NEW MEXICO'S ECONOMIC LOSS RULE, UNCONSCIONABILITY DOCTRINE, AND THE GAP BETWEEN THEM: CONCEPTS, REALITIES, AND HOW TO MEND THE GAP

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I. INTRODUCTION

There is a void in New Mexico law between tort and contract where consumers cannot recover for economic loss due to defective products or services. Tort law fails to protect consumers because the economic loss rule precludes tort claims for economic loss when claims are based on breach of a contractual duty.\(^1\) Contract law fails to protect consumers for two reasons. First, commercial providers of goods and services can easily limit consumers' remedies.\(^2\) Second, New Mexico imposes a high but unclear standard on consumers attempting to show contract terms are unconscionable.\(^3\) By considering both the economic loss rule and unconscionability, the shortcomings of tort and contract become evident. This comment examines both doctrines, especially as they exist in New Mexico, and evaluates possible methods of closing the gap in the law's protection by altering one or both rules as they apply to consumers.\(^4\)

Part II of this article provides background on the economic loss rule in general and the various forms it has taken in jurisdictions throughout the country.\(^5\) Part III sets forth New Mexico's limited economic loss rule jurisprudence.\(^6\) The decisions are discussed at some length to fully examine why New Mexico courts have applied the rule to commercial parties of comparable bargaining power, but have left undecided whether the rule applies to consumers. Part IV examines New Mexico contract law surrounding modification of consumer remedies and the basic law of unconscionability.\(^7\) Part V offers reasons the economic loss rule or unconscionability doctrine should be modified as the doctrines apply to consumers, particularly in light of New Mexico's statutes, case law, and policy.\(^8\) Part VI discusses the implications of these alternative solutions.\(^9\) Finally, Part VII offers conclusions about the form the economic loss rule should take in New Mexico and how the law of unconscionability should be applied to consumers.\(^10\)

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2. See infra Part IV.A.
3. See infra Part IV.B.
4. See infra Part V.
5. See infra Part II.
6. See infra Part III.
7. See infra Part IV.
8. See infra Part V.
9. See infra Part VI.
10. See infra Part VII.
II. BACKGROUND

A. The Economic Loss Rule’s Origins and Development

The economic loss rule precludes tort claims for purely economic loss when the claims are based on breach of an express or implied contractual duty and no tort duty independent of the contract is owed by the defendant to the plaintiff.\(^\text{11}\) Economic loss has been variously defined as “the diminution in the value of the product because it is inferior in quality and does not work for the general purposes for which it was manufactured and sold,”\(^\text{12}\) “the difference in value between what is given and received..., and the difference between the value of what is received and its value as represented.”\(^\text{13}\) Economic loss has also been defined more simply “as damages other than physical harm to persons or property.”\(^\text{14}\)

The availability of a tort action can be important. Contract damages are designed to place the injured party “in as good a position as he would have been in had the contract been performed.”\(^\text{15}\) In contrast, “the law of torts attempts primarily to put an injured person in a position as nearly as possible equivalent to his position prior to the tort.”\(^\text{16}\) Additionally, punitive damages are sometimes available in tort actions.\(^\text{17}\)

The economic loss rule developed out of products liability law.\(^\text{18}\) Under strict products liability, “[o]ne engaged in the business of selling or otherwise distributing products who sells or distributes a defective product is subject to liability for harm to persons or property caused by the defect.”\(^\text{19}\) Dissatisfaction with the remedies available to consumers under warranty and negligence law was a major reason for the development of this theory.\(^\text{20}\) However, products liability claims for economic loss blurred the line between tort and contract, and “if this development were

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\(^\text{11}\) Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1264 (Colo. 2000); see also Naylor I, 452 F. Supp. 2d 1167, 1171 (D.N.M. 2006).


\(^\text{13}\) Id. at 592 (quoting Note, Economic Loss in Products Liability Jurisprudence, 66 Colum. L. Rev. 917, 918 (1966)).

\(^\text{14}\) AZCO Constr., 10 P.3d at 1264; see also Grynberg v. Questar Pipeline Co., 70 P.3d 1, 11 (Utah 2003) (“[L]oss is strictly economic... when no damage occurs to persons or property other than the product in question.”).

\(^\text{15}\) RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. a (1981).

\(^\text{16}\) RESTATEMENT (SECOND) OF TORTS § 901 cmt. a (1979).

\(^\text{17}\) Id. §§ 908 to 909.

\(^\text{18}\) AZCO Constr., 10 P.3d at 1259.


\(^\text{20}\) Stang, 83 N.M. at 731, 497 P.2d at 733; see also Brooks v. Beech Aircraft Corp., 120 N.M. 372, 377, 902 P.2d 54, 59 (1995). Brooks identified four policies underlying strict products liability:

[Placing the cost of injuries caused by defective products on the manufacturer who is in a better position to pass the true product cost on to all distributors, retailers, and consumers of the product; relieving the injured plaintiff of the onerous burden of establishing the manufacturer’s negligence; providing full chain of supply protection; and, in the interest of fairness, providing relief against the manufacturer who—while perhaps innocent of negligence—cast the defective product into the stream of commerce and profited thereby.

\(^\text{Id.}\)
allowed to progress too far, contract law would drown in a sea of tort." Thus, a major purpose of the economic loss rule is to maintain the distinction between tort law and contract law. The rule accomplishes this by limiting plaintiffs to contract claims when the economic loss suffered is simply a failure of the purchaser to receive the benefit of its bargain.

The economic loss rule was first articulated by the California Supreme Court in the 1965 case of Seely v. White Motor Co. Seely was a products liability case in which a defective truck overturned, causing the plaintiff damages for the cost of repairing the truck and for lost profits. Chief Justice Traynor reasoned that the tort theory of strict liability did not apply because the solely economic damages resulted from a failure of the truck to perform, which is an interest protected by contract law and not tort law. The Seely approach was adopted by the overwhelming majority of jurisdictions over the next twenty years.

The rule gained momentum when a unanimous United States Supreme Court adopted an approach similar to Seely in 1986. In examining the different nature of the duties owed under contract and tort, the Court reasoned that "[w]hen a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong." This evaluation was based on several factors. For one, "[t]he tort concern with safety is reduced when an injury is only to the product itself." Further, a purchaser of a product can insure against economic losses. Another factor favoring contract over tort is that a "warranty action also has a built-in limitation on liability [in the form of the parties' agreement and the requirement that consequential damages be a foreseeable result of the breach], whereas a tort action could subject the manufacturer to damages of an indefinite amount." Also, commercial parties "may set the terms of their own agreements," so there is "no reason to intrude into the parties' allocation of the


22. See Grynberg v. Questar Pipeline Co., 70 P.3d 1, 11 (Utah 2003) (The economic loss rule's "underlying reasoning" is that "tort law should govern the duties and liabilities imposed by legislatures and courts upon non-consenting members of society, and contract law should govern the bargained-for duties and liabilities of persons who exercise freedom of contract.").


24. 403 P.2d 145 (Cal. 1965). The court stated, "Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone." Id. at 151. The economic loss rule was born from this statement. Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1260 (Colo. 2000).


27. Seely, 403 P.2d at 151.

28. D'Angelo, supra note 12, at 593 (citing Casa Clara Condo. Ass'n, Inc. v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1246 n.2 (Fla. 1993)).

29. E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 871 (1986) ("W[e adopt an approach similar to Seely and hold that a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself.").

30. Id.

31. Id.

32. Id.

33. Id. at 874.
Finally, as a matter of policy, "[t]he increased cost to the public that would result from holding a manufacturer liable in tort for injury to the product itself is not justified." The bright line rule precluding recovery of economic loss damages in tort actions and "limiting recovery to what might be obtained under the law of contracts" is the majority rule, and has been adopted by the Restatement (Third) of Torts.

Courts considering whether to allow recovery of economic loss caused by damage to the product itself have taken two other approaches, labeled minority and intermediate. At the other end of the spectrum from Seely and East River, the minority approach "allows the recovery of economic losses in a tort action under all circumstances." This approach began with Santor v. A & M Karagheusian, Inc., decided the same year as Seely. Santor involved a products liability claim for defective carpet. The court held that a manufacturer's tort duty to make non-defective products included the duty to protect against injury to the product itself. The purpose of holding manufacturers liable for defective products "is to insure that the cost of injuries or damage, either to the goods sold or to other property, resulting from defective products, is borne by the makers of the products..., rather than by the injured or damaged persons who ordinarily are powerless to protect themselves." In other words, the rationales behind strict liability apply just as forcefully when the harm is purely economic as when harm occurs to persons or other property, and no distinction between the two situations is warranted. Santor and the rule it espoused has "attracted very few adherents." The intermediate approach adopted by several jurisdictions allows economic loss "damages to be recovered in tort actions only if the defective product created an unreasonable risk of harm to persons or property other than the defective product." This approach distinguishes between products that simply disappoint the buyer's economic expectations and those that are dangerous to people and property. For example, in Maryland "[e]ven where a recovery, based on a defective product, is considered to be for economic loss, a plaintiff may still recover in tort if the defect

34. Id. at 872-73.
35. Id. at 872.
38. See Utah Int'l, 108 N.M. at 541, 775 P.2d at 743 (citing E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986)).
40. 207 A.2d 305 (N.J. 1965).
41. Id. at 306-07.
42. Id. at 312.
43. Id.
44. See id.
47. Utah Int'l, 108 N.M. at 541, 775 P.2d at 743.
creates a substantial and unreasonable risk of death or personal injury." The justification for this approach is that it provides further incentive for manufacturers to produce safe products. However, the United States Supreme Court has explicitly rejected the intermediate approach because it is "too indeterminate to enable manufacturers easily to structure their business behavior." Further, "[e]ven when the harm to the product itself occurs through an abrupt, accident-like event, the resulting loss... is essentially the failure of the purchaser to receive the benefit of its bargain—traditionally the core concern of contract law." Most courts have declined to create exceptions to the bright-line economic loss rule, especially after *East River*, and some courts that previously followed the intermediate approach have since realigned with the majority rule.

An important issue in products liability cases is whether the economic loss rule applies when a component part injures the entire product, or when the plaintiff is not the original purchaser and suffers damages to objects added to the product subsequent to the original sale by the defendant. The United States Supreme Court shed light on the issue in *Saratoga Fishing Co. v. J.M. Martinac & Co.* In *Saratoga* the defendant sold a ship to an individual, who placed a skiff, fishing net, and spare parts on it, and then resold the ship to the plaintiff. A fire in the engine room sunk the ship, and the plaintiff sued in tort for damage to the skiff, net, and spare parts, arguing the equipment was "other property" for purposes of the economic loss rule. The Supreme Court agreed with the plaintiff, holding:

> When a manufacturer places an item in the stream of commerce by selling it to an Initial User, that item is the "product itself" under *East River*. Items added to the product by the Initial User are therefore "other property," and the Initial User's sale of the product to a Subsequent User does not change these characterizations.

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51. *Id.*
52. *D'Angelo, supra* note 12, at 601-02. *D'Angelo* asserts that, "[e]specially if applied in the context of product liability cases, the [intermediate approach] not only is counter to the majority rule, but also destroys the certainty and risk allocation sought to be established by the U.C.C. and contract law." *D'Angelo, supra* note 12, at 607. *See also RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 cmt. d (1998) (recognizing that "[a] plausible argument can be made that products that are dangerous, rather than merely ineffective, should be governed by the rules governing products liability law," but concluding that "the rules of this Restatement do not apply in such situations").
53. *See, e.g.*, Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875 (1997); Utah Int'l, Inc. v. Caterpillar Tractor Co., 108 N.M. 539, 775 P.2d 741 (Ct. App. 1989); Grams v. Milk Prods., Inc., 699 N.W.2d 167 (Wis. 2005). The one product that nearly all courts hold harms other property is asbestos. *D'Angelo, supra* note 12, at 601. Despite the argument that asbestos causes purely economic loss to the product itself (the building), most courts find that asbestos harms the entire building as other property. *RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 cmt. e (1998)*. This narrow exception is justified by the uniquely serious health threat asbestos contamination presents. *Id.*
54. 520 U.S. 875 (1997).
55. *Id.* at 877.
56. *Id.*
57. *Id.* at 879.
When an entire product is damaged by a component part, some courts apply the "integrated system" rule, meaning "[i]f the 'product' at issue is a defective component in a larger 'system,' the other components are not regarded as 'other property' in a legal sense, even if they are different property in a literal sense."\(^{58}\)

Other courts simply look to the product purchased by the plaintiff rather than the product sold by the defendant.\(^{59}\) The Restatement follows this approach.\(^{60}\) Finally, in what amounts to an extension of the rule, a few courts have adopted the concept of "disappointed expectations," which denies tort recovery when a "product causes property damage but the damage was within the scope of bargaining, or... 'the occurrence of such damage could have been the subject of negotiations between the parties.'"\(^{61}\)

B. Applying the Economic Loss Rule Outside Products Liability

Although originally applied in products liability actions, the economic loss rule has more recently been extended to numerous other contexts.\(^{62}\) Because of the rule's origins in products liability, courts have focused on the nature of the harm to determine whether plaintiffs could pursue tort actions, or were restricted to contract remedies.\(^{63}\) However, the type of damages suffered does not conclusively determine the availability of a tort action in all cases.\(^{64}\) Confusion arises outside products liability cases because “some torts are expressly designed to remedy pure economic loss.”\(^{65}\) Courts can avoid this confusion “by recognizing and applying the underlying premise of the economic loss doctrine: successful separation of contract and tort law requires identification of the underlying duties governing the parties' relationship.”\(^{66}\) Thus, “the modern focus is not on the harm that occurs but instead is on the source of the duty that was breached.”\(^{67}\)

A review of the purposes of tort and contract law is illuminating. On one hand, tort obligations are "designed to protect all citizens from the risk of physical harm to their persons or to their property...[and] are imposed by law without regard to

\(^{58}\) Grams, 699 N.W.2d at 174.

\(^{59}\) See D'Angelo, supra note 12, at 599 (citing King v. Hilton-Davis, 855 F.2d 1047, 1051 (3d Cir. 1988)); see also Utah Int'l, Inc. v. Caterpillar Tractor Co., 108 N.M. 539, 542, 775 P.2d 741, 744 (Ct. App. 1989) ("We will not...engage in dissecting a commercial unit into its component parts to determine if one component injured another.").

\(^{60}\) See RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 cmt. e (1998).

\(^{61}\) Grams, 699 N.W.2d at 175 (quoting Neibarger v. Universal Coops., Inc., 486 N.W.2d 612, 620 (Mich. 1992)).

\(^{62}\) R. Joseph Barton, Note, Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims, 41 WM. & MARY L. REV. 1789, 1802 (2000) ("Although the rule originated in the context of products liability, the current trend expands the rule to apply in other contexts, most notably in real property transactions and service contracts.").

\(^{63}\) See Grynberg v. Questar Pipeline Co., 70 P.3d 1, 11 (Utah 2003).

\(^{64}\) Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1263 (Colo. 2000).

\(^{65}\) Id. (listing "professional negligence, fraud, and breach of fiduciary duty"); Grynberg, 70 P.3d at 11 ("Focusing on the character of the harm...made it difficult to apply the economic loss doctrine beyond the realm of products liability, where torts such as fraud and conversion exist to remedy purely economic losses in non-contractual settings.").

\(^{66}\) Grynberg, 70 P.3d at 11 (citations omitted).

\(^{67}\) Id.; AZCO Constr., 10 P.3d at 1263 ([C]onfusion can be avoided...by maintaining the focus on the source of the duty alleged to have been violated.").
any agreement or contract." On the other hand, "contract obligations arise from promises made between parties. Contract law is intended to enforce the expectancy interests created by the parties' promises so that they can allocate risks and costs during their bargaining." Thus, "[t]he key to determining the availability of a contract or tort action lies in determining the source of the duty that forms the basis of the action." Viewed in this light, it makes sense that in products liability actions, application of the economic loss rule turns on the nature of damages. Outside this context, however, the rule's applicability cannot be determined simply by reference to "whether the damages are physical or economic." The source of the duty must be identified.

The economic loss rule's extension to contexts outside products liability based on the source of the duty breached requires a re-articulation of the rule. For example, the Colorado Supreme Court, in Town of Alma v. AZCO Construction, Inc., phrased the rule this way:

We hold that a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law. Economic loss is defined generally as damages other than physical harm to persons or property.

In sharp contrast, other jurisdictions, including New Mexico, have not delineated the precise boundaries of the economic loss rule. Accordingly, the scope of situations to which the rule applies in this state remains unclear.

A final issue concerning the scope of the economic loss rule is whether the rule should bar tort claims brought by consumers against commercial parties. The vast majority of jurisdictions make no distinction between consumers and commercial parties when applying the rule. Again, New Mexico law on this point is unclear.
III. NEW MEXICO'S ECONOMIC LOSS RULE

A. Precedent

No coherent definition of New Mexico's economic loss rule has been formulated by our courts' limited case law dealing with the rule.\(^7\) Courts have applied the rule almost hesitantly, offering few broad guidelines.\(^6\) However, by closely examining courts' reasons for applying or withholding the rule in the eight opinions construing New Mexico law, a statement can be made of the rule's current form, as well as its likely future form.\(^7\)

Before 1989, no New Mexico appellate court had dealt with the rule.\(^7\) Prior to this, however, three federal courts predicted the position New Mexico courts would take on the issue. In \emph{Colonial Park Country Club v. Joan of Arc},\(^7\) the plaintiff country club sued a food supplier in tort after contaminated food poisoned thirty-three customers of the club, two of whom died.\(^8\) The plaintiff sought damages for economic loss suffered as a result of restocking the kitchen, paying employees while the club was under quarantine, borrowing money to keep the club open, and losing memberships.\(^9\) The Tenth Circuit agreed with the district court that New Mexico would apply the majority rule and bar the plaintiff from recovering these economic losses in products liability.\(^2\) The court gave deference to the district court's determination\(^3\) and was influenced by the fact that Section 402(A) of the Restatement applies to "liability for physical harm.\(^4\)

\emph{Allen v. Toshiba Corp.}\(^5\) involved tort and contract claims for economic loss brought by a retail office equipment dealer against defendants involved in manufacturing and distributing defective photocopiers.\(^6\) The District Court for the District of New Mexico recognized the different approaches represented by \emph{Seely} and \emph{Santor}, but noted that "[b]y far, the majority of courts have followed \emph{Seely} and held that economic losses are not recoverable under theories of recovery based on the law of torts."\(^7\) The court concluded that "[t]he better-reasoned authority and the vast majority of cases which have addressed the issue stand firmly against the proposition" that tort theories of recovery may be asserted for economic losses alone.\(^8\)

The next federal case construing New Mexico law regarding the economic loss rule created an exception to the rules applied in \emph{Colonial Park Country Club} and \emph{Allen}. In \emph{Sharon Steel Corp. v. Lakeshore, Inc.},\(^9\) the plaintiff asserted theories of

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\(^7\) See infra text accompanying notes 78–152.
\(^6\) See infra text accompanying notes 78–152.
\(^7\) See infra Part III.B.
\(^7\) 746 F.2d 1425 (10th Cir. 1984).
\(^8\) Id. at 1427.
\(^8\) Id.
\(^8\) Id. at 1429.
\(^8\) Id.
\(^8\) Id.
\(^8\) Id.
\(^8\) 599 F. Supp. 381 (D.N.M. 1984).
\(^8\) Id. at 383.
\(^8\) Id. at 385.
\(^8\) Id.
\(^8\) 753 F.2d 851 (10th Cir. 1985).
strict liability and negligence after a piece of mining equipment failed, causing other equipment to fall as much as 600 feet down a mine shaft.\textsuperscript{90} The court recognized that it had recently held "that New Mexico law does not permit recovery of economic loss in products liability cases tried on the basis of strict liability."\textsuperscript{91} The court nonetheless allowed recovery for economic losses under a negligence theory, reasoning "that tort law supports recovery of damages that could be characterized as economic loss when, because of a negligently manufactured product, plaintiff is subjected to an unreasonable risk of injury to his person or property."\textsuperscript{92} Essentially, the court predicted New Mexico would endorse the intermediate approach to the economic loss rule.\textsuperscript{93}

A New Mexico state appellate court spoke to the issue when the court of appeals adopted a version of the economic loss rule in 1989 in \textit{Utah International, Inc. v. Caterpillar Tractor Co.}\textsuperscript{94} The defendant had designed and manufactured a coal hauler, then sold it to the plaintiff.\textsuperscript{95} The machine caught on fire when a hydraulic hose ruptured, injuring the machine and interrupting the plaintiff's business.\textsuperscript{96} The plaintiff sought damages for replacement of the machine and loss of its use, asserting causes of action including negligence, strict liability, and negligent failure to warn.\textsuperscript{97} The court of appeals first discussed the majority, minority, and intermediate approaches to the economic loss rule.\textsuperscript{98} The court then recognized and found persuasive both \textit{Colonial Park} and \textit{Allen}, where federal courts had construed New Mexico law in endorsing the majority approach.\textsuperscript{99} The court of appeals also acknowledged that in \textit{Sharon Steel} the Tenth Circuit had predicted New Mexico would adopt the intermediate approach and create an exception to the rule where the product "defect creates an unreasonable risk of injury to persons or other property."\textsuperscript{100} However, the court found that "[t]he persuasiveness of \textit{Sharon Steel} ha[d] been undermined by a recent unanimous United States Supreme Court decision, \textit{East River}," and therefore declined to follow \textit{Sharon Steel}.\textsuperscript{101}

After conducting a survey of economic-loss-rule jurisprudence in general, and of decisions applicable to New Mexico in particular, the court purported to adopt the majority bright-line rule, finding the "reasoning in \textit{East River} compelling."\textsuperscript{102} The court adopted the rule for the usual reasons cited: "in order to allow commercial parties to freely contract and allocate the risk of defective products as they wish",\textsuperscript{103} because a "buyer may bargain for additional warranties from the

\textsuperscript{90} \textit{Id.} at 852–53.
\textsuperscript{91} \textit{Id.} at 852 (citing \textit{Colonial Park Country Club v. Joan of Arc}, 746 F.2d 1425 (10th Cir. 1984)).
\textsuperscript{92} \textit{Sharon Steel}, 753 F.2d at 855 (citing \textit{Penn. Glass Sand Corp. v. Caterpillar Tractor Co.}, 652 F.2d 1165, 1171–72 (3d Cir. 1981), \textit{abrogated by Aloe Coal Co. v. Clark Equip. Co.}, 816 F.2d 110 (3d Cir. 1987)).
\textsuperscript{93} See supra text accompanying notes 46–52.
\textsuperscript{94} 108 N.M. 539, 775 P.2d 741 (Ct. App. 1989).
\textsuperscript{95} \textit{Id.} at 542, 775 P.2d at 743.
\textsuperscript{96} \textit{Id.}
\textsuperscript{97} \textit{Id.}
\textsuperscript{98} \textit{Id.}
\textsuperscript{99} \textit{Id.} at 541–42, 775 P.2d at 743–44.
\textsuperscript{100} \textit{Id.}
\textsuperscript{101} \textit{Id.} at 542, 775 P.2d at 744.
\textsuperscript{102} \textit{Id.}
\textsuperscript{103} \textit{Id.}
seller and pay a higher price, or may forego warranty protection entirely in order to obtain a lower purchase price”, 104 and because “[i]nsurance against economic loss is readily available..., and in a commercial setting...insurance provides adequate protection to the party who suffers a loss from injury of a product to itself.” 105 Other important considerations were achieving consistency in the area and the “clear trend toward the approach of East River.” 106 Thus, the economic loss rule barred the plaintiff’s actions for strict products liability, negligence, and negligent failure to warn. 107

Despite this endorsement of East River and the majority approach, the court of appeals qualified the bright-line rule in several very important respects by formulating the rule as follows:

[W]e hold that, in commercial transactions, when there is no great disparity in bargaining power of the parties..., economic losses from injury of a product to itself are not recoverable in tort actions; damages for such economic losses in commercial settings in New Mexico may only be recovered in contract actions. 108

Even with the qualifications embedded in this articulation of the economic loss rule, the court cautioned, “We specifically do not address the question of whether the same rule should apply to non-commercial consumers who suffer similar injuries.” 109

Although the Utah International court adopted the economic loss rule, it is clear from the court’s formulation of the rule and the precautionary statement afterwards that the rule was not intended to be applied broadly. When the party urging application of the rule in a certain case is in a position of superior bargaining power during contract formation, or where at least the plaintiff is commercially unsophisticated, it seems the economic loss rule should not be used to deny recovery in tort.

The next New Mexico appellate case involving the economic loss rule was In re Consolidated Vista Hills Retaining Wall Litigation. 110 Among other issues, the case involved a home builder’s third-party claim for indemnification against the suppliers of defective materials used in the construction of homes. 111 The trial court had ruled that the economic loss rule barred the indemnification claim, 112 so the plaintiff urged the supreme court to overrule Utah International. 113 The court in fact reaffirmed Utah International, because “parties should not be allowed to use tort

104. Id.
105. Id.
106. Id.
107. Id. at 543, 775 P.2d at 745. The economic loss rule barred the claim for negligent failure to warn because “the same policy considerations which apply to defects in manufacturing also apply to failure to warn of defects.” Id.
108. Id. at 542, 775 P.2d at 744.
109. Id. Utah International has been cited as an example of a case making “a distinction between commercial transactions and consumer transactions, [and] allowing tort recovery for consumer transactions.” Trans States Airlines v. Pratt & Whitney Canada, Inc., 682 N.E.2d 45, 53–54 (Ill. 1997).
111. Id. at 545, 893 P.2d at 441.
112. Id. at 548–49, 893 P.2d at 445–46.
113. Id. at 549, 893 P.2d at 446.
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law to alter or avoid the bargain struck in the contract,” and if Utah International were overruled, “contract law would be subsumed by strict liability and negligence.”

As to whether the economic loss rule bars a claim for indemnification, the supreme court first noted that the purpose of the rule is not to completely “bar the recovery of economic-loss damages; rather, the rule bars recovery of such damages in tort.” By contrast, the purpose of indemnification is to prevent an unjust result by shifting liability from one not at fault to one at fault.

The court further explained:

Although a person cannot be held liable for economic-loss damages in tort because of the economic-loss rule, when that person is held liable for economic-loss damages in contract, and that person’s liability is attributable to the fault of another, it would be unjust not to allow indemnification. We therefore hold that the economic-loss rule does not bar a claim for indemnification.

The supreme court thus gave some definition to the scope of the economic loss rule in New Mexico. The decision is based on the unjust results the rule would generate if parties not at fault for their own economic damages were nonetheless denied recovery. The supreme court’s overriding concern for fairness and avoiding harsh results should guide future courts when further delineating the precise boundaries of the economic loss rule.

The next New Mexico case dealing with the economic loss rule was Spectron Development Laboratory v. American Hollow Boring Co. Here, the plaintiff purchased a light-gas gun from the defendant. The gun exploded, damaging itself, the building housing it, and other objects in the building, as well as interrupting the plaintiff’s business.

The plaintiff and its insurers brought actions for strict products liability, negligence, and breach of express and implied warranties. In a brief, one-paragraph analysis, the court denied recovery “in strict products liability for any injury to the light-gas gun or any interruption of business that can be attributed to the injury to the gun.” In support of this conclusion the court cited the Restatement (Third) of Torts and Utah International. Notably, the Spectron

114. Id.
115. Id. at 550, 893 P.2d at 447.
116. Id. (citing W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 51, at 341 (5th ed. 1984)).
118. See id.
119. 1997-NMCA-025, 936 P.2d 852. The court never uses the term “economic loss rule,” but the rule is clearly at issue from the court’s language and the authorities it cites.
120. Id. ¶ 3, 936 P.2d at 855. A light-gas gun fires projectiles at high speeds “to study the impact characteristics of materials that may be selected for such purposes as military armor or meteorite shielding for space vehicles.” Id. ¶ 2, 936 P.2d at 854.
121. Id. ¶¶ 1-6, 936 P.2d at 854-55.
122. Id. ¶¶ 4-6, 936 P.2d at 855.
123. Id. ¶ 20, 936 P.2d at 857.
124. Id. The Spectron court cited a Tentative Draft of the Restatement, RESTATEMENT (THIRD) OF TORTS (Tentative Draft No. 2, § 6(c) and cmt. d), which is now RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 cmt. d (1998). The court cited the Restatement for the proposition that “harm to persons or property does not include harm to the defective product itself.” 1997-NMCA-025, ¶ 20, 936 P.2d at 857.
court retained the language from *Utah International* limiting the economic loss rule to "commercial transactions between parties with comparable bargaining power."\(^{125}\)

The court then effectively expanded the rule in New Mexico by denying recovery in strict products liability for damage to the building and its contents.\(^{126}\) The court barred recovery for this other property despite the fact that the *Restatement* provision relied upon to deny recovery for economic loss for the product itself allows recovery of damage to "the plaintiff's property other than the defective product itself."\(^{127}\) The *Spectron* court reasoned that the transaction was commercial in nature, and the plaintiff not only "had more expertise than any other entity in this country regarding light-gas guns," but did not "suffer from having substantially less bargaining power than its supplier."\(^{128}\) Thus, the court found "no reason not to leave it to the contract negotiations between the parties to determine who should bear the cost of property damage to [the plaintiff] from a defective product."\(^{129}\) The holding on this point tacitly approves of the "disappointed expectations" concept adopted by a handful of courts.\(^{130}\) The defendants in *Spectron* were not liable in negligence for the same reasons they were not liable in strict liability.\(^{131}\)

Curiously, the economic loss rule appears not to have been applied by any New Mexico appellate court since *Spectron*. However, after a nearly decade-long hiatus, a federal district court construing New Mexico law recently held that the rule applies to service contracts.\(^{132}\) In *Naylor I*, the plaintiff hired the defendant to investigate the origin of a fire that destroyed the plaintiff's furniture store.\(^{133}\) The plaintiff brought actions for negligence and breach of warranty because the defendant failed to preserve several objects related to the fire's origin.\(^{134}\) The defendant claimed the economic loss rule barred the negligence claim.\(^{135}\) The court recognized that New Mexico has adopted the economic loss rule, but has not indicated whether the rule applies to contracts for service, as opposed to goods.\(^{136}\)

The court held that it does, reasoning that "[t]he legal and policy considerations that motivated New Mexico courts to adopt the economic loss rule in the products

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\(^{126}\) Id. ¶ 21, 936 P.2d at 857.

\(^{127}\) *RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY* § 21(e) (1998); see also id. § 21 cmt. e ("A product that fails to function and causes harm to surrounding property has clearly caused harm to other property.... The characterization of a claim as harm to other property may trigger liability not only for the harm to physical property but also for incidental economic loss.").

\(^{128}\) 1997-NMCA-025, ¶ 25, 936 P.2d at 858.

\(^{129}\) Id.

\(^{130}\) See *Neibarger v. Universal Coops.*, Inc., 486 N.W.2d 612, 620 (Mich. 1992); *Grams v. Milk Prods.*, Inc., 699 N.W.2d 167, 175 (Wis. 2005) ("No tort action is available in "situations in which a commercial product causes property damage but the damage was within the scope of bargaining, or... 'the occurrence of such damage could have been the subject of negotiations between the parties.'"). The United States Supreme Court has rejected this approach. See *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 882 (1997) ("No court has thought that the mere possibility of [a contract term apportioning loss a defective product causes to other property] precluded tort recovery for damage to an Initial User's other property.").

\(^{131}\) 1997-NMCA-028, ¶ 25, 936 P.2d at 859.

\(^{132}\) *Naylor I*, 452 F. Supp. 2d 1167, 1173 (D.N.M. 2006).

\(^{133}\) Id. at 1169.

\(^{134}\) Id. at 1169–70.

\(^{135}\) Id. at 1170.

\(^{136}\) Id. at 1172.
liability context apply equally to service contracts."\(^{137}\) In particular, "parties to service contracts realize the same commercial benefits from the economic loss rule as parties to contracts for the sale of goods."\(^{138}\) These commercial benefits include the ability "to freely contract, allocate risk based on the contractual agreement, and obtain a purchase price that reflects the contractual bargained-for exchange."\(^{139}\) The court "conclude[d] that under New Mexico law, when the parties to an agreement are sophisticated commercial entities, the economic loss rule applies both to contracts for services as well as to contracts for the sale of goods."\(^{140}\)

Rather than barring the plaintiff's tort claim based on its conclusion that service contracts are subject to the economic loss rule, the court turned to a different line of analysis. The court differentiated contracts for the sale of goods, where parties can "contractually define the expectations arising out of the commercial relationship," from service contracts, which often involve "licensed professionals who owe to their customers a duty of care that exists apart from the contractual agreements underlying their commercial relationship."\(^{141}\) Next, and most importantly, the court recognized that tort claims based on an independent duty of care are outside the scope of the economic loss rule.\(^{142}\) Significantly, focus was shifted away from the type of loss suffered and onto the source of the duty breached—the "modern focus" of the economic loss rule that enables the rule to be applied outside products liability.\(^{143}\) The court "conclude[d] that although the economic loss rule applies to service contracts, the rule does not bar tort claims arising from an independent duty of care."\(^{144}\) Because the parties had not briefed whether the defendant, a certified fire investigator, qualified as a professional, the summary judgment motion on the negligence claim was dismissed.\(^{145}\) After the parties briefed the issue in subsequent motions, the court found that certified fire investigators are professionals "under New Mexico law and therefore subject to a professional standard of care."\(^{146}\) The economic loss rule thus did not bar the plaintiff's claim for professional negligence, even though the parties contracted for the service and the only harm suffered was economic in nature.\(^{147}\)

The *Naylor* opinions are important for several reasons. First, they include service contracts within the scope of the economic loss rule. Second, they shift the focus away from whether the plaintiff's harm was solely economic and toward the source of the duty alleged to have been breached. This step is critical for the application

\(^{137}\) *Id.* at 1173. *But see* Ins. Co. of N. Am. v. Cease Elec., Inc., 688 N.W.2d 462, 467 (Wis. 2004) (noting the "split among the jurisdictions as to whether the economic loss doctrine applies to contracts for services"). The *Cease Electric* court ultimately "determine[d] that the economic loss doctrine is inapplicable to claims for the negligent provision of services." *Id.* at 472.

\(^{138}\) *Naylor I*, 452 F. Supp. 2d at 1173.

\(^{139}\) *Id.*

\(^{140}\) *Id.* at 1174.

\(^{141}\) *Id.*

\(^{142}\) *Id.* (quoting Hermansen v. Tasulis, 48 P.3d 235, 240 (Utah 2002)).

\(^{143}\) Grynberg v. Questar Pipeline Co., 70 P.3d 1, 11 (Utah 2003).

\(^{144}\) *Naylor I*, 452 F. Supp. 2d at 1174.

\(^{145}\) *Id.*


\(^{147}\) *Id.* at 1292.
of the economic loss rule to contexts outside strict products liability. 148 Finally, the Naylor opinions specifically retain the language limiting the rule to suits between sophisticated commercial parties. 149 The court explained in the second opinion that allowing tort claims against professionals does not undermine the rule’s underlying policy rationale because “[c]ourts crafted the economic loss rule to apply to commercial transactions where the parties share equal bargaining power.” 150 There is not equal bargaining power in the typical professional-client service relationship because “the recipient frequently lacks the ability to anticipate risks inherent in the provision of those services,” so “the parties [are prevented] from allocating those risks in the terms of the contract.” 151 Placing tort claims based on independent duties outside the scope of the economic loss rule ensures “that the rule applies only to those situations where the parties to a commercial transaction share equal bargaining power.” 152

B. New Mexico’s Current Economic Loss Rule

New Mexico’s economic loss rule can be synthesized from the piecemeal application of the rule by the courts discussed above. The rule precludes recovery of economic loss: (1) when there is no great disparity in bargaining power between commercial parties to a contract for the sale of goods and the damages arise from injury of a product to itself; 153 and (2) when the parties to a service contract are sophisticated commercial entities 154 and the tort claim is not based on an independent duty of care. 155 The rule potentially bars tort claims for injury to other property when the parties should have allocated that risk through negotiation. 156 The economic loss rule does not bar claims for indemnification. 157

The foregoing cases make clear that the precise parameters of New Mexico’s economic loss rule are currently undefined. For example, what happens when parties contractually disclaim economic loss damages? Should the rule apply between non-commercial parties? Between non-commercial parties who actually do bargain and contractually allocate risk? Would the rule be unfair when applied in combination with disclaimers of warranties and other limitations on contract recovery? New Mexico law, and the policies underlying it, inform the answers to these questions, and give some definition to the scope of this state’s economic loss rule.

148. See Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1262–63 (Colo. 2000); Grynberg, 70 P.3d at 11.
151. Id. (citing Steiner Corp. v. Johnson & Higgins of Cal., 196 F.R.D. 653, 658 n.7 (D. Utah 2000)).
156. See Spectron, 1997-NMCA-025, ¶ 21–26, 936 P.2d at 857–59. This is only a potential facet of New Mexico’s economic loss rule because the Spectron court never specifically invokes the rule. See supra text accompanying notes 119–131.
IV. CONTRACT'S SHORTCOMINGS

A. Commercial Entities Can Easily Limit Consumers' Contract Remedies

The economic loss rule restricts injured parties to contract remedies when purely economic loss results from breach of a contractual duty. At first glance, there seems to be no inequity in applying the rule, since contract damages presumably place the injured party "in as good a position as he would have been in had the contract been performed." Inequity results when a supplier of goods or services contractually limits or eliminates a consumer's ability to recover, or contract claims are otherwise barred. A commercial entity's ability to shape the terms of a contract to its own overwhelming advantage in fact denies contract recovery, and injured plaintiffs end up nowhere near the position they would have been in had the contract not been breached.

A consideration of the tools a commercial supplier of goods has under the Uniform Commercial Code ("UCC") illustrates the point. For example, warranties can be completely disclaimed. Even when there is a warranty, New Mexico has adopted the most restrictive of three UCC alternatives for third party beneficiaries. A seller's warranty only covers physical injuries to a purchaser's family, household members, and guests, and only when "it is reasonable to expect that such person may use, consume or be affected by the goods." Damages can be contractually liquidated or limited. Remedies can be limited. Consequential damages can be outright excluded. The normal four-year statute of limitations can be reduced, but not extended. Even worse, the "cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach." Using any or all of these mechanisms, a commercial seller can draft a one-sided contract enforceable against a consumer.

Limitations on recovery also exist outside the context of contracts for the sale of goods. For example, contract damages are limited to "what is reasonably within the

161. See, e.g., Ford Motor Co., 592 N.W.2d 201.
163. Id. § 55-2-316.
165. § 55-2-318. It should be noted this section "only addresses horizontal privity, leaving vertical privity to judicial decision." Armijo, 105 N.M. at 424, 733 P.2d at 872. New Mexico has abolished the vertical privity requirement. Perfetti, 99 N.M. at 654, 662 P.2d at 655.
166. § 55-2-718.
167. § 55-2-719(1)(a).
168. § 55-2-719(1)(b).
169. § 55-2-719(3).
170. § 55-2-725(1).
171. § 55-2-725(2).
contemplation of the parties to the contract." Further, in New Mexico "a party generally can exempt itself from liability or limit its liability in tort for harm caused by negligence." Contractual exemptions are valid for economic damages or personal injury. And even though a party to a construction contract may not completely indemnify another party for its own negligence, limitation of liability clauses in construction contracts are valid. All of these limitations on recovery can drastically diminish a deserving plaintiff's ability to recover from a commercial entity's breach of contract.

B. Unconscionability Rarely Provides Recourse for Consumers

One mechanism consumers can use to avoid injustice resulting from one-sided contracts is to show that entire contracts or specific terms are unconscionable. This mechanism is largely ineffective, however, because the threshold for unconscionability in New Mexico is "very high." Further, "[u]nconscionability is one of the most amorphous terms in the law of contracts." With no meaningful way to avoid unanticipated limitations on remedies and damages, individual consumers who suffer economic loss are left with no avenue to recovery. Contract law simply fails to protect consumers in this situation. The very high standard New Mexico consumers must meet to prove unconscionability, combined with inconsistent application of standards, renders the device mostly illusory.

Unconscionability relates to "whether there was freely manifested assent to the bargain." Contracts can be substantively or procedurally unconscionable. For a consumer to prove substantive unconscionability, "[t]he terms must be such as no man in his senses and not under delusion would make on the one hand, and no honest and fair man would accept on the other." A term is procedurally unconscionable where inequality in bargaining power "is so gross that one party's
choice is effectively non-existent." Factors bearing on procedural unconscionability include the use of sharp practices or high pressure tactics and the relative education, sophistication or wealth of the parties, as well as the relative scarcity of the subject matter of the contract. Other factors are "the particular party's ability to understand the terms of the contract and the relative bargaining power of the parties."

The UCC contains its own unconscionability provision applicable to contracts for the sale of goods. Courts can refuse to enforce entire contracts or specific terms, or to "limit the application of any unconscionable clause as to avoid any unconscionable result." However, the UCC does not define unconscionability. The comments to the section vaguely define "[t]he basic test [a]s whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract." One commentator summarizes, "A blurred doctrine designed to address extreme unfairness, unconscionability has been the focus of endless commentary but has not been a frequent basis for relief." Thus, although the New Mexico Supreme Court has declared that "the section sets out what should be the rule under the common law doctrine of unconscionability as applied to all contracts," the UCC's unconscionability section is no more helpful than imprecise common law definitions.

Courts can also refuse to enforce adhesion contracts, or provisions of them, but only "when the contract or provision is unfair." An adhesion contract has three elements:

First, the agreement must occur in the form of a standardized contract prepared or adopted by one party for the acceptance of the other. Second, the party proffering the standardized contract must enjoy a superior bargaining position because the weaker party virtually cannot avoid doing business under the particular contract terms. Finally, the contract must be offered to the weaker party on a take-it-or-leave-it basis, without opportunity for bargaining.

183. Id. at 510, 709 P.2d at 679 (citations omitted).
184. Id.
185. Id.
188. § 55-2-302.
189. Id. at cmt. 1.
193. Guthmann, 103 N.M. at 509, 709 P.2d at 678 (citations omitted).
The second element is met where the dominant party enjoys a monopoly in the relevant market, "or when all the competitors of the dominant party use essentially the same contract terms."194

Parties in New Mexico have been mostly unsuccessful in avoiding unanticipated, adverse contract terms by relying on unconscionability or the law of adhesive contracts.195 The doctrines' two main problems are their conceptually elusive nature and their failure as meaningful mechanisms for avoiding enforcement of unbargained-for and unfair contract terms. As a result, New Mexico courts have applied the doctrine inconsistently.196 These cases are the economic loss rule's contract counterpart. In conjunction, the economic loss rule and unconscionability's very high standard can deprive deserving consumers of the protection of tort and contract law.

V. ALTERNATIVE METHODS OF NARROWING THE GAP

The confluence of the economic loss rule, easily limited or extinguished contractual remedies, and New Mexico's very high unconscionability standard can leave many consumers without recovery for devastating economic injury. There is a void in the law's protection. The void can be narrowed either by supplementing New Mexico's economic loss rule to exempt consumer transactions, or by lowering the standard by which consumers prove unconscionability.197 A combination of the two alternatives is also possible. Each approach has advantages, as well as drawbacks.

A. Exempting Consumers from the Economic Loss Rule

One commonly advanced reason for the economic loss rule is that parties to a contract should be able to set the terms of their own agreements and allocate risk.198 If the rule were not applied, parties could escape their promises by suing in tort.199 These reasons make some sense in situations involving sophisticated commercial entities of comparable bargaining power because parties presumably understand and assent to all contract terms.200 However, even between sophisticated parties,
implied, unforeseen, and unbargained-for terms may become enforceable parts of a contract.201 This is particularly true in contracts for the sale of goods, where the UCC’s202 gap filler and warranty provisions can supply terms not contemplated by the parties.203 This reality undercuts a major premise of the economic loss rule, particularly when the normal, uninformed, and unrepresented consumer is involved.

Some examples from the UCC demonstrate how even commercial parties do not always bargain for every term or specifically allocate risk. To begin with, a concept as basic as the moment of a contract’s making need not be determinable.204 Sellers of goods can create warranties unintentionally.205 Enforceable warranties—including unintentional ones—can be made after contract formation.206 Section 2-207 allows terms to which one or both parties have not assented or even considered to become part of the contract.207 This particular UCC section has been described as “much maligned” and is attributed with “generat[ing] a significant amount of litigation every year.”208 The section creates “arbitrary and uncertain outcomes,” imposes upon parties terms they would not “have chosen if they had bargained about the terms,” and creates “incentives for parties to draft completely one-sided forms in an effort to either get terms that [are] unduly favorable to the drafter or to preclude getting stuck with the other side’s terms.”209 Another section of the UCC imposes terms based on the parties’ previous interactions and the norms of the particular industry, even where the terms do not appear in the parties’ contract.210 By restricting consumers to contract claims, the economic loss rule holds them to “promises” they never contemplated.

Even with its vagaries, the UCC does provide a degree of certainty and predictability for parties to a contract for the sale of goods.211 Other contractual situations do not enjoy the benefit of a comprehensive framework delineating parties’ default rights and remedies.212 There is even less reason to apply the economic loss rule against consumers in such contexts. The Wisconsin Supreme
Court recently found this difference significant enough to hold the economic loss rule inapplicable to service contracts. The court reasoned that the existence of the UCC's rights and remedies "serves as one of the critical rationales underlying the economic loss doctrine" because allowing a commercial purchaser to sue in tort for economic loss would circumvent the UCC. Service contracts are different in that they do not "enjoy the benefit of well-developed law," and "the built-in warranty provisions that the U.C.C. may provide in a contract for the sale of products or goods would not apply to a contract for services." Further, many service contracts are informal and unwritten, so "few parties actually address the allocation of risk or the limitation of remedies." Nor do the parties hire counsel to draft their agreements. As the Wisconsin Supreme Court logically observed:

[T]he concept of the parties engaging in discussions of pre-negotiated liability in the event of breach seems to fly in the face of the reality of routine service contract relationships. Although the freedom to allocate economic risk by contract should not be impinged, applying the economic loss doctrine to limit recovery based on the premise that the parties have indeed exercised that freedom simply makes no sense.

The assumption underlying a breach of contract remedy is "that the parties to a contract can negotiate the risk of loss occasioned by the breach." In many consumer transactions this assumption is not met. Thus, "it is appropriate to enforce only such obligations as each party voluntarily assumed." It is unrealistic to expect normal, unsophisticated consumers to bargain with experienced, sophisticated sellers of goods. This reality was recognized even at the economic loss rule's inception:

The traditional contract is the result of free bargaining of parties who are brought together by the play of the market, and who meet each other on a footing of approximate economic equality. In such a society there is no danger that freedom of contract will be a threat to the social order as a whole. But in present-day commercial life the standardized mass contract has appeared. It is used primarily by [parties] with strong bargaining power and position.

For these reasons, the dissent in Seely concluded that consumers should be able to pursue strict liability claims for economic loss, in order to "properly adapt traditional sales law to the marketing position of today's ordinary consumer."

213. Id. at 472. The Cease Electric court's reasoning is not offered as a critique of the Naylor decisions, but as support for exempting consumers in general from the economic loss rule.
214. Id. at 469.
215. Id.
216. Id. at 471.
217. Id.
218. Id.
220. Id. (quoting Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 869 P.2d 454, 461 (Cal. 1994)).
223. Id. at 158.
main policy reasons underlying the economic loss rule simply fall away when contracts involve ordinary consumers.

The broader policies underlying contract and tort law clarify the distinction the economic loss rule should make with regard to consumers. The rule is very much about the distinction between contract and tort, and which policies should prevail in a given situation. The distinction often blurs, however, and contract and tort policies cannot be "easily separated into neat categories." In general, "contract obligations arise from promises made between parties. Contract law is intended to enforce the expectancy interests created by the parties' promises so that they can allocate risks and costs during their bargaining." The distinction often blurs, however, and contract and tort policies cannot be "easily separated into neat categories." In general, "contract obligations arise from promises made between parties. Contract law is intended to enforce the expectancy interests created by the parties' promises so that they can allocate risks and costs during their bargaining." Tort law protects very different interests. Negligence, for example, serves four purposes: (1) "redistributing the economic burden of loss from the injured individuals on whom it originally fell"; (2) deterring unreasonable or immoral conduct; (3) compensating and satisfying injured victims; and (4) allowing "society [to] give voice and form to its condemnation of the wrongdoer." All of these "underpinnings of tort law...are applicable regardless of whether the victim suffers economic or physical injury."

Contract policies make sense where sophisticated commercial entities negotiate, allocate risks, and actually exercise the freedom to contract. Certainty and enforceability are perfectly appropriate goals. Tort policies do not make sense here because there is no need to redistribute loss or deter wrongdoing (to a point, of course). The parties have already determined their mutual obligations and rights through contract, so no tort action is necessary. Conversely, contract policies do not make sense between parties of unequal bargaining power or where no negotiated terms protect the weaker party's interest. "Freedom of contract" should not be used to enforce the unilateral economic expectations of the more powerful party embodied in a one-sided contract. Where the purchaser is not a sophisticated commercial entity of comparable bargaining power to the seller, the policies underlying tort law are strong. Economic harm should be distributed and damages should be borne by the party most capable of foreseeing and bearing them. Powerful commercial parties should be deterred from selling goods or services that will harm consumers while at the same time contractually insulating themselves from liability.

Finally, New Mexico courts have only applied the economic loss rule to sophisticated commercial parties of comparable bargaining power. The Utah International court, in adopting the rule, held "that in commercial settings when there is no large disparity in bargaining power, economic losses from a product...
injuring itself cannot be recovered in" tort.\textsuperscript{232} Six years later, the New Mexico Supreme Court held "that the economic-loss rule does not bar a claim for indemnification" because "it would be unjust."\textsuperscript{233} In \textit{Spectron}, the court of appeals retained the language from \textit{Utah International} limiting the rule to commercial parties with comparable bargaining power, and applied it against a plaintiff with "more expertise than any other entity in the country regarding" the injured product.\textsuperscript{234} A federal district court recently held that the rule applies to service contracts, but only "when the parties to an agreement are sophisticated commercial entities."\textsuperscript{235}

Exempting consumers from the economic loss rule is thus one alternative for narrowing the gap in New Mexico's protection of consumers. However, it is not the only alternative.

\textbf{B. Lowering the Unconscionability Threshold for Consumer Plaintiffs}

Lowering the unconscionability threshold for New Mexico consumers is the alternative to exempting consumers from the economic loss rule. New Mexico statutes and case law support this alternative. Unconscionability's status as "one of the most amorphous concepts in the law of contracts"\textsuperscript{236} encourages judicial delineation of the doctrine as applied to consumers. Perhaps the most compelling reason to moderate New Mexico's high unconscionability threshold is that in comparison to exempting consumers from the economic loss rule, this measure is less extreme.

New Mexico statutes and case law indicate that consumers should be given an extra level of protection in contractual situations. For example, the Uniform Arbitration Act\textsuperscript{237} provides that "between a consumer, borrower, tenant or employee and another party, a disabling civil dispute clause contained in a document relevant to the dispute is unenforceable against and voidable by the consumer, borrower, tenant or employee."\textsuperscript{238} A "disabling civil dispute clause" is defined as "a provision modifying or limiting procedural rights necessary or useful to a consumer, borrower, tenant or employee in the enforcement of substantive rights against a party drafting a standard form contract or lease."\textsuperscript{239} Parties with less knowledge and bargaining power are thus given special protection by the Act.

\begin{itemize}
  \item \textsuperscript{232} \textit{Utah Int'l}, 108 N.M. at 543, 775 P.2d at 745 (emphasis added).
  \item \textsuperscript{233} \textit{In re} Consol. Vista Hills Retaining Wall Litig., 119 N.M. 542, 551, 893 P.2d 438, 447 (1995).
  \item \textsuperscript{235} \textit{Naylor I}, 452 F. Supp. 2d 1167, 1174 (D.N.M. 2006).
  \item \textsuperscript{236} 7 PERILLO, supra note 178, § 29.1.
  \item \textsuperscript{237} NMSA 1978, §§ 44-7A-1 to -32 (2001).
  \item \textsuperscript{238} \textit{Id.} § 44-7A-5. While it appears no court has passed on the validity of this provision, "[s]tates may not subject an arbitration agreement to requirements that are more stringent than those governing the formation of other contracts." \textit{DeArmond v. Halliburton Energy Servs., Inc.}, 2003-NMCA-148, ¶¶ 9, 81 P.3d 573, 577 (citing \textit{Doctor's Assoc., Inc. v. Casaretto}, 517 U.S. 681, 687 (1996)). The provision indicates the legislature's concern for providing extra protection for consumers in contractual situations, regardless of its validity.
  \item \textsuperscript{239} \textit{Id.} § 44-7A-1(b)(4). Among the seven nonexclusive examples of disabling civil dispute clauses in the statute is a contract clause requiring the consumer to "decline to participate in a class action." \textit{Id.} § 44-7A-1(b)(4)(f).}
\end{itemize}
New Mexico's Unfair Practices Act\textsuperscript{240} is another example of legislative intent to protect consumers from economic harm in contractual settings. The Act forbids unfair, deceptive, or unconscionable trade practices,\textsuperscript{241} and "is intended to provide a private remedy for individuals who suffer pecuniary harm for conduct involving either misleading identification of a business or goods, or false or deceptive advertising."\textsuperscript{242} An unconscionable trade practice is an act that: "(1) takes advantage of the lack of knowledge, ability, experience or capacity of a person to a grossly unfair degree; or (2) results in a gross disparity between the value received by a person and the price paid."\textsuperscript{243}

A third act exemplifying the New Mexico legislature's particular concern for protecting consumers from economic harm in contractual situations is the Uniform Owner-Resident Relations Act (UORRA).\textsuperscript{244} Under the Act, if a court "finds that any provision of a rental agreement was inequitable when made, the court may limit the application of such inequitable provisions to avoid an inequitable result."\textsuperscript{245} The statute encourages courts to determine "the underlying fairness of the rental agreement" and to selectively enforce "the contract to bring about an equitable result."\textsuperscript{246} This inequity provision is modeled on the UCC's unconscionability provision.\textsuperscript{247} Like the UCC, the comparable provision in the model act uses the term "unconscionable."\textsuperscript{248} When the New Mexico legislature adopted the Act, it lowered the standard to "inequitable."\textsuperscript{249} This change led the New Mexico Supreme Court to uphold a trial court's decision that a rent set by a landlord at $125 over market value was inequitable and unenforceable.\textsuperscript{250}

Alone, these three acts cannot compensate consumers who suffer economic injury and who have no recourse due to the economic loss rule, lawfully disclaimed warranties and remedies, and New Mexico's high unconscionability threshold. Rather, the acts are legislative embodiments of the necessity for New Mexico law to provide remedies for seriously injured consumers.

The New Mexico courts' inconsistent application of unconscionability law is another reason to clarify the doctrine as applied to consumers.\textsuperscript{251} The uncertainty is not restricted to New Mexico. The word "unconscionable" itself "defies lawyer-

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\textsuperscript{240} NMSA 1978, §§ 57-12-1 to -22 (1967).
\textsuperscript{241} Id. § 57-12-3.
\textsuperscript{243} § 57-12-2(E).
\textsuperscript{244} NMSA 1978, §§ 47-8-1 to -51 (1975).
\textsuperscript{245} Id. § 47-8-12(A).
\textsuperscript{247} Id.
\textsuperscript{248} UNIF. RESIDENTIAL LANDLORD & TENANT ACT § 1.303 (1972).
\textsuperscript{249} § 47-8-12(A); see also Ramirez-Eames, 108 N.M. at 522-23, 775 P.2d at 724-25 (recognizing legislature's modification).
\textsuperscript{250} Ramirez-Eames, 108 N.M. at 523-24, 775 P.2d at 725-26. The court stated "although the New Mexico Uniform Owner-Resident Relations Act generally affirms the ability of the parties to reach their own agreement on rental price, we believe the equity provisions must be construed as a limitation on this ability." Id. at 523 n.1, 775 P.2d at 725 n.1.
\textsuperscript{251} See supra Part IV.B.
like definition." Despite decades of interpretation of the doctrine, "the arguments and uncertainty continue unabated." The lack of certainty in this area leaves New Mexico appellate courts free to articulate a clear, more moderate standard by which consumers prove unconscionability. Fairness and consistency with legislative intent would be achieved simultaneously.

VI. IMPLICATIONS

A. Exempting Consumers from the Economic Loss Rule

If New Mexico's economic loss rule were to be applied to sophisticated commercial entities and not to consumers, it would become necessary to define these parties' places on the sliding scale of commercial aptitude and clout. The standard for whether a party is a sophisticated commercial entity could be equivalent to that for qualifying as a merchant under the UCC whether the entity provides goods or services. A consumer could be defined as any other party. This approach has the benefit of predictability in the form of a statutory definition, scholarship, and well-developed case law. It is also flexible because a party may be a consumer for purposes of a given transaction, and a sophisticated commercial entity for purposes of another. Bargaining power is another important factor when determining the status of parties for purposes of economic loss rule classification. The greater the disparity in bargaining power, the less reason there is to apply the economic loss rule against the weaker party.

At times, normal consumers will voluntarily and knowingly contract with more powerful, sophisticated commercial entities. Here, the policies underlying the economic loss rule and contract are strong and the rule should bar the consumer from bringing tort claims in circumvention of the contract's terms. Tort policies would not be served by allowing tort actions in such a case. The party's status will depend on case-specific facts, such as relative bargaining power, the extent of negotiation, whether terms such as price or warranty were changed, and other factors bearing on the degree of assent.

252. 7 Perillo, supra note 178, § 29.4.
253. Swanson, supra note 190, at 359.
254. NMSA 1978, § 55-2-104(1) (1961) provides:
   "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

id.

255. See, e.g., Fear Ranches, Inc. v. Berry, 470 F.2d 905 (10th Cir. 1972) (discussing whether defendant ranchers were merchants); Ingrid Michelsen Hillinger, The Article 2 Merchant Rules: Karl Llewellyn's Attempt to Achieve the Good, the True, the Beautiful in Commercial Law, 73 GEO. L.J. 1141 (1985).
256. This is how the UCC treats merchants. See § 55-2-104 cmt. 2 (Merchant "sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.").
257. See Utah Int'l, Inc. v. Caterpillar Tractor Co., 108 N.M. 539, 543, 775 P.2d 741, 745 (Ct. App. 1989) ("We have decided that in commercial settings when there is no large disparity in bargaining power, economic losses from a product injuring itself cannot be recovered in [tort] actions.") (emphasis added).
258. See supra text accompanying notes 231–35.
259. See supra text accompanying notes 229–30.
In many situations contract remedies will place the consumer "in as good a position as he would have been in had the contract been performed." Again, there is no reason to exempt consumers from the economic loss rule by allowing them to pursue tort theories as an alternative to contract actions. These consumers are protected by contract and are thus not in the void between contract and tort. The injustice necessitating alteration of the current non-recovery rules is not present.

For all the compelling reasons to create a partial exemption to the economic loss rule for consumers, there is one very forceful argument against doing so. It would be tantamount to imposing a new tort duty upon sophisticated commercial entities to prevent economic loss. The duty to protect against economic loss is normally a contract concern, and a supplier of goods or services generally has no parallel tort duty. This proposition is fairly novel, and one which courts may be hesitant to adopt. However, this supplement to the economic loss rule would not be an outright imposition of a tort duty to protect against economic loss in all cases.

Even if consumers were partially exempted from the economic loss rule, the exemption’s novelty and scope would be tempered by several factors. First, consumers could not bring products liability claims for purely economic loss because the Restatement specifically limits Section 402A to "liability for physical harm." Consumers alleging violation of tort duties would still bear the burden of proving all the elements of their claims. Second, tort actions for economic losses are presently available to New Mexico consumers in certain instances. For example, "fraud is an economic tort which protects economic interests." Further, tort theories are available to consumers where "professional services arising from contract are substandard." The economic loss rule thus does not bar tort claims against professionals, even where a consumer suffers economic loss and a contract exists between the consumer and professional. Third, since professional providers of services currently owe an independent tort duty to consumers to prevent economic loss, it would not be entirely unfair to extend this duty to professional providers of goods. Finally, precedent for allowing consumers to pursue tort remedies as an alternative to contract remedies exists in situations where consumers

261. The court in Grynberg v. Questar Pipeline Co., 70 P.3d 1 (Utah 2003), explained that the economic loss rule’s "modern focus is not on the harm that occurs but instead is on the source of the duty that was breached." Id. at 11. Since the rule bars tort claims when the duty breached lies in contract, allowing consumers to sue in tort for economic loss would constitute imposition of a new tort duty on providers of goods and services. See Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1262-64 (Colo. 2000).
262. See Torres v. State, 119 N.M. 609, 612, 894 P.2d 386, 389 (1995) ("Courts should make policy in order to determine duty only when the body politic has not spoken and only with the understanding that any misperception of the public mind may be corrected shortly by the legislature.").
263. RESTATEMENT (SECOND) OF TORTS § 402A (1965) (emphasis added).
264. For example, "a negligence claim requires the existence of a duty from a defendant to a plaintiff, breach of that duty, which is typically based upon a standard of reasonable care, and the breach being a proximate cause and cause in fact of the plaintiff's damages." Herrera v. Quality Pontiac, 2003-NMSC-018, ¶ 6, 73 P.3d 181, 185-86.
suffer physical injury or harm to other property. Even with these four mitigating factors, imposing a new tort duty would constitute a moderately large shift in New Mexico tort law.

B. Lowering the Unconscionability Threshold for Consumer Plaintiffs

Modering the unconscionability threshold for consumers is an alternative to exempting consumers from the economic loss rule. This alternative has support in statutes and case law. It is also feasible because the law surrounding unconscionability in general is vague. The implications of lowering the unconscionability threshold for consumers are not severe precisely because of the inconsistency and lack of clarity surrounding the doctrine. Articulating a more moderate standard by which consumers prove unconscionability would bring stability to the area.

Defining the new consumer unconscionability threshold may prove difficult, given the concept’s “amorphous” nature. One option is to draw from UORRA’s “inequitable” provision. If a court “finds that any provision of a rental agreement was inequitable when made, the court may limit the application of such inequitable provisions to avoid an inequitable result.” Courts could consider “the underlying fairness” of contract provisions and selectively enforce those provisions “to bring about an equitable result.”

Another option is to use UORRA’s inequitable provision as a jumping-off point while retaining the current unconscionability framework. If a consumer could show that a contract clause is inequitable within the meaning of UORRA, the clause would be presumed unconscionable. The burden would shift to the commercial party to prove that the clause is not unconscionable. This approach would allow consumer plaintiffs to meaningfully challenge unfair, unbargained-for terms. It would not be unduly burdensome for commercial defendants to prove that terms in contracts they drafted are not unconscionable.

Finally, courts might develop a moderate unconscionability standard for consumer plaintiffs on a case-by-case basis. This would require courts to critically assess the circumstances of contract formation and the fairness of contract terms. Courts must confront disparities in bargaining power and the relative ability of the parties to prevent and absorb economic loss. These factors must have a direct bearing on the unconscionability analysis if unconscionability is to be a meaningful shield against one-sided, unanticipated contract terms.

270. Consumers suffering physical injury from a defective product can bring claims for products liability or breach of warranty. Perfetti v. McGhan Med., 99 N.M. 645, 653, 662 P.2d 646, 654 (Ct. App. 1983) ("In a personal injury case, the products liability claim and the claim concerning the implied warranty of merchantability may be identical."); see also UJI 13-1430 NMRA (In personal injury cases, "both causes of action are available to the plaintiff.").

271. See supra Part V.B.

272. See supra Part V.B.

273. See 7 PERILLO, supra note 178, § 29.1.

274. NMSA 1978, § 47-8-12(A) (1975).

275. Id.

Whatever method is used, lowering the unconscionability standard for consumer plaintiffs is a practical and viable option for narrowing the gap in the law's protection of consumers.

VII. CONCLUSION

The economic loss rule, easily disclaimed warranties and remedies, and New Mexico's very high unconscionability standard can deny deserving consumers compensation for serious economic injury. There are good reasons to partially exempt consumers from the economic loss rule. There are also good reasons to moderate the unconscionability threshold for consumers. However, adjusting the unconscionability threshold for consumers is a moderate alternative compared with partially exempting consumers from the economic loss rule. The reason for not partially exempting consumers from the economic loss rule is a strong one. Imposing a tort duty upon providers of goods and services to prevent economic loss is a fairly extreme proposition. To fill the gap in New Mexico's law, either a new tort duty must be imposed, or an unsettled corner of contract law must be given definition and certainty. Accordingly, moderating New Mexico's unconscionability threshold for consumers is the better alternative.