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TORT AND INSURANCE PRACTICE SECTION
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Editorial Statement

The *Tort & Insurance Law Journal* is published by the Section of Tort and Insurance Practice of the American Bar Association as a service to its members and for the benefit of lawyers and lay persons involved in the practice of tort law and insurance. As a publication of the Section, the *Journal's* interests mirror those of the Section which span thirty-seven general substantive and procedural areas involved in or affecting the law of torts and insurance. These areas are listed in the *Journal* with the names of the present General Committee chairpersons. Also, the Section has created special task forces devoted to additional areas of concern such as AIDS, improvement of the civil justice system, the solo practitioner, reauthorization of Superfund, workers' compensation reform, and long-term health care.

The *Tort & Insurance Law Journal*, known formerly as *The Forum*, is committed to the publication of articles that present scholarly analysis of and insight into issues affecting the broad scope of tort and insurance law and practice. The *Journal* stands within the legal community as a focal point for the examination of timely legal issues confronting the judiciary, the tort and insurance bar, and the general insurance community. The Section actively seeks to serve as an umbrella for the varied and disparate special interest bars and organizations within the field of tort and insurance law. To that end, the *Tort & Insurance Law Journal* will continue to solicit and present the multiplicity of views that exist within our legal community. The Editorial Board trusts that each issue will be a significant contribution to practitioners and students.

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intent in subjective terms. However, adding a definition would suggest ambiguity where to date courts and insurers have agreed it does not exist. Furthermore, a definition at this time would be premature, and ultimately may be unnecessary, given that many courts have steadfastly interpreted manifest intent as a subjective intent standard. The industry's best option is to continue arguing the case for a subjective reading of the manifest intent requirement, while remaining alert to the potential for coverage problems in those jurisdictions that see it as something less.

EMPLOYEE LIABILITY FOR ECONOMIC LOSSES OF THE EMPLOYER'S CUSTOMERS: A CALIFORNIA-BASED EXAMINATION OF THE QUESTION OF DUTY

Richard Malamud

I. INTRODUCTION

A. Overview

The increasing number of bankruptcy filings by professional service organizations, including several national legal and accounting partnerships, and the undercapitalization of start-up companies of all types have resulted in plaintiffs being unable to collect damages against negligent businesses. Thus, plaintiffs occasionally have named employees as defendants in the hope of finding a solvent defendant. The complaint generally alleges the employee negligently, carelessly, and recklessly rendered services, thereby breaching a duty of due care owed the plaintiff. Even in the case of solvent employers, employees often are named as defendants in lawsuits.

Using California law as a point of reference, the article suggests that an employee does not owe a legal duty to a customer to refrain from negligent, as opposed to wrongful, conduct in cases involving economic, as opposed to physical, injury.

B. Assumptions

Whenever relevant, the article assumes: (1) the defendant in examples and hypotheticals was a California employee¹ who worked solely in California and was not

1. Specific employment situations, such as legal services and medical services, may have unique professional or statutory rules of conduct that require additional analysis not provided in this article.

the owner of the business;² (2) the employee performed his or her duties in an unreasonable, negligent³ manner; (3) the employee's action or inaction was the cause of the plaintiff's injury; (4) the plaintiff suffered an *economic* injury; and (5) the plaintiff named the employee as a defendant in litigation relating to the injury.

C. Examples

This article discusses the legal liability of an employee whose unreasonable conduct causes economic (as opposed to physical) injury.⁴ The following examples illustrate the nature and context of an economic injury:

- (1) Abe, a plumber and employee of ABC Plumbing, installed sprinklers at the home of plaintiff. Unfortunately, Abe used an incorrect pipe fitting, resulting in an underground leak that damaged plaintiff's house.
- (2) Barbara, an accountant for DEF Accounting, Inc., prepared plaintiff's tax return using information supplied by plaintiff. Barbara failed to report dividends recorded on a 1099 that plaintiff had supplied. This failure to report income resulted in a tax penalty assessment against plaintiff.
- (3) Carlos, a mechanic at a franchise of GHI Oil & Lube, Inc., performed an oil and lube service advertised for \$19.95. Carlos never met the customer. While changing the oil filter on a very expensive sedan, Carlos forgot to put oil on the gasket. The resulting explosion caused \$4,000 damage to the engine.

II. THE QUESTION OF DUTY

This article will focus on whether an employee owes a legal duty to a customer when the employee's alleged negligence results in economic damage.⁵ Within that

2. Although the author believes the law discussed in this article applies equally to employees and owner-employees, there are no cases discussing this factual distinction. Accordingly, in the case of an owner-employee of a corporation, one must consider whether the public policy and statutory provisions discussed herein should be applied differently. That analysis may be bifurcated into those owners who hold themselves out as owners, such as Joe Smith of Joe Smith, Inc., and those who do not inform the public they are the owners, such as Joe Smith, President (and 100% owner) of Widget, Inc.

3. Throughout the article, the terms "negligent" and "negligently," when used to describe conduct of a defendant rather than a cause of action, refer to situations in which the party acted unreasonably or did not act in the same manner as a reasonable person would have acted.

4. Economic losses resulting from physical damages, such as lost wages due to an incapacitating physical injury, are considered physical harm for this purpose. This must be compared to lost wages resulting from an economic injury, such as when a plaintiff cannot work because the defendant's negligent conduct resulted in destruction of the plaintiff's work place. See *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200, 201 (Ohio Ct. App. 1946).

For the purposes of this article, injury to land or chattels will be considered economic damage rather than physical injury. Compare RESTATEMENT (SECOND) OF TORTS § 15 (1965) (defining "bodily harm" as "any physical impairment of the condition of another's body, or physical pain or illness"), with *id.* § 7(3) (defining "physical harm" as "physical impairment of the human body, or of land or chattels").

5. This should not imply a different result would occur if the alleged negligence resulted in physical injury. However, an argument can be made that the state has a substantially different interest to protect when human safety is involved than when economic interests are involved. Thus, the analysis of legal duty may differ in physical injury cases because the public policy considerations may be different.

general subject, the following specific issues are addressed: (1) statutory limitation of duty—California Civil Code section 2343; (2) negligence and legal duty; (3) assumption of the risk; (4) contract provisions—waivers; (5) legal duty when plaintiff never looked to the employee for recovery; and (6) liability for nonfeasance, misfeasance, or malfeasance.

Defenses available to the employee could lead to relief from liability, but generally only after lengthy and expensive pretrial discovery, a trial, and often an appeal.⁶ However, if the plaintiff's case can be dismissed prior to discovery or trial on a theory that duty is lacking, substantial time, effort, and expense can be avoided.

In California dismissal may be of little economic consequence if the employee works for a solvent employer because the employer must indemnify the employee.⁷ This indemnity includes the costs of legal defense.⁸ Employees of bankrupt employers may be protected by the court,⁹ but those who are not protected may have to bear the loss personally because very few employees carry liability insurance.¹⁰

6. This article does not address affirmative defenses, such as the statute of limitations and laches. See generally David M. Lester, *No Man Is an Island: A Compendium of Legal Issues Confronting Attorneys When Individual Defendants Are Named in an Employment Litigation Complaint*, 20 PAC. L.J. 293 (1989).

7. California Law provides:

An employer shall indemnify his employee for all that the employee necessarily expends or loses in direct consequence of the discharge of his duties as such, or of his obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying such directions, believed them to be unlawful.

CAL. LAB. CODE § 2802 (West 1994).

Even a negligent employee will be fully indemnified against loss if the employer is solvent. Thus, it may be only a minor inconvenience for an employee of a solvent employer to be named in a lawsuit.

8. See *Douglas v. Los Angeles Herald Examiner*, 123 Cal. Rptr. 683, 692 (Ct. App. 1975) (Labor Code § 2802 covers damages paid by employee and legal costs incurred by employee in defending lawsuit, regardless of merits of plaintiff's case).

9. For a discussion of bankruptcy court orders staying all lawsuits and discovery against officers, directors, and employees, see Richard F. Broude, *The Automatic Stay*, in UCLA SCHOOL OF LAW BUSINESS BANKRUPTCY INSTITUTE 27, 56-57 (1993). For an article discussing stays as they relate to partners, see Michael J. Cramers & Joseph T. Moldovan, *Sec. 105 Injunctions Offer Protection to Members of Professional Partnerships*, N.Y. L.J., Mar. 29, 1993, at 5.

Interestingly, in the recent unpublished order confirming the amended plan of reorganization in the bankruptcy of Laventhol & Horwath, a national accounting partnership, the bankruptcy court precluded all plaintiffs from filing any action against any former employee of the debtor. See *In re Laventhol & Horwath*, No. 90 B 13839 (CB) USBC 33-34 (Bankr. S.D.N.Y. Aug. 24, 1992).

Do employees have standing to request or require a court to issue an injunction? If not, what is the incentive for a bankruptcy court to issue an injunction, especially if no suits have been filed against employees of the bankrupt firm at the time of the hearing? The bankruptcy court will not provide any relief when a company simply closes down or disappears, leaving no assets and thus no bankruptcy case.

10. Unlike doctors, nurses, and other health care employees, who can purchase malpractice insurance policies providing legal defense as well as liability coverage, such insurance generally is not available to attorneys, accountants, mechanics, engineers, and other employees outside the health professions. Thus, even if a case against an employee ultimately is dismissed, most employees must pay the costs of their defense if the employer does not pay them. Interestingly, many faculty members at California State University Dominguez Hills join the California Faculty Association because it provides group malpractice insurance and free legal defense in the event of employment-related lawsuits.

A. Statutory Limitation of Duty—California Civil Code Section 2343

The California Legislature has provided specific statutory guidelines defining when an employee owes a legal duty to a third party.¹¹ Enacted in 1872, California Civil Code section 2343 identifies the circumstances under which agents or employees can be held liable to a third party for their actions. Section 2343 states:

Acts for Which Agent Personally Liable

One who assumes to act as an agent is responsible to third persons as a principal for his acts in the course of his agency, in any of the following cases, and in no others:

1. When with his consent, credit is given to him personally in a transaction;
2. When he enters into a written contract in the name of his principal, without believing in good faith that he has authority to do so; or,
3. When his acts are wrongful in their nature.¹²

Because an employee is the agent of the employer, section 2343 is the exclusive authority for a lawsuit against an employee.¹³ Thus, when the actions of an employee result in damage to a customer, the employee owes a legal duty to the customer only if the employee's conduct falls within one of the categories delineated in section 2343.

Subdivision 1 of section 2343, personal credit given to the agent, will apply to the unreasonable acts of an employee only if the employee expressly assumes personal responsibility for the contract.¹⁴ Thus, a disclosed agent will not be liable to third parties simply because the agent (employee) has signed a contract for the

11. An example of recent legislation eliminating or reducing a common-law duty is California Civil Code § 1714:

(b) It is the intent of the Legislature to abrogate the holding in cases such as *Vesely v. Sager* (5 Cal. 3d 153), *Bernhard v. Harrah's Club* (16 Cal. 3d 313), and *Coulter v. Superior Court* (____ Cal. 3d ____), and to reinstate the prior judicial interpretation of this section as it relates to proximate cause for injuries incurred as a result of furnishing alcoholic beverages to an intoxicated person

(c) No social host who furnishes alcoholic beverages to any person shall be held legally accountable for damages suffered by such person, or for injury to the person or property of, or death of, any third person, resulting from the consumption of such beverages.

CAL. CIV. CODE § 1714 (West 1994). By enacting this statute, the legislature has shown that it, rather than the courts, may limit legal duty in specific situations even though a broader duty might exist under the foreseeability test in the absence of such a specific legislative mandate.

12. *Id.* § 2343 (West 1985).

13. Although the Civil Code does not define principal or agent, an employer-employee relationship clearly falls within that definition. See 2A C.J.S. *Agency* § 16 (1972).

14. A defendant was held liable for damages under § 2343 in *Bayuk v. Edson*, 46 Cal. Rptr. 49 (Ct. App. 1964), but he had personally agreed with the plaintiff to perform under the contract. The court stated it was not concerned with "the worrisome problem of the liability of an agent to third persons for injury resulting from his failure to perform a duty which normally he owes only to his principal." *Id.* at 56-57 (emphasis original).

In this respect California law is similar to New York law, under which an agent will not be bound by a contract unless the intent to do so is manifested with reasonable clarity. See *Jones v. Archibald*, 360 N.Y.S.2d 119 (App. Div. 1974).

disclosed principal. This presumption may be rebutted in situations in which industry practice makes the agent liable.¹⁵ In most cases liability cannot be based upon subdivision 1 because the employee is a disclosed agent.

Subdivision 2 applies only when an agent enters into a written contract in the name of the principal without the good faith belief he is authorized to do so.¹⁶ These circumstances are not present in the ordinary situation in which the employee, such as a plumber or mechanic, causes economic injury to a customer because the employee was not the person who entered into the contract or, if he or she did sign the contract, the employee believed in good faith he or she had the authority to do so. Thus, no legal duty should be found under subdivision 2 of the statute in most lawsuits naming an employee as a defendant.

Under subdivision 3 an employee or agent owes a legal duty to third persons only if the employee's acts are "wrongful in their nature." This standard should apply to all actions taken by employees that are not covered by subdivisions 1 or 2. Because employee liability generally does not exist under subdivisions 1 or 2, the pivotal determination in most cases will be whether the employee owes a legal duty under subdivision 3. It thus becomes critical to identify the types of acts included in the statutory phrase "wrongful in their nature."

By using the term "wrongful" rather than "negligent" or an equivalent term such as "ordinary care," the California Legislature clearly intended to insulate employees from liability for negligence resulting in economic damages to customers. Subdivision 3 of section 2343 was intended to create a statutory duty *only* if the employee's acts were "wrongful."

1. Section 2343 "Wrongful Acts"

The courts that have examined section 2343 have neglected to analyze the import of the statutory term "wrongful." Nor do the cases analyze the facts as they relate to the "wrongful" conduct of the employee. Rather than analyze the statute, courts typically respond in a summary fashion:

A tort may grow out of or be coincident with a contract, and the existence of a contractual relationship does not immunize a tortfeasor from tort liability for his wrongful acts in breach of the contract.¹⁷

One decision citing section 2343 simply states that an agent or employee is always liable for his own torts regardless of whether the principal is liable and whether

15. See *Midwest Television, Inc. v. Scott, Lancaster, Mills & Atha, Inc.*, 252 Cal. Rptr. 573 (Ct. App. 1988) (plaintiff permitted to sue advertising agency because it was customary in advertising industry for agent to be responsible for payment for advertisements placed for its principal).

16. See *Nichols G. & M. v. Jersey Farms D. Co.*, 24 P.2d 925 (Cal. Ct. App. 1933) (agent held liable under § 2243(2) because he was not authorized to execute agreement and he did not believe in good faith he was authorized).

17. *Bayuk v. Edson*, 46 Cal. Rptr. 49, 56 (Ct. App. 1965).

the agent acts according to his principal's directions.¹⁸ Another decision—without analyzing the statute or defining "wrongful" behavior—indicates an agent is personally liable under section 2343 for his own tortious acts committed in the course and scope of his agency or even at the direction of his principal.¹⁹ Other courts simply cite the statute and conclude the defendant either owed a duty or did not owe a duty to the plaintiff.

Section 2343 is cited infrequently given the volume of litigation involving claims that tortious conduct of an employee caused injury to the plaintiff. The lack of authority is understandable for a number of reasons. First, if the employer is solvent, it must indemnify the employee for any losses.²⁰ A solvent employer may provide a defense for the employee and decide not to seek dismissal of the employee. After all, the employer will have to defend the case even if the employee is dismissed because of its own potential liability to the plaintiff under the theory of respondeat superior. When the employer is insolvent only a limited number of cases will be filed against employees because most employees will not have sufficient assets or insurance to justify filing a lawsuit. When employees are named in lawsuits their liability under section 2343 apparently is seldom an issue on appeal.

The reported cases citing section 2343 in support of a determination that an employee acted in a "wrongful" manner have involved a real estate broker's failure to deal honestly with third parties;²¹ the negligent selection of an independent contractor by a government agent;²² the cutting of timber in the honest belief the employer owned it;²³ a slip-and-fall claim by a market patron against the store's manager;²⁴ an alleged conspiracy by an apartment manager to maintain property in breach of the warranty of habitability;²⁵ disclosure in contravention of state law of personal and confidential information maintained for a state agency;²⁶ and an alleged conspiracy to misappropriate state compensation insurance funds.²⁷

The reported decisions that cite section 2343 in holding that an employee did not owe a legal duty because his or her conduct was not "wrongful" have involved

an insurance agent who acted in good faith;²⁸ an insurance claims adjuster accused of fraudulently delaying a claim filing;²⁹ a brokerage employee who prepared an escrow and a form assignment of lease;³⁰ an apartment manager accused of wrongful termination of the plaintiff;³¹ a party to a contract made without fraud or misrepresentation;³² an officer of a corporation in an antitrust case;³³ and transfer agents who failed to transfer securities.³⁴

Many California decisions dealing with agents arguably governed by section 2343 do not cite or analyze the statute. One case involved employees who conspired with their employer to induce a breach of contract. The employees, who did not act for their own benefit, were not held liable because the acts were considered privileged.³⁵ Another case involved a union charged with racial discrimination. The court assumed the discrimination was wrongful and permitted a cause of action.³⁶

It is difficult to reconcile the holdings in these decisions. One court may have explained why the cases cannot be reconciled when it observed that concluding employees are always liable under section 2343 for their own torts (regardless of whether their employers are also liable) ignores the proposition that employees are liable only if their conduct is a "tortious breach of duty."³⁷ Were "wrongful" substituted for "tortious," the proper analysis might be applied by the courts. Another way to try to reconcile the case law is to assume actions causing physical injury are always "wrongful," but negligent acts that affect only economic interests are not "wrongful." This analysis is consistent with the California Supreme Court's statement that liability usually will be imposed upon agents for active participation in tortious acts of the principal only in cases involving physical injury to third persons.³⁸

28. *Iversen v. Superior Ct.*, 127 Cal. Rptr. 49 (Ct. App. 1976). This case may be unique because the court held the duty of good faith applies only to parties to the contract. Because Iversen was an agent of the insurer and not a party to the contract of insurance, he was not bound by the implied covenant and owed no duty to the insured not to breach it. In rejecting plaintiff's argument that the agent can be held independently liable under § 2343 for his own torts, the court stated simply that the agent did not breach a duty of good faith owed by him.

29. *Mottola v. R. L. Kautz & Co.*, 244 Cal. Rptr. 737, 743 (Ct. App. 1988).

30. *Damesghi v. Texaco Ref. & Mktg.*, 6 Cal. Rptr. 2d 515, 521 (Ct. App. 1992).

31. *Otanez v. Blue Skies Mobile Home Park*, 3 Cal. Rptr. 2d 210 (Ct. App. 1991).

32. *Pratt v. Robert S. Odell & Co.*, 122 P.2d 684 (Cal. Ct. App. 1942). The court stated, however, that the good faith of the defendant would be a vital issue on retrial.

33. *Murphy Tugboat v. Shipowners & Merchants Towboat*, 467 F. Supp. 841 (N.D. Cal. 1979) (duty under § 2343 owed only if officer's conduct was "inherently" unlawful, which did not include violation of the Sherman Act; court did not define "inherently unlawful" conduct).

34. *Towt v. Pope*, 336 P.2d 276 (Cal. Ct. App. 1959) (citing with approval *Mears v. Crocker First Nat'l Bank*, 218 P.2d 91 (Cal. Ct. App. 1950) (transfer agent of corporation owed no duty to third-party stockholder for failure to transfer stock (nonfeasance) even though corporation might be liable); see also *Morefield v. Ozark Pipeline Corp.*, 27 F.2d 890 (N.D. Okla. 1928); *Plunkett v. Gulf Ref. Co.*, 259 F. 968, 973-74 (N.D. Ga. 1919).

35. *Wise v. Southern Pac. Co.*, 35 Cal. Rptr. 652 (Ct. App. 1963).

36. *James v. Marinship Corp.*, 155 P.2d 320 (Cal. 1944).

37. *Iversen v. Superior Ct.*, 127 Cal. Rptr. 49 (Ct. App. 1976).

38. *United States Liability Ins. Co. v. Haidinger-Hayes, Inc.*, 463 P.2d 770 (Cal. 1970).

18. *Holman v. State*, 124 Cal. Rptr. 773 (Ct. App. 1975).

19. *Pescosolido v. Maddock*, 218 Cal. Rptr. 165 (Ct. App. 1985).

20. See CAL. LAB. CODE § 2802 (West 1994).

21. *Norman I. Krug Real Estate v. Praszker*, 269 Cal. Rptr. 228 (Ct. App. 1990).

22. *Holman v. State*, 124 Cal. Rptr. 773 (1975). The court remanded the case for a determination whether the employee was immune under a California statute immunizing government employees from liability for injuries resulting from the exercise of the discretion vested in them.

23. *Natural Resources, Inc. v. Wineberg*, 349 F.2d 685, 691 (9th Cir. 1965).

24. *Dillon v. Wallace*, 306 P.2d 1044 (Cal. Ct. App. 1957).

25. *Stoiber v. Honeychuck*, 162 Cal. Rptr. 194 (Ct. App. 1980). This decision was based on the conclusion the result of the manager's acts was reasonably foreseeable. Cf. *Otanez v. Blue Skies Mobile Home Park*, 6 Cal. Rptr. 2d 515 (Ct. App. 1992). If foreseeability is no longer the test of legal duty, as discussed below, the court's conclusion may no longer be valid.

26. *Pescosolido v. Maddock*, 218 Cal. Rptr. 165 (Ct. App. 1985).

27. *State v. Day*, 173 P.2d 399 (Cal. Ct. App. 1946). The court jumped to the conclusion the conspiracy itself was the wrongful act. It did not discuss whether misappropriation alone would be a wrongful act.

Unfortunately, most opinions discussing section 2343 assume that a legal duty exists for all negligence causes of action. The courts and counsel are quick to assume a duty exists. Most reported decisions focus on the alleged breach of duty. The assumed existence of a legal duty may reflect the legal community's familiarity with the standard foreseeability test, under which almost all conduct that ultimately causes injury occurs in a situation in which a legal duty exists. Thus, advocates and the courts fail to discuss legal duty because they simply assume it always exists when an employee's conduct is the cause of the customer's economic damage.

Several cases imply that negligence is an insufficient basis for employee liability for "wrongful" conduct under section 2343. One court appears to have perceived that section 2343 does not cover negligence when it questioned whether the defendant's act was "wrongful in its nature" and observed there "was no evidence of fraud or misrepresentation."³⁹ In another decision, which does not cite section 2343, the court held conspiracy to defraud is a form of wrongful activity because it is the commission of an intentional wrong.⁴⁰

2. Statutory Construction

The only proper way to determine if an agent owes a duty under section 2343 is to analyze the statute and the meaning of "wrongful." In interpreting statutes, words and phrases should be construed according to the context of the statute and the approved usage of language.⁴¹ Under California law, only "technical" words and phrases and such other words that have acquired a "peculiar and appropriate meaning in law" are to be construed according to such a definition.⁴²

"Wrongful" obviously is not a technical word or one that has acquired a peculiar meaning. Legislative history from the California Code Commission is of little help in explaining the statute.⁴³ In addition, because "wrongful" is a simple word, doctrines of statutory construction are of little use.⁴⁴

39. *Pratt v. Robert S. Odell & Co.*, 122 P.2d 684 (Cal. Ct. App. 1942). Was the court saying that negligence is not wrongful conduct or that fraud and misrepresentation are always wrongful conduct?

40. *State v. Day*, 173 P.2d 399 (Cal. Ct. App. 1946). It is unclear whether the wrongful act in this case was the fraud or the conspiracy.

41. CAL. CIV. CODE § 13 (West 1994).

42. *Id.*

43. California Civil Code provisions passed in 1872 that are substantially the same as then-existing statutes or common law are to be construed as continuations thereof and not as new enactments. *Id.* § 5. The California Code Commission stated it would specifically so indicate when it intended to modify existing common law. *Id.*; see *Mears v. Crocker First Nat'l Bank*, 218 P.2d 91 (Cal. Ct. App. 1950). No such comments were made for § 2343. The commission simply stated that respondeat superior does not exempt the agent from liability, even for mere negligence. *Id.* at 96.

For an interesting article suggesting it may not be possible to determine legislative history through committee reports such as the California Code Commission's statements, see William R. Bishin, *The Law Finders: An Essay in Statutory Interpretation*, 38 S. CAL. L. REV. 1, 14 (1965).

44. See generally Max Radin, *A Case Study in Statutory Interpretation: Western Union Co. v. Lenroot*, 33 CAL. L. REV. 219 (1945).

One court has stated:

It is a fundamental rule of statutory construction that a court should ascertain the intent of the Legislature so as to effectuate the purpose of the law. In determining such intent the court looks first to the words of the statute. When the legislative intent is so apparent from the face of the statute that there can be no question as to its meaning, there is no need for construction and courts should not indulge in it.⁴⁵

One need not look further than the dictionary to conclude that "wrongful" does not include simple negligence. "Wrongful" is defined in one legal dictionary as "[u]nlawful, inequitable, contrary to natural justice, or in violation of the principles of good morals."⁴⁶ Negligence, in contrast, is defined as "[t]he omission to do something which a reasonable man, guided by those considerations which ordinarily regulate human affairs, would do, or doing something which a prudent and reasonable man would not do."⁴⁷ A popular college dictionary defines "wrongful" as "unjust or unfair; a wrongful act"⁴⁸ and "wrong" as "not in accordance with what is morally right or good."⁴⁹ The word "negligent" is defined as "guilty of or characterized by neglect" or "careless and indifferent."⁵⁰ Clearly, both the legal and the lay definitions of the term "wrongful" contemplate some action or inaction beyond simple negligence.

Unfortunately, none of the opinions relying on section 2343 attempts to define the term "wrongful." Nor do they generally discuss whether a legal duty can be established only if the employee's conduct is wrongful.⁵¹ Perhaps the courts assume, as one author has, that "Civil Code section 2343 does not protect an individual from a pure tort cause of action"⁵²

By examining another California statute it is easy to demonstrate the fallacy of equating the terms "wrongful" and "negligence." Civil Code section 2338, which was enacted at the same time as section 2343, provides:

Unless required by or under the authority of law to employ that particular agent, a principal is responsible to third persons for the negligence of his agent in the transaction of the business of the agency, including wrongful acts committed by such agent in and as a part of the transaction of such business, and for his willful omission to fulfill the obligations of the principal.⁵³

45. *Barrett v. Lipscomb*, 240 Cal. Rptr. 336 (Ct. App. 1987); see also CAL. CIV. PROC. CODE § 1858-1859 (West 1983).

46. BALLENTINE'S LAW DICTIONARY 1382 (3d ed. 1969).

47. *Id.* at 840.

48. RANDOM HOUSE WEBSTER'S COLLEGE DICTIONARY 1539 (1991).

49. *Id.*

50. *Id.* at 905.

51. See *Iversen v. Superior Ct.*, 127 Cal. Rptr. 49 (Ct. App. 1976).

52. David M. Lester, *No Man Is an Island: A Compendium of Legal Issues Confronting Attorneys When Individual Defendants Are Named in an Employment Litigation Complaint*, 20 PAC. L.J. 293, 303 (1989). The statement appears to extend the liability to any and all torts, not just negligent and wrongful torts. Could an employee be liable for product defects under a tort theory?

53. CAL. CIV. CODE § 2338 (West 1985).

In comparing the two sections, one must assume the legislature knew it was using the same word, "wrongful," in two statutes that deal with related matters and were passed at the same time. Importantly, however, both "wrongful" and "negligence" are used in section 2338. The legislature certainly understood that "care should be taken that the same word or term is not used with different meaning in the same act."⁵⁴ It seems apparent that the legislature at a minimum intended "wrongful" and "negligent" to have different meanings.

A review of employer liability under common law confirms that the terms "negligence" and "wrongful" in section 2338 have different meanings. Generally, under common law, an employer is liable for the negligent acts of its employees.⁵⁵ In enacting section 2338 the legislature had to determine whether to include in its scope any acts beyond mere negligence. For example, suppose an agent commits a truly wrongful (i.e., not merely negligent) act, such as driving while intoxicated, and causes injury to a third party. Is the employer liable, or could the employer claim protection from liability for such a wrongful, as opposed to negligent, act? In a case decided before enactment of section 2338 the California Supreme Court held that a railroad could be liable to a wrongfully ejected passenger for actual damages, but could not be liable for exemplary damages when its conductor's malice, violence, and personal indignity caused the passenger's injury.⁵⁶ Section 2338 thus clarifies that the employer will be held responsible if the agent's acts are either negligent or wrongful and are within the scope of the employment.

The use of the phrase "including wrongful acts" in section 2338 to increase the scope of the employer's liability thus is indicative of legislative intent that "wrongful" mean something other than "negligent." Because section 2343 uses only the word "wrongful," the legislature must have intended that section 2343 be more restrictive than section 2338 and that a negligent act by an agent/employee cannot give rise to employee liability unless the act was also wrongful.

Another illustration of legislative differentiation between "negligent" and "wrongful" behavior can be found in California's statutory definition of "wrongful death." Also enacted in 1872, that definition provides in part: "When the death of a person . . . is caused by the wrongful act or neglect of another, his heirs . . . may maintain an action for damages . . ."⁵⁷ If the term "wrongful" were meant to include negligent acts, the legislature would have had no need to include the term "neglect" in the wrongful death statute. Similarly, under

Family Code section 783 a spouse may file a lawsuit based on a "negligent or wrongful act" of a third party even if a negligent or wrongful act or omission of the other spouse was a concurring cause of the injury.⁵⁸ These statutes thus support the conclusion that an act must be more than "negligent" to be "wrongful" for purposes of employee liability under section 2343.

Still another California statute demonstrates the legislature's intent to distinguish between "negligent" and "wrongful" conduct. Civil Code section 3346 specifies damages for "wrongful injuries to timber, trees, or underwood" as "three times such sum as would compensate for the actual detriment."⁵⁹ Only wrongful—not negligent—behavior gives rise to treble damages under this provision. This distinction is consistent with one case under section 2343 in which the court held an employee who had exercised dominion and removed plaintiff's timber had acted wrongfully even though he committed the acts in the honest belief his employer owned the timber.⁶⁰ The courts thus have determined trespass may be wrongful conduct even though trespass does not include negligent behavior.

Another example of legislative use of the term "wrongful" is contained in Civil Code section 2774, which permits indemnity against an act already done, even though the act was known to be wrongful, unless it was a felony.⁶¹ By implication and under common law, one always could indemnify for negligent acts. In section 2774 the legislature intended to go further, stating clearly that public policy would not prohibit indemnification for nonfelonious wrongful acts.⁶²

Courts have wrestled with the meaning of the words "negligent" and "wrongful" in other contexts as well. In determining whether the federal government waived sovereign immunity for ultrahazardous activity under the Federal Tort Claims Act, the court in *In Re Bomb Disaster at Roseville*⁶³ was required to determine the meaning of a statute that provided for recovery for "death caused by the negligent or wrongful act or omission of any employee of the Government."⁶⁴ The court was forced to determine if the word "wrongful" was unnecessary because it was simply a synonym of the word "negligent." In determining that the words had independent meaning, the court stated:

To say that "wrongful act" is a tautological phrase meaning negligence is inconsistent with the general rule of statutory interpretation, namely, that no portion of a statute susceptible of meaning is to be treated as superfluous.⁶⁵

54. Paul Mason, *Legislative Bill Drafting (Concluded)*, 14 CAL. L. REV. 379, 382 (1926).

55. See *Warner v. Southern Pac. Co.*, 45 P. 187 (Cal. 1896). The court, without citing § 2338, stated a principal is liable for the actual damage done by an agent in the usual course of employment. It went on to state (from the common law) the principal is not responsible for punitive damages for wanton and malicious damage done by the agent absent consent, approval, or subsequent ratification by the principal. *Id.* at 188. In an earlier case, the court held an employer is not liable for the wanton and mischievous acts of its employees. *Stephenson v. Southern Pac. Co.*, 29 P. 234 (Cal. 1892).

56. *Turner v. North Beach & M. R.R.*, 34 Cal. 594, 599 (1868).

57. CAL. CIV. PROC. CODE § 377 (West 1973) (repealed 1992 and replaced by CAL. CIV. PROC. CODE § 377.60 (West Supp. 1994)).

58. CAL. FAM. CODE § 783 (West 1994).

59. CAL. CIV. CODE § 3346 (West 1970).

60. *Natural Resources, Inc. v. Wineberg*, 349 F.2d 685, 691 (9th Cir. 1965).

61. CAL. CIV. CODE § 2774 (West 1970).

62. Interestingly, in enacting Corporations Code § 5239, which provides some relief from general tort liability for officers and directors of nonprofit corporations, the 1987 legislature did not provide protection against liability for reckless, wanton, intentional, or grossly negligent acts. See CAL. CORP. CODE § 5239 (West 1990).

63. 438 F. Supp. 769 (E.D. Cal. 1977).

64. See 28 U.S.C.A. § 1346(b) (West 1993) (emphasis added).

65. 438 F. Supp. at 776.

Congressional hearings on the original bill indicated the words "wrongful act" may have been added to cover trespass because "negligence" would not cover such an act.⁶⁶ The court observed that the judiciary generally has held that legislative use of the word "wrongful" reflects an intent to include more than just negligent acts.

Courts have found trespass, conversion, waste, and duress to be wrongful acts within the meaning of the Federal Tort Claims Act.⁶⁷ Other causes of action that might be covered by "wrongful" but not "negligence" are assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, and interference with contract.⁶⁸ One California court has held that fraud is wrongful conduct under section 2343.⁶⁹

An interesting case that interpreted the "wrongful" requirement of section 2343 was one in which a mobile home park manager was sued for turning off a tenant's electricity. Under another state statute "landlords" are prohibited from disconnecting tenants' utilities.⁷⁰ Although that statute applies only to property owners, the plaintiff argued that the manager could be liable under section 2343 for wrongful conduct. The court concluded the acts of the manager were not wrongful in their nature. The court provided a unique and limiting definition by stating that acts are wrongful only if they are proscribed by statute. It concluded: "Because section 789.3 does not apply to persons other than landlords, we can see no basis for holding the managers liable."⁷¹ This was so even though the same actions would have violated the Civil Code if taken by the landlord.

A detailed analysis of section 2343 and the terms "wrongful" and "negligent" as used in statutory and judicial authority leads to the conclusion that section 2343 precludes employee liability for actions that are "negligent" but not "wrongful."⁷² Both legal and nonlegal definitions of "wrongful" clearly indicate that merely negligent behavior is not wrongful, with the possible exception of negligence resulting in physical injury. Although there is a paucity of case law on the point, most of the cases have followed the assumption wrongful acts do not include negligent acts in economic injury cases.

Two conclusions are clear. First, under section 2343 a legal duty is owed only by an employee who acts in a wrongful manner. Second, a legal duty is not owed

by an employee whose negligent but not wrongful actions cause economic injury to the employer's customer or to other third parties.

B. Negligence and Legal Duty

Even if a court were to determine that section 2343 does not preclude employee liability for his or her negligent conduct, an employee still will not be liable for negligence if the employee does not owe a legal duty to the injured party. In determining legal duty and thus liability for negligence in California, Civil Code section 1714(a) states:

Everyone is responsible, not only for the result of his willful acts, but also for an injury occasioned to another by his want of ordinary care or skill in the management of his property or person, except as far as the latter has, willfully or by want of ordinary care, brought the injury upon himself.⁷³

In addition, California Civil Code section 1708 states: "Every person is bound, without contract, to abstain from injuring the person or property of another, or infringing upon any of his rights."⁷⁴

Thus, a defendant's negligence resulting in a plaintiff's injury generally will cause the defendant to be liable for the resulting damages. How far can this liability be extended? For example, suppose a produce truck driver takes his eyes off the road to find a radio station. As a result, the fully loaded truck spills onto the freeway, closing the freeway for several hours. Should the truck driver owe a legal duty and therefore be liable for the lost wages of all drivers who are late to work because of the accident?

In 1968 the Second Circuit held the answer to a similar question was "no." In this case, the court found no legal duty even though the defendant's negligence was obvious and clearly had caused the economic loss alleged by the plaintiff.⁷⁵ In discussing whether a legal duty should exist, the court, quoting the dissent in *Palsgraf v. Long Island R.R.*, stated: "It is all a question of expediency . . . of fair judgment, always keeping in mind the fact that we endeavor to make a rule in each case that will be practical and in keeping with the general understanding of mankind."⁷⁶ Similarly, the Supreme Court of Ohio has held that a contractor hired by a hospital could not sue an architect who provided negligent plans to the hospital because there was no privity of contract and therefore no tort cause of action.⁷⁷ Thus, outside California, legal duty is not as broad as a literal reading of section 1714 would imply.

66. *Id.* at 777; see also *Dalehite v. United States*, 346 U.S. 15, 45 (1953).

67. *Bomb Disaster*, 438 F. Supp. at 778; see also Mark D. Flanagan, Comment, *Lateral Moves and the Quest for Clients: Tort Liability of Departing Attorneys for Taking Firm Clients*, 75 CAL. L. REV. 1809, 1835 (1987) (libel, slander, or fraud may be the basis for wrongful conduct required to bring lawsuit based on tort of intentional interference).

68. *Bomb Disaster*, 438 F. Supp. at 777.

69. See *Mottola v. R.L. Kautz & Co.*, 244 Cal. Rptr. 737, 743 (Ct. App. 1988).

70. CAL. CIV. CODE § 789.3 (West 1994).

71. *Otanez v. Blue Skies Mobile Home Park*, 3 Cal. Rptr. 2d 210, 213 (Ct. App. 1991).

72. This conclusion seems to be implicit in a very early decision in which the U.S. Supreme Court interpreted an Idaho wrongful death statute that provided liability for wrongful acts or neglect. The Court concluded the defendant railroad had not acted either willfully or wantonly in running its trains. The Court stated: "[A]ll that can at most be said is that there was ordinary negligence." *Northern Pac. Ry. v. Adams*, 192 U.S. 440, 451 (1904).

73. CAL. CIV. CODE § 1714(a) (West 1994).

74. *Id.* § 1708.

75. *In re Kinsman Transit Co.*, 388 F.2d 821, 825 (2d Cir. 1968).

76. *Id.* (quoting *Palsgraf v. Long Island R.R.*, 162 N.E. 99, 104-05 (N.Y. 1928) (Andrews, J., dissenting)).

77. *Floor Craft Floor Covering Inc. v. Parma Community Hosp. Ass'n*, 560 N.E.2d 206 (Ohio 1990).

To compare these decisions with California precedent it is necessary to examine the history of the law of negligence in California. In California, as elsewhere, the elements of a negligence cause of action⁷⁸ are: (1) that there was a (legal) duty imposed on the defendant to use due care (in favor of the plaintiff);⁷⁹ (2) that defendant breached that duty; (3) that there was a reasonably close causal connection between that breach and the resulting injury, the breach was the natural and foreseeable, proximate, cause of the injury; and (4) that the plaintiff suffered damage.

This article is limited to the question of legal duty: whether an employee owes a legal duty to the customer when the employee's actions or inaction cause economic damage. The discussion that follows is limited to negligence⁸⁰ cases involving defendants who were not parties to contracts with the plaintiffs.⁸¹

1. Defining Legal Duty

It is virtually impossible to define "legal duty" in a sentence or paragraph. One court, in trying to reconcile cases involving legal duty, summarized its analysis as follows:

Judicial treatment of the concept of "duty" within the negligence context has left a legacy of analytical confusion. . . .

Analysis of liability for negligence within the context of "duty" has been criticized as a "question-begging process"; for "duty" is not sacrosanct or an immutable fact of nature, but only a shorthand expression of the sum total of public policy considerations which lead the law to protect a particular plaintiff from harm.⁸²

Another court was just as perplexed. It stated:

[L]egal duties are not discoverable facts of nature, but merely conclusory expressions that, in cases of a particular type, liability should be imposed for damage done.⁸³

78. See *Carleton v. Tortosa*, 17 Cal. Rptr. 2d 734 (Ct. App. 1993) (certified for publication except part II); *Ahern v. Dillenback*, 1 Cal. Rptr. 2d 339 (Ct. App. 1991); BERNARD E. WITKIN, SUMMARY OF CALIFORNIA LAW § 732 (9th ed. 1987).

79. In the case of malpractice by an attorney the courts appear to have combined the proof of the negligence with the duty owed to the defendant by defining the first element as "the duty of the professional to use such skill, prudence, and diligence as other members of his profession commonly possess and exercise." *Banerian v. O'Malley*, 116 Cal. Rptr. 919 (Ct. App. 1974).

80. The employee's liability, if any, is based solely on tort principles and not on the law of contracts because the employee typically is not a party to a contract for services. Because the employee is not a party to the contract and therefore is not bound by it, the cause of action against the employee must be dismissed. *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973). However, the same act may be both a tort and a breach of contract. *Bayuk v. Edson*, 46 Cal. Rptr. 49 (Ct. App. 1965). Thus, most lawsuits against employees allege a tort cause of action.

81. Even if an injured customer does not have a cause of action against the responsible employee, he or she almost always has legal recourse against the (solvent) employer for breach of an oral, written, or quasi contract, or for providing negligent services. The employer also is liable under the theory of respondeat superior. See CAL. CIV. CODE § 2338 (West 1994).

82. *Lopez v. McDonald's Corp.*, 238 Cal. Rptr. 436 (Ct. App. 1987).

83. *Christensen v. Superior Ct.*, 820 P.2d 181 (Cal. 1991) (quoting *Tarasoff v. Regents of the Univ. of Cal.*, 551 P.2d 334 (Cal. 1976)).

Many lawyers do not understand the requirement of legal duty. This conclusion is based on several factors, including: (1) a liability conscious tort system; (2) a concept, fueled by published opinions, that negligence law provides a remedy for all those harmed; and (3) an analytical confusion in the minds of many lawyers that legal duty begins and ends with whether the plaintiff's injuries were foreseeable.⁸⁴

Because agents, employees, and other third parties cannot be sued for breach of contract,⁸⁵ plaintiffs try to establish legal duty against third-party defendants through a tort cause of action.⁸⁶ The question then becomes whether a third-party employee owes a legal duty to the injured plaintiff in the absence of a contractual relationship.⁸⁷ The California Supreme Court held in *Biakanja v. Irving*⁸⁸ that a notary public who negligently failed to have a will attested owed a duty to third-party plaintiffs who would have been the beneficiaries had the will been properly attested.⁸⁹ Although the court set forth a six-part test to determine whether in a specific case a defendant owed a duty to a third party, it focused its attention on the issue of foreseeable harm to the plaintiff.

There obviously was no privity of contract in *Biakanja*. The *Biakanja* court stated that whether the defendant will be held liable to a third person in such cases is a matter of policy and involves the balancing of various factors, including: (1) the extent to which the transaction was intended to affect the plaintiff; (2) the foreseeability of harm to him; (3) the degree of certainty that the plaintiff suffered injury; (4) the closeness of the connection between the defendant's conduct and the injury suffered; (5) the moral blame attached to the defendant's conduct; and (6) the policy of preventing future harm.⁹⁰

2. Foreseeability: The Test of Legal Duty

Although the *Biakanja* court listed six factors for determining the existence of a duty, it stated that foreseeability of risk is of primary importance in the absence of an overriding public policy. Interestingly, in *Dillon v. Legg*⁹¹ the court characterized "whether defendant should reasonably foresee the injury to plaintiff" as "other

84. See James C. Martin, *Torts: Back to the Basics*, CAL. LAW., Nov. 1992, at 61.

85. *Stoiber v. Honeychuck*, 162 Cal. Rptr. 194, 207 (Ct. App. 1980).

86. *Id.* at 208. In dealing with this issue the court stated that the defendant employee may be liable for his torts, but nothing in the case law suggests he should be held liable under contractual theories.

87. Whether a legal duty exists in cases of third-party economic damages may depend on the nature of the relationship. This article reviews some of the major cases of third-party liability solely to determine the general state of the law as it applies to legal duty. Because this article concerns all employees rather than specific kinds of employees, it will not speculate as to whether particular classes of employees (doctors, lawyers, police officers, etc.) should owe a greater duty than other classes of employees (carpenters, bookkeepers, postal workers, etc.).

88. 320 P.2d 16 (Cal. 1958).

89. *Id.* at 19.

90. *Id.*

91. 441 P.2d 912 (Cal. 1968).

terminology" for "whether defendant owes plaintiff a duty of due care."⁹² Foreseeability accordingly was used as the litmus test to determine if a legal duty was owed.

The court used the foreseeability test in a physical injury case when it allowed recovery for negligent infliction of emotional distress to a mother who witnessed the death of her daughter.⁹³ The court held the negligent driver liable because the injury was foreseeable.⁹⁴ In a subsequent case the court held that therapists owe a legal duty to warn potential crime victims of potential violence because the resulting injury is foreseeable.⁹⁵

The *Biakanja* case did not address whether the foreseeability test is different if the loss is economic as opposed to physical. Citing *Biakanja*, one court has stated that a plaintiff may recover for the loss of expected economic damages when a "special relationship exists between the parties."⁹⁶ The court found such a relationship existed in the case of a contractor who delayed performance of his contract with a landlord and thereby caused a tenant to lose business. The court stated that a foreseeable injury to a plaintiff's economic interests should not go uncompensated because there was no personal or property damage.⁹⁷ The foreseeability test thus has been used to determine legal duty in both physical and economic injury cases. However, in third-party economic injury cases a special relationship between the plaintiff and defendant may have to exist, probably because of the lack of privity between the parties.⁹⁸

3. Abandoning the Foreseeability Test

Twenty years after allowing recovery for foreseeable injuries in negligent infliction of emotional distress cases, the California Supreme Court took an about-face and refused to follow the foreseeability test. Instead, it held the state's public policy in favor of marriage precluded recovery for negligent infliction of emotional distress by a cohabitant who witnessed an accident, even though such distress was clearly foreseeable.⁹⁹

92. *Id.* at 920.

93. *Id.* at 920-21.

94. *Id.* at 921.

95. *Tarasoff v. Regents of the Univ. of Cal.*, 551 P.2d 334 (Cal. 1976).

96. *J'Aire Corp. v. Gregory*, 598 P.2d 60, 63-64 (Cal. 1979).

97. *Id.* For a complete list of cases that allow or preclude causes of action against third parties when only economic damages exist, see Kelly M. Hnatt, Note, *Purely Economic Loss: A Standard for Recovery*, 73 IOWA L. REV. 1181, 1181-82 nn.1-3 (1988).

98. The reason the privity test is not needed in the case of physical injury can be illustrated by a hypothetical, assuming (for purposes of the hypothetical) no legal duty is owed simply for economic damages. Compare an employee who drives a car and hits a pedestrian to one who drives a car and hits another vehicle, causing only physical damage to the other vehicle. Public policy could support a legal duty to make sure all drivers refrain from causing physical injury or death to others because no amount of monetary damages can compensate for such an injury. However, public policy may not be sufficient to impose on employees a legal duty to prevent economic damages, which are amenable to adequate compensation by a cash payment by the employer.

99. *Elden v. Sheldon*, 758 P.2d 582 (Cal. 1988).

In 1989 the California Supreme Court retreated further from the foreseeability analysis in negligent infliction of emotional distress cases, stating that the case-by-case development of the law had misled the lower courts, produced inconsistent lower court rulings, and provoked considerable critical comment by legal scholars.¹⁰⁰ The court found it appropriate in the case of negligent infliction—as opposed to intentional infliction, for which damages are intended to be punitive—to restrict recovery to those persons who suffer an emotional impact beyond that which can be anticipated whenever one learns a relative is injured. When so limited, liability bears a reasonable relationship to the culpability of the negligent defendant.¹⁰¹ The court reasoned:

Even if it is "foreseeable" that persons other than closely related percipient witnesses may suffer emotional distress, this fact does not justify the imposition of what threatens to become *unlimited liability* for emotional distress on a defendant whose conduct is simply negligent. Nor does the *abstract* "foreseeability" warrant continued reliance on the assumption that the limits of liability will become any clearer if lower courts are permitted to continue approaching the issue on a "case-to-case" basis. . . .

We conclude, therefore, that a plaintiff may recover damages for emotional distress . . . if, but only if, said plaintiff: (1) is closely related to the injury victim, (2) is present at the scene of the injury producing event at the time it occurs and is then aware that it is causing injury to the victim; and (3) as a result suffers serious emotional distress in a reaction beyond that which would be anticipated in a disinterested witness and which is not an abnormal response to the circumstances.¹⁰²

Abandonment of the foreseeability test for determining legal duty is thus clear in negligent infliction of emotional distress cases. The California Supreme Court also appears to have abandoned the use of the foreseeability test in negligence cases involving economic damages. In reviewing the concept of legal duty as it applies to an accountant's liability to third parties, the California Supreme Court concluded in *Bily v. Arthur Young & Co.*¹⁰³ that the six-part duty test¹⁰⁴ does not allow all

100. *Thing v. La Chusa*, 771 P.2d 814 (Cal. 1989); see also Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513 (1985); Timothy M. Cavanaugh, Comment, *A New Tort in California: Negligent Infliction of Emotional Distress (for Married Couples Only)*, 41 HASTINGS L.J. 447 (1990).

101. Because this article deals with economic loss rather than physical loss, the sole relevance of the negligent infliction of emotional distress cases is to demonstrate how the California Supreme Court has abandoned the foreseeability test and adopted a public policy/economic risk shifting approach to negligence cases and legal duty. Thus, this is not the proper place to question the analysis of public policy underlying the court's conclusions that a defendant who negligently injures a married person owes a duty to the spouse, but a defendant who acts in an identically negligent manner and strikes a person who is engaged or in a "nontraditional" relationship with a third party does not owe a duty to the third party.

102. *Thing v. La Chusa*, 771 P.2d 814, 829-30 (Cal. 1989) (footnotes omitted) (emphasis added).

103. 834 P.2d 745 (Cal. 1992).

104. The law of third-party liability for negligence has developed not so much on the basis of the six-factor test in *Biakanja* as on an analysis of the particular defendant. For example, separate analyses of duty exist for attorneys, accountants, pharmacists, and architects.

For cases on attorney liability, see Joseph F. Edwards, Note, *The Negligent Drafting of Wills and*

foreseeable third-party users of financial statements to recover from a negligent accountant.¹⁰⁵ The court stated:

"[F]oreseeability . . . is endless because [it], like light, travels indefinitely in a vacuum. . . .

"[P]olicy considerations may dictate a cause of action should not be sanctioned no matter how foreseeable the risk . . . for the sound reason that the consequences of a negligent act must be limited in order to avoid an intolerable burden on society."

In line with our recent decisions, we will not treat the mere presence of a foreseeable risk of injury to third persons as sufficient, standing alone, to impose liability for negligent conduct. We must consider other pertinent factors.¹⁰⁶

The court then discussed in detail the reasons for its finding that no legal duty was owed by an auditor to readers of the audited financial statement:

- (1) Given the watchdog role of the defendant, the complexity of the profession, and the potentially tenuous casual relationship between the audit report and the economic losses, the defendant's exposure to negligence claims from all foreseeable third parties is far out of proportion to its fault;
- (2) The more sophisticated class of plaintiffs in auditor liability cases permits the effective use of contract rather than tort liability to control and adjust the relevant risks through private ordering;¹⁰⁷ and

Simon v. Zipperstein: *A Step Backward in Ohio Jurisprudence?*, 20 U. TOL. L. REV. 133 (1988); Ellen S. Eisenberg, Note, *Attorney's Negligence and Third Parties*, 57 N.Y.U. L. REV. 126 (1982); Michael P. Moreley, Note, *Privity as a Bar to Recovery in Negligent Will Preparation Cases: A Rule Without Reason*, 57 U. CIN. L. REV. 1123 (1989).

The most recent California case on accountants' liability is *Bily v. Arthur Young & Co.*, 834 P.2d 745 (Cal. 1992). For articles that predate *Bily*, see Francis Achampong, *Liability of Accountants for Negligence to Non-Contractual Parties: Recent Developments*, 91 DICK. L. REV. 677 (1987); Howard B. Weiner, *Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation*, 20 SAN DIEGO L. REV. 233 (1983); Brian J. Frank, Comment, *Adjusting Accountants' Liability for Negligence: Recovery for Reasonably Foreseeable Users of Financial Statements*, 13 U. BALT. L. REV. 301 (1984).

For cases on pharmacists, see Elizabeth D. Smith, Note, *Are Pharmacists Responsible for Physicians' Prescription Errors?* McKee v. American Home Products, 65 WASH. L. REV. 959 (1990).

For cases on architects, see Mary Yuen, Case Note, *Absent Privity of Contract, Contractors May Not Recover Economic Damages Caused by an Architect's Negligence*: Floor Craft Floor Covering, Inc. v. Parma Community General Hospital Ass'n, 60 U. CIN. L. REV. 565 (1991).

105. Before listing the *Biakanja* factors the court stated: "We have employed a checklist of factors to consider in assessing legal duty in the absence of privity of contract between a plaintiff and a defendant." *Bily*, 834 P.2d at 761. It then abandoned the multipart test in favor of a public policy test.

106. *Id.* at 762 (quoting *Thing v. La Chusa*, 771 P.2d 814 (Cal. 1989), and *Eldon v. Sheldon*, 758 P.2d 582 (Cal. 1988)).

107. How helpful is this "sophisticated class of plaintiff" analysis? For example, if one of the investors hurt by a negligently prepared audited financial statement is not sophisticated, does that investor retain a cause of action, or is his subjective knowledge or sophistication irrelevant? Has the court adopted a "reasonable investor" standard?

The problem with the "sophistication of the plaintiff" factor is it throws the entire question of duty back on the court on a case-by-case basis for each profession and on each plaintiff within each profession. Thus, are clients of architects more sophisticated than lawyers' clients, and does it matter whether the client is a commercial client or a homeowner?

- (3) The asserted advantages of imposing liability—more accurate work by the defendant and more efficient loss spreading through negligence lawsuits based on foreseeability—are unlikely to occur.¹⁰⁸

The court also stated that successful lawsuits by third parties against accountants undoubtedly would increase the expense and decrease the availability of defendant's services in some sectors of the economy.¹⁰⁹

The *Bily* court found *Restatement of Torts* section 552(b) consistent with the elements and policy foundations of the tort of negligent misrepresentation. The *Restatement* avoids unlimited and uncertain liability for economic losses by limiting the class of plaintiffs to those third persons the supplier of information (accountant, attorney, architect, engineer, title insurer and abstractor, and the like) intended the information to influence.¹¹⁰ It also requires prior notice of potential third-party claims, thereby allowing potential defendants to ascertain the potential scope of liability and to make rational decisions regarding business undertakings. The court stated that no unfairness occurs because users can establish direct contact with the auditor and obtain a report for their own use and benefit.¹¹¹

The *Bily* court dealt with another threshold issue in determining whether the accountant intended to influence a third party. The court stated there is no liability in the absence of such intent even though a plaintiff has reasonably and foreseeably relied on the misrepresentation to his or her detriment.¹¹² Thus, an accountant who knows financial reports will be read by investors and bankers does not have a duty to them. It could be argued that by concluding no legal duty is owed to foreseeable third parties, the court has created for tort law the equivalent of a requirement of privity of contract. This conclusion is supported by a comparison of the *Biakanja* and *Bily* holdings. A close examination indicates only two of the six *Biakanja* factors—moral blame and public policy—were absent in the *Bily* case.

108. Without citing any authority, one pre-*Bily* commentator observed that the courts have long been troubled by three interrelated problems, despite the foreseeability of harm: (1) the difficulty of defining the threshold harm, (2) the prospect of fraudulent claims, and (3) the fear of widespread tort liability. See Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513, 1524 (1985).

109. See Note, *An Efficiency Analysis of Vicarious Liability Under the Law of Agency*, 91 YALE L.J. 168 (1981).

110. See Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513, 1514-15 (1985) (noting that economic loss cases involve the problem of widespread tort liability).

111. What is the effect of this statement? It may be, for example, that an auditor asked by a bank for a copy of a client's financial statement should reply as follows: "I may be potentially liable for negligent misrepresentation if I send you a copy of this report. Therefore, please either: (1) sign this waiver and assumption of the risk form upon receipt of the report; (2) pay me a set fee so that I can purchase (additional) third-party insurance; or (3) call the client and request the information directly so I will not be liable to you because you are a third party and my only liability is to my client."

112. *Bily v. Arthur Young & Co.*, 834 P.2d 745 (Cal. 1992) (citing *Stagen v. Stewart-West Coast Title Co.*, 196 Cal. Rptr. 732 (Ct. App. 1983)).

The other four *Biakanja* factors (intent, foreseeability, certainty of harm, and proximate cause) were satisfied in *Bily*.

The *Bily* court obviously did not look at each factor and determine legal duty by the presence of a majority of factors. Instead it looked exclusively at public policy considerations that were unrelated to the six factors it previously cited as the proper test for determining legal duty.¹¹³

Given that an accountant does not owe a legal duty to such foreseeable third parties as investors, lenders, and credit reporting agencies, an employee similarly should not owe a duty to a known third party in the absence of privity of contract or intentional misconduct. After all, the accountant can take into consideration the possibility of third-party lawsuits before deciding to perform accounting services for a client. An employee does not have the same opportunity to choose. Most employees must perform all work assigned regardless of the risk posed by potential third-party plaintiffs. Their only real alternative is to quit. This is true regardless of whether the employee would have chosen such work if the employee were self-employed.¹¹⁴

Ultimately, as *Bily* illustrates, whether a legal duty exists is a question of public policy. An analysis of relevant policy considerations confirms the intuitive soundness of addressing the employee and accountant situations similarly.

4. Public Policy and Legal Duty

In considering public policy, one must remember an employee owes a duty of good faith and fair dealing to his or her employer. In determining the extent of an employee's legal duty to third parties, the courts must determine whether public policy justifies a departure from the general rule that persons will be held liable for failing to act reasonably.¹¹⁵ As one court has stated, this really is a question of legal remedy, not duty.¹¹⁶ Society is not intending to foster unreasonable conduct when liability is restricted. Instead, other policy interests are seen as being adversely affected if defendant's conduct and decisions are subject to judicial scrutiny and sanctions.

In *Clarke v. Hoek*¹¹⁷ the California Court of Appeals considered whether a physician who proctored but otherwise did not participate in a surgical operation owed a duty to the patient. The court compared the consequences of its alternatives to

113. One could draw the conclusion that the issue of legal duty is oriented toward results. To achieve the result it desires, the court picks and chooses from different parts of the six-part *Biakanja* test. It then concludes that a legal duty either does or does not exist.

114. There are several reasons why the employee might not want to perform work for a particular client. The work assigned may be in an area outside of the employee's expertise. The employer, however, may assign the responsibility for the work to the employee to avoid losing a valuable customer, thus creating the potential for a negligently performed job. The employee also might reject the job simply because he does not like the client or because he is too busy at the time to do a thorough job.

115. CAL. CIV. CODE §§ 1714(a), 1708 (West 1994).

116. *Lopez v. McDonald's Corp.*, 238 Cal. Rptr. 436 (Ct. App. 1987).

117. 219 Cal. Rptr. 845 (Ct. App. 1985).

the defendant and to the community. Absent a duty, a proctor would have no legal obligation to prevent injury. However, imposition of a duty to the patient could cause proctoring to become unavailable, thus affecting the quality of care. Given the balance of interests and the absence of a relationship between the proctor and the patient, the court found it inadvisable to impose a legal duty on the proctor. The court clearly feared that potential malpractice liability would discourage participation in medical volunteer review committees and stifle objective evaluations.¹¹⁸

Should the *Clarke* analysis be limited to proctors, or does it apply to all employees? Suppose a plumber is instructed to replace a leaking PVC pipe. Following an inspection, the plumber informs his employer that the new pipe will break unless he uses a larger pipe. If the employer instructs the plumber to complete the job as originally specified, should the law impose a duty on the plumber to inform the homeowner of the potential problem? If the law does impose such a duty the employee may be fired for insubordination. A solution is to use the *Clarke* public policy test and conclude that public policy favors protecting the employee-employer relationship over the interests of the third-party homeowner.

It is unwise from a public policy standpoint to require an employee to choose between his duty to his employer and a duty owed to the customer, especially when the job is beyond the employee's expertise or experience. If the job assignment is refused for fear of committing malpractice, the employee may be fired, potentially placing the employee on unemployment or welfare. If the employee owes a legal duty to the customer and does not perform the job properly, the employee faces a possible lawsuit. What benefit can society achieve by placing an employee in such a position, especially when the employer is always responsible for the employee's actions? Moreover, if the purpose of imposing a legal duty is to change the employee's behavior, it is unlikely that imposing a duty will have the intended result.¹¹⁹

Almost thirty years before *Bily*, in *Raymond v. Paradise Unified School District*,¹²⁰ a personal injury case, the California Court of Appeal discussed public policy and legal duty:

An affirmative declaration of duty simply amounts to a statement that two parties stand in such relationship that the law will impose on one a responsibility for the exercise of care toward the other. Inherent in this simple description are various and sometimes delicate policy judgments. The social utility of the activity out of which the injury arises, compared with the risks involved in its conduct; the kind of person with whom the actor is dealing; *the workability of a rule of care, especially in terms of the parties' relative ability to adopt practical means of preventing injury; the relative ability of the parties to bear the financial burden of injury and the availability of means by which*

118. *Id.* at 853.

119. For a complete discussion of the effect on employee behavior of the imposition of a legal duty on the employee, see Lewis A. Kornhauser, *An Economic Analysis of the Choice Between Enterprise and Personal Liability for Accidents*, 70 CAL. L. REV. 1345 (1982).

120. 31 Cal. Rptr. 847 (Ct. App. 1963).

the loss may be shifted or spread; the body of statutes and judicial precedents which color the parties' relationship; the prophylactic effect of a rule of liability; in the case of a public agency defendant, the extent of its powers, the role imposed upon it by law and the limitations imposed upon it by budget; and finally, the moral imperatives which judges share with their fellow citizens—such are the factors which play a role in the determination of duty. . . . Occasions for judicial determination of a duty of care are infrequent, because in "run of the mill" accident cases the existence of a duty may be—and usually is—safely assumed. Here the problem is squarely presented.¹²¹

The test described in *Paradise* suggests that a duty should not be extended to employees in cases of economic injury caused by their simple, unintentional, negligent acts. After all, the employee has no ability to control the type of job or client assigned, but the client may select an employer with adequate capabilities and financial resources.¹²²

Public policy analysis thus supports the conclusion that a legal duty should not be imposed on an employee acting within the scope of his or her employment even though a customer may have suffered economic injury as the result of the employee's negligent acts. Even absent such public policy considerations, however, contract and tort law override any duty owed or shift it from the employee to the injured party.¹²³

C. Duty and Economic Damages

The foregoing discussion of legal duty involves cases dealing with physical rather than economic damages. In addressing duty and economic damages as they relate to employees (agents) in his *Summary of California Law*,¹²⁴ Bernard Witkin wrote:

An agent's mere failure to perform a duty owed to his principal may render him liable to third persons who rely on his undertaking, where there is physical damage to person or property. . . . But where the effect is merely to cause economic loss, the law does not yet recognize liability to a third person, except where a duty is created by statute.¹²⁵

Although Witkin fails to support this contention with case citations, numerous cases do address the duty issue as it involves economic interests.¹²⁶ In many of

121. *Id.* at 851-52 (emphasis added).

122. This is consistent with *Bily*, in which the court noted that the auditing CPA has no expertise in or control over the products or services of its clients or their markets. The accountant does not choose the client's executives or make its business decisions. *Bily*, 834 P.2d at 762-64. Thus, the accountant should not be liable when the business fails. The employee is in almost the identical situation vis-à-vis customers of its employer.

123. See 3 C.J.S. Agency § 379 (1973).

124. BERNARD E. WITKIN, SUMMARY OF CALIFORNIA LAW § 149 (9th ed. 1994).

125. *Id.*; see also HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIPS §§ 129, 131 (3d ed. 1990).

126. There are several possible reasons why Witkin could not cite any cases for the proposition that an employee has no duty to act reasonably in the case of economic damages to third parties.

First, it may be that economic damage claims against employees generally are settled out of court because there usually is insurance or, particularly in professional liability cases, because the defendants do not want their alleged malpractice to become part of the public record.

Second, many plaintiffs may not name employees because they can sue the "deep pocket" employers

these cases the courts concluded that no duty is owed to third parties for economic damages.¹²⁷ In *State v. Testbank*,¹²⁸ for example, the Fifth Circuit held that plaintiffs who sustained damage to property as the result of a chemical spill caused by a ship collision could not recover for their economic injury.¹²⁹ The court stated that denying recovery for purely economic losses is a pragmatic limitation on the doctrine of foreseeability, a limitation it found both workable and useful.¹³⁰

The *Restatement (Second) of Agency* concurs with Witkin and the logic of *Testbank*. Section 352 states: "An agent is not liable for harm to a person other than his principal because of his failure adequately to perform his duties to his principal, unless physical harm results from reliance upon performance of the duties by the agent."¹³¹

Other judicial decisions suggest that an employee should not be liable for failure to perform his or her job satisfactorily when only economic injury results. In a 1965 warranty case California Supreme Court Justice Traynor stated:

The distinction that the law has drawn between tort recovery for physical injuries and . . . for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risk of harm. . . . [The consumer] can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. Even in actions in negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone.¹³²

under the theory of respondeat superior. Why join the employee if he or she has little or no money with which to pay damages?

Third, if the employee is named, the employer's attorney may not attempt to have the employee dismissed because the company's insurer, which probably will represent both the employer and the employee, gains nothing by having the employee dismissed. The employer will be liable regardless of whether the employee remains in the case.

Fourth, if the court does dismiss the employee the plaintiff is unlikely to appeal as long as the employer is financially capable of paying the judgment.

Fifth, a defendant employee of a solvent employer who is not dismissed would have no reason to appeal because the employer will pay all damages under Labor Code § 2802.

Finally, the plaintiff may not name the employee because the employee may be a better witness if he or she has not been sued.

127. See James Fleming Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 443 (1972).

128. 752 F.2d 1019 (5th Cir. 1985) (en banc).

129. *Id.* at 1032.

130. *Id.*

131. RESTATEMENT (SECOND) OF AGENCY § 352 (1958).

132. *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965); see also RESTATEMENT (SECOND) OF TORTS § 402A (1965).

Although negligence law now allows recovery of economic damages in some cases, *Seely* remains relevant in showing that when addressing the issue of duty, different standards of judicial review and public policy should exist in physical and economic injury cases.

Thus, there is substantial authority under both tort and agency law for the proposition that no duty is owed to third parties by employees for economic damages. These authorities dictate the conclusion that no legal duty is owed by an employee to a third party in the absence of physical injury or intentional acts.

D. Assumption of the Risk

The traditional assumption of the risk defense may play a role in employee liability cases. In two recent decisions, *Knight v. Jewitt*¹³³ and *Ford v. Gouin*,¹³⁴ the California Supreme Court determined that assumption of the risk was a complete defense to a negligence cause of action. The cases involved injuries to sports participants under comparative negligence standards.¹³⁵ In discussing legal duty and assumption of the risk the plurality opinion in each case states that a participant in an active sport breaches a legal duty of care to other participants only if the participant intentionally injures another player or engages in conduct so reckless as to be totally outside the range of the activity ordinarily involved in the sport.¹³⁶

One lower court has cited *Knight* for the proposition that defendants do not have a duty to protect plaintiffs against risks inherent in an active sport.¹³⁷ In other words, a legal duty is not owed to an injured party if that party assumed the risk of the injury.¹³⁸ The court's analysis appears to be broad enough to apply to cases beyond those involving injuries to participants in sporting activities.¹³⁹

133. 834 P.2d 696 (Cal. 1992).

134. 834 P.2d 724 (Cal. 1992).

135. In *Coker v. Abell-Howe Co.*, 491 N.W.2d 143 (Iowa 1992), the court stated that assumption of the risk can be used to show the defendant did not owe a legal duty to the plaintiff in cases in which contributory negligence is not available, such as strict liability cases. *Id.* at 147.

136. *Ford*, 834 P.2d at 726; *Knight*, 834 P.2d at 710.

137. *Stimson v. Carlson*, 14 Cal. Rptr. 2d 670 (Ct. App. 1992).

138. Under California's present system of comparative negligence, assumption of the risk is a complete defense to a negligence cause of action even if the plaintiff suffered physical injuries. See *Ford*, 834 P.2d at 727-28 (injury to water skier); *Knight*, 834 P.2d at 712 (injury to touch football player). Thus, if assumption of the risk applies outside the sporting context, such as in the employee-customer context, it should act as a complete defense.

139. Justice Kennard's dissent in *Knight* states:

Although there is nothing inherently wrong with the plurality's no-duty rule as applied to *organized, competitive, contact sports with well-established modes of play*, it should not be extended to other, more casual sports activities. . . . Outside the context of organized and well-defined sports, the policy basis for the duty limitation that the law should permit and encourage vigorous athletic competition . . . is considerably weakened or entirely absent. Thus, the no-duty-for-sports rule logically applies only to organized sports contests played under well-settled, official rules. . . . *Knight*, 834 P.2d at 723 (Kennard J., dissenting) (emphasis added).

In the companion case, *Ford v. Gouin*, the injury occurred in a water skiing accident, not in connection with a sport with established, official rules. Without discussing the "official rules" requirement, Justice Kennard concurred, finding, based on the facts in the case, the plaintiff had voluntarily assumed a known risk of injury. *Ford*, 834 P.2d at 741 (Kennard, J., concurring).

It is important to note that Justice Kennard characterized assumption of the risk as an affirmative defense rather than an issue of legal duty. Because *Knight* was decided by a three-judge plurality, it is not clear whether the plurality's duty analysis will prevail or whether assumption of the risk will become an affirmative defense.

Given the broad historical use of assumption of the risk, there appears to be no policy reason for precluding its extension to cases involving employee liability to third parties. As with all assumption of the risk cases, however, the defendant must prove the plaintiff had knowledge of and assumed the risk of injury. Just as a skier realizes there are dangers involved in skiing, and spectators at a baseball game know they may be hit by a foul ball, most plaintiffs know and arguably assume the risk that employees may be negligent in the conduct of their jobs. The customer also knows that employee negligence, without proper review or supervision by the employer, may cause injury.¹⁴⁰ Only when a customer sustains economic injury and then finds that the employer is insolvent does the customer assert that he did not assume the risk of employee negligence.¹⁴¹ Will courts adopt assumption of the risk as a defense in economic cases, thus moving the defense beyond the traditional physical injury cases? The prospect is unlikely, but they probably should. As one author points out, assumption of the risk has been unfashionable with legal theorists, but it still has life with the general public.¹⁴²

E. Contract Provisions—Waivers

A concept very similar to but much more expansive than assumption of the risk is contractual waiver. Unlike assumption of the risk, however, which generally is a question of fact, waivers are entered into by the parties for valuable consideration as part of the contract for services. Except in the case of minors, incompetents, and violations of public policy, the law generally permits offerors and offerees to shift risks of loss by use of waivers.¹⁴³

In *Carleton v. Tortosa*,¹⁴⁴ for example, the plaintiff sued a real estate broker for failing to provide tax advice.¹⁴⁵ The plaintiff commenced suit in spite of an agreement containing what essentially was a waiver of a duty to provide tax advice. The agreement stated that the client should consult with an attorney or accountant for legal or tax advice. The plaintiff alleged that the broker had a duty to warn the plaintiff of any potential tax problems because the broker had taken courses on

140. Even if the customer assumed the risk an employee may act unreasonably, it does not necessarily follow that the customer made the same assumption as to the employer. The customer may assume that the employer has adequate safeguards to correct employee errors before the final product or service is delivered or that the employer has sufficient assets or insurance to satisfy claims based on the negligent conduct of the employee.

141. In *Bily* the California Supreme Court observed that the accountant becomes the prime target in litigation for economic losses when a client fails because the accountant is the only "remaining solvent defendant." *Bily*, 834 P.2d at 763.

142. Walter Olsen, *Tortification of Contract Law: Displacing Consent and Agreement*, 77 CORNELL L. REV. 1043, 1048 (1992).

143. For an analysis of the factors affecting the enforceability of waivers, see Kevin F. Harrison, *Taking the Tort out with a Contract: Liability Release Contracts in California*, 15 W. ST. U. L. REV. 781 (1988). For a discussion of the validity of waivers as they affect minors and incompetents and a discussion of public policy considerations, see Richard B. Malamud & John E. Karayan, *Contractual Waivers for Minors in Sports-Related Activities*, 2 MARQ. SPORTS L.J. 151 (1992).

144. 17 Cal. Rptr. 2d 734 (Ct. App. 1993).

145. *Id.* at 737.

the tax implications of real estate transactions.¹⁴⁶ The plaintiff claimed the broker had breached this duty by not informing the plaintiff that an alternative transaction could have saved substantial tax liability. The court found that no duty existed because the document negated any duty.¹⁴⁷

A similar waiver could be used to shift the risk of loss from the employee to either the employer or the customer. Unfortunately for employees, very few contracts contain such a provision even though it could provide substantial savings to the employer. There are several possible reasons why employers typically do not place such a waiver in their services contracts: (1) the employer may not use written contracts for services; (2) the employer may not have considered placing such a clause in its contract; (3) the employer may think a customer would object to signing a contract with an employee waiver and it would not be worth the added cost of "renegotiating" the standard contract with those customers; or (4) the employer may think most plaintiffs will not sue an employee.¹⁴⁸ Perhaps due to a combination of these reasons, employees do not benefit from a clause that should be a standard part of each employer's contract with its customers.¹⁴⁹

It is unclear whether an agreement between employer and employee can be used as a defense in a lawsuit brought against the employee by a plaintiff *who is not a party* to the contract. In an Ohio case a contract between an architect and a hospital explicitly denied the existence of any contractual relationship between the architect and a floor covering contractor.¹⁵⁰ The court interpreted this provision as an agreement between the parties that the hospital would be liable for any economic damages sustained by the floor covering contractor. If a tort cause of action were permitted against the architect by the third-party floor covering contractor, which was not a party to the contract, the contract provision would be meaning-

146. *Id.* at 742.

147. *Id.* at 743; see also Lisa Garn & John S. Dioconis, *Liability Release Forms: How Valid?*, 92 *BEST'S REV.* 52 (1991).

148. One article discussing how to interpret contracts provides another possible explanation:

Parties drafting a contract confront a serious knowledge problem. Because they cannot foresee every future event or know precisely how their own purposes may change, they cannot negotiate terms specifically to cover all contingencies. As a result, their manifested agreement will be silent as to these matters. As the duration of a contract is extended, the knowledge problem facing the parties is likely to increase and the completeness of their agreement to decrease.

Incompleteness of contracts is also a function of the parties' interests. Settling in advance even those contingencies that can be foreseen is costly. Many foreseeable contingencies, given their low probability, are better left unnegotiated *ex ante* in the hopes they will not materialize or will be handled cooperatively *ex post* if they do. And strategic considerations may lead one or both parties to remain silent about a particular issue.

Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 *VA. L. REV.* 821 (1992).

149. The employer incurs additional out-of-pocket expense only if the employee hires separate counsel, because the employer must indemnify the employee for such costs. But how much productivity is lost and what is the effect on the employer-employee relationship when a worker is named in a lawsuit?

150. *Floor Craft Floor Covering v. Parma Gen. Hosp. Ass'n*, 560 N.E.2d 206, 211-12 (Ohio 1990).

less. The court found no sufficient nexus to serve as a substitute for contractual privity and thus held the architect free from liability for economic loss resulting from its negligently prepared plans.¹⁵¹ The court stated that the purpose of the contract—to uphold the bargain between the parties—would be avoided if a third party could recover against the architect simply by asserting a tort claim for economic damages.¹⁵² Thus, at least one court believes parties can, by contract, waive the rights of known third parties, even without their consent.¹⁵³

F. *Legal Duty When Plaintiff Never Looked to the Employee for Services*

Even if a court determines that, as a general proposition, a legal duty is owed for economic damages caused by an employee's negligent conduct, should a legal duty be imposed if only economic loss is suffered and the plaintiff never looked to the employee as a responsible party prior to the injury?¹⁵⁴ For example, suppose a car is dropped off for an oil change by a customer who returns at night to pick up the car. Assume further that the mechanic forgets to put oil on the oil filter gasket, which causes the filter to explode, damaging the engine. There is no question the service station had a duty to change the oil properly and is responsible for the actions of its employee.¹⁵⁵ But should the mechanic owe a legal duty to the customer, who never intended that the mechanic be liable in the event of a problem with the car?¹⁵⁶

In *Cline v. Atwood*¹⁵⁷ an insurance agent was asked to procure car insurance from an insurance company, his principal. In discussing whether the agent could be held liable for failing to procure the policy the court stated: "If circumstances make it clear that the parties, with an understanding of the facts, had no intention that the agent should be liable, he will not be."¹⁵⁸ Although the plaintiff in this case dealt directly with the agent and never dealt with the principal, the court held the

151. *Id.* at 212.

152. To the extent the affected third party is aware of the waiver, the court's logic is impeccable. If third party is not aware of the waiver, however, the court's analysis determines the existence of tort duties owed to an injured party who was not in privity of contract and who was not even aware his or her rights had been waived. Is it fair for a contract provision to waive what otherwise would be a legal duty owed to the third party? It only seems fair if the defendant did not owe a duty in the first place.

153. This analysis is very similar to the reasoning in *Bily v. Arthur Young*, in which the court indicated that a third party who intends to rely on an accountant should make a contractual arrangement with the accountant. In *Bily*, however, the court ruled there never was a legal duty. Thus none had to be waived.

154. This argument is similar to assumption of the risk. In assumption of the risk, however, the plaintiff knows of a potential risk of loss and, as between the two parties, assumes that risk. If the plaintiff never intended that the employee be responsible, it should not be necessary that the plaintiff know of the risks or assume them.

155. The California Civil Code provides that "a principal is responsible to third persons for the negligence of his agent in the transaction of the business of the agency." CAL. CIV. CODE § 2338 (West 1985).

156. This assumes the employee acted unreasonably.

157. 50 Cal. Rptr. 233 (Ct. App. 1966).

158. *Id.* at 236.

agent was not liable because he had informed the plaintiff of the principal's identity and the parties had not intended that the agent be liable.

This analysis should apply to almost any case in which a plaintiff hires a company and meets with an employee or a disclosed agent.¹⁵⁹ The plaintiff in *Cline* personally selected the defendant as the agent and never met the principal. The court nevertheless held that the plaintiff had not relied on the defendant. This analysis should apply in most economic injury cases because most customers choose the business (principal) they frequent based on a variety of considerations,¹⁶⁰ only one of which may be the identity of the employee. Should liability extend to an employee whose actions procure the client, such as an attorney who brings in a new client, as opposed to a mechanic at a garage who is assigned to work on cars owned by people he or she has never met? It should not make a difference if the person is a disclosed agent. This is consistent with *Cline*, in which the court held the insurance agent was not liable even though the agent was the sole and procuring contact with the customer.

In virtually all contracts for services the name of the employee who will perform the service is intentionally omitted from the contract. This allows the principal the freedom to have any of its employees work on the customer's job. Knowing that the employer controls who works on a given job, how can a customer argue he or she was looking to a specific employee as a guarantor of reasonable behavior?¹⁶¹

The logic of *Cline* applies with even more force to the first and third hypothetical posed at the beginning of this article. If anyone fits the definition of someone to whom the customer was not looking as a possible defendant, it is Abe the plumber and Carlos the mechanic, neither of whom ever met the customer. However, *Cline* also suggests that a customer cannot recover from the accountant, Barbara, because the customer never looked to her to be responsible for any damages.

Holding an employee owes a legal duty to a customer for negligent conduct would provide a plaintiff with an additional defendant whom the plaintiff never intended to hold liable. Moreover, it is hard to see why the logic of the *Bily* case, which barred third-party claims against accountants, should not apply to third-party claims against employees. The *Bily* court indicated that a third party who wants to rely on an accounting firm's work must separately negotiate with the accounting

159. Any plaintiff who knowingly deals with a corporation must be aware the individual acting on behalf of the corporation is an agent.

160. In referring to the plaintiff's alleged reliance on the defendant's financial statement, the *Bily* court observed that the plaintiffs had misjudged a number of factors (including the product, the market, the competition, and the company's manufacturing capacity), but focused their litigation exclusively on the audit report. *Bily*, 834 P.2d at 763-64.

161. In the accounting context it is not uncommon for several accountants, many of whom have never met the client, to work on a tax return or audit report. Can the client ever argue reliance was placed on a specific accountant? Even when the client has developed a long-term personal relationship with a particular staff member, if that person transfers offices, quits, or is fired, the firm, not the individual accountant, will finish the job. This is consistent with standard engagement letters stating the accounting firm will provide tax or financial services, as well as with common noncompetition agreements barring departing employees from taking firm clients with them.

firm for its services. The same rule should apply to employees. A customer should be required to negotiate separately with an employee if the customer intends to look to that employee as a guarantor of the services he or she provides.¹⁶²

G. Liability for Nonfeasance, Misfeasance, or Malfeasance

Several courts specifically have held that an employee or an agent does not owe a duty to third parties in the case of nonfeasance resulting in economic injury.

One court has stated that a person is under no duty to take affirmative action to assist or protect another, absent a special relationship giving rise to a duty to act, no matter how great the physical danger in which the other is placed or how easily the defendant could prevent the injury.¹⁶³ This doctrine is rooted in the distinction between action and inaction, or misfeasance and nonfeasance. Misfeasance exists when the defendant is responsible for making the plaintiff's position worse, i.e., the defendant created a risk. Nonfeasance is found when the defendant failed to aid the plaintiff through beneficial intervention. Liability for nonfeasance is limited to cases involving special relationships. Liability for misfeasance, however, is governed by the standard of ordinary care.¹⁶⁴

A New York decision illustrates the differing treatment of nonfeasance and misfeasance cases:

[A]n agent who has undertaken no individual responsibility, nor expressly obligated himself in a contractual relationship with a third party cannot be held liable for nonfeasance only. . . . There must be affirmative acts of negligence or wrongdoing. . . . Unless the agent has assumed authority and responsibility, as if he were acting on his own account, then the duty which the agent fails to perform is a duty owing only to his principal and not to the third party to whom he has assumed no obligation.¹⁶⁵

A 1919 Georgia decision similarly states that an agent ordinarily is not liable to third parties merely for nonfeasance.¹⁶⁶ In Oklahoma a foreman was held not

162. Very few employees could be induced to sign agreements with customers making them personally liable for mistakes made on the job. Moreover, not many employers would want their customers to contact their employees with such proposals.

If the employee owes a duty to both the employer and the customer, can the employee be fired for insubordination for fulfilling a legal duty owed to the customer if that duty conflicts with a duty owed to the employer? Will terminated employees bring unlawful termination lawsuits alleging they were simply fulfilling their legal duty to customers? Worse yet, can an employee caught in the middle bring an injunctive suit asking the court to determine which duty is greater, the duty to the employer or to the customer in cases where there is a conflict? If so, what happens to the customer who needs immediate service and cannot get service until the lawsuit is completed?

This conflict probably exists when personal injury is possible, as in the case of an employee doctor. In the physical injury context different public policy considerations probably dictate that the employee's first concern be for the patient.

163. *Clarke v. Hoek*, 219 Cal. Rptr. 845, 849 (Ct. App. 1985); see also RESTATEMENT (SECOND) OF TORTS § 314 (1965).

164. *Clarke v. Hoek*, 219 Cal. Rptr. 845, 849 (Ct. App. 1985).

165. *Jones v. Archibald*, 360 N.Y.S.2d 119, 122 (App. Div. 1974).

166. *Plunkett v. Gulf Ref. Co.*, 259 F. 968, 973 (N.D. Ga. 1919).

the tax implications of real estate transactions.¹⁴⁶ The plaintiff claimed the broker had breached this duty by not informing the plaintiff that an alternative transaction could have saved substantial tax liability. The court found that no duty existed because the document negated any duty.¹⁴⁷

A similar waiver could be used to shift the risk of loss from the employee to either the employer or the customer. Unfortunately for employees, very few contracts contain such a provision even though it could provide substantial savings to the employer. There are several possible reasons why employers typically do not place such a waiver in their services contracts: (1) the employer may not use written contracts for services; (2) the employer may not have considered placing such a clause in its contract; (3) the employer may think a customer would object to signing a contract with an employee waiver and it would not be worth the added cost of "renegotiating" the standard contract with those customers; or (4) the employer may think most plaintiffs will not sue an employee.¹⁴⁸ Perhaps due to a combination of these reasons, employees do not benefit from a clause that should be a standard part of each employer's contract with its customers.¹⁴⁹

It is unclear whether an agreement between employer and employee can be used as a defense in a lawsuit brought against the employee by a plaintiff *who is not a party* to the contract. In an Ohio case a contract between an architect and a hospital explicitly denied the existence of any contractual relationship between the architect and a floor covering contractor.¹⁵⁰ The court interpreted this provision as an agreement between the parties that the hospital would be liable for any economic damages sustained by the floor covering contractor. If a tort cause of action were permitted against the architect by the third-party floor covering contractor, which was not a party to the contract, the contract provision would be meaning-

less. The court found no sufficient nexus to serve as a substitute for contractual privity and thus held the architect free from liability for economic loss resulting from its negligently prepared plans.¹⁵¹ The court stated that the purpose of the contract—to uphold the bargain between the parties—would be avoided if a third party could recover against the architect simply by asserting a tort claim for economic damages.¹⁵² Thus, at least one court believes parties can, by contract, waive the rights of known third parties, even without their consent.¹⁵³

F. Legal Duty When Plaintiff Never Looked to the Employee for Services

Even if a court determines that, as a general proposition, a legal duty is owed for economic damages caused by an employee's negligent conduct, should a legal duty be imposed if only economic loss is suffered and the plaintiff never looked to the employee as a responsible party prior to the injury?¹⁵⁴ For example, suppose a car is dropped off for an oil change by a customer who returns at night to pick up the car. Assume further that the mechanic forgets to put oil on the oil filter gasket, which causes the filter to explode, damaging the engine. There is no question the service station had a duty to change the oil properly and is responsible for the actions of its employee.¹⁵⁵ But should the mechanic owe a legal duty to the customer, who never intended that the mechanic be liable in the event of a problem with the car?¹⁵⁶

In *Cline v. Atwood*¹⁵⁷ an insurance agent was asked to procure car insurance from an insurance company, his principal. In discussing whether the agent could be held liable for failing to procure the policy the court stated: "If circumstances make it clear that the parties, with an understanding of the facts, had no intention that the agent should be liable, he will not be."¹⁵⁸ Although the plaintiff in this case dealt directly with the agent and never dealt with the principal, the court held the

146. *Id.* at 742.

147. *Id.* at 743; see also Lisa Garn & John S. Dioconis, *Liability Release Forms: How Valid?*, 92 *BEST'S REV.* 52 (1991).

148. One article discussing how to interpret contracts provides another possible explanation:

Parties drafting a contract confront a serious knowledge problem. Because they cannot foresee every future event or know precisely how their own purposes may change, they cannot negotiate terms specifically to cover all contingencies. As a result, their manifested agreement will be silent as to these matters. As the duration of a contract is extended, the knowledge problem facing the parties is likely to increase and the completeness of their agreement to decrease.

Incompleteness of contracts is also a function of the parties' interests. Settling in advance even those contingencies that can be foreseen is costly. Many foreseeable contingencies, given their low probability, are better left unnegotiated ex ante in the hopes they will not materialize or will be handled cooperatively ex post if they do. And strategic considerations may lead one or both parties to remain silent about a particular issue.

Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 *V.A. L. REV.* 821 (1992).

149. The employer incurs additional out-of-pocket expense only if the employee hires separate counsel, because the employer must indemnify the employee for such costs. But how much productivity is lost and what is the effect on the employer-employee relationship when a worker is named in a lawsuit?

150. *Floor Craft Floor Covering v. Parma Gen. Hosp. Ass'n*, 560 N.E.2d 206, 211-12 (Ohio 1990).

151. *Id.* at 212.

152. To the extent the affected third party is aware of the waiver, the court's logic is impeccable. If third party is not aware of the waiver, however, the court's analysis determines the existence of tort duties owed to an injured party who was not in privity of contract and who was not even aware his or her rights had been waived. Is it fair for a contract provision to waive what otherwise would be legal duty owed to the third party? It only seems fair if the defendant did not owe a duty in the first place.

153. This analysis is very similar to the reasoning in *Bily v. Arthur Young*, in which the court indicated that a third party who intends to rely on an accountant should make a contractual arrangement with the accountant. In *Bily*, however, the court ruled there never was a legal duty. Thus none had to be waived.

154. This argument is similar to assumption of the risk. In assumption of the risk, however, the plaintiff knows of a potential risk of loss and, as between the two parties, assumes that risk. If the plaintiff never intended that the employee be responsible, it should not be necessary that the plaintiff know of the risks or assume them.

155. The California Civil Code provides that "a principal is responsible to third persons for the negligence of his agent in the transaction of the business of the agency." *CAL. CIV. CODE* § 23 (West 1985).

156. This assumes the employee acted unreasonably.

157. 50 *Cal. Rptr.* 233 (Ct. App. 1966).

158. *Id.* at 236.

agent was not liable because he had informed the plaintiff of the principal's identity and the parties had not intended that the agent be liable.

This analysis should apply to almost any case in which a plaintiff hires a company and meets with an employee or a disclosed agent.¹⁵⁹ The plaintiff in *Cline* personally selected the defendant as the agent and never met the principal. The court nevertheless held that the plaintiff had not relied on the defendant. This analysis should apply in most economic injury cases because most customers choose the business (principal) they frequent based on a variety of considerations,¹⁶⁰ only one of which may be the identity of the employee. Should liability extend to an employee whose actions procure the client, such as an attorney who brings in a new client, as opposed to a mechanic at a garage who is assigned to work on cars owned by people he or she has never met? It should not make a difference if the person is a disclosed agent. This is consistent with *Cline*, in which the court held the insurance agent was not liable even though the agent was the sole and procuring contact with the customer.

In virtually all contracts for services the name of the employee who will perform the service is intentionally omitted from the contract. This allows the principal the freedom to have any of its employees work on the customer's job. Knowing that the employer controls who works on a given job, how can a customer argue he or she was looking to a specific employee as a guarantor of reasonable behavior?¹⁶¹

The logic of *Cline* applies with even more force to the first and third hypothetical posed at the beginning of this article. If anyone fits the definition of someone to whom the customer was not looking as a possible defendant, it is Abe the plumber and Carlos the mechanic, neither of whom ever met the customer. However, *Cline* also suggests that a customer cannot recover from the accountant, Barbara, because the customer never looked to her to be responsible for any damages.

Holding an employee owes a legal duty to a customer for negligent conduct would provide a plaintiff with an additional defendant whom the plaintiff never intended to hold liable. Moreover, it is hard to see why the logic of the *Bily* case, which barred third-party claims against accountants, should not apply to third-party claims against employees. The *Bily* court indicated that a third party who wants to rely on an accounting firm's work must separately negotiate with the accounting

159. Any plaintiff who knowingly deals with a corporation must be aware the individual acting on behalf of the corporation is an agent.

160. In referring to the plaintiff's alleged reliance on the defendant's financial statement, the *Bily* court observed that the plaintiffs had misjudged a number of factors (including the product, the market, the competition, and the company's manufacturing capacity), but focused their litigation exclusively on the audit report. *Bily*, 834 P.2d at 763-64.

161. In the accounting context it is not uncommon for several accountants, many of whom have never met the client, to work on a tax return or audit report. Can the client ever argue reliance was placed on a specific accountant? Even when the client has developed a long-term personal relationship with a particular staff member, if that person transfers offices, quits, or is fired, the firm, not the individual accountant, will finish the job. This is consistent with standard engagement letters stating the accounting firm will provide tax or financial services, as well as with common noncompetition agreements barring departing employees from taking firm clients with them.

firm for its services. The same rule should apply to employees. A customer should be required to negotiate separately with an employee if the customer intends to look to that employee as a guarantor of the services he or she provides.¹⁶²

G. Liability for Nonfeasance, Misfeasance, or Malfeasance

Several courts specifically have held that an employee or an agent does not owe a duty to third parties in the case of nonfeasance resulting in economic injury.

One court has stated that a person is under no duty to take affirmative action to assist or protect another, absent a special relationship giving rise to a duty to act, no matter how great the physical danger in which the other is placed or how easily the defendant could prevent the injury.¹⁶³ This doctrine is rooted in the distinction between action and inaction, or misfeasance and nonfeasance. Misfeasance exists when the defendant is responsible for making the plaintiff's position worse, i.e., the defendant created a risk. Nonfeasance is found when the defendant failed to aid the plaintiff through beneficial intervention. Liability for nonfeasance is limited to cases involving special relationships. Liability for misfeasance, however, is governed by the standard of ordinary care.¹⁶⁴

A New York decision illustrates the differing treatment of nonfeasance and misfeasance cases:

[A]n agent who has undertaken no individual responsibility, nor expressly obligated himself in a contractual relationship with a third party cannot be held liable for nonfeasance only. . . . There must be affirmative acts of negligence or wrongdoing. . . . Unless the agent has assumed authority and responsibility, as if he were acting on his own account, then the duty which the agent fails to perform is a duty owing only to his principal and not to the third party to whom he has assumed no obligation.¹⁶⁵

A 1919 Georgia decision similarly states that an agent ordinarily is not liable to third parties merely for nonfeasance.¹⁶⁶ In Oklahoma a foreman was held not

162. Very few employees could be induced to sign agreements with customers making them personally liable for mistakes made on the job. Moreover, not many employers would want their customers to contact their employees with such proposals.

If the employee owes a duty to both the employer and the customer, can the employee be fired for insubordination for fulfilling a legal duty owed to the customer if that duty conflicts with a duty owed to the employer? Will terminated employees bring unlawful termination lawsuits alleging they were simply fulfilling their legal duty to customers? Worse yet, can an employee caught in the middle bring an injunctive suit asking the court to determine which duty is greater, the duty to the employer or to the customer in cases where there is a conflict? If so, what happens to the customer who needs immediate service and cannot get service until the lawsuit is completed?

This conflict probably exists when personal injury is possible, as in the case of an employee doctor. In the physical injury context different public policy considerations probably dictate that the employee's first concern be for the patient.

163. *Clarke v. Hoek*, 219 Cal. Rptr. 845, 849 (Ct. App. 1985); see also *RESTATEMENT (SECOND) OF TORTS* § 314 (1965).

164. *Clarke v. Hoek*, 219 Cal. Rptr. 845, 849 (Ct. App. 1985).

165. *Jones v. Archibald*, 360 N.Y.S.2d 119, 122 (App. Div. 1974).

166. *Plunkett v. Gulf Ref. Co.*, 259 F. 968, 973 (N.D. Ga. 1919).

responsible for an accident caused by his failure to inspect because the allegation charged no more than nonfeasance—mere omission on the part of the foreman to perform his master's duty as to inspection and repair.¹⁶⁷

An interesting twist appears in a Louisiana case in which the defendant-agent performed affirmative acts. The court nevertheless held that an agent who omits a duty owed solely to his principal is not guilty of misfeasance in respect to a third party, even if he causes a breach of contract by the principal. By implication, the court seems to be agreeing that the agent owed no duty to the plaintiff.¹⁶⁸

California also has adopted the rule that an action generally will not lie against an agent in the case of nonfeasance. Thus, in an action brought against the secretary of a corporation for conspiring to block the transfer of the plaintiff's stock, a demurrer was sustained. The court reasoned that the action could be brought against the corporation, but the secretary could not be held liable for an official act of nonfeasance in the absence of a statutory provision.¹⁶⁹ Thus, when an employee fails to file a tax return, issue stock, file a lawsuit, or repair a customer's property, the nonfeasance cannot result in a cause of action against the employee. The customer must proceed, if at all, against the employer for either breach of contract or professional malpractice under the theory of respondeat superior.¹⁷⁰

III. CONCLUSION

An employee whose negligent action or inaction is the cause of a customer's economic damage should not owe a legal duty to the customer. The employer selected by the customer will be responsible for damages sustained by the customer. The employee, however, should be dismissed from the customer's suit or motion because legal duty is a question of law for the court.

Even if a court finds that an employee may owe a duty to customers under some circumstances, it should recognize significant limitations on that duty. Assumption of the risk, contractual waivers, the intent of the plaintiff, and the nonfeasance rule can and should come into play in appropriate cases.

167. *Morefield v. Ozark Pipe Line Corp.*, 27 F.2d 890, 891 (N.D. Okla. 1928).

168. *Granger v. Bouillion*, 220 So. 2d 764, 766 (La. Ct. App. 1969).

169. *Lacoe v. Wolfe*, 23 P.2d 831, 832 (Cal. Ct. App. 1933).

170. This is not to say that the agent does not owe a duty simply because the principal is liable. Those are separate issues. The point is that the principal may be liable even if the agent does not owe a duty to the plaintiff.

CASENOTE

TRANSPORTATION INSURANCE COMPANY v. MORIEL: THE TEXAS SUPREME COURT SETS SUBSTANTIVE AND PROCEDURAL CONTROLS ON PUNITIVE DAMAGES AWARDS

Richard C. Mason

In its June 8, 1994, decision in *Transportation Insurance Co. v. Moriel*¹ the Texas Supreme Court held that punitive damages are not justified in bad faith cases unless the insurer's actions threatened its insured with extraordinary harm, such as "death, grievous physical injury, or financial ruin."² The court also required trial courts to bifurcate punitive damages trials to withhold from the jury evidence of a defendant's net worth until the liability phase of the trial has concluded.³

Moriel had been hotly anticipated by both sides of the tort reform battle, and the case attracted national attention, including that of the U.S. Chamber of Commerce which targeted the case as a "vehicle" for changing Texas punitive damages law. A representative of CNA Insurance Company described the outcome as "spectacular,"⁴ but the insured's attorney complained, "[t]his is the result of all the insurance companies trying to do away with people's right to be able to punish them."⁵

In part, *Moriel* owes its pedigree to a trio of decisions by the U.S. Supreme Court recognizing that, absent appropriate procedural safeguards, punitive damages awards threaten defendants' due process rights. Despite these Supreme Court pronouncements, however, insurance companies would not be celebrating *Moriel* today.

1. 879 S.W.2d 10 (Tex. 1994).

2. *Id.* at 24.

3. *Id.* at 29-30.

4. George Taylor, *Tougher Test Set for Punitives by Texas Supreme Court*, NAT'L L.J., Jan. 2, 1994, at 3.

5. Janet Elliot, *Justices Unite Against Punitives; Moriel's New Rules; Bifurcated Trials, More Appellate Scrutiny*, TEX. LAW, Feb. 27, 1994, at 1.

6. *Id.*

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