the second half of the twentieth century, tort liability in common law countries expanded and invaded contractual territories, imposing tortious, non-consensual liability on contracting parties for contract-related losses. This shift in direction was brought about by the following changes in the self-restraint policy.

1. Relaxation of the Self-Restraint Policy: Indeterminate Liability

Over the years, the concerns about indeterminate liability have gradually declined. The diminishment of practical concerns regarding overdeterrence, huge litigation costs, and a disabling flood of suits has led to a corresponding relaxation of the self-restraint policy, so that tort law has experienced a long period of gradual expansion. Although periods of rapid expansion can be followed by periods of offsetting contraction,[36] the long-run trend obviously seems expansive.

A major manifestation of this expansive trend has been the relaxation of the exclusionary rule through exceptions that may turn the rule itself into the exception.[37] An important aspect of this relaxation has been the expansion into the territory of contracts. The gates preventing the imposition of liability in negligence on contracting parties for pure economic loss are no longer closed. Yet these gates have not been opened wide. The pragmatic concerns that indeterminate liability would result in overdeterrence, huge costs of litigation, and the overburdening of the courts still warrant self-restraint for effective control over the flow of lawsuits. This means that the task of the courts has become much more complicated. The simple solution of exclusion has had to be replaced by a sophisticated set of monitoring devices to check and control the flow of liability in negligence for pure economic loss, including liability imposed on contracting parties.

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35 Kötz, *Privity of Contract, supra* note 16, concludes, for example, that the distinction between contract and tort "should not be sacrificed without compelling reasons, and that in the borderline cases one should, as German law does, let contract flowers bloom rather than allow the tort elephant to trample them down."

36 The English decisions in *Caparo Industries Plc. v. Dickman*, [1990] 2 A.C. 605, and *Murphy v. Brentwood D.C.*, [1991] 1 A.C. 398, reflect just such a backlash.

37 Feldthusen, *supra* note 5, refers to five categories of cases in which liability in negligence for pure economic loss has been recognized to varying degrees.

This delicate balancing process is well exemplified by the common-law-oriented tort law in Israel. The first major area in which liability for pure economic loss was imposed under negligence was negligent misrepresentation. To monitor the flow of liability, given the risk of indeterminacy, the Israeli Supreme Court set three threshold conditions that must be met before a duty of care can be recognized: the requirement of special relations between the plaintiff and defendant, originating in the requirement of proximity between tortfeasor and plaintiff; the requirement of legitimate reliance by the plaintiff on a misrepresentation made by the defendant; and finally, the assumption of responsibility requirement, which limits liability in terms of whose reliance is protected, for what purposes, and to what extent of loss to those cases where it can be said that the defendant stands behind his representation. This model of restricted liability for pure economic loss was soon extended to cover the broad fields of professional liability and liability of service providers. Over the years, the restricting conditions themselves were gradually relaxed, and liability has been cautiously extended along with the declining concern over indeterminate liability.[38] But despite their shortcomings,[39] the controlling

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38 For the development of Israeli law regarding liability in negligence for pure economic loss, see Israel Gilead, *Tort Liability in Negligence for Pure Economic Loss, in* Israeli Reports to the XV International Congress of Comparative Law 79 (Sacher Inst., Jerusalem 1999).

39 The "assumption of responsibility" requirement, for example, has attracted a lot of criticism for its ambiguity. *See* Kit Barker, *Unreliable Assumptions in the Modern Law of Negligence*, 109 Law Q. Rev. 461 (1993). As mentioned, under this concept, the law of negligence finds, as a precondition to the recognition of a duty of care, an implied consent on the part of the defendant to "stand behind" a statement or service that may cause pure economic loss. It is still unclear what exactly is to be assumed and whether and to what extent "assumption of responsibility" is based on the implied "real" consent of the defendant or is attributed by law to the defendant regardless of her real intention. See the different views of the Law Lords in White v. Jones, [1995] 2 A.C. 207, at 251, 266, 268, 275, 293-95; Whittaker, *supra* note 9, at 204-07; Rogers, *supra* note 1, at 124-32. Recent comments in *Phelps v. Hillington L.B.C.*, 3 W.L.R. 776 (H.L. 2000), seem to distance the requirement from its consensual origins. Lord Slyn observed,

> That phrase may be misleading in that it can suggest that the professional person must knowingly and deliberately accept responsibility. It is, however, clear, that the test is an objective one ... . The phrase means simply that the law recognizes that there is a duty of care. It is not so much that responsibility is assumed as that it is recognized or imposed by law.

Id. at 791. Lord Clyde adds to the confusion, commenting that "[t]he expression may be descriptive rather than definitive." *Id.* at 807. But it is submitted that the concept is nevertheless meaningful and useful in establishing and monitoring liability. It

devices are still useful tools in regulating the flow of liability, as they actually do in other common law countries. Moreover, one should not forget that the duty of care, an essential element of liability in negligence, can be denied on more general grounds, for example, that liability in the circumstances is not "fair, just and reasonable."[40]

The flexibility of negligence law and its ability to fine-tune the scope of liability through the duty of care concept and other legal tools has another important aspect: the degree of carelessness required to establish negligent behavior as the preliminary element of liability. While the rule is that "simple" objective carelessness is sufficient to establish liability, there may be exceptions where no duty of care will be recognized unless there is gross carelessness or even bad faith conduct. Such flexibility is manifest in Israeli law of negligence, under which liability was recently imposed on a claimant for persuading the court to issue an *ex parte* interlocutory seizure order based on misleading information, thereby causing pure economic loss to the defendant.[41] This liability was justly limited to gross negligence or bad faith cases.[42]

2. Relaxing Self-Restraint: The "Bull in the China Shop" Problem

The ability of courts to keep tort liability for pure economic loss within controlled boundaries through sophisticated monitoring devices and delicate balancing has affected the self-restraint policy not only with regard to indeterminate liability concerns, but also with regard to the "bull" problem. The flexibility of evolving tort law could quiet concerns that expansive,

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can be identified with a moral test. People should, and do, morally stand behind statements or services they provide, but such commitment is, by nature, limited to a confined number of people and to limited purposes. Liability that exceeds this moral test is unfair, even though reliance by others or for different purposes is reasonably foreseeable. Feldthusen, *supra* note 32, at 50, observes that "assumption of responsibility can provide an accurate, sufficient and theoretically sound basis for duty of care."

40 Caparo, *supra* note 36. In C.A. 915/91, State of Israel v. Levi, 48(3) P.D. 45, Israel's Supreme Court has basically followed the Caparo structure of the duty of care.

41 C.A. 1565/95, Sacher Sherutey Yam Ltd. v. Shalom Weinstein Co. Ltd., 54(5) P.D. 638.

42 Whittaker, *supra* note 9, at 206, in contrast, argues that the "reasonable person" objective standard of negligence law is too rigid when compared with the diversity of contractual obligations, ranging from the strict obligation that a particular result materialize to a mere obligation to refrain from dishonesty. He seems, however, to disregard the flexible ability of tort law to use the duty of care concept to limit liability to gross negligence or bad-faith conduct.

overriding tort law would either ignore or fail to see the delicate balance, the sensitive and fine-tuned allocation of responsibilities between the parties to the contract. The argument against interventionist tort law loses its vigor when tort law incorporates the contractual value into its balancing process, attaches proper weight to it, and is well equipped to adapt and adjust to the contractual environment by employing the monitoring devices of special relations, reliance, and assumption of responsibility, alongside the more general requirements of fairness, justice, and reasonableness.[43]

However, the expansion of tort liability into contractual territories obviously tends to enlarge the overlapping zone in cases of concurrent liability. To the extent that such overlapping creates a problem of conflicting inner rules with regard to remedies, defenses, limitation of actions, etc., the potential conflict should be taken into account as a restraining factor. But how severe is the problem of conflicting inner rules in the overlapping zone? This question is addressed below, following a discussion of the relevant guidelines and their application.[44]

C. Tortious Non-Consensual Liability of a Party to a Contract: Guidelines

Two general guidelines can be derived from the above discussion regarding the imposition of tort liability on a party to a contract for pure economic losses related to that contract. The one guideline, which would apply to all aspects of negligence law and not just to contract-related liability is: "Avoid the imposition of indeterminate liability leading to overdeterrence, flood, etc." This guideline would be applied with the assistance of the liability-controlling device of duty of care and the related concepts of reliance, special relations or proximity, and assumption of responsibility, with *future* concepts serving the same end. The second guideline is: "When considering the imposition of contract-related liability on a contracting party, the negative effects on the contractual value should be taken into account as a relevant factor and be given proper weight in the balancing process."

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43 See, for example, *Norwich City Council v. Harvey*, [1989] 1 W.L.R. 828, where it was held, even with respect to damage to *property*, that exclusion of liability in a contract intervening in the relations between *A* and *C* negates *C*'s negligence claim against *A*, because the imposition of a duty of care that disregards the exclusion of liability in the intervening contract is not "just and reasonable" in the circumstances. As mentioned, the French "group contracts" doctrine (*supra* note 30) has a similar limiting effect.

44 *See infra* Section VI.

Let us now apply these guidelines to the three following cases.

D. Case Analysis: The Tort Perspective

1. Liability between Contracting Parties for Contract-Related Misconduct
Between contracting parties the three devices of self-restraint that monitor indeterminate liability are easily met: contractual relations are special relations; the contracting parties legitimately rely on each other; and they have assumed responsibility toward each other. To say that unreasonable performance of a contract constitutes a tort in negligence is, therefore, acceptable under the first guideline.

However, the second guideline, which reflects the "bull in the china shop" problem, should be applied with great caution. The imposition of non-consensual liability that affects consensual relations can easily disrupt the delicate balance between the contracting parties, frustrate legitimate expectations, and generate uncertainties, thereby damaging the contractual value.

2. Liability of a Producer to a Third Party, a Remote Purchaser, for Pure Economic Loss Caused by a Shoddy Product Not Tailored to a Specific User
Since the tort liability of a producer to a remote purchaser of a shoddy product not tailored to specific consumers may well fit into the scope of the self-restraint policy exercised to avoid indeterminate liability, it appears that in such cases, the monitoring conditions and justifications are met. The remote purchaser *relies* on the producer as to the quality of the product; the producer knows this and can be regarded as having *assumed liability*; and the parties are *closely related* to each other by reliance and by being indirectly connected through a chain of contracts.[45]

With regard to self-restraint exercised to refrain from undue intervention in contractual relations, however, such tort liability toward a remote purchaser obviously would be problematic, as it would exceed the producer's contractual liability toward the immediate purchaser. Such liability is justified with regard to defective products that endanger body and property, as considerations of deterrence and justice take precedent over the contractual value, but not necessarily with regard to shoddy products involving loss

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45 Although "chain of contract" as such is insufficient to justify a contractual claim against an indirect party, where such liability conflicts with the contractual value (*see* text accompanying *supra* note 28), it is a relevant factor in tort claims in finding "proximity" or "special relations," thereby reducing the number of potential claimants.

that is purely economic. To avoid disruption to the contractual balance, the controlling devices should be applied.

3. Liability of a Service Provider to a Third Party for Pure Economic Loss Caused by Improper Service

The tort liability of a service provider (*A*) for economic loss incurred by a third party (*C*) due to improper performance of the service contract (with *B*) may often be problematic in relation to both aspects of the self-restraint policy.

With regard to the indeterminate liability guideline, *C* may often be unaware of *A*'s existence (an employer unaware of a sub-contractor; a designated legatee unaware of the will drafted by a lawyer). In such cases, the threshold requirement of reliance is not met. Waiving this requirement may prove problematic, as this is a major flood-control device. Likewise, it may be artificial to argue that a party to a contract assumed such liability toward third parties, especially when this significantly increases the costs of contracting. Against this background, and especially when *A* and *C* are not indirectly connected by a chain of contracts, special relations can hardly be recognized.

With regard to self-restraint exercised to avoid the "bull" problem, we have already seen in the contractual context that non-consensual liability toward a third party can often conflict with the contractual value.[46]

There may be cases, however, where the circumstances permit the imposition of tort liability in accordance with the above guidelines. Israeli law provides such examples, recognizing, for instance, that attorneys and banks may be liable in negligence to third parties who negotiate or contract with clients of the former. This kind of liability has been justified on the grounds of special relations (fiduciary duties owed by attorneys and banks to the public at large) and reliance (by the public on the fulfillment of these fiduciary duties).[47]

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46 *See supra* Section IV.3.d.

47 Gilead, *supra* note 38, at 111-14.

V. NON-CONSENSUAL LIABILITY OF A CONTRACTING PARTY: THE WIDER "CONTORT" PERSPECTIVE

A. The Guidelines: An Overview

The preceding discussion of guidelines for the imposition of non-consensual liability on a contracting party for contract-related pure economic loss can be summarized as follows. From the perspective of contract law, the question is whether such liability promotes and protects the contractual value, namely, the contract as a social-economic institution that plays a prominent role in the promotion of individual self-realization and efficiency. Non-consensual liability under contract law should be sanctioned when it protects and promotes this second-order value that underlies contract law. Otherwise, and especially when such liability conflicts with the contractual value, it might be allowed only to promote other prevailing first- or second-order goals and values that outweigh the contractual value, provided that no other fields of law are more suitable to meeting that end. Negligence law, in contrast, has a wider perspective. Being "in charge" of achieving the first-order goals of justice and efficiency in cases of misconduct, it specializes in imposing non-consensual liability after balancing a variety of conflicting values and goals, the contractual value being only one among many others. The conclusion to be made is that non-consensual liability that is non-conducive to the contractual value, because it is either neutral or conflicting, is better imposed by tort law unless tort law refrains from imposing such liability under its self-restraint policy or when contract law provides a better menu of remedies.

Under these integrated guidelines there are four options regarding non-consensual liability: avoiding liability on the ground that neither contract law nor tort law ("contort" law) supports it; exclusive contractual liability where lack of fault or the self-restraint policy negates tort liability; exclusive tortious liability where the contractual guidelines are not met; and, finally, concurrent liability. The fourth option, however, should take into account the problem of conflicting inner rules with regard to the nature of liability, remedies, defenses, limitation of actions, etc. Let us briefly address this problem and its implications before applying the four-option analysis to our three cases.

B. Conflicting Inner Rules

What are the inner rules of tort law and contract law that may conflict when

both branches of law impose non-consensual liability? A major difference between contract and tort seems to lie in the nature and scope of liability. While contractual liability is essentially strict, based on the failure to secure a given result, the relevant tort liability is primarily fault-based, originating in the failure to act reasonably. Indeed, in the Introduction, it was noted that more and more areas of tort law are now governed by strict or even absolute liability regimes, a development that seems to blur this traditional distinction between tort and contract. Yet, upon closer look, we will find that this distinction is still pertinent and meaningful. Strict liability in tort does differ from contractual strict liability. While the former is usually imposed to compensate victims of bodily injuries and is justified on grounds of loss spreading, deterrence, and reduction of administrative costs, the latter is based on the notion that promises should be honored and therefore applies to pure economic loss as well. It does not follow, however, that contractual non-consensual liability can be only strict. When liability is consensual, parties may agree that their obligations will be limited to reasonable efforts to reach a given result, namely, fault-based obligation. When liability is non-consensual, the obligations imposed by law may also be so limited.[48] These varying types of obligations render contractual non-consensual liability flexible and adjustable. Still, the potential for conflict between fault-based tort liability and strict contractual liability does exist.[49]

As to remedies, contract law provides a wider range of remedies. Under the traditional view, while tort law usually compensates for losses that have diminished the claimant's pre-tort welfare, contract law compensates for such losses (reliance) and, in addition, for frustrated expectations, deprived benefits that would have increased the claimant's welfare. This traditional distinction, as mentioned, has been weakened as negligence law has expanded to impose liability for pure economic loss. When restoring the claimant to the position he would have been in but for the tort (*restitutio in integrum*), tort law can provide pecuniary compensation for lost opportunity, that is, for loss of alternative benefits. Moreover, to the extent that a breach of a contract constitutes a tort, tort law, like contract law, will award compensation for frustrated expectations. Still, compensation for expectation

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48 It has been argued that the majority of contractual obligations concerning the quality and safety of services are fault-based. Whittaker, *supra* note 9, at 209, relying on Guenter H. Treitel, The Law of Contract 753-55 (9th ed. 1995).

49 It has been submitted that when a fault-based obligation to confer a gain is breached, the claimant is entitled not to the gain, but, rather, to the chance that the gain would have been attained had the obligation been met. *See* Whittaker, *supra* note 9, at 210-11.

losses are, in general, more attainable under contract law. Another major difference is that contract law provides the remedy of specific performance, whereas tort law, in principle, does not — a court would not issue an order under tort law to repair a shoddy product or to provide a better service or to rescind a contract.

There may also be differences between tort and contract regarding the applicability of defenses such as contributory negligence, limitation of actions, and exempting contractual clauses. Other differences may be found regarding rules of capacity, choice of law, causation, assessment of loss, vicarious liability, compensability of collateral non-pecuniary loss, punitive damages, etc.[50]

What are the implications of these potential conflicts between the inner rules of contract and tort? As already mentioned, where interventionist tort law causes disruption to the finely tuned contractual balance, this "bull" problem should be considered a factor in favor of restraining tort liability. However, this conclusion applies mainly to tort intervention with *consensual* liability. Where liability in contract is non-consensual, that is, is imposed by law, concurrent tort liability does not really impinge on the parties' will. In this regard, concurrence means that tort and contract offer different menus for non-consensual liability: strict liability versus fault-based liability; availability versus non-availability of given defenses and remedies; longer or shorter periods of limitation; etc.

Obviously, there is an advantage in being afforded two different menus: the more fitting menu can be chosen. The problem arises in cases of concurrence of tort and contract, where conflicts may appear, but there are different ways of coping with different, apparently conflicting menus. First, the claimant, not the court, could be allowed to opt for the more favorable source of liability. For example, she could opt for the contractual claim and enjoy strict liability and specific performance or choose to sue for the lost opportunity remedies under tort law. This claimant-oriented approach may be justified on the ground that when both tort and contract offer remedies under their distinct agendas, the claimant is entitled to opt for the best venue and even enjoy the best of both worlds as long as there is no real conflict between the two in terms of goals and remedies. This is in fact the Israeli approach.[51] Second, rules of conflict of laws could

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50 For conflicting "inner rules," see Gallagan, *supra* note 8, at 462-74; International Encyclopedia of Comparative Law, *supra* note 1, ch. 1, at 12.

51 *See* Gilead, *supra* note 38, at 95-98. This seems to be the trend in English law as well. Rogers, *supra* note 1, at 9-10.

be established to determine which field of law should prevail in cases of real conflict.[52] Third, harmonization of contract and tort should be promoted. Past and pending changes to Israeli law have been part of the acceleration in removing unjustified differences between torts and contracts. For example, the contributory fault defense has been applied to contract law;[53] the rules governing the limitation of civil actions have been united, to a great degree, for claims arising from both tort and contract;[54] both contract and negligence law allow compensation for pure non-pecuniary loss;[55] and Israel's proposed Civil Code unifies tort and contract remedies in the same chapter.

The bottom line is that the differences between contract and tort *per se* justify neither the French *non cumul* approach, on the one hand, nor the merger of tort and contract into a huge, amorphous field of "contort" law or the middle ground of a new field of law, on the other.[56]

C. Integrated Analysis of the Cases

1. Liability between Contracting Parties for Contract-Related Misconduct

Non-consensual liability imposed on one party to a contract in favor of the other party for contract-related misconduct often can promote the contractual value, but may also conflict with it or be neutral to it.

When such liability promotes the contractual value and does not raise problems of indeterminate liability, it is warranted under both tort and contract guidelines. The claimant could be allowed, in principle, to sue on both grounds and enjoy both menus. Where such non-consensual liability conflicts with the contractual value (or is neutral thereto), but is nevertheless

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52 "[T]he best course is surely to decide which of the two rules produces the most just result in the case at hand, and to apply the rule." Cane, *supra* note 16, at 431-32.

53 C.A. 3912/90, Eximin S.A. v. Textile & Shoes Itel Ferrari Style, 47(4) P.D. 64.

54 In C.A. 3599/94, Yupiter v. Bank Leumi Leisrael, 50(5) P.D. 423, it was held that the period of limitation for a contractual loss-based claim begins to run (the cause of action accrues) with the occurrence of the loss and with the preceding breach of the contract.

55 Contracts (Remedies for Breach of Contract) Law, 1970, § 13, 25 L.S.I. 11 (1970-71), provides that the court may award compensation for damage other than pecuniary "at the rate it deems appropriate in the circumstances of the case." Liability for pure non-pecuniary loss under the law of negligence was recognized in C.A. 243/83, City of Jerusalem v. Gordon, 39(1) P.D. 113.

56 As proposed by Feinman, *supra* note 14, at 137. *See infra* note 66. *See also* N.J. McBride & A. Hughes, *Hedly Byrne in the House of Lords: An Interpretation*, 15 Legal Stud. 376 (1995) (arguing that liability for negligent misstatement may be classified as neither contract nor tort, but rather closely related to fiduciary liability).

justified on grounds of prevailing goals, tort law would be the better option, as it is better equipped to balance the contractual value against other values. Contract law should be opted for only when those prevailing goals call for contractual specialties, such as strict liability or specific performance.

Israeli law provides a good illustration of these considerations. Under Israeli law, non-consensual liability among contracting parties originates in a statutory provision of contract law that has been interpreted as establishing an objective standard of good faith.[57] It is still unclear whether and in what way this contractual "objective good faith" differs from the objective reasonable person standard of negligence law — the due care standard. The difference between the two may lie in the extent to which the law is inclined to take into account the idiosyncrasies of each individual. While tort law might impose a stricter standard that disregards limitations and shortcomings of the individual other than permanent and apparent physical disabilities and age, contract law might adopt a softer standard that takes into account individual shortcomings such as lack of experience or mental limitations. If this is, indeed, the case, the question is whether the stricter due care standard conflicts with the contractual value protected by the less demanding objective good faith. Assuming that it does, it appears that negligence law, as a rule, should refrain from applying the due care standard to contracting parties and, instead, adhere to the contractual standard of objective good faith. Negligence law can thus be adjusted by limiting the scope of the duty of care between contracting parties to conduct that fails to meet objective good faith.

2. Liability of a Producer to a Third Party, a Remote Purchaser, for Pure Economic Loss Caused by a Shoddy Product Not Tailored to a Specific User

With regard to shoddy products not tailored to a specific consumer or user,[58] we have seen that the imposition of liability in contract on a producer toward a remote purchaser meets the contract guidelines for imposing non-consensual liability, because it does not really conflict with the contractual value and may even serve the interests of the contracting parties. As to liability under negligence law, we have seen that such liability meets the self-restraint guideline aimed at avoiding indeterminate liability, but that regarding the second guideline — self-restraint exercised to refrain from undue intervention in contractual relations — such liability is problematic when it imposes on the producer liability toward a remote purchaser that exceeds the producer's

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57 *See* H.C. 59/80, Pub. Transp. Serv. v. Nat'l Labor Court, 35(1) P.D. 828. *See supra* notes 23-24 and accompanying text.

58 On shoddy products, see Feldthusen, *supra* note 32, at 178-87.

contractual liability toward the immediate purchaser. Can negligence law be adjusted to avoid this? As far as liability between contracting parties is concerned, a possible solution would be to find no duty of care with regard to liability that conflicts with the contractual value on the ground that it is neither reasonable, just, nor fair to impose such liability. Yet if contract law provides an appropriate solution, there is no need to resort to such adjustments to the concept of duty of care.

There are other reasons to prefer contractual liability in this context. First, since tort liability is fault-based, a producer cannot be held strictly liable in tort toward a remote purchaser. But if the producer is strictly liable to an immediate purchaser under the contract, why should this liability be reduced to fault-based liability against a remote purchaser? Second, under tort law, specific performance usually is not available, so that only contractual liability could allow the remote purchaser to demand repair or replacement of the shoddy product.

In practice, such contractual liability may be imposed by laws of sale, by the doctrine of transmissible warranties attached to the product,[59] or by assuming that the contractual rights of the immediate purchaser are transferred by him to subsequent purchasers.

3. Liability of a Service Provider to a Third Party for Pure Economic Loss Caused by Improper Service

The guidelines for both tort law and contract law indicate that imposition of non-consensual liability on a service provider *(A)* for economic loss incurred by a third party *(C)* due to improper performance of *A*'s service contract with the contractual party *(B)* may often be problematic. From both contract law and tort law perspectives, such liability may often conflict with the contractual value by increasing the costs of contracting and activating the "bull in the china shop" problem. From the tort perspective, such liability may also raise problems of indeterminate liability when any of the limiting factors of reliance, special relations, and assumption of responsibility between *A* and *C* is lacking.

Yet there are cases when imposing non-consensual liability on *A* toward *C* is commensurate with the guidelines of contract, tort, or both. For example, when such liability does not conflict with the contractual value (transferred loss) and raises no problems of indeterminate liability, both contract and tort are fitting sources of the liability. Here, as well, the different menus, when available, offer flexibility. If, for example, there are reasons for holding *A*

59 Whittaker, *supra* note 9, at 343-54.

strictly liable to *C*, contract law is the fitting source. When the liability of *A* toward *C* conflicts with the contractual value, but overriding considerations nevertheless support the imposition of liability, tort law, as suggested, is the better venue. The mentioned liability under Israel's law of attorneys and banks toward third parties who negotiate or contract with their clients is an example of such tort liability.[60] Yet, contract law may be resorted to when tort liability is restrained by indeterminate liability considerations or when contract law provides the better menu. To avoid uncertainties and artificial contractual liability, this type of liability could be restricted to limited, particular types of contracts.[61]

The well-known English decision *White v. Jones*[62] provides an illustration of the complexities of *A*'s non-consensual liability toward *C*. The failure of an attorney *(A)* to prepare a new will securing the transmission of the property of his client *(B)* to the designated third party *(C)* resulted in a loss to *C*, the disappointed testamentary legatee. Absent consideration and strict privity, liability was imposed on *A* in tort. Yet, under the guidelines suggested in this paper, such liability is problematic. *C* did not rely on *A*, and liability imposed in the absence of reliance may throw open the floodgates of indeterminate liability.[63] Should liability be imposed under contract law? That depends on whether it conflicts with the contractual value. Assuming that in the special circumstances of the case, *A* (the attorney) is not exposed to liability toward *B* (his client) or his estate because the loss occurs only after *B*'s death, such liability promotes the contractual value by providing incentives to attorneys drafting wills to perform their duties toward their clients. Contractual liability toward *C* protects the contract between *A* and *B*. Moreover, *C* is the apparent beneficiary under the contract between *A* and *B*, so that liability to *C* is well within the expectations of the parties. Furthermore, *C*'s contractual claim is subject to limitations imposed on *A*'s liability under the contract with *B*. Assuming, for example, that *A*'s liability under the contract with *B* is limited to a specified amount, this limitation

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60 *Supra* note 47.

61 As suggested by Whittaker, *supra* note 9, at 214, "the type of contract which the parties have entered is of crucial importance to its effects." Whittaker further suggests that contractual liability beyond privity should be perceived as an exception. *Id.* at 216.

62 [1995] 2 A.C. 207.

63 Lord Mustill, dissenting, argued that such liability of *A* toward *C* for negligent performance of service to *B* would go "far beyond anything so far contemplated by our law of negligence" and may be "causing serious harm to the general structure of the law." *Id.* at 291.

should apply to *C*'s claim as well. In sum, contract liability may be a more fitting option in such cases.[64]

CONCLUDING REMARKS

First-order goals such as justice and efficiency may well justify the imposition of non-consensual liability on a contracting party for inflicting contract-related pure economic loss on another contractual party or on third parties. Such liability, however, should fit into pre-established categories of liability, in our case, contract and tort (or unjust enrichment). This is how the legal system works and how it should work. Each of these categories, even when sharing and serving the same first-order goals, has its own second-order agenda, as well as built-in limitations, monitoring devices, and inner rules that provide coherence and stability to these distinct fields of law. Tort and contract therefore offer different menus in terms of the nature of liability, defenses, remedies, etc. This diversity should be perceived as an advantage. It allows tort law and contract law to support and supplement one another to find the more suitable legal solution to a given case. When a solution exceeds the boundaries of tort law, contract law may come to the rescue, and *vice versa*, allowing each field to preserve its characteristics, coherence, and stability at any given phase of evolution so that neither gets out of control.[65] When both tort and contract apply, any potential conflict of inner rules can and should be solved by allowing the claimant to choose between them, or by conflict of law rules that determine which field is to prevail, or by better harmonization of tort and contract either through the existing inner flexibility of each field or through legislative reform.

It should be borne in mind that the pre-established categories of contract and tort should not be perceived as rigid and arbitrarily confining of liability. On the contrary, as illustrated above, the categories are gradually evolving to accommodate new areas of liability within their expanding territories. They are responding and adjusting to changing values, concepts, technology, and

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64 For a contractual solution preferable to *White v. Jones*, see Werner Lorenz & Basil S. Markesinis, *Solicitors' Liability toward Third Parties: Back to the Trouble Waters of the Contract/Tort Divide*, 56 Mod. L. Rev. 558 (1993). Whittaker as well argues (*supra* note 9, at 218-19) in favor of a contractual solution, as does Kötz, *Privity of Contract, supra* note 16, at 201-03, referring to cases of frustrated beneficiaries before *White v. Jones*.

65 Markesinis, *Expanding Tort Law, supra* note 16, at 397, warns that tort law may get out of control because of rigid contract law.

other developments. This process of gradual evolution should be encouraged, *inter alia*, by removing obsolete traditional barriers that hinder the process.

When compared with the above recommendation of cooperation and harmonization through evolution, the other options of insisting on traditional separation between tort and contract, melding them into an amorphous field of "contort," or creating another field of law seem obviously inferior.[66]

66 Feinman, *supra* note 14, concludes, in contrast, that legal argument, analysis and decisions can be improved by reformulating the current classification of contract and tort to recognize economic negligence as a new field of law regulating the liability of contracting parties toward third parties for negligent performance of a contract. It appears, however, that the assumption underlying Feinman's analysis is that tort law is a china-shop bull that tends to disregard the contractual value and the delicate balance reached by contracting parties. If tort law, as I have argued, is and should be adaptable, malleable, and sensitive to the contractual value, there is obviously no need for a third, in-between category that will only exacerbate the problems of classification.