

TEL AVIV UNIVERSITY

STUDIES IN LAW

VOLUME 9

1989



THE CEGLA INSTITUTE FOR COMPARATIVE AND PRIVATE INTERNATIONAL LAW  
FACULTY OF LAW, TEL AVIV UNIVERSITY

**THE CEGLA INSTITUTE FOR COMPARATIVE  
AND  
PRIVATE INTERNATIONAL LAW  
To Promote International Understanding, Unification,  
and Harmonization of Laws**

Editor:  
DANIEL FRIEDMANN

Associate Editor:  
NOMA FLOOM

ISSN 0334-5947

©

ALL RIGHTS RESERVED BY TEL AVIV UNIVERSITY  
FACULTY OF LAW, 1989

Printing at 'Graph-Chen' Press Ltd., Jerusalem

# PRODUCTS LIABILITY AND PROPERTY DAMAGES

INGEBORG SCHWENZER\*

## I. Introduction

From the very beginning of products liability law, its aim has been to protect human life and limb. One may, for example, recall the development in the United States: from the so-called food cases<sup>1</sup> and *MacPherson v. Buick Motor Co.*,<sup>2</sup> to *Henningsen v. Bloomfield*<sup>3</sup> and *Greenman v. Yuba Power Products*,<sup>4</sup> all involved a situation where the defect had caused personal injury. The prevention of personal injury still is the major issue in this field, as shown by the EEC Directive or by newly emerging problems of causation, as alternative or market share liability, or the discussion of the "state of the art" defence and so forth.

But it is unanimously held that products liability law covers property damage as well as personal injury. In German law, this follows from the starting point of manufacturer's liability: the basic provision of tort law<sup>5</sup> holds property as well as a protected interest as life and limb. In American law, only a small step was necessary to equate property damage with personal injury by putting them both under the heading of physical injury.<sup>6</sup> The EEC Directive<sup>7</sup> holds the manufacturer liable for property damages only under

\* Professor of Law, University of Basel/Switzerland.

1. For a citation of cases, see Prosser, "The Assault Upon the Citadel (Strict Liability to the Consumer)," 69 *Yale L.J.* 1099 (1960) at 1106 *et seq.*

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

3. 32 N.J. 358, 161 A.2d 69, 75 A.L.R.2d 1 (1960).

4. 59 Cal. 2d. 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

5. BGB Section 823 par 1.

6. For a citation of cases, see Prosser, "The Fall of the Citadel (Strict Liability to the Consumer)," 50 *Minn. L. Rev.* 791, 821 (1966).

7. Art. 9 (b).

limited circumstances: only if the chattel damaged or destroyed is ordinarily intended for private use or consumption and in the specific case has been so used by the claimant.

On the other hand most legal systems deny compensation for purely economic loss under tort principles. Although in the United States a few states follow the famous *Santor* decision<sup>8</sup> and extend strict liability in tort to cover economic loss,<sup>9</sup> most states follow the aforementioned rule.<sup>10</sup> New Jersey itself in the meantime has limited the *Santor* ruling as applicable to consumers only.<sup>11</sup>

Thus in most legal systems the definition of property damage and the drawing of the line between property damage and economic loss becomes a crucial question in products liability law. The practical importance in this context lies in damages the ultimate user or consumer sustains. Property damages a mere bystander suffers — for example, his car is damaged in a collision with a defective car — do not pose greater problems, as principally this property is totally unrelated to the product.

The issue to be discussed here is closely related to the general question of

8. *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965).
9. See, e.g., *Cova v. Harley Davidson Motor Co.*, 26 Mich. App. 602, 182 N.W. 2d 800 (1970); *Herbstman v. Eastman Kodak Co.*, 131 N.J. Super. 439, 330 A.2d 384, 17 UCC Rep. 39 (1974) (*dictum*); *Ford Motor Co. v. Lonon*, 217 Tenn. 400, 398 S.W.2d 240 (1966) (*dictum*); prior to *Santor*: *Suvada v. White Motor Co.*, 32 Ill. 2d 612, 210 N.E.2d 182, 2 UCC Rep. 762 (1965); and recently: *Berkeley Pump Co. v. Reed-Joseph Land Co.*, 653 S.W.2d 128 (Ark. 1983).
10. See, e.g., *Seely v. White Motor Co.*, 63 Cal. 2d 1, 45 Cal. Rptr. 17, 403 P.2d 145 (1965); *Superwood Corp. v. Siempelcamp Corp.*, 311 N.W.2d 159 (Minn. 1981); *Tri-State Insurance Company v. Lindsay Bros. Co.*, 364 N.W. 2d 894 (Minn. App. 1985); *Valley Farmer's Elevator v. Lindsay Bros.*, 380 N.W. 2d 874 (Minn. App. 1986); *Moorman Manufacturing Co. v. National Tank Co.*, 92 Ill. App. 3d 136, 47 Ill. Dec. 186, 435 N.E. 2d 443 (1982); *Burnell v. Morning Star Homes, Inc.* 494 N.Y.S.2d 488 (App. Div. 1985); *Schlavone Construction Co. v. Elgood Mayo Corp.* 436 N.E. 2d 1322 (N.Y. 1982); *contra*: *N.Y. S.Ct. App.Div.* 439 N.Y.S.2d 933 (App.Div. 1981); *Sacramento Regional Transit Distr. v. Flexible*, 158 Cal. App. 3d 289, 204 Cal. Rptr. 736 (1984); *Purvis v. Consolidated Energy Products Co.*, 674 F.2d 217 (4th Cir. 1982); *American Home Assur. Co. v. Major Tool & Machine, Inc.*, 767 F.2d 446 (8th Cir. 1985); *McConnell v. Caterpillar Tractor Co.*, 646 F. Supp. 1520 (D.N.J. 1986); *Sanco, Inc. v. Ford Motor Co.*, 579 F. Supp. 893 (S.D.Ind. 1984), *affirmed* 771 F.2d 1081 (7th Cir. 1985).
11. *Spring Motors Distributors, Inc. v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985); see Note, "Products Liability — Damages — Commercial Entity Limited to Breach of Warranty Theory for Recovery of Economic Losses — *Spring Motors (ibid.)*," 17 *Seton Hall L. Rev.* 330–354 (1897) at 344 *et seq.*

what kinds of interests should be protected by tort law and which ones are exclusively to be dealt with by contract law.

In the following I shall focus on German and American law as well as the EEC Directive, although under the latter the problem is of less concern as liability for property damages of commercial buyers — in practice the most important issue — is not within the scope of the Directive.

The most controversial cases I want to deal with, may be classified into four groups:

## II. Groups of Cases

1. The first type is damage to the chattel itself. Can the buyer of a product claim damages in tort from the seller or the remote manufacturer if the product itself is damaged or destroyed by its defect?

2. In the second group the question arises whether there is actionable property damage where property of the buyer necessarily and deliberately comes in close contact with the product, for instance, material to be processed by a machine.

3. The third group is closely related to the second one: it includes the case where a product is designed to protect property of the ultimate user but by not living up to these expectations, this very property is damaged or destroyed.

4. At last, in the fourth group I want to pose the question of whether one might equate the actual threatening of personal injury or property damage with property damage already ensued and thus allow recovery for costs of repair and replacement of the defective product under products liability law, similar to some recent asbestos cases in the United States.<sup>12</sup>

Before I turn to a discussion of these four groups of cases, however, I would like to recall the consequences that follow from a classification of these cases as either under contract law or under tort principles.

12. *Cf. infra* note 85; for details, see Brenza, "Asbestos in Schools and the Economic Loss Doctrine," 54 *U. Chi. L. Rev.* 277-311 (1987).

### III. Consequences of Classification as Contractual or Tortious

#### 1. *Persons Liable*

In the first place the classification of a loss as property damage recoverable under tort law is decisive in determining the group of persons to be held liable. This is true for German law, where contractual liability generally depends on privity<sup>13</sup> and probably in the majority of the American states, where the privity rule in implied warranty actions for economic loss is retained,<sup>14</sup> although a number of these states allow recovery for economic loss under an express warranty without a direct contractual relationship.<sup>15</sup> The EEC Directive only comes into play if the consumer suffered any property damage.

#### 2. *Major Differences Between Contractual and Tortious Liability*

Defining a loss as property damage may be decisive in the relationship between a buyer and his immediate seller, or in determining the extent and details of the liability of a remote manufacturer if privity is not required. Limitations innate in contract law are all too often circumvented by tort law.

##### a) Extent of Liability

Anglo-American contract law,<sup>16</sup> as well as the Hague and the Vienna Convention on Contracts for the International Sale of Goods,<sup>17</sup> restrict liability for secondary economic loss, i.e., primarily profits, by the so-called contemplation rule: that under the contract, the only losses recoverable are those that must have been foreseen as a reasonable consequence of breach by the seller at the time of the conclusion of the contract.<sup>18</sup> In the Federal

13. See the leading case BGH 26 Nov. 1968, BGHZ 51, 91 = JZ 1969, 387; annotated by Deutsch, *ibid.*
14. See Cartwright & Phillips, *Products Liability* (1986), Section 2.26 at 204 with further quotations.
15. See *Baxter v. Ford Motor Co.*, 168 Wash. 456, 12 P.2d 409 (1932); *Randy Knitwear, Inc. v. American Cyanamid Co.*, 11 N.Y. 2d 5. 226 N.Y.S.2d 363, 181 N.E.2d 399 (1962); *Seely v. White Motor Co.*, *supra* note 10.
16. *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854); UCC Section 2-715 (2) (a).
17. ULIS Art. 82; CISG Art. 74.
18. See *supra* note 16.

Republic some authors at least favor this rule in connection with the planned revision of parts of the BGB.<sup>19</sup>

In tort law principally there does not exist any comparable limitation once property damage has been established. Under German law it is not even necessary that the defendant foresee the consequential damages resulting from property damage.<sup>20</sup>

### b) Disclaimers and Limitations of Remedies

The classification as property damage or purely economic loss is furthermore of great importance in respect to disclaimers and limitation of remedies clauses.

Although West German courts pay lip service to the rule that liability in tort may be disclaimed,<sup>21</sup> there is a strong tendency to disfavor such clauses once tortious liability has been established by applying the so-called "*contra proferentem rule*"<sup>22</sup> and interpreting exculpatory clauses narrowly. Some German authors take a further step and hold unconscionable any clause that purports to exclude or limit liability in tort.<sup>23</sup>

The same is true for American law. Whereas contractual liability may be disclaimed within the boundaries set forth by the UCO,<sup>24</sup> strict liability in tort generally cannot be disclaimed,<sup>25</sup> although there are some decisions

19. See U. Huber, in I *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts*, (1981) 674 at 729, 802 *et seq.*
20. Cf. Larenz, II *Lehrbuch des Schuldrechts*, vol. II (1981) 12th ed.) Section 71 I; I (1987 14th ed.) 27 III.
21. See BGH 4 June 1975, BGHZ 64, 355; BGH 24 Nov. 1976, BGHZ 67, 359; *see also* Brandner, in Ulmer, Brandner & Hensen, *AGBG* (1986 5th ed.) Section 9 No. 115.
22. *AGBG* Section 5; cf. e.g., BGH 11 March 1986, *NJW* 1986, 2757; BGH 24 Nov. 1976, *supra* note 21.
23. See U. Huber, "Zur Haftung des Verkäufers wegen positiver Vertragsverletzung," in *AcP* 177 (1977), 281, 330 *et seq.*; *idem* in Soergel *BGB* (1986 11th ed.), Vor Section 459 No. 233; von Westphalen *NJW* 1979, 838 at 842 *et seq.*; *idem* *WM* 1983, 976 at 980; *contra*: Manfred Wolf *NJW* 1980, 2433 at 2434; *see also*, Deutsch, I *Haftungsrecht*, (1976) Section 20 III.4 at 333.
24. See UCC Section 2-316, 2-719; for details, see Cartwright & Phillips, *supra* note 14 Section 2.08 at 153 *et seq.*
25. *Vandermark v. Ford Motor Co.*, 61 Cal. 2d 256, 37 Cal. Rptr. 896, 391 P.2d 168 (1964); *see also* Cartwright & Phillips, *supra* note 13, Section 2.12 at 161; Section 402A *Restatement of Torts (Second)*, comment m.

upholding an exculpatory clause bargained for between commercial entities of equal bargaining power.<sup>26</sup>

The EEC Directive, too, explicitly denies any possibility of disclaiming liability within its field of application.<sup>27</sup>

### c) Notice of Breach

Sales law usually requires a buyer, in German law at least a merchant buyer, to give timely notice of the breach or he loses his remedies.<sup>28</sup>

It has long been in dispute under German law whether the commercial buyer who did not notify the seller of defects discoverable by a reasonable inspection thereby loses his action in tort law as well. In a landmark decision the German Supreme Court in 1987<sup>29</sup> took the position that the buyer's claim based in tort is not barred. The facts of the case are interesting enough to be summarized here. The buyer, a winery, ordered corks of the lowest grade, generally used to cork bottles with inexpensive wines not to be stored for long periods of time. The buyer, however, used them to cork bottles of "Spätlese," expensive wine made from late-gathered grapes, only to find out a few months later that the wine had been ruined which caused him a loss of about 300.000 DM. Had the buyer inspected the corks — just by cutting one through — he easily could have found out that the corks were totally unsuitable for his intended purpose. Although all contractual remedies were barred, the Supreme Court allowed the buyer to recover at least part of his loss as property damage under tort law.

In the United States as well the notice requirement in products liability has been restricted to cases based on warranty.<sup>30</sup> No such requirement is imposed where the plaintiff seeks recovery in negligence or — as the landmark case of

26. *K-Lines Inc. v. Roberts Motor Co.*, 273 Or. 242, 541 P. 2d 1378 (1975); *Delta Airlines, Inc. v. McDonnell Douglas Corp.*, 503 F.2d 239 (5th Cir. 1974); *Keystone Aeronautics Corp. v. R.J. Enstrom Corp.*, 499 F.2d 146 (3rd Cir. 1974); *S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines) v. Boeing Co.*, 641 F.2d 746 (9th Cir. 1981).

27. Art. 12.

28. UCC Section 2-607; HGB Section 377.

29. BGH 16 Sept. 1987, *WM* 1987, see also BGH 28 April 1976, BGHZ 66, 208; cf. also Schlechtriem in *II Festschrift Rheinstein*, (1969) 683, 695 *et seq.*; Schwark *AcP* 179 (1979) 57, 76 *et seq.*

30. See Cartwright & Phillips, *supra* note 14, Section 2.35 at 234.



*Greenman v. Yuba Power Products, Inc.*<sup>31</sup> already laid down in 1962 — in strict liability in tort.

#### d) Statutes of Limitations

The question of what statute of limitations is to be applied becomes of great practical importance.

In West German law, contractual remedies for breach of warranty are barred six months after delivery of the goods,<sup>32</sup> whereas the statute of limitations for claims for property damages in tort law sets an outer limit of three years beginning with the moment the plaintiff has knowledge of the injury and the person of the defendant,<sup>33</sup> at the latest 30 years after the tortious conduct. The Supreme Court has never transferred the shorter contractual limitation period to concurring liability in tort.<sup>34</sup>

Although in the United States the relevant statutes of limitations do not differ as much concerning the periods they provide as under German law (under the UCC it is four years;<sup>35</sup> state statutes of limitations in respect to property damages provide for periods between one and six years<sup>36</sup>), the differentiation becomes highly relevant when dealing with the time when the statute begins to run.<sup>37</sup> Contractual remedies are barred four years after delivery, whereas statutes of limitations for tort actions begin to run with the time of injury or the time the plaintiff discovered or reasonably should have discovered all the essential elements of his possible cause of action.<sup>38</sup>

31. *Supra* note 4.

32. BGB Section 477.

33. BGB Section 852.

34. *See, e.g.*, BGH 25 May 1976, BGHZ 66, 315 at 318; for a thorough discussion, see Schlechtriem, in II *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts*, (1981) 1591, 1661; *contra*, OLG Düsseldorf 14 Oct. 1974, *NJW* 1975, 453; *but cf.* Schubert *NJW* 1975, 1230.

35. UCC Section 2-725.

36. For an overview of state statutes of limitations, see Appendix E to *In re Agent Orange Product Liability Litigation*, 597 F. Supp. 740 at 879-898 (E.D.N.Y. 1984).

37. *See* Cartwright & Phillips, *supra* note 14, Section 9.15 at 1167 *et seq.*

38. *See Ohler v. Tacoma Gen. Hosp.*, 598 P.2d 1358 (Wash. 1979). For further case law, see Prosser & Keeton, *The Law of Torts* (1984 5th ed.) Ch. 5, Section 30 at 166 *et seq.*

### e) Conventions on the International Sale of Goods

Last but not least, the classification of a loss as property damage in the case of an international sale of goods may be decisive for the application of internationally unified sales law and/or national tort law.

It is unanimously held that the Hague Convention on Contracts for the International Sale of Goods does not exclude national tort law.<sup>39</sup> The Vienna Convention seems to embrace property damages — Article 5 expressly excludes liability for personal injuries only from the sphere of application. However German authors favor the position that if there is property damage in the sense of Section 823 par. 1 BGB, the seller's liability is also governed by domestic tort law,<sup>40</sup> a result that might interfere with basic ideas of the Convention.

Bearing these implications in mind I now want to discuss possible solutions for the groups of cases mentioned at the beginning.

## IV. Classification in Detail

### 1. *Damage to the Chattel Itself*

Whether damage to the chattel itself may be recovered under tort theories is a highly controversial issue.

In the Federal Republic until 1976 damage to the chattel itself was not regarded as property damage in the sense of Section 823 par. 1 BGB, since it was argued the buyer never was the owner of a chattel free from defects that could be damaged. In 1976, however, the Supreme Court changed its position allowing, for the first time, recovery in tort in the case of damage to the chattel itself attributable to a so-called "spreading defect."<sup>41</sup>

In further decisions,<sup>42</sup> this holding has been affirmed. Initially unclear what criteria to apply to draw the line between purely economic loss and

39. See, e.g., Dölle (-Herber), EKG (1976), EKG Art. 8 No. 11.

40. See Schlechtriem, *Einheitliches UN-Kaufrecht* (1981) at 21; but cf. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (1982) at 102 et seq.

41. BGH 24 Nov. 1976, BGHZ 67, 359 = JZ 1977, 343; annotated by Lieb and Rengier, *ibid.*

42. BGH 5 July 1978, NJW 1978, 2241; BGH 18 Jan. 1983, BGH 86, 256 = JZ 1983, 499 annotated by Stoll, *ibid.*; BGH 14 May 1985, NJW 1985, 2420; contra LG Karlsruhe 22 July 1987, JZ 1987, 828.

property damage, it is now considered essential whether the original depreciated value is identical with the loss suffered later or not.<sup>43</sup> That means whenever the defect was reparable, a tort action for damage to the chattel itself is possible. The nature of the defect, however, is not decisive. Thus in the latest case decided by the Supreme Court in 1985,<sup>44</sup> the buyer of a compressor prevailed in a tort action, while warranty remedies were barred by the statute of limitations. The compressor had a defectively designed oil drain causing damage to the diesel engine, that had to be replaced.

American courts, too, seem divided on the question of whether damage to the chattel itself is actionable in tort.<sup>45</sup> Those states allowing recovery of purely economic loss under tort theories<sup>46</sup> consequently do not hesitate to hold the manufacturer liable in tort for damage to the chattel itself. On the other hand, there seems to be a slight majority defining damage to the chattel itself as purely economic loss,<sup>47</sup> thus denying recovery at least under strict liability in tort — a position that has lately been taken by the U.S. Supreme Court<sup>48</sup> under Maritime Law, too. There are some cases, however, allowing recovery on a negligence theory.<sup>49</sup>

A number of states take a middle course. Instead of focusing on the items for which recovery is sought, major importance is given to the nature of the defect and the type of risk it poses. One of the leading cases enunciating this principle — though this reasoning seemingly goes back as far as a case decided by the Appellate Division of the N.Y. Supreme Court in 1915<sup>50</sup> — is *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*<sup>51</sup> A front-end loader, purchased from the defendant and used by the plaintiff for four

43. BGH 14 May 1985, *supra* note 42; *contra* Reinicke & Tiedtke, "Stoffgleichheit zwischen Mangelunwert und Schäden im Rahmen der Produzentenhaftung," in *NJW* 1986, 10, 13 *et seq.* (non-practicability of this criterion).
44. BGH 14 May 1985, *supra* note 42.
45. See Note, "Tort Recovery for Self-Inflicted Damages," 84 *Mich. L. Rev.* 517 (1985); Cartwright & Phillips, *supra* note 14, Sections 2.31–2.33 at 218–228.
46. See, e.g., *Santor v. A. & M. Karagheusian, Inc.*, *supra* note 8; *Lang v. General Motors Corp.*, 136 N.W.2d 805 (N.D. 1965).
47. For a citation of cases, see Cartwright & Phillips, *supra* note 14, Section 2.22 at 186 *et seq.*
48. *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 106 S. Ct. 2295 (1986).
49. See Cartwright & Phillips, *supra* note 14, Section 2.21 at 183 *et seq.*; Prosser & Keeton, *supra* note 38, Ch. 7, Section 101 at 708 n. 3; see also Gaebler, "Negligence, Economic Loss, and the U.C.C.," 61 *Ind. L.J.* 593 (1986) at 627 *et seq.*
50. *Quackenbush v. Ford Motor Co.*, 167 App. Div. 433, 153 N.Y.S.2d 131 (1915)
51. 652 F.2d 1165 (3d Cir. 1981).

years, suddenly caught fire in the front portion near the hydraulic lines. The operator failed to shut off the motor upon leaving the machine. As a result, hydraulic fluid continued to fuel the fire and the machine was severely damaged. The plaintiff contended that the design of the loader was defective because it omitted a fire suppression system, and that an additional defect was the lack of adequate warnings. The court regarded the alleged defect as constituting a safety hazard that posed a serious risk of harm to people. Thus — it was argued — the complaint fell within the policy of tort law that the manufacturer should bear the risk of hazardous products.<sup>52</sup>

On the other hand, absent a “man-endangering” defect, courts generally define damage to the chattel itself as purely economic loss. An excellent example comparable to the compressor case of the German Supreme Court is *Gibson v. Reliable Chevrolet, Inc.*<sup>53</sup> where a car’s engine was irreparably damaged because the engine’s heater core had ruptured permitting the coolant to escape and thus developing excessive heat. Recovery in tort was denied.

The EEC Directive<sup>54</sup> explicitly limits liability to “any item of property other than the product itself.” Thus there seems to be a clear solution to the “damage to the chattel itself” situation. But a closer look reveals that the question may still arise in cases where an item composed of several parts is damaged. “Product” in the sense of the Directive is defined as any “movable, even though incorporated into another movable.”<sup>55</sup> Thus it may be argued in the heater core case that the “defective product” is the heater core only, an item easily distinguishable from other parts of the car, thus leaving the damage to the engine actionable as property damage under the Directive. The comment on the Draft of the West German Products Liability Statute, implementing the Directive, expressly leaves the line-drawing in these cases to the courts.<sup>56</sup> And German authors, commenting on the Directive, have already taken the view that the aforementioned interpretation should be possible<sup>57</sup> especially if the distinguishable defective part has not been

52. *Ibid.* at 1174–1175.

53. 608 S.W.2d 471 (Mo. App. 1981).

54. Art. 9 par. 1 lit b.

55. EEC Directive Art. 2.

56. See “Begründung zu dem Gesetz über die Haftung für fehlerhafte Produkte,” in *Arbeitsmaterialien zum deutschen Produkthaftungsgesetz*, PHI Sonderdruck, July 1987 at 106.

57. See Schlechtriem, “Angleichung der Produkthaftung in der EG,” *VersR* 1986, 1033, 1041 *et seq.*

produced by the manufacturer of the whole product, but by a component part manufacturer.<sup>58</sup> So even under the EEC Directive there remains the task of differentiating between property damage and economic loss, at least in case of a so-called spreading defect.

I think the line has to be drawn according to the basic aims of contract and tort law, respectively. Contract law aims to secure that the buyer receives what he bargained for. The contemplation rule as to secondary economic loss, the possibility of disclaiming liability, notice requirements, and statutes of limitation beginning to run on delivery — all these characteristics seek to balance the interests between seller and buyer according to the terms of the contract. Tort law, in contrast, does not relate to the bargain; its most important concern is accident reduction and safety, primarily safety for human health.

Damage to the chattel itself therefore, in my opinion, has to be dealt with primarily by contractual remedies. Why should the buyer in the German compressor case<sup>59</sup> be able to sue the seller for a minimum period of 30 years whereas if the whole compressor were irreparably defective and therefore just stopped after six months, his action would be barred by the statute of limitations concerning warranties. It is hard to see any difference between the two cases; in either case the buyer has not received what he bargained for.

However, there are strong arguments to allow recovery under tort theories if the damage to the chattel itself results from a man-endangering defect and is accompanied by personal injury or damage to other property, or these latter losses do not occur by pure chance only. Viewed from the objective of prevention of marketing unsafe products, it should not be decisive what item of property is damaged or destroyed, but rather what kind of a defect is imputed to the defendant.

This solution corresponds to the aforementioned line of cases in American law.<sup>60</sup> It may also be achieved under the EEC Directive though, at least in cases where a discernable part of the chattel is unreasonably dangerous. Article 6 of the Directive, that defines a product as being defective if it does not provide the safety which a person is entitled to expect, may form the basis for the differentiation supported here.

58. See Schmidt-Salzer, I *Kommentar EG-Richtlinie Produkthaftung*, (1986) Art. 9 No. 28.

59. *Supra* note 42.

60. *Supra* notes 50 and 51; see also G. Hager, "Einstandspflicht des Produzenten für das Äquivalenz- und Nutzungsinteresse des Produkterwerbers," *BB* 1987, 1748, 1750.

## 2. *Damage to Property Intentionally Coming into Close Contact with the Product*

In the second group, the question arises whether damage to property deliberately coming into close contact with the product may be defined as property damage under tort law.

The examples are numerous: contaminated sand is commingled with other materials belonging to the buyer, the defective oil drain is installed into the buyer's car; the defective sawmill spoils the lumber being processed.

German courts dealing with these cases generally take a rather formalistic approach: whether there is actionable property damage is defined on the basis of property law. In the commingling cases, property damage is denied because the commingled materials form a new item of property, although defective as a whole.<sup>61</sup> It is argued that the buyer, thus becoming owner of newly originating property, cannot be damaged in said property at the same time.

In the other cases where, according to property law principles, the product and the earlier acquired property of the buyer do not form a new item of property a claim in tort usually is approved.<sup>62</sup> Rare are the cases where German courts favor a more functional than formalistic approach.<sup>63</sup>

With respect to processing machinery there are only a few German appeal cases. Whereas in the case of a defective sawmill one appellate court<sup>64</sup> denied a property damage in respect to the lumber, another appellate court<sup>65</sup> in a dictum involving dairy machinery answered the question in the affirmative, where the defect would cause the milk to be stirred into butter.

Although there are a few American cases — especially when processing machinery is concerned<sup>66</sup> — supporting a finding of property damage with similar arguments as those used by German courts, namely, that property

61. See RG 27 April 1905, *JW* 1905, 367, No. 6.

62. See BGH 4 March 1971, *BGHZ* 55, 392; BGH 24 March 1977, *NJW* 1977, 1819, annotated by Schlechtriem, *ibid.*: BGH 16 Sept. 1987, *supra* note 29.

63. Cf. BGH 25 May 1972, in Schmidt-Salzer, III *Entscheidungssammlung Produkthaftung*, at I. 159.

64. OLG Hamm 12 July 1961, *VersR* 1962, 432.

65. OLG Karlsruhe 30 May 1985, *VersR* 1986, 1125.

66. Cf. *LeSueur Creamery, Inc. v. Haskon, Inc.*, 660 F. 2d 342 (8th Cir. 1981); *Abco Metals Corp v. J.W. Imports Co.*, 560 F. Supp. 125 (N.D. Ill. 1982).

previously owned by the buyer is destroyed,<sup>67</sup> there seems to be a strong tendency to draw the line in this group according to the "damage to the chattel itself" situation.<sup>68</sup>

That means an action for property damage in tort does not depend on the intricacies of property law. It rather depends on the nature of the defect and the manner in which the loss occurred. Thus recovery in tort has been denied where an assembler of turbines suffered physical damages to the turbine because parts supplied by a component part manufacturer did not conform to the contract drawing;<sup>69</sup> where the defect of a computer caused the loss of stored data;<sup>70</sup> where because of defective shingles the underlying roofing material was damaged;<sup>71</sup> or where polluted flour contaminated other ingredients.<sup>72</sup> Recovery in tort, however, was allowed where the defect of a product used in construction resulted in the cracking of masonry on the exterior of a building posing a real risk for persons going by;<sup>73</sup> or where the malfunctioning of a manual controller of a gas turbine damaged the latter by fire and explosion.<sup>74</sup>

The EEC Directive does not give any explicit guidance as to whether an action under the Directive will lie for the group of cases discussed here, leaving it to national law to make the appropriate distinctions.

In many of the cases discussed here, the closely related property of the buyer is damaged because the product does not live up to the rightful expectations of the buyer according to the provisions of the contract. An excellent example is the already discussed cork case decided by the German Supreme Court in 1987.<sup>75</sup> Suppose the buyer did not clarify his intended use for the corks, thus leaving the seller to believe that they would

67. *Queensbury Union v. Jim Walter Corp.*, 442 N.Y.S. 2d 650 (App. Div. 1981); *Manning v. International harvester Co.*, 381 N.W.2d 376 (Iowa App. 1985).
68. See text *supra* at Section IV.1; see also Cartwright & Phillips, *supra* note 14, Section 2.29 at 209 *et seq.*
69. *American Home Assur. Co. v. Major Tool & Machine, Inc.*, 767 F.2d 446 (8th Cir. 1985).
70. *Antel Oldsmobile Cadillac Inc. v. Sirius Leasing Co.*, 475 N.Y.S. 2d 944 (App. Div. 1984).
71. *2000 Watermark Ass'n, Inc. v. Celotex Corp.*, 784 F.2d 1183 (4th Cir. 1986); *Chicago Heights Venture v. Dynamit Nobel of America*, 782 F. 2d 723 (7th Cir. 1986); *Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp.*, 626 F.2d 280 (3rd Cir. 1980).
72. *Dixie-Portland Flour Mills v. Nation Enterprises*, 613 F. Supp. 985 (D.C. Ill. 1985).
73. *Philadelphia National Bank v. Dow Chemical Co.*, 605 F. Supp. 60 (E.D. Penn. 1985).
74. *Salt River Project Agricultural Improvement and Power District v. Westinghouse Electric Corp.*, 694 P. 2d 198 (Ariz. 1984).
75. *Supra* note 29.

be used as customary, namely for rather inexpensive wines. Should the seller be held liable in case of a defect for the much greater loss the buyer suffered when bottling “Spätlese”? Here the example given by Molinaeus<sup>76</sup> as early as the sixteenth century is still valid: One who sells a leaking beer barrel is liable for the value of lost beer but not for the higher value of wine that has been barreled unexpectedly. It is here, too, where notice requirements and the possibility for the seller to disclaim his liability are perfectly adequate.

Again, however, cases where the defect causes a safety hazard, especially to human health, should be distinguished. If in the cork case, the corks poison the wine and the buyer prevents personal injury of the consumer by not marketing or by recalling already marketed bottles, it is primarily the manufacturer of the corks who is, according to the general goals of tort law, to be held liable for the situation. Giving the buyer a remedy in tort for destruction of the wine at the same time serves these general purposes.

### 3. *Products Designed to Protect Property*

The third group comprises products exclusively designed to protect property. Does a tort action lie if the very damage to the property that the product is designed to prevent occurs? Cases coming to courts mostly concerned pesticides or herbicides and, in the U.S., alarm systems.

In two landmark decisions in 1981 the German Supreme Court approved the buyer's claim in tort against the manufacturer of fungicides.<sup>77</sup> The fungus that the product was supposed to kill had become resistant, thus destroying the buyer's apple harvest. Liability in tort in these cases lies — as the Supreme Court put it — if the user could have prevented the damage by applying other measures of protection and the manufacturer kept him from doing so, because he relied on the suitability of the product.<sup>78</sup> The majority of American courts seem to follow another line. Thus a farmer who had purchased barns for the curing of tobacco was confined to repair and replacement under the contract,<sup>79</sup> and neither the buyer of an irrigation system who suffered a loss of 50 percent of his corn crop,<sup>80</sup> nor the buyer of

76. See König in *Kolloquium für von Caemmerer* (1973) 75, 77.

77. BGH 17 March 1981, BGHZ 80, 186; BGH 17 March 1981, BGHZ 80, 199.

78. BGH 17 March 1981, BGHZ 80, 199.

79. *Purvis v. Consolidated Energy Products Co.*, 674 F. 2d 217 (4th Cir. 1982).

80. *Lockwood Corp. v. Spencer*, 613 S.W. 2d 369 (Tex. App. 1981).



defective animal feed that caused chickens at first to produce eggs that tasted badly and finally not to produce any eggs at all,<sup>81</sup> prevailed on the basis of strict liability in tort.

The alarm system cases are treated similarly.<sup>82</sup> Where a burglar alarm system fails and the buyer loses his property by burglary, American courts generally agree that the buyer should be confined to contractual remedies, which also usually means upholding a clause in the contract that limits liability to a certain amount very much below the actual loss sustained.

Again, the EEC Directive does not express any opinion on the question of whether the damages in this group can be regarded as property damage. One German author<sup>83</sup> has argued that in this group of cases under the Directive it is rather a question of causation than one of defining the term of property damage. I cannot agree with this interpretation.

In respect to property protecting products, it is even more necessary to draw an accurate line between contract and tort law than in the aforementioned groups of cases. The suitability of a product is the typical contractual interest of a buyer. This may be shown by a simple comparison with late delivery. The buyer may sustain the very same damage if the seller does not deliver a defective product but if he is merely late in delivering it, only if the buyer relying on timely performance refrains from other protective measures.

The qualities a product must have in order to protect certain property depends on the specific terms of the contract. Liability for damages resulting from nonsuitability typically should be open to negotiation between the parties. And it is here as well that a failure of inspection and notification should bar the buyer's remedies.

Still, there might be cases in this group as well where a tort remedy will lie, namely, where the product is not just unsuitable for the intended purpose but poses a safety hazard, like where the property protected by a burglar alarm system is destroyed by a fire caused by a short circuit in the system.

81. *Brown v. Western Farmers' Ass'n*, 268 Or. 470, 521 P. 2d 537 (1974).

82. *Aronson's Men's Stores v. Potter Elec., etc.*, 632 S.W.2d 472 (Mo. en banc 1982); *Fireman's Fund American Insurance Co. v. Burns Electronic Security Services, Inc.* 417 N.E. 2d 131 (Ill. App. 1980); *Lobianco v. Property Protection, Inc.*, 437 A. 2d 417 (Pa. Super. 1981); for further cases, see Annotation, 37 A.L.R. 4th (1985) 47 *et seq.*

83. Schlechtriem, *supra* note 57 at 1034.

#### 4. *Actual Threat of Personal Injury or Property Damage as Equivalent to Property Damage*

It is not until recently that the question has been put anew whether costs for repair and replacement may be claimed under tort law, at least if there is an actual threat of personal injury or property damage. Whereas in the past these losses were nearly unanimously regarded as constituting economic loss recoverable under contract law only, recent case law suggests a process of change.

The German Supreme Court did not have to rule on the question recently. There is, however, a dictum by a German appellate court<sup>84</sup> allowing the manufacturer of dairy machinery to recoup, in tort, the costs of repairs he performed when the machines were already delivered to his customers from the component part manufacturer of capacitors. Because of an alleged defect of the capacitor, damage to the milk being processed was allegedly threatening.

In the U.S. the law seemed to be rather settled for a long time by the well-known decision of the New York Supreme Court in *Trans World Airlines v. Curtiss-Wright*,<sup>85</sup> denying tort recovery for the replacement costs of defective aircraft engines. Although there are many cases that still adhere to the position that before any accident occurs, repair and replacement costs have to be treated as purely economic loss,<sup>86</sup> numerous exceptions to this rule can be found in recent American case law.

One important group where recovery on the basis of strict liability in tort has been allowed are the asbestos cases,<sup>87</sup> where owners of buildings equipped with asbestos-containing materials claim damages from the manufacturers for removing said materials. Major importance in these cases is given to the fact that there is a continual serious risk of personal injury that can only be prevented by removing the materials. A result similar to that in the asbestos

84. OLG Karlsruhe 30 May 1985, *VersR* 1986, 1125.

85. 1 Misc.2d 477, 148 N.Y.S.2d 284 (Sup.Ct. 1955).

86. See *Baltimore Football Club, Inc. v. Lockheed Corp.*, 525 F. Supp. 1206 (N.D.Ga. 1981); *Hilt Truck Line, Inc. v. Pullman, Inc.*, 382 N.W.2d 310 (Neb. 1986); *Eaton Corp. v. Magnavox Co.*, 581 F.Supp. 1514 (D.C.Mich. 1984); *National Crane Corp. v. Ohio Steel Tube Co.*, 332 N.W.2d 39 (Neb. 1983).

87. See *County of Johnson, Tennessee v. United States Gypsum Co.*, 580 F. Supp. 284 (E.D. Tenn. 1984); *Adams-Arapahoe School Dist. v. Celotex Corp.*, 637 F. Supp. 1207 (D.Col. 1986); *City of Greenville v. W.R. Grace & Co.*, 640 F. Supp. 559 (D.S.C. 1986).

cases was reached by the Alaska Supreme Court,<sup>88</sup> where the plaintiffs had to tear out the inner walls of their building because of ureaformaldehyde insulation that had been used when constructing the building.

Although in these cases one still might have argued that other property had been contaminated and thus damaged, there is a line of further cases where damage to other property was certainly absent. In California, the holding in *Seely v. White Motor Co.*<sup>89</sup> serves as precedent disallowing recovery of purely economic loss under strict liability in tort; however the Court of Appeals in 1985 allowed a seafood company to recover for purely economic loss against a remote manufacturer of cans on the basis of a negligence action.<sup>90</sup> Although the court relied on the fact of a close connection between the plaintiff and the manufacturer in the case at bar — the reasoning of the California Supreme Court in the *J'Aire* case<sup>91</sup> — much emphasis was laid on the nature of the defect as well. If the cans had been actually used to pack abalone as intended and known to the can manufacturer, they would have been subject to acid corrosion and in turn would have proved hazardous to the health of the ultimate consumers of the abalone.<sup>92</sup> Thus liability of the can manufacturer was seen to accomplish two societal objectives: first, to discourage manufacturers from putting dangerous products into the stream of commerce; and second, to encourage intermediate enterprises to detect and remove dangerous products from the market before they can cause harm to the ultimate consumer. This solution corresponds to recent developments in the field of liability of builders, designers and architects for defective construction of buildings. Where the defects of the building are dangerous, a negligence action against these persons will lie, even though there has not been any harm to other property.<sup>93</sup>

The EEC Directive does not tackle this problem, thus leaving its solution to national tort law.

The answer for this group of cases must again depend on the respective goals of contract and tort liability. In view of the general purpose of tort law

88. *Shooshanian v. Wagner*, 672 P.2d 455 (Alaska 1983).

89. *Cf. supra* note 10.

90. *Ales-Peratis Foods v. American Can Co.*, 164 Cal. App.3d 277, 209 Cal.Rptr. 917 (1985).

91. *J'Aire Corp. v. Gregory*, 24 Cal.3d 799, 157 Cal.Rptr. 407, 598 P.2d 60 (1979).

92. 164 Cal.App.3d 277 at 289 *et seq.*, 209 Cal.Rptr. 917 at 924 *et seq.*

93. *Cf. Huang v. Garner*, 203 Cal.Rptr. 800 (Cal.App. 1984); *Council of Co-Owners Atlantis Condominium Inc. v. Whiting Turner Contracting Co.*, 308 Md. 18, 517 A.2d 336 (1986).

to protect society's interest in freedom from harm through unanticipated injury,<sup>94</sup> it seems but the last consequent step to focus exclusively on the nature of the defect — leaving aside the nature of damage sustained and the way in which it occurred, that is whether or not there was a sudden and calamitous event — and to allow recovery for repair and replacement if there exists an actual threat of personal injury. The reasoning of the California Court of Appeals in this respect appears to be compelling.

The famous argument that has often been advanced against recovery of economic loss under tort theories, namely that allowing recovery would open a floodgate of liability in an indeterminate amount for an indeterminate time to an indeterminate class,<sup>95</sup> is not valid here: costs of repair and replacement, in contrast to lost profits for example, are of a limited and generally predictable amount and the number of possible plaintiffs is at least restricted by the number of marketed products.

It should be noted, however, that extending liability in tort to repair and replacement costs has to go hand in hand with defining property damage as such narrowly, as has been suggested for the previous groups of cases. Otherwise liability in tort might indeed be no more predictable.

## V. Conclusion

The aforementioned observations lead to the conclusion that the nature of the damage sustained is and should be becoming of less importance as a guideline to distinguish contract and tort liability in products liability cases. Instead, primary emphasis should be laid on the type of defect of the product in question.

In American law, this step seems to be easier to take as one can rely upon the wording of Section 402A of *Restatement of Torts (Second)*, that presupposes “a product in a defective condition unreasonably dangerous to the user or consumer.” However, similar results seem possible under the EEC Directive which defines a product as being defective when it does not provide the safety which a person is entitled to expect.<sup>96</sup>

But also under German law a similar interpretation can be justified.

94. See *Spring Motors Distributors, Inc. (N.J.)*, *supra* note 11.

95. See the opinion of Justice Cardozo in *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931).

96. Art. 6 par. 1.

*Verkehrspflichten* of the product manufacturer, i.e. duties whose violation may be actionable in tort, may be well defined in the sense of Section 402A of *Restatement of Torts (Second)*; namely the principal duty not to market any man-endangering product.

There remains one problem to be mentioned: Does restricting liability in tort to cases where a product is dangerous to human health lead to an insupportable deficiency in the protection of property interests?

Two alternatives have to be distinguished here: first the case of a contractual relationship between the manufacturer and the plaintiff; and second, the case where privity is lacking.

In case of privity, the buyer undoubtedly is entitled to contractual remedies. The major problem posed in German law, however, is the six month statute of limitations in warranty actions. Circumventing this very short period has been one of the main reasons — although not verbally expressed — why courts tended to resort to tort remedies.<sup>97</sup> But instead of extending tort law, the statute of limitations should be and probably will be amended.<sup>98</sup>

Where there is no privity, restricting tort liability seems to leave a protection gap at first glance, as the buyer can only sue his immediate seller, who might have gone out of business. But here, in my opinion, the appropriate path is to eliminate the requirement of vertical privity in certain cases.<sup>99</sup> The crucial point is that this liability for defective products remains contractual in nature except for the privity requirement, that is, it is governed by all the aforementioned characteristics of contract law, especially the possibility to disclaim or limit liability.

97. Except for BGH 18 Jan. 1983, BGHZ 86, 256, all decisions allowing tort recovery for damage to the product itself involved an immediate seller-buyer relationship.

98. See, e.g., Heinrichs, "Reform des Verjährungsrechts?" *NJW* 1982, 2021 at 2027.

99. See White & Summers, *Handbook of the Law under the Uniform Commercial Code*, (1980 2d ed.) Section 11-3 at 401 *et seq.* For a citation of states that have enacted their own expansive provisions, see *ibid.* at 404 note 20.