Economic Loss Due to Defective Product Design Held Sufficient to State a Cause of Action in Strict Products Liability Against Remote Manufacturer

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ness as a lending institution.\textsuperscript{71} Thus, it is hoped that the judiciary will examine the \textit{Kagan} court’s decision and arrive at a more equitable interpretation of section 673.

\textit{John James Lynch}

\textbf{DEVELOPMENTS IN NEW YORK LAW}

\textit{Economic loss due to defective product design held sufficient to state a cause of action in strict products liability against remote manufacturer}

In the area of products liability, the requirement that the plaintiff have a direct contractual relationship with the manufacturer against whom it brings an action for damages traditionally had acted as a formidable barrier to the plaintiff’s recovery.\textsuperscript{72} This privity requirement gradually has eroded, however, and is now dependent upon two variables: the type of harm the plaintiff has incurred and the theory upon which the plaintiff’s cause of action is premised.\textsuperscript{73} Thus, in New York, a plaintiff who seeks to redress

\textsuperscript{71} Based on the holding in \textit{Kagan}, bank officials, fearing disproportionate felony sanctions, may be reluctant to lend money when there is a mere possibility that the amount lent may exceed a regulatory limit, even if the transaction would be in the bank’s best interest and there is no risk of loss. See Scott, \textit{The Patchwork Quilt: State and Federal Roles in Bank Regulation}, 32 \textit{STAN. L. REV.} 687, 696 (1980).

\textsuperscript{72} When there is a direct contractual relationship between the plaintiff and the defendant-manufacturer, the parties are said to be in “privity of contract.” See R. Erstein, Modern \textit{PRODUCTS LIABILITY LAW} 9 (1980); Comment, Manufacturers’ Liability to Remote Purchasers for “Economic Loss” Damages—Tort or Contract, 114 U. PA. L. REV. 539, 545 (1966) [hereinafter cited as \textit{Tort or Contract}]. This privity requirement once effectively barred plaintiffs from recovering damages against remote manufacturers. See Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 373, 161 A.2d 69, 77 (1960) (manufacturers were able to achieve a “large measure of immunity for themselves”); Howard & Watkins, \textit{Strict Products Liability in New York and the Merging of Contract and Tort}, 42 \textit{ALB. L. REV.} 603, 603-04 (1978). For illustrations of the types of cases which were barred by the requirement of privity, see Lebourdais v. Vitrified Wheel Co., 194 Mass. 341, 343, 80 N.E. 482, 482 (1907) (remote manufacturer “ordinarily is not responsible . . . to those who may receive injuries caused by [a product’s] defective construction”; negligence action barred); Turner v. Edison Storage Battery Co., 248 N.Y. 73, 74, 161 N.E. 423, 424 (1928) (“[t]here can be no warranty [either express or implied] where there is no privity of contract”); Chysky v. Drake Bros. Co., 235 N.Y. 468, 472, 139 N.E. 576, 578 (1923) (“unless there be privity of contract, there can be no implied warranty”).

\textsuperscript{73} See generally Zammit, Manufacturers’ Responsibility for Economic Loss Damages in Products Liability Cases: What Result in New York?, 20 \textit{NY.L.F.} 81, 82, 87 (1974). The type of damages incurred by the plaintiff are characterized as economic or physical. \textit{Id.} at 82. Economic damages include, \textit{inter alia}, loss of bargain and cost of repairs. \textit{Id.} Physical
personal injuries or property damages, and who brings a breach of express warranty, breach of implied warranty, negligence, or strict products liability cause of action need not be in privity with the remote manufacturer. When that same non-privity plain-


76 See MacPherson v. Buick Motor Co., 217 N.Y. 382, 390, 111 N.E. 1050, 1053 (1916), one of the landmark cases in this area. In MacPherson, Judge Cardozo allowed the plaintiff to recover under a negligence theory against the remote manufacturer of a defective wheel. Id. He stated that "[w]e are dealing now with the liability of the manufacturer of the finished product, who puts it on the market to be used without inspection by his customers. If he is negligent, where danger is to be foreseen, a liability will follow." Id.

tiff seeks to redress economic losses, however, the cause of action selected is important. Although a plaintiff may recover economic losses from a remote manufacturer under a breach of express warranty cause of action, he may not pursue such a remedy under negligence or breach of implied warranty theories. Moreover, it has been unclear whether a plaintiff may recover economic losses under a strict products liability cause of action.

Recently, in

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78 See, e.g., Randy Knitwear, Inc. v. American Cyanamid Co., 11 N.Y.2d 5, 16, 181 N.E.2d 399, 404, 226 N.Y.S.2d 363, 367 (1962). The plaintiff in Randy Knitwear sought damages incurred as a result of the shrinkage of a fabric manufactured by the defendant and advertised as shrinkproof. Id. at 9, 181 N.E.2d at 400, 226 N.Y.S.2d at 364. The Court, upon rejecting the defendant's argument that privity of contract was essential to the plaintiff's recovery of economic losses under an express warranty theory, held the manufacturer liable. Id. at 16, 181 N.E.2d at 404, 226 N.Y.S.2d at 367.


80 See generally John R. Dudley Constr., Inc. v. Drott Mfg. Co., 66 App. Div. 2d 368, 372-74, 412 N.Y.S.2d 512, 514-16 (4th Dep't 1979); Mendelson v. General Motors Corp., 105 Misc. 2d at 348-49, 432 N.Y.S.2d at 134-35. The plaintiff in Dudley, who had purchased a defective crane manufactured by the defendant, was permitted to recover under a strict products liability theory, although the physical damages were limited to the crane itself. 66 App. Div. 2d at 372, 412 N.Y.S.2d at 514. Despite this extension of strict products liability, the court indicated that it would not be willing to include "benefit of bargain" losses within the sphere of recoverable damages. Id. at 514. In Mendelson, although the plaintiff's complaint did not set forth a cause of action in implied warranty against the manufacturer of a defective forklift, the non-privity plaintiff could not state a cause of action in implied warranty against the manufacturer of a defective forklift.

81 The issue has generated considerable controversy among various jurisdictions. See, e.g., Seely v. White Motor Co., 63 Cal. 2d 9, 15-18, 403 P.2d 145, 149-50, 45 Cal. Rptr. 17, 22-23 (1965); Santor v. A & M Karagheusian, Inc., 44 N.J. 52, 59-63, 207 A.2d 305, 308-10 (1965). In Santor, the court held that the plaintiff could sue the manufacturer of defective carpeting on an implied warranty theory. Id. at 63, 207 A.2d at 310. The court also indicated that the facts were sufficient to maintain an action in strict products liability. Id. The measure of the plaintiff's damages would be the loss in value of the carpeting. Id. at 68-69, 207 A.2d at 313. The court reasoned that the obligation of the manufacturer of a defective product should be one of an "enterprise liability, and one which should not depend upon the intrica-
Schiavone Construction Co. v. Elgood Mayo Corp., the Appellate Division, First Department, held that economic losses are recoverable against a remote manufacturer under a strict products liability cause of action.

In Schiavone, the plaintiff had purchased a truck hoist from the defendant Elgood, who in turn contracted with the defendant Timberland for the manufacture of the hoist. The hoist delivered to the plaintiff was inoperable, however, and to redress its ensuing economic losses, the plaintiff brought an action against both Elgood and the remote manufacturer, Timberland. Upon motioning to attach the assets of Timberland, however, the plaintiff's causes of action in breach of implied warranty and negligence were dismissed. Nonetheless, special term permitted the plaintiff to amend its complaint to state a cause of action in strict products liability.
liability, and approved the plaintiff's attachment motion on this theory.\(^9\)

On appeal, a divided appellate division affirmed the lower court's grant of attachment.\(^{10}\) Writing for the majority,\(^9\) Justice Fein rejected the traditional view that because economic losses sound in contract they may only be recouped through a breach of warranty cause of action, wherein privity of contract is mandated.\(^{11}\) Notwithstanding that the court attacked the necessity for privity in the breach of warranty context on grounds that the requirement presupposed "dubious" economic principles\(^9\) and engendered circuitous actions,\(^9\) it thereafter neglected this line of reasoning. Indeed, Justice Fein opted instead to circumvent the "citadel of privity" by holding that economic losses may be recovered under a cause of action having no privity defense—strict products liability.\(^9\) Conceding that such causes of action generally have been confined by courts outside of New York to claims sounding in tort, \textit{viz.}, injuries to the person, Justice Fein stated that New York case law could be interpreted as sanctioning the use of a strict products liability cause of action to recover economic losses.\(^7\)

Dissenting, Justice Silverman stressed that New York case law did not support the use of a strict products liability cause of action to redress economic losses.\(^8\) The dissent further argued that the

\(^{9}\) Id.
\(^{10}\) 81 App. Div. 2d at 227, 439 N.Y.S.2d at 937.
\(^{11}\) Justices Ross and Markewich joined in Justice Fein's majority opinion. Justice Silverman filed a dissenting opinion in which Presiding Justice Sullivan concurred.
\(^{12}\) 81 App. Div. 2d at 223-24, 439 N.Y.S.2d at 934-35. Justice Fein criticized the view that a strict products liability cause of action should apply only to physical damages, thus leaving the commercial aspects of a transaction to be covered by warranty provisions. \textit{Id.} at 224, 439 N.Y.S.2d at 935.
\(^{13}\) \textit{Id.} at 225, 439 N.Y.S.2d at 935. The majority criticized the argument that the ability of a purchaser and seller to bargain for warranty or disclaimer provisions in their contract is a sufficient means of apportioning losses. \textit{Id.; see} Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp., 626 F.2d 280, 287-89 (3d Cir. 1980).
\(^{14}\) 81 App. Div. 2d at 225, 439 N.Y.S.2d at 935.
\(^{15}\) \textit{Id.} at 227, 439 N.Y.S.2d at 936.
\(^{16}\) \textit{Id.} at 225, 439 N.Y.S.2d at 935 (citing John R. Dudley Constr., Inc. v. Drott Mfg. Co., 66 App. Div. 2d 368, 372, 412 N.Y.S.2d 512, 514 (4th Dep't 1979)); \textit{see} note 81 supra. The majority stated that "[t]here is no reason why New York need follow either California or the Federal courts in attempting to bar liability on the theory that strict liability is grounded in tort and not in warranty." 81 App. Div. 2d at 225, 439 N.Y.S.2d at 935. The majority relied heavily upon \textit{Dudley}'s extension of strict products liability to include property damage to the product itself. \textit{Id.} at 223, 439 N.Y.S.2d at 934. \textit{But see} note 98 infra.
\(^{17}\) 81 App. Div. 2d at 228-29, 439 N.Y.S.2d at 937-38 (Silverman, J., dissenting). In its
"economic ramifications" of permitting economic losses to be recouped through a strict products liability cause of action evinced the necessity for legislative rather than judicial reform in this area. As further support for renouncing a judicial initiative, the dissent contended that a manufacturer's duty to distribute safe products is distinct from its duty to distribute operable products, and that economic losses incurred by a consumer in the latter situation are not actionable unless a manufacturer fails to meet an agreed upon performance standard. The dissent concluded that since such an agreement sounds in contract, it properly should be enforced through a breach of warranty and not a strict products liability cause of action.

It is submitted that the Schiavone court improperly fashioned a tort remedy for what are essentially contract damages. None-


99 81 App. Div. 2d at 229, 439 N.Y.S.2d at 938 (Silverman, J., dissenting). The dissent expressed the concern that the economic consequences of the majority's decision would be "so extensive and unforeseeable that it [would be] better for the courts not to extend strict products liability to this area, leaving the owner of the product to its remedy based on its contract with the seller." Id. (Silverman, J., dissenting).

100 Id. at 230-31, 439 N.Y.S.2d at 939 (Silverman, J., dissenting) (citing Seely v. White Motor Co., 63 Cal. 2d at 16, 18, 403 P.2d at 149, 150, 45 Cal. Rptr. at 21-23; see note 81 supra).


102 Although the distinction between physical and non-physical damages seems arbitrary, see, e.g., Moorman Mfg. Co. v. National Tank Co., 92 Ill. App. 3d 136, 414 N.E.2d 1302, 47 Ill. Dec. 186 (App. Ct. 1980); Ribstein, Guidelines for Deciding Product Economic Loss Cases, 29 MERCER L. REV. 493, 499 (1978), the characterization of recovery for economic loss as a contract remedy appears to be necessary. See generally Speidel, Products Liability, Economic Loss and the UCC, 40 TENN. L. REV. 309, 318 (1973); Comment, The Last Vestige of the Citadel, 2 HOFSTRA L. REV. 721, 730 (1974). Contract law is viewed as the proper framework in which to seek recovery against a seller of defective merchandise. Strict products liability was developed to deal with physical damages incurred by the consumer. See Tort or Contract, supra note 72, at 548-49.
theless, it appears that the court’s objective, to prevent the “ves-
tiges of the citadel of privity”103 from barring the plaintiff’s claim, was commendable. Indeed, the Schiavone court recognized the fact that New York courts generally have been “astute” in finding a remedy against remote manufacturers104 and that the placement of responsibility for a defective product at the top of the distribution chain is a desirable aim.105 It is suggested, however, that an extension of the breach of implied warranty cause of action to include foreseeable remote users who are injured, whether physically or economically, would better implement these policies and not ob-
fuscate the fact that economic losses sound in contract, not in tort.106

Indeed, it is suggested that New York should join those states which have abolished the privity requirement in breach of implied warranty causes of action brought to recoup economic losses.107 Of

103 81 App. Div. 2d at 227, 439 N.Y.S.2d at 936.

105 blity in New York, stated that “the time has now come when our court, instead of rational-
izing broken field running, should lay down a broad principle, eschewing the temptation to
devise more proliferating exceptions.” Id. at 339, 298 N.E.2d at 626, 345 N.Y.S.2d at 467

106 (citation omitted).
107 81 App. Div. 2d at 225, 439 N.Y.S.2d at 935 (quoting Randy Knitwear, Inc. v. Amer-
ican Cyanamid Co., 11 N.Y.2d at 13, 181 N.E.2d at 403, 226 N.Y.S.2d at 368); see note 78
supra. The majority noted that the Court of Appeals, in Randy Knitwear, desired to force
the manufacturer to “shoulder the responsibility” for placing a defective product on the
market. 81 App. Div. 2d at 225, 439 N.Y.S.2d at 935. Indeed, “[h]aving invited and solicited
the use, the manufacturer should not be permitted to avoid responsibility, when the ex-
pected use leads to injury and loss, by claiming that he made no contract directly with the
user.” Randy Knitwear, Inc. v. American Cyanamid Co., 11 N.Y.2d at 13, 181 N.E.2d at 403,
226 N.Y.S.2d at 368.

breach of implied warranty are distinct. “Different facts must be proven to establish liability
under the two claims and each potentially could permit recovery where the other would not.” Id. But see Tort or Contract, supra note 72, at 549, wherein the author, although
supporting the view that an action for economic loss should be brought under a contract
theory, nevertheless believes that “the results under the two doctrines may not turn out to be
significantly different.” Id.

“convinced that sound policy considerations support the extension of implied warranties to
a remote purchaser and that economic loss should be compensable”); JKT Co. v. Hardwick,
course, section 2-318 of the New York Uniform Commercial Code does permit persons not in privity with a manufacturer to recover damages under a breach of warranty cause of action.\textsuperscript{108} The statute, however, is restricted to "injuries to the person."\textsuperscript{109} Hence, it is suggested that the legislature should adopt alternative "C" of section 2-318 of the Uniform Commercial Code, which extends the section's coverage to all injuries.\textsuperscript{110} Moreover, given the refusal of the Court of Appeals to abandon outright the doctrine of privity of contract,\textsuperscript{111} it is urged that the legislature follow the lead of other


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

\textsuperscript{109} See note 108 supra.

\textsuperscript{110} Compare U.C.C. § 2-318, Alternative C (1978 version) with N.Y.U.C.C. § 2-318 (McKinney 1964 & Supp. 1980-1981). In 1975, New York had amended section 2-318 so as to include as a potential plaintiff in a warranty action any natural person reasonably expected to use, consume, or be affected by the seller's product and who is injured in person by breach of the warranty. The U.C.C.'s Alternative C, on the other hand, does not expressly limit the coverage of the action to personal injuries. Rather, any person who is injured by breach of the warranty may maintain an action against the seller who impliedly or expressly warrants his product. U.C.C. § 2-318, Alternative C (1978 version) (emphasis added). Alternative C, however, as written, does leave open the possibility that the seller may exclude or limit such a warranty with respect to non-physical injuries. Id. Alternative C has been adopted in substance by several states. See, e.g., Colo. Rev. Stat. § 4-2-318 (1973) (does not leave open the possibility of seller's exclusion or limitation of section for non-personal damages); Del. Code Ann. tit. 6, § 2-318 (1978); R.I. Gen. Laws § 6A-2-318 (Supp. 1981).

\textsuperscript{111} See generally Martin v. Julius Dierck Equip. Co., 43 N.Y.2d 583, 589-90, 374 N.E.2d 97, 100, 403 N.Y.S.2d 185, 188 (1978). The Court of Appeals, in Martin, stated that a plaintiff who is not in privity with the seller of an allegedly defective product may maintain an action only in negligence or strict products liability against the seller. Id. The Court did not apply the newly amended U.C.C. section 2-318, which would have covered the plaintiff's action for implied warranty, because the operative facts of the case occurred prior to the amendment. Id. at 591, 374 N.E.2d at 101, 403 N.Y.S.2d at 189. The Court left open the
states which have reworded section 2-318 to expressly abolish the
defense of privity in breach of warranty causes of action. Such
legislation would foster the equitable result strived for by the
Schiavone court without requiring the courts to "astutely" stretch
tort causes of action to redress contract damages.

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Party to contract may not offer evidence of other party's prior
contradictory agreement with third party

The parol evidence rule prohibits parties to an integrated con-
tract from contradicting the terms of the writing with their prior or
contemporaneous agreements. To avoid the harsh results of in-

effect of the amendment, while "not[ing] the likelihood of disagreement as to its effect
should a case arise in which its applicability may properly be considered." Id. As predicted
by the Court, there is disagreement as to the amendment's effect in light of Martin, with
some courts disregarding Martin, see, e.g., Atkinson v. Ormont Mach. Co., 102 Misc. 2d 468,
469, 423 N.Y.S.2d 577, 579 (Sup. Ct. Kings County 1979); Martin v. Drackett Prods. Co.,
100 Misc. 2d 728, 733, 420 N.Y.S.2d 147, 150 (Sup. Ct. Erie County 1979), and others view-
ing the Court of Appeal's decision as retaining the defense of privity in implied warranty
actions. See, e.g., Held v. 7-Eleven Food Stores, 438 N.Y.S.2d 976, 979 (Sup. Ct. Erie
County 1981) (dictum).

112 See, e.g., ME. REV. STAT. ANN. tit. 11, § 2-318 (Supp. 1981-1982); MASS. GEN. LAWS
ANN. ch. 106, § 2-318 (West 1981); N.H. REV. STAT. ANN. § 382-A: 2-318 (Supp. 1979); VA.
CODE § 8.2-318 (1965). Through amendments to section 2-318 of the U.C.C., several states
have expressly abolished the defense of lack of privity in products liability cases. The Mas-
sachusetts provision, for example, states that "[lack of privity between plaintiff and defen-
dant shall be no defense in any action brought against the manufacturer, seller, lessor or
supplier of goods . . . [provided the plaintiff was a foreseeable user or consumer of the
goods]." MASS. GEN. LAWS ANN. ch. 106, § 2-318 (West 1981); see J. WHITE & R. SUMMERS,
UNIFORM COMMERCIAL CODE § 11-3, at 404 n.20 (2d ed. 1980).

113 See Loch Sheldrake Assocs. v. Evans, 306 N.Y. 297, 305, 118 N.E.2d 444, 447 (1954);
Heller v. Pope, 250 N.Y. 132, 135, 164 N.E. 881, 882 (1928); Allen v. Oseida, 210 N.Y. 496,
503, 104 N.E. 920, 922 (1914); Thomas v. Scutt, 127 N.Y. 133, 137 (1891). The parol evi-
dence rule has been well established in New York since the 19th century. See, e.g., Hutchins
v. Hebbard, 34 N.Y. 24, 26 (1865); Barry v. Ransom, 12 N.Y. 462, 464 (1855). Judge Pound
stated that "[p]arol evidence may not be received to vary the clear and unambiguous terms
Co., 242 N.Y. 134, 142, 151 N.E. 155, 157 (1926). The rule has been used repeatedly by the
New York courts in determining whether to admit evidence of terms other than those em-
bodyed in the language of a written contract. See Sabo v. Delman, 3 N.Y.2d 155, 161, 143
N.E.2d 906, 908, 164 N.Y.S.2d 714, 717 (1957); Smith v. Dotterweich, 200 N.Y. 299, 305, 93
N.E. 985, 987 (1911); Aratari v. Chrysler Corp., 35 App. Div. 2d 1077, 1077, 316 N.Y.S.2d
680, 681 (4th Dep't 1970).

The parol evidence rule was created to prevent fraud, avoid the danger of memory
lapses, and minimize the effect of the death of key witnesses. Less v. Lamprecht, 196 N.Y.