

Posner on Economic Loss in Tort: *EVRA Corp v Swiss Bank*

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The economic loss rule bars recovery in tort when the plaintiff suffers a loss that is exclusively pecuniary, unaccompanied by property damage or a personal injury. The rule has long puzzled scholars and students for its seeming inconsistency with other tort principles that take a more expansive approach to liability, such as the eggshell skull rule or the adage that a defendant takes his victim as he finds him.¹ In *EVRA Corp v Swiss Bank Corp*,² Judge Richard A. Posner swept away much of the confusion surrounding the economic loss rule and reconciled it with other liability-expanding doctrines of tort law. The *EVRA* case is remarkable for the intellectual order it brought to the question of economic losses, a feat that some scholars thought impossible.³

As striking as the substantive contribution of the *EVRA* opinion is, the manner in which Posner decides the case is equally worthy of notice. He makes sense of the economic loss rule by relying on a case familiar to every lawyer from the curriculum of the first year of law school, *Hadley v Baxendale*.⁴ The *Hadley* opinion is an odd choice as a lodestar of tort law. It is, after all, a contracts case, and other courts have rejected its application to tort law.⁵ A loose-fitting analogy to an

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¹ The persistence of the latter principle may be partly due to the prominent position that a famous eggshell skull case, *Vosburg v Putney*, 80 Wis 523, 50 NW 403 (1891), occupies in legal education. *Vosburg* often appears as the first case in many first-year torts casebooks. See, for example, Richard A. Epstein, *Cases and Materials on Torts* 4 (Aspen 8th ed 2004); Ward Farnsworth and Mark F. Grady, *Torts: Cases and Questions* 1 (Aspen 2004). See also *Stoleson v United States*, 708 F2d 1217, 1220–21 (7th Cir 1983) (Posner) (discussing the application of the eggshell skull rule in the “dynamite heart” case).

² 673 F2d 951 (7th Cir 1982).

³ See, for example, Douglas Laycock, *Modern American Remedies: Cases and Materials* 111 (Aspen 3d ed 2002) (“The logical basis for the rule is obscure.”); Victor P. Goldberg, *Recovery for Pure Economic Loss in Tort: Another Look at Robins Dry Dock v. Flint*, 20 J Legal Stud 249, 251 (1991) (favoring a “nonunitary approach” to economic loss); Gary T. Schwartz, *Economic Loss in American Tort Law: The Examples of J’Aire and of Products Liability*, 23 San Diego L Rev 37, 38 (1986) (“I recommend that we abandon any effort to formulate any single general theory [for the economic loss problem].”).

⁴ 156 Eng Rep 145 (Ex 1845).

⁵ See, for example, *Petition of Kinsman Transit Co*, 338 F2d 708, 724 (2d Cir 1964) (Friendly) (“[T]he rule of *Hadley v Baxendale* has no place in negligence law.”) (citation omitted). But see *Overseas Tankship (U.K.) Ltd v Morts Dock & Engineering Co Ltd (Wagon Mound (No 1))*, 1961 App Cas 388, 419 (PC 1961).

old English contracts case would seem to bring only more confusion to an already puzzling torts doctrine. Posner demonstrates that the opposite was true. The analogy draws out the economic loss rule's consistency with other tort doctrines, and more generally, it establishes the "affinity" of various avoidable consequences doctrines in both tort and contract law.⁶

In showing the common purposes of these doctrines, Posner illustrates two characteristic features of his approach to law. Posner is, of course, rightly famous for his intellectual leadership in economic analysis of the law.⁷ A reader may readily take his opinion in *EVRA* as an exercise in the economic analysis of tort law, even though he nowhere uses value-laden economic terms such as "efficiency" or "social welfare." The analogy to *Hadley* and its principles partly permit him to pursue this analysis without explicit references to economic purposes. In addition, Posner's willingness and virtuosic ability to analyze legal questions from the perspectives of multiple fields of law shows his preference for practical reasoning and his belief in pragmatic adjudication.

I. THE CASE

The plaintiff in *EVRA*, the Hyman-Michaels Company, chartered a ship named the *Pandora*.⁸ The charter agreement required the plaintiff to make payments to the shipowner's bank account in Geneva, Switzerland. The agreement also provided that tardiness of payment gave the owner the right to cancel the charter. In October 1972, the owner attempted to invoke this provision of the charter because Hyman-Michaels' payment was four days overdue. Charter rates had risen dramatically since the signing of the charter, and the cancellation of the charter would permit the owner capture the gains of these higher rates by leasing it to someone else.⁹ Hyman-Michaels had mailed the payment from Chicago one day before it was due in Geneva, Switzerland, and when the owner informed Hyman-Michaels of its intention to cancel the charter, Hyman-Michaels wired the payment. The owner refused that payment, and the dispute went to arbitration as the charter required. Over the dissent of one of its members, the arbitration panel found for Hyman-Michaels but gave Hyman-Michaels notice that in the future it would strictly enforce the charter's payment provisions.¹⁰

⁶ *EVRA*, 673 F2d at 957-58.

⁷ See, for example, Richard A. Posner, *Economic Analysis of the Law* (Aspen 7th ed 2007).

⁸ Hyman-Michaels subsequently became EVRA Corporation. See *EVRA*, 673 F2d at 951.

⁹ *Id.* at 952-54.

¹⁰ *EVRA v Swiss Bank Corp.*, 522 F Supp 820, 824 (N D Ill 1981).

The dispute over the October 1972 payment was a prelude. The incident that gave rise to Posner's opinion in *EVRA* occurred in April 1973. Following the arbitration panel's decision, Hyman-Michaels made payments on the charter through electronic funds transfers rather than postal mail. In April 1973, Hyman-Michaels instructed its bank, Continental Illinois National Bank, to make an electronic funds transfer for the amount of the next charter payment to the shipowner's account at the Banque de Paris in Switzerland. Continental gave Hyman-Michaels a receipt showing a debit to Hyman-Michaels' account in the amount of the charter payment. But Continental did not effect this transaction directly. Rather, its London office telexed its correspondent bank in Geneva, Swiss Bank, and requested that Swiss Bank deposit the amount of the charter payment in the shipowner's account at the Banque de Paris. On this day, Continental encountered difficulty transmitting the message. Its London office tried unsuccessfully for nearly an hour to send a telex to Swiss Bank's general cable office. Continental's agent then sent the message to the telex machine in Swiss Bank's Foreign Exchange Department and received signals at the beginning and end of the transmission indicating that Swiss Bank had received Continental's message.

Swiss Bank, however, did not deposit the funds into the shipowner's account. Two days later, the *Pandora's* owner informed Hyman-Michaels that it was canceling the charter because the payment had not been made. Hyman-Michaels and the shipowner again went before the arbitration panel, and this time, it unanimously ruled in favor of the shipowner.

Hyman-Michaels also brought a diversity action in federal district court against Swiss Bank seeking recovery of profits lost from the cancellation of the charter.¹¹ At a bench trial, the district court found that it had been negligent in losing Hyman-Michaels' telex and that this negligence was the proximate cause of the loss of the charter. It also found that Hyman-Michaels had not been negligent. The bank appealed to the Seventh Circuit.

In a decision written by Posner, a unanimous appellate panel reversed the district court's judgment. The appellate court's decision could have been a workaday order in an ordinary business dispute over a late payment. But in Posner's hands, it was an opportunity to trace the kinship of particular tort and contract doctrines. To reach these issues, he deftly set aside the applicability of the Uniform Com-

¹¹ Continental was also party to this litigation. Swiss Bank impleaded Continental as a third-party defendant, and Continental and Hyman-Michaels filed cross-claims each alleging the other's negligence. See *EVRA*, 673 F2d at 954. For simplicity of exposition, attention is given here only to the claims between Hyman-Michaels and Swiss Bank.

mercial Code's provision on lost checks by "assum[ing]" it did not apply to electronic funds transfers. Instead, Posner proceeded directly to "apply common law principles" and immediately compared the case to *Hadley*.¹² He provided three versions of the lesson of *Hadley*, each of which, in Posner's analysis, pointed toward denial of recovery.¹³

The first interpretation of *Hadley* is that a defendant should not be liable for consequential damages, absent notice of special circumstances.¹⁴ A second version of "animating principle of *Hadley*" is that the party who can avoid a loss at the cheapest cost should bear the burden of the loss.¹⁵ The final version of "the rule" of *Hadley* is that only foreseeable damages are recoverable.¹⁶ Each of these perspectives on *Hadley* identifies a policy rationale for the economic loss rule, and, collectively, they offer a framework for understanding the seemingly inconsistent application of the economic loss rule in other cases.

A. Asymmetric Information

The first version of *Hadley*—the rule of no liability for consequential damages without notice of special circumstances—creates incentives for the efficient revelation of asymmetric information. For Posner, *EVRA* was a case in which information about the customer's potential economic loss was distributed asymmetrically. He conceded that Swiss Bank knew ("or should have known") Hyman-Michaels's transfers were payments on the charter. But Swiss Bank did not know and could not have reasonably known the specific terms of the charter, such as when the payments were due. Nor did it know the particular circumstances of the relationship between Hyman-Michaels and the *Pandora*'s owner. For example, it did not know that the ship owner was keen to cancel the charter and that the rise in the market price for charters had intensified its eagerness. In contrast, Hyman-Michaels possessed all this information. But it failed to disclose the information

¹² *Id.* at 955. In *Hadley*, the breakage of an engine shaft necessitated the closure of a mill, and the miller hired a carrier to transport the broken engine shaft to a manufacturer who would use it as a model in constructing a new shaft. When the carrier negligently delayed delivering the shaft, the miller sought to recover for the profits lost during the period of delay. See *Hadley*, 156 Eng Rep at 145–46. The *Hadley* court denied recovery for these consequential damages because in "the great multitude" of such cases "under ordinary circumstances," a carrier would not expect that its delay would result in closure of a mill. Moreover, the miller had failed to communicate its "special circumstances" to the carrier. *Id.* at 151.

¹³ But see Melvin Aron Eisenberg, *The Principle of Hadley v. Baxendale*, 80 Cal L Rev 563, 564–68 (1992) (describing only two versions of the holding of *Hadley*).

¹⁴ *EVRA*, 673 F2d at 955–56.

¹⁵ *Id.* at 957.

¹⁶ *Id.* at 958.

to Swiss Bank or offer to pay a premium to the bank for insurance against late payment.

Posner's view of these facts conforms with several scholarly analyses of how the *Hadley* rule creates incentives for efficient information disclosure.¹⁷ According to these analyses, the losses resulting from delayed delivery of a crankshaft or a bank telex are likely small in most instances and large in only a few circumstances. But a crankshaft carrier or a bank has no means to distinguish the few customers facing potentially large consequential losses from the mass of customers facing only small losses or no consequential losses at all. In the absence of information about the magnitude of a specific customer's potential loss, a carrier or bank would exercise the level of care appropriate to the average customer and charge customers a price reflecting the cost of this average care. Under a rule permitting recovery for consequential damages, this average would be a higher level of care than is necessary for the mass of customers who face only a small loss. Under a rule denying recovery for economic losses, this average would be a lower level of care than is necessary for the few customers who face a large loss. Thus, neither rule is optimal because under either rule, the level of precaution and the price do not correspond to the potential loss faced by the individual customer.

The behavior of the performing party is only half of the story. The reactions of customers to these rules is the other half. The customers might negotiate with the carrier for a level of care (and thus a price) different from the average level of care. That is, they might reveal information about the size of losses they face. Under a rule of consequential damages, small-loss customers would seek a reduction in the level of care and price, while under a rule of no consequential damages, large-loss customers would seek an increase in the level of care and price. Once one group of customers reveals their type, the carrier can adjust the degree of care it exercises on the two groups to the appropriate levels.

Which of the two rules is socially optimal depends in part on the magnitude of the transactions cost of negotiating around the default rule.¹⁸ The cost to the individual customer of bargaining with the car-

¹⁷ See Douglas G. Baird, Robert H. Gertner, and Randal C. Picker, *Game Theory and the Law* 147–50 (Harvard 1994) (explaining how the *Hadley* rule encourages negotiations that reveal information and lead to optimal outcomes); Lucian Ayre Bebhuk and Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of *Hadley v. Baxendale**, 7 J L Econ & Org 284, 287–92 (1991); Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L J 87, 101–04 (1989) (explaining how the holding in *Hadley* operates as a penalty default that incentivizes information sharing).

¹⁸ Another consideration is whether the magnitude of a customer's potential loss is verifiable. In *EVRA*, verifiability was not an issue because the magnitude of Hyman-Michaels's loss

rier might vary according to whether the customer faces a small or a large loss. But, a priori, there is no reason to think that the cost of bargaining correlates with the amount of potential loss. Instead, if the cost of bargaining is the same for all customers, the amount of transactions costs incurred will depend on the number of customers seeking to negotiate around the default rule. As most customers are small-loss types, a rule denying recovery for consequential damages will induce the smaller number of parties to strike individual bargains with the carrier and hence incur fewer transaction costs. This suggests that in some circumstances the *Hadley* bar on the recovery of consequential damages, absent specific notice, may be socially optimal.¹⁹

Posner's analysis of *EVRA* is consistent with this scholarship on asymmetric information. Swiss Bank did not know and could not readily have known the consequences of failing to transfer in a timely manner the payment to the shipowner's account. Fewer transactions costs may be incurred if the default rule prompts individual customers, such as Hyman-Michaels, to disclose their vulnerability to large losses, rather than a default rule that prompts Swiss Bank to negotiate with many customers. In the absence of Hyman-Michaels' disclosure of this information to Swiss Bank, efficiency considerations counsel the denial of liability.

This information-forcing approach may also induce vulnerable customers to take their precautions against loss (or to self-insure).²⁰ Part I.B discusses the role of the parties' precautions in greater detail. But relevant to the discussion of asymmetric information is that the

was easily verified by comparing the value of the amount of the charter payments to the prevailing market price for charters.

¹⁹ Two prominent exceptions to the economic loss rule are consistent with this analysis. Both exceptions permit recovery for economic losses when the exchange is intended to benefit a specific third party—a circumstance that strongly suggests that one party impliedly or expressly gave notice of special circumstances and sought protection against consequential damages. First, third-party beneficiaries may recover even when their losses are purely pecuniary. See, for example, *Lucas v Hamm*, 15 Cal Rptr 821, 364 P2d 685, 689 (1961). Second, recipients of negligent misrepresentations from suppliers of information to be used in commercial transactions may recover for economic losses when the supplier manifests an intent to supply the sort of information for the sort of use in which the plaintiff's loss occurs. See Restatement (Second) of Torts § 552. But see *Ultramares Corp v Touche*, 255 NY 170, 174 NE 441, 445–47 (1931) (Cardozo) (barring suit for negligent misrepresentations against a public accountant by a party who benefited only incidentally or collaterally from the information provided by the accountant).

²⁰ Seven years after *EVRA*, Posner wrote another opinion involving economic loss and in which he also emphasized “the classification of a case as a tort case or as a contract case is not decisive” to the question of recovery for economic loss. See *Rardin v T&D Machine Handling, Inc.*, 890 F2d 24, 27 (7th Cir 1989). In *Rardin*, Posner recognized—through a vivid hypothetical in which a negligently repaired watch results in a missed appointment and the loss of a business—that a service provider, such as a watch repairer, would likely not agree to bear the risk of loss for the amount of consideration the customer is willing to offer. A second watch rather than the transfer of risk is likely the more cost-effective precaution. *Id.*

customers' precautions may sometimes involve the purchase of specialized services that offer a higher degree of protection.

Several Illinois precedents upon which Posner relied illustrate the point. In *Siegel v Western Union Tel Co*,²¹ a gambler wired funds to a friend so that the money could be bet on a specific horse. When the wire service negligently failed to transmit the funds until after the race was completed (and after the designated horse had romped to victory), the Illinois court relied expressly on *Hadley* and held that the gambler could not gallop into court to recover his would-be winnings.²² The wire service escaped liability because it received "no notice or knowledge of the purpose" of the transmission.²³ Posner contrasted the situation in *Siegel* to two other errant telegram cases in which the plaintiffs secured recovery.²⁴ In *Postal Tel Cable Co v Lathrop*,²⁵ the court awarded lost profits to a coffee trader when a telegraph company mistook the quantity in the trader's purchase instruction to a broker. In *Providence-Washington Ins Co v Western Union Tel Co*,²⁶ the court permitted an insurer to recover when a telegraph company misdirected a message ordering cancellation of the policy and fire subsequently destroyed the insured building. Posner distinguished *Lathrop* and *Providence-Washington* from *EVRA* on the grounds that in the earlier cases "the defendants had more information and the plaintiffs were not imprudent."²⁷

But, a plausible reading of the Illinois cases is that they weaken rather than buttress Posner's assertion that information possessed exclusively by Hyman-Michaels was critical. True, Swiss Bank did not know when the *Pandora's* charter required payments, the shipowner's eagerness to cancel the charter, or the upturn in the market price for charters. But neither did the telegraph company in *Lathrop* know the prevailing market prices or even which commodity the plaintiff was trading. Yet, the *Lathrop* court imposed liability for lost profits.²⁸ The telegram in *Providence-Washington* did not disclose the amount of insurance coverage or how much advance warning of the decision to cancel the policy required the insurer provide. Yet, the court imposed liability for the loss there, too.²⁹ Against these precedents, it seems hardly necessary to require Swiss Bank to know the specifics of the

²¹ 312 Ill App 86, 37 NE2d 868 (1941).

²² *EVRA*, 673 F3d at 956.

²³ *Siegel*, 37 NE2d at 871.

²⁴ *EVRA*, 673 F2d at 959.

²⁵ 131 Ill 575, 23 NE 583 (1890).

²⁶ 247 Ill 84, 93 NE 134 (1910).

²⁷ *EVRA*, 673 F3d at 956.

²⁸ *Lathrop*, 23 NE at 583-84.

²⁹ *Providence-Washington*, 247 Ill at 85-88.

Hyman-Michaels' charter or the current market prices for charters in order to impose liability for consequential losses.

The facts of *EVRA* more closely resemble *Lathrop* and *Providence-Washington* than *Siegel* with respect to the form of communication, too. The communication in *EVRA* was a telex transferring of funds between international banks. The very nature of this form of communication signals its importance. The district court in *EVRA* took this view: "The fact that [the] plaintiff was transferring funds by wire rather than through the mail was sufficient to alert Swiss Bank to the importance of the transaction."³⁰ A telex is a type of communication reserved for trades in fluctuating markets and commercial matters that if handled negligently, are likely to result in large losses. It is unlike the sort of money orders wired in *Siegel* where the transmitted amount may be modest and where consumer convenience rather urgency may motivate the use of the wires. Moreover, following the dispute over its first late payment, the superior reliability and speed of wire transfers induced Hyman-Michaels to use that method of transmitting its charter payments rather than postal mail.

Posner, however, dismissed the notion that a wire transfer informs the bank of the importance of the transaction. "Electronic funds transfers are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer did go awry."³¹ He would have required the communication convey "enough information [for Swiss Bank] to infer that if it lost a \$27,000 payment order it would face a liability in excess of \$2 million."³² In effect, Posner would limit recovery of consequential damages to situations in which the defendant has knowledge of the exact magnitude of plaintiff's potential loss.

Posner's approach to the information-forcing default rule is obviously one that limits recovery of consequential damages. Although he did not cite the scholarly literature on *Hadley*, his analysis in this section closely parallels it, and his approach takes quite seriously the idea that the defendant must have knowledge of the size of the plaintiff's loss before consequential damages are recoverable. This knowledge requirement restricts recovery of consequential damages to virtually only the circumstance of express agreements to transfer of the risk. This approach is perhaps more restrictive than the Illinois precedents, *Lathrop* and *Providence-Washington*. Even if it is, the approach is characteristic of Posner: reasoning pragmatically from principles rather than adhering rigidly to precedent.

³⁰ *EVRA*, 522 F Supp at 833.

³¹ *EVRA*, 673 F2d at 956.

³² *Id.*

B. The Cost of Precautions

The second version of *Hadley*—that the party who can avoid a loss at lowest cost should bear it—creates incentives for the efficient precautions against loss. Posner’s exposition of this interpretation is the highlight of his already provocative opinion. The passage commands attention because he clashes directly with the district court’s opinion and turns its characterization of the facts on its head. More importantly, the second interpretation of *Hadley* is the vehicle for the opinion’s main conceptual contribution. He sketches the “affinity” of various avoidable consequences doctrines in both tort and contract law and provides new insights into the parallel economic functions of these doctrines.³³

The second version of *Hadley* encompasses two circumstances. One is that even when transactions costs are modest and a party has disclosed its vulnerability to large losses, the transfer of risk to the other party may not be cost justified. In this way, the second interpretation is partly a corollary to the first reading of *Hadley*, which addressed the optimal liability rule when the transfer of risk was cost justified. The second situation is when transactions costs are so high they foreclose the possibility of bargaining or prevent negotiating parties from reaching agreement. In these circumstances—when transactions cost preclude the transfer of risk, or when transactions costs are not an obstacle but the transfer of risk is not itself cost justified—the second lesson of *Hadley* is that the would-be plaintiff’s own precautions against the risk of consequential losses may be the more efficient solution.

Posner begins this passage with the reminder that *Hyman-Michaels* and *Swiss Bank* were not joined by contract and that *Hyman-Michaels*’ cause of action resides in tort.³⁴ He explores whether the tort-contract distinction matters for purposes of drawing lessons from *Hadley*. Two immediate differences are that contract liability is strict and that it excludes recovery for economic damages. The other interpretations of *Hadley* – pertaining to asymmetric information and foreseeability – chip away at the appropriateness of recovery for consequential damages. In this portion of the opinion, the discussion of precautions casts doubt on whether liability in contract law is always strict.

³³ Id at 957–58.

³⁴ The situation of *EVRA*, in which the plaintiff and defendant have no contract between themselves but a third party has contractual ties to both litigants, is a common fact pattern in cases involving the economic loss rule. See generally, for example, *Flint v Robins Dry Dock & Repair Co*, 13 F2d 3 (2d Cir 1926).

Posner points to several avoidable consequences doctrines in contract law. Perhaps the most familiar of which is the duty to mitigate damages: a victim of a contractual breach must take reasonable steps to reduce the magnitude of the loss.³⁵ But the avoidance principle is not limited to minimizing harms after breach. Courts also apply the principle to the conduct of the parties before breach. The leading example of mitigation before breach is the denial of recovery in *Hadley* itself. The *Hadley* court pointed out that the miller could have avoided the closure of the mill by keeping an extra crankshaft on hand.³⁶ Even if closure of the mill were necessary, the miller might have prevented the loss of sales by maintaining an inventory of ground grain from which to meet customer demand.³⁷

These contract doctrines seem to have little to do with a torts case such as *EVRA*. But Posner observed that parallel doctrines exist in tort law and that the situation in *EVRA* was “much the same [as *Hadley*], though it arises in a tort rather than a contract setting.”³⁸ He noted that the duty to seek prompt medical attention after an accident is a form of ex post mitigation.³⁹ A similar doctrine governs the ex ante behavior of would-be tort plaintiffs. By giving the example of a driver who failed to wear a seat belt, he presented contributory negligence as a form of ex ante mitigation in tort.⁴⁰ The parallel between tort and contract is not exact, of course. In tort, the prominence of contributory negligence suggests that ex ante avoidance has greater significance, while the greater emphasis in contract on mitigation implies ex post

³⁵ See UCC § 2-715(2)(a) (ALI 2005) (“Consequential damages resulting from the seller’s breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by [the buyer purchasing substitutes as defined in § 2-712] or otherwise.”); Restatement (Second) of Contracts § 350 (1979) (disallowing recovery for damages that could have been avoided “without undue risk, burden or humiliation”).

³⁶ 156 Eng Rep at 151 (“Suppose the plaintiffs had another shaft in their possession put up or putting up at the time, . . . the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill.”).

³⁷ Victor P. Goldberg, *Recovery for Economic Loss Following the Exxon Valdez Oil Spill*, 23 J Legal Stud 1, 21 (1994).

³⁸ *EVRA*, 673 F2d at 957.

³⁹ See Restatement (Second) of Torts § 918 (“[O]ne injured by the tort of another is not entitled to recover damages for any harm that he could have avoided by the use of reasonable effort or expenditure after the commission of the tort.”).

⁴⁰ *EVRA*, 673 F2d at 958 (“If you are hurt in an automobile accident and unreasonably fail to seek medical treatment, the injurer, . . . will not be held liable for the aggravation of the injury due to your own unreasonable behavior.”), citing *Slater v Chicago Transit Authority*, 5 Ill App 2d 181, 125 NE2d 289, 291 (1955) (stating that the duty to “exercise reasonable care to minimize the damages” is “not disputed”). See also *Mount v McClellan*, 91 Ill App 2d 1, 234 NE2d 329, 331 (1968) (holding that evidence of seat belt use is admissible on the question of damages).

avoidance is more important.⁴¹ But Posner's opinion shows that, regardless of whether the cause of action arises in tort or contract, the avoidable consequences doctrines create incentives for plaintiffs to take cost-justified actions to reduce harms.

Posner makes his presentation of the symmetry of the ex ante and ex post avoidance doctrines in tort and contract surprising through his assiduous avoidance of the familiar torts phrase "contributory negligence." Nowhere in *EVRA* does he expressly state that the appellate panel is reversing the district court's conclusion that the plaintiff was not contributorily negligent. A reader of Posner's *EVRA* opinion who did not also examine the district court decision might well come away with the impression that the issue of contributory negligence had not been litigated in the court below. But it was. Despite his avoidance of the phrase, it is abundantly clear from Posner's reproach of Hyman-Michaels's conduct—he denounces it as "imprudent" three times in a single paragraph—that he deemed the plaintiff contributorily negligent.⁴² By sidestepping the phrase "contributory negligence" and by delaying discussion of it until the halfway point of the opinion, Posner's introduction of the issue of the plaintiff's conduct appears unexpected and momentous. He suddenly reframes an issue that first seemed to involve only the defendant's negligence as a joint tort. He recasts a unilateral accident as a bilateral accident.⁴³ He implicitly reminds the reader of the Coase's insight about the reciprocal nature of harms—that accidents result from the conduct of both plaintiffs and defendants.⁴⁴

Applying this framework to the facts, the district and appellate courts reached conflicting conclusions as to which party was the lower cost avoider. The district court found Swiss Bank negligent for failing to institute a system of logging messages and insuring that diverted messages were not lost. It also concluded the fact that bank's telex machine confirmed receipt of messages even when it did not record content of the message constituted negligence. "Such a cavalier atti-

⁴¹ See Goldberg, 23 J Legal Stud at 17–19 (cited in note 37) (analyzing ex ante and ex post incentives for mitigation in the context of the economic loss rule).

⁴² *EVRA*, 673 at 957.

⁴³ This reframing mirrors Posner's reformulation of an abnormally dangerous activity into a joint tort in his famed *Indiana Harbor* opinion. See *Indiana Harbor Belt Railroad Co v American Cyanamid Co*, 916 F2d 1174, 1181 (7th Cir 1990) ("[T]he inappropriate use to which land is being put . . . may be, not the transportation of hazardous chemicals, but residential living."). But see generally Alan O. Sykes, *Strict Liability versus Negligence in Indiana Harbor*, 74 U Chi L Rev 1917 (arguing that Posner was faithful to the Restatement's framework for abnormally dangerous activities).

⁴⁴ R.H. Coase, *The Problem of Social Cost*, 3 J L & Econ 1, 2 (1960) (describing the "reciprocal nature of the problem" of harm).

tude toward major transactions by a sophisticated international bank is shocking to the [district] court.”⁴⁵ Moreover, the district court found that Hyman-Michaels was not contributorily negligent. Hyman-Michaels was entitled to assume that Continental and its correspondent banks would exercise due care, and it send the payment with sufficient lead time for completion.⁴⁶

Posner’s view of the facts of *EVRA* was precisely the opposite. He concluded that the loss could have been avoided at lower cost by Hyman-Michaels. It could have sent the charter payment well before it was due, and once Swiss Bank lost the telex, it could have “pull[ed] out all the stops” to transmit payment to the ship owner’s account. The failure to take these low cost steps constituted “a lack of prudence.”⁴⁷ Posner did not condone Swiss Bank’s “sloppy handling” of the telex. But Hyman-Michaels’s waiting until the eve of the deadline to send payment was like driving with an unfastened seat belt, and that once the telex was lost, Hyman-Michaels’s failure to send duplicate payments was like delaying medical treatment.

The divergent views on which party was the lowest cost avoider reflect that *EVRA* was a close case. Or, it may indicate that it was different from other cases involving the economic loss rule. For many purely economic losses, avoidance requirements seem misplaced because the victim has no opportunity to take precautions against harm. In these circumstances, the concern over the plaintiff’s imprudence, as in *EVRA*, is unnecessary. Among the classic economic loss situations are road blockages and bridge closures that render the plaintiff’s place of business inaccessible.⁴⁸ Through a defendant’s negligence, these plaintiffs lose profits but suffer no physical harms. These situations present seemingly strong cases for recovery under Posner’s second version of *Hadley* because these plaintiffs have no opportunities to avoid their losses. The defendant is surely the lower-cost avoider. But the economic loss rule or physical impact requirement denies recovery in these cases.

One explanation for the bar on recovery in these circumstances is that the would-be customers of the plaintiff in these circumstances find substitutes from other businesses. Another purveyor of the goods

⁴⁵ *EVRA*, 522 F Supp at 829.

⁴⁶ *Id.* at 831–32.

⁴⁷ *Id.*

⁴⁸ See, for example, *532 Madison Avenue Gourmet Foods, Inc v Finlandia Center, Inc*, 96 NY2d 280, 750 NE2d 1097, 1101–03 (2001) (holding that plaintiffs could not recover for economic harms resulting from a road blockage that prevented clients from reaching the plaintiffs’ businesses); *Rickards v Sun Oil Co*, 23 NJ Misc 89, 41 A2d 267, 269–70 (1945) (holding that the defendant, who negligently destroyed a bridge and thus prevented customers from reaching plaintiffs’ businesses, was not liable for consequential economic damages).

or services offered by the plaintiff captures the profits that the plaintiff lost. While the plaintiff's would-be customers may incur some additional transactions costs in obtaining substitutes, these costs are likely modest.⁴⁹ In these cases, the defendant's negligence begets a redistribution from the plaintiff to a third party (a competitor of the plaintiff) rather than a social loss. The absence of a physical injury or property damage indicates absence of a social loss.⁵⁰

The denial of recovery in *EVRA* is consistent with this analysis. Hyman-Michaels lost the charter, and the ship owner gained the opportunity to lease it to a new party. A difference from the road blockage and broken bridge cases is that the shipowner in *EVRA* rather than a third-party, an economic rival of the plaintiff, pocketed the profits Hyman-Michaels would have obtained on the charter. Thus profits were redistributed but no apparent social loss was apparent. The lack of any social harm in *EVRA* suggests that Posner's resolution of the case was correct. But it may also indicate that despite all of the insights that his analysis of avoidance doctrines generates, the question which party was the lowest-cost avoider may not have been determinative in this case.

C. Foreseeability of Loss

The third version of *Hadley*—that liability should attach only for foreseeable losses—provides certainty about the extent of liability. The foreseeability concept is crucial in determining the level of due care because when the likelihood and size of the possible harm are unknown, an actor cannot determine what amount of care is cost justified.⁵¹

As to whether the loss in *EVRA* was foreseeable, the district court and Posner again reached opposite conclusions. The district court decried the “appalling lack of regard on the part of Swiss Bank for the more than reasonably foreseeable possibility that the negligent maintenance of its foreign exchange telex machines could result in substantial

⁴⁹ See Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 Ariz L Rev 735, 737 (2006) (discussing excess capacity); Goldberg, 23 J Legal Stud at 20–29 (cited in note 37) (discussing the components of these losses).

⁵⁰ See Goldberg, 23 J Legal Stud at 19–20 (cited in note 37) (discussing offsetting benefits and the relevance of supply elasticity); William M. Landes and Richard A. Posner, *The Economic Structure of Tort Law* 251 (Harvard 1987) (explaining that pure business injuries create matching external benefits as well as external costs, and therefore do not create social harm); W. Bishop, *Economic Loss in Tort*, 2 Oxford J Legal Stud 1, 4–7 (1982) (using examples to illustrate the propositions that “[i]n a range of cases private economic loss caused by a tortious act is not a cost to society,” and “[i]n the overwhelming bulk of cases physical damage entails real social cost”).

⁵¹ *EVRA*, 673 F2d at 958, citing *United States v Carroll Towing Co*, 159 F2d 169, 173 (2d Cir 1947).

damage to one of its customers.”⁵² In contrast, Posner felt that “as a sophisticated international bank” Hyman-Michaels “knew or should have known” that banks may lose messages even when they exercise due care.⁵³ His view was consistent with his conclusion that Hyman-Michaels should have either disclosed its vulnerability to loss and negotiated a specific contractual protection, or taken its own precautions.

The analogy between the tort and contract foreseeability concepts encounters two difficulties. As applied to the facts of *EVRA*, the concept of foreseeability collapses into the earlier analysis of asymmetric information. As international businesses, neither party could credibly claim that the misdirection of bank telex and the resulting large financial loss are wholly unforeseen.⁵⁴ One of the parties had more information about the size of the potential loss, but it was not utterly unexpected in the same sense as Mrs. Palsgraf’s injuries. Posner’s response to this objection is that a “kind of general foreseeability, which is present in virtually every case, does not justify an award of consequential damages.”⁵⁵ But this response presents the second difficulty with the analogy between the foresight doctrines. While foreseeability principles are well established in both contract law⁵⁶ and in tort law,⁵⁷ they are not precisely the same principle. Contract law’s version is more demanding.⁵⁸ Arguably, Posner sought to import contract law’s notion of foreseeability into tort law.

Posner did still more. He predicted dire consequences if the court imposed liability for Hyman-Michaels’s lost profits. It would induce Swiss Bank to invest resources in acquiring information about its telex

⁵² *EVRA*, 522 F Supp at 829.

⁵³ *EVRA*, 673 F2d at 957.

⁵⁴ See, for example, Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 18 J Legal Stud 105, 124 (1989) (“To call what happened in *Hadley* unforeseeable, or beyond the contemplation of the parties, is to make professional businessmen systematically ignorant of the commonplace.”).

⁵⁵ *EVRA*, 673 F 2d at 959.

⁵⁶ See Restatement (Second) of Contracts § 351 (“Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.”).

⁵⁷ See, for example, *Wagon Mound (No 1)*, 1961 AC at 389. But see *In re Polemis & Furness, Withy Co*, 1921 3 KB 560, 574 (CA 1921) (holding the defendant could be liable even for consequences of her negligent conduct that were not foreseeable); *Kinsman Transit*, 338 F2d at 723-24 (questioning the rule of *Wagon Mound No 1*); Restatement (Second) of Torts § 435.

⁵⁸ See, for example, Grant Gilmore, *The Death of Contract* 58 (Ohio State 2d ed 1995) (“In the Holmesian revision [of the meaning of *Hadley*] foreseeability was not enough; there must have been a deliberate and conscious assumption of risk by the contract breaker.”); Epstein, *Beyond Foreseeability* at 124 (“If anything remotely like the capacious tort standards of foresight are used, then [the outcome in the *Hadley*] case is quite trivial—the other way.”) (cited in note 54). See generally Saul Levmore, *The Wagon Mound Cases: Foreseeability, Causation, and Mrs. Palsgraf*, in Robert L. Rabin and Stephen D. Sugarman, eds, *Torts Stories* 129 (Foundation 2003).

customers in order to gauge more accurately the extent of its potential liability and which precautions would prevent these losses. Swiss Bank would have to gather “reams of information about firms that are not even its regular customers” in order to know “how many and how elaborate fail-safe features to install” in its telex procedures.⁵⁹ Posner implied these precautions would be socially wasteful because the

circumstances [were] too remote from Swiss Bank’s practical range of knowledge to have affected its decisions . . . any more than the falling of a platform scale because a conductor jostled a passenger who was carrying fireworks was a prospect that could have influenced the amount of care taken by the Long Island Railroad.⁶⁰

The grim prediction seems a bit overwrought in view of the fact that a precaution as simple as keeping Swiss Bank’s telex machine well-stocked with paper or instructing its employees on the proper delivery of messages may have prevented the entire fiasco.⁶¹ Setting these practicalities aside, there are objections to this prediction at the conceptual level. A brief model identifies these objections.⁶² Consider a situation in which there are two states of the world, s and sN , each with a probability $p(X)$ and level of damages D^X . The state of the world with more extensive damages occurs less frequently. That is, $D^s < D^{sN}$ and $p(s) > p(sN)$. A tortfeasor may take precautions against harm in amount y at cost $B(y)$. The precautions reduce the probability that harm occurs in each state of the world, or $p(y|s)$. The social loss function is $L = p(s) \cong p(y|s)D^s + p(sN) \cong p(y|sN)D^{sN} + B(y)$, and the socially optimal level of precaution is determined by the first-order condition, $-[p(s) \cong p_{y|s}D^s + p(sN) \cong p_{y|sN}D^{sN}] = B_y$, where subscripts denote partial derivatives with respect to y . The tortfeasor should add units of care until their additional cost equals the expected reduction in damages, where the expected value considers both states of the world.

This framework identifies two quantities that are helpful in understanding the impact of the foreseeability doctrines on the level of precaution a potential tortfeasor will exercise: $p_{y|sN}$ and $p(sN)$. The term $p_{y|sN}$ represents the marginal productivity of precautions in lower-

⁵⁹ *EVRA*, 673 F2d at 958.

⁶⁰ *Id.*, citing *Palsgraf v Long Island R Co*, 248 NY 339, 162 NE 99 (1928).

⁶¹ *EVRA*, at 953.

⁶² This model is taken from the analysis of proximate cause in “nervous injury” cases in Landes and Posner, *Economic Structure* at 243–46 (cited in note 50).

ing the risk of harm in the high damage state of the world,⁶³ and the term $p(sN)$ represents the probability that the high damage state of the world occurs. Notice that if either $p_{y|sN}$ or $p(sN)$ takes a value close to zero, the value of the second term on the left-hand side of the first-order condition is very small. The effect of this term on the tortfeasor's optimal choice of y is likely to be very modest, too.⁶⁴ Even if liability for the unforeseeable event is large, as consequential damages sometimes are, it may have little effect on ex ante decisions.

The second term on the right-hand side of the optimality condition may be small when either the probability of the high damage state of the world or the marginal productivity of precautions in the high damage state of the world is low. One interpretation of an unforeseeable event is that it is a state of the world to which a reasonable person assigns ex ante a nearly zero probability.⁶⁵ If the probability of the high damage state of the world, sN , is unforeseeable, then the value of $p(sN)$ approaches zero. In other words, some harms are so unlikely to occur or are so remote from an actor's conduct that a reasonable actor would not contemplate them in choosing which precautions to take. These remote events occur with essentially zero probability and thus add nothing to the level of expected damages. Liability for harms that are not reasonably foreseeable should not induce any change in the actor's ex ante decisions.

Similarly, when the productivity against harms in the high damage state of the world is very low, liability in the high damage state of the world may not influence the defendant's conduct. Even if large damages occur with high frequency or high $p(sN)$, the inefficacy of precautions in this state of the world may dissuade the potential tortfeasor from taking any greater precautions. For example, if a new computer system would not eliminate errors in Swiss Bank's telex transmissions, it would not invest in the new system even if the risk that a lost telex would result in liability for consequential damages were high. Thus, when either the probability of large losses or the ability of the defendant to prevent them is low, the court's choice to permit or to deny recovery for consequential damages may have little effect on the level of ex ante precaution.

Posner's assertion that liability for consequential damages would prompt Swiss Bank to take excessive and perhaps futile efforts to investigate the extent of its potential liability therefore runs contrary to

⁶³ Id, citing Steven Shavell, *An Analysis of Causation and the Scope of Liability in the Law of Torts*, 9 J Legal Stud 463, 483 (1980).

⁶⁴ Landes and Posner, *Economic Structure* at 244 (cited in note 50).

⁶⁵ See id at 246 (cited in note 50) (describing the injury in *Palsgraf* as involving the less probable state of the world sN).

a simple model of unilateral accidents. A standard economic analysis of liability for an unforeseeable or low-probability loss, even if the loss is large in magnitude, may induce a potential tortfeasor to take no precautions rather than excessive precautions.

A final consideration in determining whether economic losses should be recoverable, a consideration that Posner overlooks, is the administrative cost of permitting recovery. It may be costly for a court viewing events from an ex post perspective to sort out which events were foreseeable ex ante and which not, and, if foreseeable, whether the defendant took a reasonable level of care.⁶⁶ The answers would likely be different for different kinds of economic losses. Even when a court permits recovery for purely economic losses, it must decide which economic losses are compensable and which are not.⁶⁷ Perhaps for these reasons, some courts in the context of both physical and economic harms have simply demarcated the boundary of proximate causation and thus liability with bright line rules.⁶⁸ Indeed, the economic loss rule is sometimes called the “physical impact requirement” to reflect that pecuniary losses are in general recoverable only when a victim has suffered physical injury or property damage.⁶⁹ The rule is itself a bright line prohibition on recovery when physical injuries or property damage do not accompany the pecuniary losses.⁷⁰

CONCLUSION

Posner’s opinion in *EVRA* is a bravura performance. He skillfully sets aside marginal issues, cogently recites a complex set of facts,

⁶⁶ See, for example, Epstein, *Beyond Foreseeability*, at 133 (criticizing Posner’s application of *Hadley* in *EVRA* because the “*Hadley* rule . . . obviate[s] the need for an in-depth examination of the plaintiff’s conduct”).

⁶⁷ *People Express Airlines, Inc v Consolidated Rail Corp*, 100 NJ 246, 495 A2d 107, 112–18 (1985) (permitting recovery for the economic losses of an airline when its flights were delayed but not permitting recovery for persons delayed along a neighboring highway).

⁶⁸ See, for example, *Ryan v New York Central Railroad*, 35 NY 210, 212–13 (1866) (limiting liability in the case of a spreading fire to the first adjacent house); *Guste v M/V Testbank*, 752 F2d 1019, 1021–28 (5th Cir 1985) (en banc) (permitting recovery for commercial fisherman for economic losses arising from an oil spill and denying recovery by seafood companies and marina and boat operators).

⁶⁹ Laycock, *Remedies* at 116 (cited in note 3) (discussing the nature of the physical impact requirement).

⁷⁰ The “physical impact requirement” moniker better captures the necessity of physical injuries or property damage as a prerequisite to recovery for economic losses. For a time, courts required emotional distress be to parasitic on physical harm in order to obtain recovery, but they have since shifted to other metrics of proximate causation for emotional distress. See *Mitchell v Rochester R Co*, 45 NE 354, 354 (NY 1896) (denying recovery for emotional distress unaccompanied by physical harm); *Dillon v Legg*, 69 Cal Rptr 72, 441 P2d 912, 915 (1968) (rejecting the “zone-of-danger” test). See also Landes and Posner, *Economic Structure* at 244–45 (cited in note 50) (speculating about the trajectory of recovery for emotional distress).

and adroitly frames the central questions. Posner turns a lost wire transfer into a demonstration of the continuing vitality of *Hadley* and a seminar on the common structure of seemingly dissimilar tort and contract doctrines. Of course, there could be criticisms. Perhaps his attention to precedent is a bit too quick, or perhaps his treatment of the facts a tad partial. These are, at worst, quibbles that merely appear larger by virtue of Posner's having illuminated the truly difficult questions.