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## **DUTY IN TORT LAW: AN ECONOMIC APPROACH**

KEITH N. HYLTON

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## Duty in Tort Law: An Economic Approach

Keith N. Hylton\*

February 2006

*Abstract:* Theories of tort law have focused on the breach and causation components of negligence, saying little if anything about duty. This paper provides a positive economic theory of duty doctrine. The theory that best explains duty doctrines in tort law is the same as the theory that explains strict liability doctrine. The core function of both sets of doctrines is to regulate the frequency or scale of activities that have substantial external effects. Strict liability aims to suppress or tax activities that carry unusually large external costs. Duty doctrines, especially those relieving actors of a duty of care, serve several functions, but one important class encourages or subsidizes activities that carry substantial external benefits. Another class of duty-relieving doctrines serves as complements to property rules. Still another class of duty-relieving doctrines serves to permit markets to function without distortions created by liability.

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## I. Introduction

Torts textbooks say that a negligence claim consists of four components: duty, breach, causation, and damages. The plaintiff must show, or at least the court must be prepared to assume, that the defendant owed the plaintiff a duty to take care. If the defendant owed the plaintiff a duty of care, the plaintiff will be permitted to prove that the defendant breached the duty of care. The third component consists of the plaintiff's proof that the defendant's breach caused his injury, and the final component is the plaintiff's proof that he suffered a compensable injury.

Theories of tort law have focused on the breach and causation components of negligence, saying little if anything about duty.<sup>1</sup> Indeed, the two most comprehensive consequentialist efforts to explain tort law, the utilitarian analysis of Holmes,<sup>2</sup> and the economic analysis of Posner,<sup>3</sup> have focused almost entirely on breach and causation issues while virtually ignoring the duty question.<sup>4</sup>

My goal in this paper is to fill the space left largely untouched by Holmes and Posner by providing an economic framework that explains duty doctrine. I hope to make clear that duty doctrine is in no sense inconsistent with economic rationales of tort law.<sup>5</sup> Moreover, providing a positive economic theory of duty doctrine leads to a more comprehensive synthesis of the economic literature on torts; specifically by showing the connection within the context of negligence doctrine between property rules, which enjoin conduct, and liability rules, which merely tax conduct.<sup>6</sup>

The theory that best explains duty doctrines in tort law is the same as the theory that explains strict liability doctrine. The core function of both sets of doctrines is to

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<sup>1</sup> For criticism of the lack of attention to duty doctrine in modern torts scholarship, see John C. P. Goldberg and Benjamin C. Zipursky, *The Moral of MacPherson*, 146 U. Pa. L. Rev. 1733 (1988); Goldberg and Zipursky, *The Restatement (Third) and the Place of Duty in Negligence Law*, 54 Vand. L. Rev. 657 (2001).

<sup>2</sup> Oliver Wendell Holmes, Jr., *The Common Law* (1881).

<sup>3</sup> William M Landes and Richard A. Posner, *The Economic Structure of Tort Law* (Cambridge, MA: Harv. Univ Press, 1987).

<sup>4</sup> To be fair, Posner did examine the duty issue in a narrow setting in his article on rescue, see Landes and Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. Leg. Stud. 83 (1978). The Landes-Posner analysis of rescue anticipates, in some respects, the argument of this paper. However, the Landes-Posner article on rescue does not claim to set out a general theory of duty doctrine, which is the aim of this paper.

<sup>5</sup> There is a more general critique of consequentialist, or sanction-centered, theories of law that asserts that they are inadequate because they ignore the internal sense of obligation that is perceived by actors in advanced legal systems. See H.L.A. Hart, *The Concept of Law* (1994). The lack of attention to duty doctrine reflected in the consequentialist approach could be viewed as an important fact supporting this internal-viewpoint critique. Looking from this perspective, this paper's message is that consequentialist theories are quite capable of explaining duty doctrine.

<sup>6</sup> In particular, duty doctrine provides a link, in the context of negligence law, between the property and liability rules initially identified in Guido Calabresi and Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 Harv. L. Rev. 1089 (1972). For discussion, see *infra* text accompanying notes 21 and 22.

regulate the frequency or scale of activities that have substantial external effects. Strict liability aims to suppress or tax activities that carry unusually large external costs. Duty doctrines, especially those relieving actors of a duty of care, serve several functions, but one important class encourages or subsidizes activities that carry substantial external benefits. Another class of duty-relieving doctrines serves as complements to property rules. And still another class of duty-relieving doctrines serves to permit markets to function without distortions created by liability.

While the traditional economic approach to tort law focuses on care or instantaneous precaution decisions, this paper focuses on activity decisions – how much to engage in activities that impose uncompensated costs or benefits on others. In this analysis four types of rule can be identified in terms of their activity effects: property rules, which prohibit activity; strict liability rules, which tax activity without prohibiting; negligence rules, which do not affect activity levels; and no-duty rules, which subsidize activity. I use the framework developed here to explain doctrines such as the rescue rule (the absence of a general duty to rescue), the duties of landowners, and other pockets of law in which courts have consistently relieved some actor of a duty to take care.

## II. A Skeletal Theory

### A. Traditional approach and its shortcomings

The traditional economic analysis of tort law takes the famous balancing test of the Learned Hand formula as the default rule for questions of liability.<sup>7</sup> Under the Hand balancing test, one should compare the benefits of taking additional care, in terms of expected injury costs avoided, to the burden of taking additional care. It is sometimes described as the *BPL* test, where *B* represents the burden, *P* the probability of an injury, and *L* the dollar amount of the injury. Under the Hand balancing test, a court should hold a defendant liable when he failed to care in a setting in which the burden of additional care is less than the expected injury costs that could have been avoided ( $B < PL$ ).

One does not need to have an interest in economics to see the applicability of economic reasoning to the Hand formula. The economic efficiency rationale for the Hand formula is easy to state.<sup>8</sup> If the cost of taking care is less than the expected injury costs that could be avoided by taking care, the actor should be encouraged to take care in order to reduce overall social costs. In other words, social welfare is

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<sup>7</sup> The Learned Hand formula was articulated by Judge Hand in *United States v. Carroll Towing Co.*, 159 F.2d 169 (2d Cir. 1947). For extensive treatments of the traditional economic approach see William M Landes and Richard A. Posner, *The Economic Structure of Tort Law* (Cambridge, MA: Harv. Univ. Press, 1987); Steven Shavell, *Economic Analysis of Accident Law* (Cambridge, MA: Harv. Univ. Press, 1987).

<sup>8</sup> Of course, this should not be taken to mean that it is obvious. Indeed, the economic efficiency rationale was first articulated only thirty years ago, see Richard A. Posner, *A Theory of Negligence*, 1 *J Legal Stud.* 29 (1972).

higher when the actor takes care than when he does not take care. However, if the cost of taking care is greater than the expected injury costs of not taking care, it would be economically inefficient to take care.

Calabresi, Posner, and Shavell have modified this approach by recognizing the importance of distinguishing care level and activity level concerns.<sup>9</sup> One can reduce the likelihood of an accident by taking care, or by not acting at all. For example, one can reduce the likelihood of a traffic injury occurring by driving with greater care, or by not driving at all. The decision not to drive, or to drive less frequently, is an *activity level* decision, while the decision to drive more slowly is a *care level* decision.

Distinguishing activity level and care level effects permits one to make an economic case for choosing strict liability over negligence. Since actors will take care under both the negligence and strict liability rules, strict liability is preferable to negligence only if it is desirable to reduce the activity level. It might be desirable to reduce the activity level if, for example, taking extra care will do little to reduce the frequency of injury.<sup>10</sup>

To sum up, the traditional economic approach to tort law treats the Hand balancing test as the default rule, and strict liability as an option that should be adopted when it is desirable to reduce activity levels. The traditional approach has been applied largely to negligence law, and has been successful in explaining negligence doctrine.<sup>11</sup>

Surprisingly, in view of its success in explaining negligence doctrine, the traditional economic approach has so far not had as much success in providing positive theories of two broad areas of tort doctrine: duty and strict liability.<sup>12</sup> The traditional economic approach, largely due to Posner, has hardly mentioned duty doctrine, save for the special case of rescue.<sup>13</sup> In this sense, the traditional economic model has followed the course set by the utilitarian analysis of Holmes, which also failed to find a role for duty doctrine in tort law.<sup>14</sup>

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<sup>9</sup> Guido Calabresi, *The Costs of Accidents: A Legal and Economic Analysis* (Yale Univ. Press, 1970); Richard A. Posner, *A Theory of Negligence*, supra note 7; Steven Shavell, *Strict Liability Versus Negligence*, 9 *J. Leg. Stud.* 1 (1980). For a critique of the Posner-Shavell approach as a theory of the case law, see Stephen Gilles, *Rule-Based Negligence and the Regulation of Activity Levels*, 2 *J. Leg. Stud.* 319 (1992).

<sup>10</sup> This view of the purpose of strict liability was stressed by Judge Posner in *Indiana Harbor Belt R.R. v. American Cyanamid Co.*, 916 F.2d 1174 (7th Cir. 1990).

<sup>11</sup> See, e.g., Landes and Posner, supra note 7.

<sup>12</sup> Hylton, *Theory of Tort Doctrine and the Restatement of Torts*, 54 *Vand. L. Rev.* 1413 (2001).

<sup>13</sup> Landes and Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 *J. Leg. Stud.* 83 (1978).

<sup>14</sup> In particular, Holmes apparently did not see a need to relieve actors of a duty of care. See Oliver Wendell Holmes Jr., *The Theory of Torts*, 7 *Am L. Rev.* 652, 660 (1873) (endorsing a general duty of “all the world to all the world”). See also, Goldberg & Zipursky, supra note 1.

The same can be said of strict liability. The argument that strict liability should be chosen over negligence when it is desirable to reduce activity levels begs the question rather than provide a theory of strict liability. Why should we prefer to reduce activity levels? The traditional approach, reflected in the work of Posner and Shavell and put most clearly in application in Judge Posner's *Indiana Harbor Belt R.R.* decision, seems to answer that question by saying that we should adopt strict liability when due care is insufficient to eliminate accidents.<sup>15</sup> But due care is never sufficient to eliminate accidents, so this theory suggests that strict liability should be adopted across the board in place of the negligence rule in tort law.<sup>16</sup> Moreover, there are some instances, such as zoos, in which substantial risk remains after the defendant has exercised due care, and yet courts choose not to adopt strict liability.

It happens that the concurrent shortcomings of the traditional economic approach to tort law in providing positive theories of duty doctrine and of strict liability doctrine are not coincidental. In other words, this is not a case in which the traditional approach misses two distinct targets for totally independent reasons. The theoretical bases for duty doctrine and strict liability doctrine, I will argue, are essentially the same. The traditional approach fails to hit the bull's-eye of both of these targets because they are not distinct targets. A theory that explains duty doctrine will also explain strict liability doctrine, and conversely.

#### B. Missing Markets Framework: Explaining the Functions of Duty and Strict Liability Rules

An alternative approach that I labeled the "missing markets" model offers a positive theory of strict liability doctrine.<sup>17</sup> In this part I will argue that the missing markets framework also explains duty doctrine. Indeed, the two doctrines are so closely related that any theory that explains one will necessarily explain the other.

The missing markets framework focuses on activity levels and assumes that externalities are prevalent. Strict liability is preferable to negligence if the costs externalized by an activity substantially outweigh the benefits externalized.<sup>18</sup> Negligence is preferable if there is a rough equality between externalized benefits and externalized costs. A rule stating that the actor has no duty, I will argue here, is

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<sup>15</sup> *Indiana Harbor Belt R.R.*, at 1176-1177. See also, Landes and Posner, *Economic Structure of Tort Law*, supra note 7, 107-118, which applies the traditional argument to several cases. It is true that in a case such as blasting, a great risk of harm continues to be imposed on others even when reasonable care is being taken. For that reason, the claim that strict liability is appropriate when due care is insufficient seems justifiable. However, there is a residual risk of harm imposed on others in all circumstances of risk-creating conduct – such as driving a car. The theory presented by Landes, Posner, and Shavell implies that strict liability should apply to all such conduct (including automobile use). And the theory runs into difficulty in explaining the negligence rule applied to zoos, Landes and Posner, supra note 7, at 108. Why should the negligence rule apply in the case of a zoo, and strict liability in the case of a private owner of a wild animal?

<sup>16</sup> Hylton, *Theory of Tort Doctrine*, supra note 12.

<sup>17</sup> Hylton, *A Missing Markets Theory of Tort Law*, 90 *Northwestern U.L. Rev.* 977 (1996).

<sup>18</sup> *Id.*

preferable to the negligence rule when the benefits externalized are considerably in excess of the externalized costs.

Let us consider an illustration of the missing markets model. Suppose we are considering some activity (e.g., the amount of automobile use or the amount of rail service). The incremental or marginal private benefits of the activity are the benefits that accrue to the acting party, the person deciding the scale at which he will engage in the activity. The marginal private benefits can be represented by a downward-sloping schedule, somewhat like the standard demand schedule of supply-demand analysis. This is the curve labeled *MPB*, for marginal private benefit, in Figure 1. The horizontal axis measures the scale of the activity. The downward-sloping *MPB* schedule reflects the assumption of diminishing marginal utility as the activity increases. Consider, for example, driving as an activity. The incremental private benefits of driving are high initially, as one makes use of a car for the most important tasks – going to work, or obtaining necessities. As the use of the car increases, the gain from an additional mile of driving declines, because the driver uses the car for less pressing needs – e.g., to save time traveling some distance that could easily be walked.

The marginal cost of the activity can be represented by an upward sloping schedule, as shown in Figure 1, and labeled *MPC*, for marginal private cost. The marginal private cost schedule reflects costs borne by the actor who is determining the scale at which to engage in the activity. The upward slope shown in the figure assumes the incremental cost increases as the actor increases the scale of the activity. For example, as the driver increases the frequency of use of his car, the costs incurred from depreciation and exposure to accidents increases.

Since externalities are assumed to be prevalent, I have included in Figure 1 alternative schedules that reflect external costs and external benefits. If there are external benefits, the social benefit from the actor's activity is simply the sum of the private and external benefits. This is shown by the curves labeled *MSB (low externality)* and *MSB (high externality)*. For example, suppose that a driver uses his car to get to work. Suppose in addition a co-worker occasionally asks the driver for a ride to some place on the driver's usual path. The fact that the driver uses his car to go to work provides an external benefit to the coworker.<sup>19</sup> That external benefit is reflected in the vertical distance between the marginal private benefit schedule and the marginal social benefit schedule.

The private benefit and private cost schedules allow us to find the scale of the activity chosen by the actor under a negligence rule – that is, the *privately optimal* scale of activity. The negligence rule does not force the actor to bear the external costs of his activity when the actor is exercising due care. Thus, when the actor is exercising due care, which is assumed to be the case, the scale of the activity will be

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<sup>19</sup> Of course, the driver may benefit directly from offering rides to coworkers, through reciprocal favors. However, he is unlikely, as a general matter, to value the benefits of offering rides to coworkers as much as the coworkers value those benefits themselves.

given by the activity level associated with point *A* in Figure 1. This is the privately optimal scale because it reflects costs and benefits borne by the actor.

The social benefit and social cost schedules allow us to find the *socially optimal* scale of the activity. The reason is that an activity should be carried on a greater scale as long as the incremental societal benefit exceeds the incremental societal cost. As long as this is true, an increasing the scale adds to society's wealth. When the marginal social benefit is just equal to the marginal social cost, the activity's scale should not be increased further, since to do so would push it to the point where the incremental social benefit is less than the incremental social cost. Thus, the optimal scale is represented by the intersection between the marginal social cost and marginal social benefit.

If externalized costs and externalized benefits are roughly equal, then the socially optimal scale of the activity will be the same as the privately optimal scale of the activity. This is shown by point *B*. At point *B*, the marginal social cost, which is the sum of the marginal private cost and the marginal external cost, is equal to the marginal social benefit, which is the sum of the marginal private benefit and the marginal external benefit. Alternatively, if the costs externalized by the actor are roughly equal to the costs externalized by the victim, the same result holds.<sup>20</sup>

Suppose external benefits are relatively modest and external costs are large in comparison. When external costs are considerably larger than external benefits, the socially optimal scale of the activity will be given by point *C*. If, on the other hand, external benefits are far in excess of external costs, the optimal scale will be point *G*.

Now we come to the law. When the externalized benefits and externalized costs associated with the actor's activity (or the costs externalized by both injurer and victim) are roughly the same, as in *B*, the negligence rule is optimal. The reason is that the negligence rule imposes no liability on the actor when he exercises reasonable care, as assumed. Since the negligence rule imposes no liability on the actor when he exercises reasonable care, and since it is assumed that he will exercise reasonable care, liability will not distort his activity level choice away from the socially optimal scale (the scale associated with point *A* and *B*).

An equally important point is that when the externalized costs and externalized benefits connected to the actor's activity are the same, or when there is a reciprocal exchange of externalized costs, the actor should *owe a duty of care* to the potential victim. Of course, if the actor's externalized costs are greater than his externalized benefits, the duty of care is still socially desirable.

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<sup>20</sup> Consider the following unitization rationale. Imagine two firms imposing reciprocal costs of \$1 per month on each other. If the firms merged, would they require a transfer of \$1, both ways, between the merged units? No, because it would have no effect on the incentives of relevant actors. By the same reasoning, when two actors impose the same costs, imposing strict liability on both would not alter their activity levels.

A strict liability rule would force the actor to pay for the external costs generated by his activity, whether or not he had taken care. As a result, the actor would exercise reasonable care, just as he would under the negligence rule. However, in addition to inducing care, strict liability affects the actor's activity scale decision. Under strict liability, the actor's cost schedule becomes the marginal social cost schedule, which represents the sum of private and external costs. If external costs are large relative to external benefits, the actor's privately optimal scale will be point *E*. This is not necessarily the same as the socially optimal scale. If there are relatively modest external benefits, the socially optimal scale is the activity level associated with point *C*. However, it is closer to the socially optimal scale than is the scale associated with point *A*, and for this reason represents a desirable scale change caused by the imposition of strict liability.

Consider, for example, the keeping of wild animals. In most cases, keeping a lion in your backyard imposes a risk on your neighbors that is far in excess of any benefit they may receive from the novelty of observing a lion from close range. The law imposes strict liability in order to discourage the activity, even if you have surrounded the lion with an impenetrable steel cage. However, if you are operating a zoo, some courts have held that the negligence rule applies.<sup>21</sup> The reason is that the public benefits offered by the zoo are substantial. The ratio of externalized risk to externalized benefit is much lower in the case of the zoo than in the case of the individual who keeps a lion in his backyard.

A *no-duty rule* would relieve the actor of a duty to take care, which subsidizes his activity. To see the subsidization effect, compare this case to that of the negligence rule. Recall that under the negligence rule, the actor faces no costs from liability because he takes care. However, even in the case of the negligence rule the actor bears the cost of taking care. The no-duty rule subsidizes the actor by relieving him of the cost of taking care. This is equivalent to shifting the actor's private marginal cost schedule down, resulting in a new scale choice of *F*.

Could a no-duty rule be socially desirable? Consider the case in which the external benefits associated with the actor's activity are large (represented in the figure by *MSB (high externality)*), and the external costs are relatively modest (represented by the schedule labeled *MSC (low externality)*). The socially optimal scale of the activity is that associated with point *G*. Subsidizing the actor by relieving him of a duty to take care shifts his private marginal cost schedule down, resulting in scale choice *F*. Since the scale associated with *F* is close to the scale associated with *G*, the subsidy results in an optimal shift in the actor's preferred scale of activity. In other words, the no-duty rule is socially desirable in this case.

What if the external costs are so large that the marginal social benefit schedule, representing the sum of private and external costs, moves so high upward that it no

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<sup>21</sup> *Guzzi v. New York Zoological Society*, 182 N.Y.S. 257 (N.Y. App. Div. 1920), *aff'd*, 233 N.Y. 511 (1922); *City of Denver v. Kennedy*, 29 Colo. App. 15, 476 P.2d 762 (1970), *after remand*, 31 Colo. App. 561, 506 P.2d 764 (1972).

longer crosses the marginal social benefit schedule (see *MSC (very high externality)* in Figure 1)? This is the case in which costs are so high relative to benefits that the optimal scale of the activity is zero. In this case, a *property rule* rather than a liability rule is desirable.<sup>22</sup> A property rule prohibits the actor's activity altogether rather than simply internalizing the costs it generates.<sup>23</sup> An example of this last scenario is reckless conduct. Recklessly endangering the lives of others is a tort and also a violation of the criminal law in most states. The law aims to go beyond internalizing costs in the case of reckless conduct. The law aims to prohibit it.

Note that this theory suggests that negligence is appropriate when and only when there is a rough equality between externalized cost and externalized benefit. If there is no such equality, as in point *E*, there is no economic or utilitarian basis for choosing the negligence rule instead of strict liability.

In addition to the *subsidization* function illustrated in Figure 1 (see *F*), no-duty rules also serve as *complements to property rules*. Thus, when conduct by an injurer against a victim is prohibited by a property rule, we will see that corresponding conduct by the victim against the injurer is often governed by a no-duty rule.

The foregoing functions of no-duty rules correct market failures or missing markets. Another function of no-duty rules is to simply permit markets to optimally regulate activity levels. In some instances, we will see below, the imposition of a duty of care (negligence liability) may distort the activity level choice away from the socially optimal level. One setting in which this occurs is when the actors can observe external costs and benefits and take them into account in contracting decisions. When informed actors are aware of potential external costs, and can effectively contract over both the scale of activity and the level of care, imposing liability may distort activity levels by preventing parties from contracting over the care level. Conversely, there are settings where, because of informational asymmetry, imposing negligence liability for a certain type of loss distorts the market.

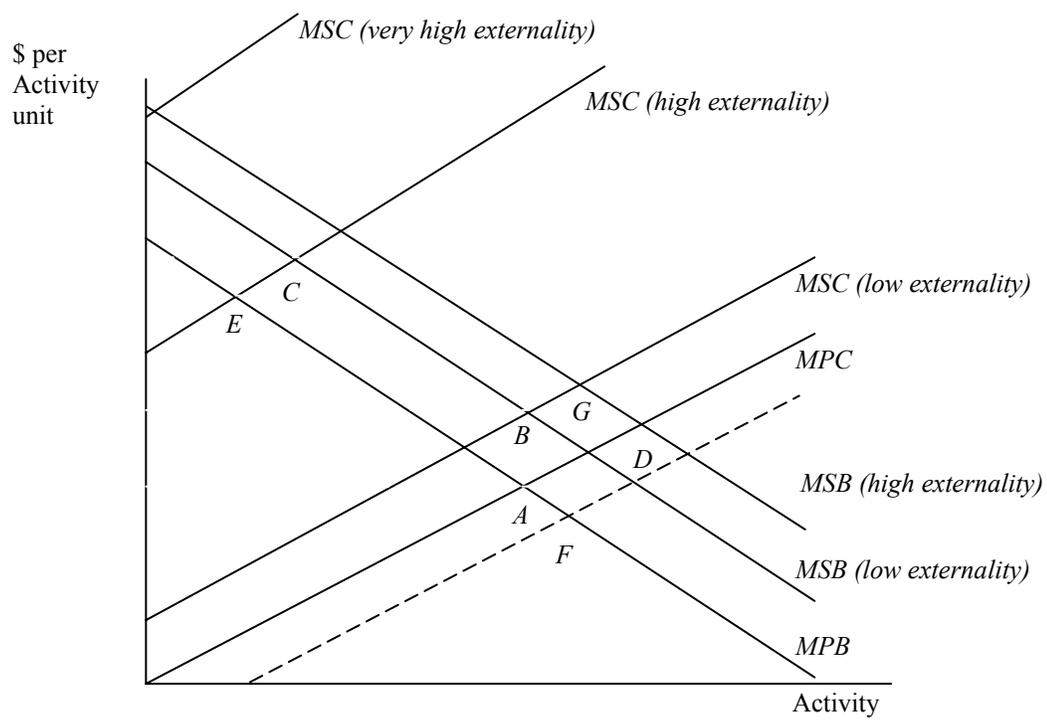
The three functions of no-duty rules are (1) to provide subsidization, (2) to serve as complements to property rules, and (3) to permit the market to regulate activity levels without distortions created by liability. The first and third functions, as will be clear shortly, are quite similar. The foregoing analysis is a skeletal discussion of the functions of duty rules and strict liability. In the next section I will consider cases and describe how they fit within the skeletal structure developed to this point.

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<sup>22</sup> On property rules and liability rules, see Calabresi and Melamed, *supra* note 6; Louis Kaplow and Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 *Harv. L. Rev.* 713 (1996); Hylton, *Property Rules and Liability Rules, Once Again*, available in SSRN electronic library.

<sup>23</sup> Calabresi and Melamed, at 1092.

Figure 1



### III. Applications

#### A. Complements to Property Rules: Duties to Trespassers and to the Reckless

##### 1. Trespasses to Property

Some “no duty” rules in tort law are simply complements to property rules. The rule that a landowner owes no duty of care to a trespasser is an example of such a complementary property rule.<sup>24</sup>

Trespass law is a property rule in the sense that it permits the landowner to enjoin the trespasser and to seek damages. The power to enjoin forces the would-be trespasser to bargain for access to the landowner’s property. The injunction power protects the subjective valuation of the landowner, because if the trespasser could invade the landowner’s property and be required to do no more than pay compensatory damages, the subjective portion of the landowner’s valuation would not be protected by the law.

The rules regarding duties of landowners to trespassers are surprisingly complicated. The landowner owes no duty to take care to avoid an injury to the trespasser. Thus, if the landowner has a patch of quicksand on his property, he does not have a duty to warn the trespasser to avoid the quicksand. However, the landowner is not permitted to intentionally injure the trespasser, or to lay traps for him.<sup>25</sup> Moreover, if the landowner attempts to remove the trespasser, he must use force that is reasonable in light of the circumstances.<sup>26</sup> Thus, the no-duty rule regarding trespassers is coupled under the law with a reasonable force rule governing the landowner’s intentional conduct toward the trespasser.

The law on trespass, then, has the following general form. A property rule governs trespass. The property rule allows the landowner to enjoin and to seek damages for invasions. As a complement to that property rule, there is a no-duty-of-care rule that applies to the landowner. The *property-complement* rule also contains a reasonable force requirement that bars certain intentional torts committed by the landowner against the trespasser.

Continuing with the effort to generalize the law on trespass, we may say that it consists of a property rule, which enjoins potential trespassers and imposes strict liability against trespassers, and property-complement rule, which relieves landowners of the duty of care and imposes liability for unreasonable uses of force by the landowner.

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<sup>24</sup> See, e.g., *Robert Addie & Sons (Collieries), Ltd. V. Dumbreck*, [1929] A.C. 358; *Buch v. Amory Manufacturing Co.* 44 A. 809 (N.H. 1897); *Turbeville v. Mobile Light & R. Co.*, 221 Ala. 91, 127 So. 519 (1930); William L. Prosser, *Handbook of the Law of Torts* 357 (4th 1971)

<sup>25</sup> E.g., *Robert Addie & Sons*, [1929] A.C. 358, 367.

<sup>26</sup> *M’Ilvoy v. Cockran*, 2 A.K. Marsh 271 (Ky. 1820); *Bird v. Holbrook*, 130 Eng. Rep. 911 (C.P. 1825).

The purpose of the property-complement rule is easy to see. It relieves the landowner of a duty of care to the trespasser in order to protect the landowner's subjective valuation of his property. In other words, the no-duty-toward-trespassers rule serves the same function as the injunction right in trespass law. If landowners owed a duty of care to trespassers, they would have to invest resources into preventing harm to trespassers. Since trespassers can arrive from many different directions – they don't generally choose the front gate as the point at which to invade – a duty to prevent harm could impose enormous costs on the landowner. Since the required investments would be made to benefit the trespasser, a duty of care toward trespassers would effectively transfer part of the landowner's valuation of his property to the trespasser. This obviously contradicts the function of the property rule. If trespassers desire protection against defective conditions or other lapses in care on the landowner's property, they should bargain for it. The property-complement rule effectively forces potential trespassers to bargain for the protection that a duty of care would give them.

The reasonable force rule can be viewed as an implication of a more basic property rule, the one prohibiting intentional batteries. The fact that a trespasser winds up on your property does not give you the right to shoot him with a rifle or run him through with a spear. On the other hand, some force used to remove the trespasser is permitted or privileged, again as a complement to the underlying property rule.

As an illustration of the function of the no-duty rule, consider *Gladon v. Greater Cleveland Regional Transit Authority*.<sup>27</sup> The plaintiff, Gladon, had been beaten up by two men while waiting for a train and had been left on the tracks with his leg draped over one of the rails. An approaching train failed to break in time, causing severe injuries. Although he did not intentionally walk onto the tracks, he got there through no fault of the railroad. The court classified him as a trespasser and held that the railroad owed no duty to discover and avoid injuring him.

The plaintiff in *Gladon* offered a sympathetic case for compensation. However, a rule requiring the railroad to discover and avoid injury to a trespasser on the rails would impose an enormous burden on the railroad. The duty would apply not only to unfortunate victims who slip or who are thrown onto the tracks, but also to risk-seekers who choose to run along the tracks for the fun of it. Perhaps it is enough to say that that is no way to run a railroad. If it were feasible at all to continue to offer rail service under a duty to look out for trespassers on the rails, it would surely become an exorbitantly expensive service. With a small client base – the result of cost increases passed on to customers – and substantial fixed costs, rail service would generally fail as a business or government service.

Admittedly, the no-duty-to-trespassers rule seems harsh in many applications. For example, in *Buch v. Amory Manufacturing Co.*,<sup>28</sup> the court denied compensation to

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<sup>27</sup> 75 Ohio St. 3d 312, 66 N.E. 2d 287 (1996).

<sup>28</sup> 69 N.H. 257, 44 A. 809 (1898).

an eight-year-old boy who had followed his brother into a mill to learn his brother's work. The boy's hand was crushed in a machine as his brother tried to teach him how to use it. The court held that the boy was a trespasser and therefore not entitled to a warning about the dangers of the machines, which would have been obvious to an adult. The result seems harsh given that the mill overseer knew of the boy's presence and presumably could have put him out rather than let him continue to expose himself to great risk.<sup>29</sup>

Harsh seeming cases involving the no-duty rule are the ones most likely to be litigated. They are not necessarily representative of the rule's operation in general. The function of the rule is better assessed in light of the case of an intentional trespasser who walks onto train tracks or into a manufacturing plant. In these cases, property rules appear to be necessary parts of the organization of productive activities. Railroads must be able to exclude others from their tracks and to use their tracks with the assumption of exclusive possession. Manufacturers must be able to exclude pedestrians from their plants. The no-duty-to-trespassers rule is simply a component of the property rules that facilitate productive efforts.

## 2. Trespasses to the Person

If the no-duty-to-trespassers rule is simply a part of the structure of property rules, an analogous rule must exist in the case of trespasses to the person. Property rule protection – that is, the power to enjoin and to hold liable – exists for real property and for personal integrity too.

Consider false imprisonment. The wrongful detainer's position is similar to that of a trespasser on real property. I am assuming, of course, that the detention is without justification. In other words, this example assumes that the detainer cannot justify his decision to imprison the victim by some claim that he needed to confine the victim in order to investigate the loss of personal property or to prevent an intentional tort at the hands of the detainee.<sup>30</sup>

To make the comparison reasonably close, assume the detainer has not yet confined the victim. The detainer is approaching the victim, with an apparent aim to confine him. Suppose the potential victim has been infected by some highly communicable disease – the SARS virus or Ebola – that would be communicated to the detainer if the detainer carries out his plan. The theory of this paper implies that the potential victim has no duty to warn the detainer of the risk.

One could justify this answer in narrow economic terms by saying that “moral hazard” would be introduced by a rule imposing a duty on the potential victim to

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<sup>29</sup> The mill overseer ordered the boy to leave after he had assisted the other employees, in full view of the overseer, for roughly a day and half. The boy did not leave and was injured soon after being ordered to leave.

<sup>30</sup> See, e.g., Kirby v. Foster, 22 A. 1111 (R.I. 1891); Coblyn v. Kennedy's Inc., 268 N.E.2d 860 (Mass. 1971).

warn a kidnapper of the risk of contracting a disease. The same could be said of a rule that requires trains to look out for unauthorized individuals on their tracks; that it creates the moral hazard of encouraging risk-seekers to stroll on train tracks. But the moral hazard argument presupposes a noncommittal view of the underlying property rights. If the underlying property rights are fixed, as they are by the law, then any duty to warn a trespasser necessarily implies a weakening of those rights, and a corresponding transfer of value. Property rules are designed precisely to prohibit such a transfer of value.

Once the detainer has apprehended or captured his victim, the victim earns the right to use force to prevent the capture or to escape. The use of force is privileged to the extent that it is reasonable in light of circumstances. Deadly force may be privileged in some instances. Questions of care in the course of defending oneself from a kidnapping are largely resolved by the reasonable force requirement of the law.

Suppose, however, that the potential victim uses reasonable force against the detainer, and an injury results because of some danger that the potential victim failed to observe. Suppose, to take a concrete example, the victim pushes the detainer in order to escape his grasp, and the detainer falls on a bed of nails and is severely injured. If the victim had taken a second more to observe his surroundings, he would have noticed the bed of nails, and may have chosen to push the detainer in a different direction.

Would the detainer, in this scenario, have an action for negligence in self-defense? Such an action would assume that the potential victim had a duty to avoid carelessly injuring the attacker in addition to the requirement of reasonable force. Although the institution of insurance has given rise to claims of negligent self-defense, such a claim would appear to be inconsistent with the underlying theory of property-rule protection.

### 3. Reckless Conduct

The preceding property-complement rule examples have dealt with events that can be described as “takings” in some sense. A trespass to real or to personal property is a taking in the sense that the taker expropriates something of value, exclusive possession, from the victim in a circumstance in which the taker could have bargained for consent. The same general description applies to trespasses to the person, such as wrongful imprisonment or battery. Property rules apply in these circumstances because they force potential invaders to seek consent from the property owner. Property rules apply in these circumstances, as Calabresi and Melamed demonstrated,<sup>31</sup> precisely because transaction costs are low.

There is another set of circumstances in which property rules should apply. That is when the actor’s conduct is socially undesirable no matter the scale. In other words, the socially desirable scale of the activity is zero. This is the case in which marginal

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<sup>31</sup> Calabresi & Melamed, *supra* note 6.

social cost of the actor's activity is so high that it is always greater than its marginal social benefit (see Figure 1, *MSC (very high externality)*). The standard is example is reckless conduct; for example, driving against the direction of traffic, or playing with a loaded gun in a crowded area.

As a general rule, contributory negligence is not permitted as a defense to a claim of recklessness.<sup>32</sup> Translating this rule to the language of duty, this is equivalent to saying that the victim of reckless conduct owes no duty of care toward the reckless actor. The duty imposed on *X* to take care to avoid injury to *Y* is suspended when *X* is a potential victim and *Y* is acting recklessly. To take a concrete example, suppose *X* is carelessly looking at a highway billboard rather than the road while driving. *Y* is recklessly driving at a high speed against the highway traffic direction. If *Y* smashes into *X*, *Y* will be barred from asserting contributory negligence against *X* even though *X* might have avoided the injury if he were not staring at the billboard.

The rule relieving the victim of reckless conduct of the duty of care relative to the injurer is a property-complement rule, which serves essentially the same function as the previous property-complement rules examined. It prevents the subsidization of conduct to which a property-rule prohibition applies.

## B. Subsidization through Law and Related Goals

### 1. Rescue Attempts

Rescue appears to have a special status in tort law. The law attempts to encourage or subsidize rescue efforts. At the same time, the law makes a special effort to avoid imposing penalties on individuals who refuse to rescue. The approaches appear contradictory at first glance, but can be reconciled within the framework of this paper.

Let us start with the law governing rescue attempts. Courts have held that someone who attempts a rescue cannot be held guilty of contributory negligence unless he has acted in a rash or reckless manner.<sup>33</sup> In other words, the duty of care that one owes oneself, and that courts regularly enforce, is suspended in the case of rescue. The rescuer owes no duty to take reasonable care to avoid injuring himself.

In *Eckert v. Long Island R.R.*,<sup>34</sup> the plaintiff's decedent saw a child standing on a train track as a train approached, running in reverse. The decedent ran to the track and threw the child clear of it but was struck by the oncoming train. There was evidence of negligence on the part of the railroad. The railroad argued in defense that the decedent was contributorily negligent because he had voluntarily put himself in the way of the train. The court held that the plaintiff's decedent would not be

<sup>32</sup> William L. Prosser, *Handbook of the Law of Torts* 426 (4th ed. 1971)

<sup>33</sup> See, e.g., *Eckert v. Long Island R.R.*, 43 N.Y. 502 (1871).

<sup>34</sup> 43 N.Y. 502 (1871).

deemed contributorily negligent unless his conduct was “such as to be regarded either rash or reckless.”<sup>35</sup>

A similar question arose in *Wagner v. International Ry.*<sup>36</sup> The plaintiff and his cousin boarded a train, and were unable to move away from the open doors because of the crowd. The cousin was thrown overboard as the train crossed a bridge. The plaintiff was allowed to walk along the bridge, to look for his cousin’s body. He lost his footing and fell to the ground below, suffering injuries. The defendant railroad argued that it should not be held responsible for the injuries to the rescuer because his intervention, which was not reflexive or impulsive but was preceded by several minutes in which he could consider the risks and benefits of attempting to rescue, severed the chain of causation between their initial negligence and the rescuer’s injury. Cardozo, citing *Eckert*, held that the rescuer’s intervention should be considered a natural and foreseeable result, unless his actions were reckless.

In terms of the skeletal theory offered in the previous part, the rule that a rescuer has no duty of care on his own behalf is consistent with the subsidization function of no-duty rules (see Figure 1, point *F*). By relieving rescuers of the duty to take care for their own safety, courts effectively subsidize rescue attempts. This is justifiable on the theory that the societal benefits of high-stakes altruism are substantial.<sup>37</sup>

The fact the rescuers hardly ever think about the possibility of receiving compensation does not clearly undermine this account of the rule relieving the rescuer of a duty to care for his own safety. All that is necessary for this theory to fit the reasoning of the cases is that courts recognize that high-stakes altruism provides a substantial social benefit relative to other activities. That recognition alone is sufficient to justify the decision by courts to relieve rescuers of the duty of self-care, and that recognition is apparent in the reasoning of *Eckert*.<sup>38</sup>

Since the subsidization function of the no-duty rule is so clear in the case of rescue, this is a good place to consider one other area of the law in which the no-duty rule’s subsidization function is equally clear. The subsidization function is perhaps most obvious in settings in which aggressive conduct is permitted or encouraged. The two most obvious examples are violent sports and courtroom litigation. There is no duty imposed on a football player to take care to avoid injuring an opponent.<sup>39</sup> No duty is imposed on an attorney to take care to avoid causing unnecessary harm to an adversary in litigation.<sup>40</sup> The reason is the same in both cases. Aggressive conduct

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<sup>35</sup> 43 N.Y., at 506.

<sup>36</sup> 133 N.E. 437 (N.Y. 1921).

<sup>37</sup> Certainly society behaves as if the social benefits of high-stakes altruism are substantial, see e.g. E.O. Wilson, *On Human Nature* 149-150 (1978). Perhaps the reason we reward altruism so consistently is because some level of reciprocal altruism is necessary in a well-functioning society.

<sup>38</sup> The law has so high a regard for human life that it will not impute negligence to an effort to preserve it. . . .” *Eckert*, 43 N.Y., at 506.

<sup>39</sup> *Hackbart v. Cincinnati Bengals, Inc.* 601 F.2d 516 (10th Cir. 1979); *Nabozny v. Barnhill*, 334 N.E. 2d 258 (Ill. App. 1975).

<sup>40</sup> Dan B. Dobbs, *The Law of Torts*, § 488, 1397 (2000).

toward adversaries is considered socially desirable in both settings. A duty of care toward adversaries would discourage precisely the sort of conduct that society demands of participants.

## 2. The Duty to Rescue

Although tort law subsidizes rescue, it avoids imposing a duty to rescue. Indeed, the general default rule in tort law is that there is no duty to rescue. How can we reconcile the subsidization provided by the law governing rescue attempts (*Eckert, Wagner*) with the law's refusal to require rescue?

Before explaining how the no-duty-to-rescue rule (or the "rescue rule") fits within this framework, I should mention two preliminary matters. First, the rescue rule has exceptions. One exception imposes a duty on an individual who starts to rescue a victim and then abandons the effort, leaving the victim in a position probably worse than if the rescuer had never attempted to help.<sup>41</sup> Another exception imposes a duty to rescue when you have harmed someone in a way that leaves the victim helpless and in danger of further harm.<sup>42</sup> Another exception is the case in which the actor's conduct, negligent or not, creates a dangerous condition for the potential victim.<sup>43</sup>

The second preliminary matter is that the rescue rule should be judged in terms of its impact in obvious and common circumstances rather than the fact patterns that appear in the cases. The reported cases involving the rule tend to be the most difficult ones on which to justify it. That is not a coincidence. The cases that are most likely to be litigated, and reported in casebooks, are those involving the most troubling applications of the rule. For example, *Buch* is a troubling outcome, viewing it as a rescue case. The mill overseer in *Buch* could have acted more forcefully to bar the eight year old victim from returning to the mill where his hand was later crushed. The same can be said of *Yania v. Bigan*,<sup>44</sup> where the defendant, Bigan, had taunted Yania to jump into the water in which he drowned. Cases such as *Buch* and *Yania* are litigated precisely because they are troubling applications of generally well-accepted rules.<sup>45</sup>

The most obvious setting in which the rescue rule operates is one in which the potential rescuer does nothing to create the danger in which the victim finds himself. Suppose, for example, the potential rescuer goes to the beach to read a book. A stranger calls for help from the water. The potential rescuer watches as the stranger drowns. I will label this "the typical rescue scenario".

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<sup>41</sup>Zelenko v. Gimbel Bros., 287 N. Y.S. 134, 135 (N.Y. Sup. Ct. 1935); Black v. New York N. H. & H.R.R., 79 N. E. 797 (Mass. 1907)

<sup>42</sup> Summers v. Dominguez, 84 P.2d 237 (Cal. App. 1938).

<sup>43</sup> Montgomery v. National Convoy & Trucking Co., 195 S.E. 247 (S.C. 1937).

<sup>44</sup> 155 A.2d 343 (Pa. 1959).

<sup>45</sup> Another famous troubling application of the rescue rule is *Osterlind v. Hill*, 263 Mass. 73, 160 N.E. 301 (1928) (Defendant rented canoe to intoxicated victim, then sat on the dock, equipped with boat and rope, and watched victim drown while smoking a cigarette).

The function of the rescue rule in the typical rescue scenario can be understood in terms of the theory set out earlier. Ordinarily, a duty to take care is imposed when there is some reciprocal exchange between risk and benefit, or a reciprocal exchange of risks (see Figure 1, point *B*). However, in the typical rescue scene, there is no reciprocal exchange of risks, or between risk and benefit. The potential rescuer's activity does not externalize any extraordinary risk to the potential victim. To hold the potential rescuer liable for the victim's drowning would be the same, in terms of activity level effects, as holding him liable for some random accident involving people with whom he has no connection.

Sure, the potential rescuer could have prevented the harm to the victim. But under the theory of tort liability offered here, a necessary condition for the imposition of a duty of care is that there be a reciprocal exchange between costs externalized by both the victim's and the actor's activity or between the costs and benefits of the actor's activity.<sup>46</sup> When there is no such reciprocal exchange because there is no substantial risk externalized by the actor's activity, the duty of care acts as a tax on the actor's activity. Tort law, however, avoids taxing activities in the absence of an imbalance between externalized costs and benefits or a nonreciprocal exchange of risk. It follows that a duty to rescue would be an unjustifiable tax on the potential rescuer's activity.

Consider, for example, *Hoff v. Vacaville Unified School District*,<sup>47</sup> where the plaintiff pedestrian was injured by a recklessly driving student on the way out of the high school parking lot. The plaintiff sued the school district on the theory that it had a duty to supervise the student. The school district officials, however, did not know, nor had reason to know, of the student's recklessness. The court held that the school district had no duty to supervise the student under these circumstances. Although framed as a standard negligence claim, it is essentially a rescue case. The outcome is justifiable under the theory of this paper, because the school district, by enrolling the student, did not introduce a risk to pedestrians that was any greater than the background risk that the state had already introduced by licensing young drivers

If this theory explains the absence of a duty to rescue in the typical rescue scenario, it should also explain the exceptions. Consider the exception that applies when the potential rescuer takes the victim away from other potential rescuers and then fails to carry through with reasonable care. For example, suppose the potential rescuer sequesters the victim of an illness or of a beating, so that others cannot provide help, and simply allows the victim to suffer,<sup>48</sup> perhaps in a misguided effort to help. The potential rescuer's conduct in this case dramatically increases the risk of harm to the victim – at least in comparison to doing nothing. This changes the exchange

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<sup>46</sup> If the actor's activity imposes a much greater external cost than external benefit, a duty of care is socially desirable too. But in that case, strict liability is also desirable in order to suppress the activity. For this reason, I describe the reciprocal exchange case as a necessary or minimum condition for the imposition of a duty of care.

<sup>47</sup> 19 Cal. 4<sup>th</sup> 925 (1998).

<sup>48</sup> See, e.g., *Zelenko v. Gimbel Bros.*, 287 N. Y.S. 134 (N.Y. Sup. Ct. 1935).

between externalized risk and benefit in a manner that justifies the imposition of a duty of care.

### 3. Duties toward Licensees and Invitees

In addition to the rule that says that a landowner owes no duty of care to a trespasser, the law traditionally has distinguished the duties owed to a licensee and to an invitee. The landowner owes a general duty of care to the invitee. To the licensee, the landowner has a duty to inform or correct defective conditions in the property of which the landowner is aware. However, the landowner has no duty, with respect to the licensee, to investigate and discover defective conditions. In brief, the landowner's duties to the invitee and licensee are the same except that the landowner owes to the invitee, and not to the licensee, a duty to make a reasonable inspection for potential hazards.

The function of this distinction is the same as the previous ones considered: to optimally regulate activity levels. Optimal regulation of activity levels generally means allowing markets or quasi-markets to function without distortions of liability. On the other hand, where substantial imbalances in externalized risks and benefits exist, optimal regulation of activity levels requires the imposition of strict liability, or, in other cases, subsidization through exemption from liability (no-duty rule).

The key difference between the invitee and the licensee is that the licensee, under the law, assumes the risk of latent defects on the property of which the landowner is unaware. The invitee does not assume the risk. We could also view this difference as a subsidy created by the law. The law appears to subsidize the landowner to some extent in his relationship with the licensee. Alternatively, or equivalently, we could view the law as taxing the landowner in his relationship with the invitee by imposing strict liability for latent defects. Either view could be defended in the context of this model. Does the law make sense in terms of the model of this paper?

First, consider the invitee. The invitee visits for a business reason. For example, an invitee might be the repairman who visits the landowner's house in order to repair the central air conditioning system. To do so, he may have to climb up to the attic, where defective conditions might exist that would ordinarily not come to the attention of the owner. Since the invitee is likely to be unaware of any particular conditions on the landowner's property, and typically does not have the freedom to choose where he will go on the property, there is no hypothetical-contract basis for treating him as one who has assumed the risk of latent defects. Moreover, in most such relationships it is assumed that all of the costs and benefits are recognized in the contract. There are no external costs and benefits, or if so, they are trivial. There is no reason in this setting to adopt a subsidy of any sort for either party. The general negligence test should apply, as it does.

Even though the general negligence test applies to the invitee case, it operates much like a rule holding the landowner strictly liable for latent defects. The reason for this

is that the burden of preventing latent defects from occurring is probably too high to be met. Preventing latent defects from occurring requires nondurable precaution – that is, precaution that is almost continual monitoring and investment. As Mark Grady has argued, rules that impose a duty to take nondurable precaution often operate in effect like strict liability.<sup>49</sup>

To the extent that the duty, owed to the invitee, to prevent latent defects from occurring acts like strict liability, it is still defensible within the context of this model. The reason is that the invitee does not have enough information to assume the risk with respect to such defects. A rule relieving the landowner of liability for such defects would lead to overexposure to or “overconsumption” of risk on the part of the invitee. This is analogous to the case of the consumer who, in the absence of strict products liability, consumes a risky product without knowing its characteristics.<sup>50</sup> Imposing liability for latent defects effectively controls the activity level chosen jointly by the landowner and invitee, by internalizing the cost of latent defects to the landowner.

Next, consider the licensee. The licensee is typically a social guest. Unlike the invitee, the social guest often knows something about the condition of the landowner’s property, and, if not, at least intends to assume a wide privilege to enjoy the property when he arrives to it. The invitee does not have to climb up to the landowner’s attic, and if he does so, it is usually without any compulsion. The licensee often has enough information, or makes voluntary decisions as if he has enough information, to make an informed decision to confront the risk of a defective condition in the property. There is a hypothetical-contract basis for treating him as one who has assumed the risk. Given this, the licensee does not overconsume risk in his relationship with the landowner, and therefore there is no basis for internalizing the cost of latent defects to the landowner. Moreover, in most such relationships there is an imbalanced exchange between costs and benefits. The licensee typically enjoys the benefits – he has come to the landowner’s property for that reason, perhaps, for example, to swim in the landowner’s pool – and the benefits are funded by the landowner. The law can bring about a closer equality between the exchange of costs and benefits (externalized or not mediated through the price system) by providing a subsidy to the landowner, which it does in the form of the rule relieving the landowner of a duty to inspect for defective conditions.

These arguments suggest that as a default rule, the traditional distinction between invitees and licensees can be justified in terms of its impact on activity level decisions. The assumption of risk component is in accord with typical conditions and allows the quasi-market in “social exchange” to function without being distorted by the liability rule. The narrow no-duty rule with respect to licensees is justifiable in light of the licensee’s knowledge of risk and the exchange between uncompensated benefits and costs among the parties.

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<sup>49</sup> Mark F. Grady, *Res Ipsa Loquitur and Compliance Error*, 142 U. Pa. L. Rev. 887, 909-12 (1994).

<sup>50</sup> James Buchanan, *In Defense of Caveat Emptor*, 38 U Chi L. Rev 74 (1970).

This analysis points to key factors that should determine the distinction between invitees and licensees. First, the victim should have exercised a free choice about where to go on the landowner's property. The exercise of a voluntary decision, rather than one compelled by a prior contractual commitment made in the dark as to the conditions of the property, justifies the law's decision to treat the victim as having assumed the risk. Second, there should be an observable uncompensated exchange in which the licensee is the net beneficiary.

The law is not uniformly viewed even among states that apply the traditional rule because of conflicts between these underlying factors. In many cases, the licensee is the one who provides the benefit to the landowner; while at the same time the licensee exercises a free choice over where he will go on the property.

For example, in *Lemon v. Busey*,<sup>51</sup> the plaintiff grandmother, a part-time church employee, brought her five-year-old granddaughter to the church while she worked there. The child wandered off and fell to her death from the roof of the church. The court held that the plaintiff was a licensee and rejected her claim on the ground that the church had no duty to inspect for dangerous conditions that might not be apparent to the eyes of a five-year-old. Needless to say, *Lemon* is a troubling outcome because the grandmother deserved to be treated as an invitee. The church provided a benefit beyond the basic contract by permitting the plaintiff to bring her granddaughter with her, but this concession may have simply been necessary to get her to work. In other words, the agreement to bring the granddaughter may have been a part of the employment contract, which implies that there was no uncompensated benefit given to the plaintiff.

Another set of cases in which courts have shown confusion over the licensee-invitee distinction are those in which a social guest comes over to the landowner's property to help with some project, and is injured as the result of a hidden defective condition. For example, in *Burrell v. Meads*,<sup>52</sup> the homeowner and a friend were installing a ceiling in the homeowner's garage. The friend climbed up to the rafters, and after handing some items to the homeowner, walked across something he thought was plywood but was not. The friend fell to the garage floor, suffering severe injuries. The court rejected the traditional categorization and treated the friend as an invitee.

#### 4. Landlords and Tenants

Traditional common law regarding the landlord's liability holds the landlord liable for injuries "resulting from defective and dangerous conditions in the premises if the injury [was] attributable to (1) a hidden danger in the premises of which the landlord but not the tenant is aware, (2) premises leased for public use, (3) premises retained under the landlord's control, such as common stairways, or (4) premises negligently

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<sup>51</sup> 461 P.2d 145 (Kan. 1969).

<sup>52</sup> 569 N.E.2d 637 (Ind. 1991).

repaired by the landlord”.<sup>53</sup> The traditional law can be explained by the framework of this paper.

The explanation for the traditional law regarding the liability of landlords begins with the observation that all observable costs and benefits will typically be taken into account in the contracting stage between the parties. If the general state of the property is obvious to the tenants, the market will result in a price that compensates for the risk accepted by the tenant, relative to some safer alternative. Under this assumption, there would be no substantial externalized costs or benefits – because all costs and benefits will be taken into account in setting the terms of the contract. This implies that the proper default liability rule is negligence (Figure 1, point *B* or *A*).<sup>54</sup>

The default rule of negligence is consistent with the traditional law’s treatment of the landlord’s duty to tenants in spaces under the landlord’s control, such as common areas. The law puts a general duty of care on the landlord, which implies a duty to fix defective conditions when the landlord is aware of them and the tenant is not, and to make reasonable inspections for defective conditions. In other words, the tenant is treated as an invitee in common areas. Of course, this is a default rule. Presumably the tenant could bargain for a less generous treatment if he preferred a discount on the rental charge in exchange for waiving any claims for liability in connection with defective conditions in common areas.

While the traditional law treats the tenant as an invitee in common areas, it treats the tenant as licensee in the space which he occupies. What explains the difference? Unlike the traditional invitee-licensee distinction, there is no general imbalance in uncompensated benefits and costs in the landlord-tenant relationship. The entire exchange is mediated through the price system. However, there is a hypothetical-contract basis for treating the tenant as having assumed some risk with respect to the space that the tenant occupies. The tenant is likely to have as much information or more than does the landlord as to defective conditions in the area he occupies. He is in a position to offer a price that reflects his assessment of the risk of the rental unit he occupies. The tenant is in a position to demand an upgrade in the conditions of his rental unit in exchange for a higher rental charge.

On the assumption that the tenant accurately observes the risk level, treating the tenant as a licensee in the rental unit that he occupies permits the market to assign different prices to different risk levels. If the risk level of a unit is in general a function of the likelihood of a defective condition developing, then the rule relieving the landlord of a duty to inspect for defective conditions in the tenant’s unit permits the landlord and the tenant to contract over the risk level of the tenant’s unit. Consumer/tenants will offer lower bids for units with higher risk levels. The sorting

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<sup>53</sup> Richard Epstein, *Cases and Materials on Torts* 582 (7th ed.) (citing *Sargent v. Ross*, 308 A. 2d 528, 531 (N.H. 1973)).

<sup>54</sup> Point *B* in Figure 1 assumes there are insubstantial externalized risks and benefits, while point *A* assumes there are no externalized risks or benefits. Either would fit as a description of this case.

of consumer/tenants according to risk preferences enhances consumer welfare relative to a rule that discourages sorting.

The common areas that the landlord controls are distinguishable from the unit occupied by the tenant. In common areas, it is unlikely that tenant has as much or more information on the risk level. And even if the tenant is as well informed as the landlord on the risk level of the common areas, his incentives are quite different from the case in which he assesses the risk of his own unit. The level of safety in the common area is a public good, and this diminishes the extent to which the risk level will be made a part of the contracting process between the landlord and the tenant. While the tenant may exit if he finds the risk level too high in the common area, he will have weak incentives to offer a higher bid in exchange for a reduction in the risk level.

If tenants were unable to accurately observe the risk level of a rental unit, this justification for the traditional common law governing landlord liability would be invalid. If tenants could not observe or assess risk, allowing the tenant and landlord to contract over the risk level would result in overconsumption of risky rental units. A duty rule would be a desirable mechanism to push the level of consumption of risky rental units to a lower level.

Consider, for example, the rule regarding premises leased for public use, which imposes on the landlord a general duty of care. Suppose, for example, the landlord rents a space to be used for some specific function attended by people who are unfamiliar with the property. In this case, the short-term tenants would have no reason to be aware of the risk level of the unit they temporarily occupy. A rule treating them as licensees would lead to overconsumption of risk, since the short-term tenants would not have taken the risk level into account at the contracting stage. The traditional common law appears to adopt the optimal regulatory response because it treats the short-term tenants as invitees. In other words, the law recognizes that a market in which the risk level is priced is unlikely to develop in the short-term scenario. Consequently, it treats the short-term occupants as invitees when the property is leased for public use.

##### 5. Duties of Landlords Continued: Obvious Conditions and Crime

Even though landowners have a general duty of care to invitees, they are not liable to them for injuries resulting from obvious conditions. Suppose, for example, a building owned by the landowner has such a low entryway that visitors bump their heads on the doorframe as they enter the building. Since this is likely to be an obvious condition, something a visitor could easily see on his way toward the door, the landowner will often escape liability in these cases. Similarly, the general duty owed by landlords to tenants in common areas is suspended in the case of obvious conditions.

There are straightforward reasons that a landowner is not held liable for obvious conditions. The fact that the condition is obvious implies that there may be no need to employ liability in order to regulate activity level decisions. Second, the injuries resulting from obvious conditions are typically due to the negligence of the victim.

Crime is also an obvious condition, especially in urban areas. However, in *Kline v. 1500 Massachusetts Avenue Apartment Corp.*,<sup>55</sup> the D.C. Circuit held that landlords have a duty to take steps to protect tenants from foreseeable criminal acts in common areas of the building. The decision went against the earlier settled rule that a private person, whether landlord or not, does not have a duty to protect another from a criminal act.

*Kline* is difficult to square with the framework of this paper, and could be treated as unjustifiable deviation from the traditional common law rule. However, the decision has survived more than thirty years and is now the rule in most jurisdictions. Are there conditions under which it might be seen as consistent with this paper's framework?

I noted earlier that defective conditions in common areas are less likely to be regulated optimally by the market. The same can be said of safety from crime in common areas, since it is a public good. Tenants have weak incentives to bargain for safety. Suppose, for example, there are three tenants. The cost of hiring a security guard is \$1200 per week, or \$400 per tenant if the cost is passed on in full. Suppose one tenant is willing to pay an additional \$700 per week for security. If that one tenant knows that the other two are in favor of additional security and willing to pay the same amount, that tenant has an incentive to understate his desire for security, free-riding off the others. Conversely, if one tenant knows that the other two are not willing to pay anything for a guard, he has no incentive to seek additional security, since his bid will not be sufficient to cover the cost. The only case in which the one tenant has an incentive to state his preferences honestly is when his vote is pivotal to the decision.

The argument that safety is unlikely to be regulated optimally by the market implies that landlords should have a duty to take steps to enhance safety. This is simply a version of the argument for requiring a general duty of care to tenants in the common areas of the landlord's building. On the other hand, this argument is undercut by the fact that crime is typically an obvious condition.

There is one key distinction between crime and other obvious conditions, such as a low doorframe, that might justify the decision in *Kline*. Most obvious conditions in common areas are permanent conditions that are encountered frequently by the tenant. Crime, in contrast, is observed infrequently and its rate of occurrence changes over time.

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<sup>55</sup> 439 F.2d 477 (D.C. Cir. 1970).

In the case of a low doorframe, the tenant will observe the feature every day, and perhaps several times a day. Moreover, in the vast majority of instances, accidents are not serious. Most tenants tall enough to bump their heads against the doorframe will simply tell themselves to remember to duck the next time. Obvious conditions in common areas can be described as high-probability-low-harm events. They happen frequently without causing much harm in most cases.

However, crime is observed infrequently and is quite harmful when it occurs. The ability to learn of the risk is limited in this case.<sup>56</sup> Moreover, even if the rate of occurrence is well known, that rate is a changing function of the opportunities presented. One may assume that the probability of a tenant being victimized is a function of the overall vulnerability of the apartment building and the individual vulnerability of the victim. The overall vulnerability of the apartment building depends on the relative proportions of old and young tenants, male and female tenants, and so on. The individual vulnerability is a function of the victim's age, sex, and other characteristics. Changes in the composition of the apartment building will therefore affect the individual tenant's likelihood of becoming a crime victim. But these changes may be unobservable to the tenants. This implies that the market may fail to bid down the rental charge in a manner that accurately reflects the likelihood of crime in any given time period and for any particular tenant. Indeed, for an existing or incumbent tenant, the frequency of crime may be a latent defect from his or her perspective.

The upshot of this argument is that *Kline* may, in spite of its apparent inconsistency with the traditional law, be consistent with the framework of this paper. Crime is an obvious condition to any tenant, but not obvious in the same way as a low doorframe in a building entrance. The reasons for thinking the market will price risk effectively in the case of most obvious conditions may not hold in the case of crime.

## 6. *Palsgraf* and Proximate Cause

As every law student knows, Cardozo's opinion in *Palsgraf* defines the duty to take care as an obligation to foreseeable victims. The underlying economic rationale is the same as that set out above for the rescue rule. Imposing liability for harms to unforeseeable victims is equivalent to taxing the defendant's activity. This is desirable on economic grounds only when the risk externalized by the defendant's activity is substantially greater than reciprocal risks accepted or benefits externalized by the actor.

A visual picture of this argument can be described as follows. Imagine that each actor is surrounded by a probabilistic cloud illustrating the risks externalized to

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<sup>56</sup> Early behavioral experiments by Skinner suggested that subjects learn the connection between action and reward (or punishment) through repeated interaction. B.F. Skinner, *Science and Human Behavior* (1953). Crime is an example of a punishment that occurs randomly and infrequently in response to failures to guard against it. Potential victims are unlikely to accurately estimate, or act as if they had accurately estimated, the likelihood of crime occurring.

others when he is engaging in some activity with reasonable care. When two actors are engaged in an activity such as driving, their clouds come into contact with each other. The convergence of these clouds implies a duty to take care. And since the risk clouds put equal impositions on one another, there is no need to tax one of the actors in order to reduce his activity level. If an injury occurs from a traffic accident, the negligence rule should apply, as it does. However, if the risk clouds never come into contact, then each of the actors is an unforeseeable victim, from the perspective of the other actor. There is no basis in theory, and no basis in law under *Palsgraf*, for imposing a duty of care.

The thought exercise just conducted could just as easily have been put in terms of proximate cause. When the risk clouds do not come into contact, the victim of the accident is not foreseeable, and his claim for damages fails on proximate cause grounds. *Palsgraf* elevated this basic component of proximate cause analysis, foreseeability, to the duty prong of the four-part negligence inquiry.

As this suggests, all analyses that can be framed in terms of the foregoing thought exercise involving risk clouds – or “activity risk” – can be considered within the language of proximate cause. That implies that the rescue rule cases could easily be analyzed as proximate cause cases. However, it should not be a matter of indifference to courts whether to treat rescue, and foreseeability cases generally, as issues of duty or proximate cause.<sup>57</sup> Duty rules are rules of law rather than the primarily fact-bound inquiry that determines proximate cause. It follows that it makes sense to treat cases of activity risk under a duty analysis when it is desirable to minimize uncertainty surrounding the application of the rule. The rescue rule appears desirable, in this light, because it minimizes the uncertainty that would be generated by an ill-defined duty to rescue. On the other hand, the desirability of the *Palsgraf* rule, relative to the general proximate cause analysis, is open to question.

The choice between duty and proximate cause analysis involves a trade off between uncertainty costs and flexibility. Proximate cause analysis gives the court maximum flexibility to respond to a set of facts that suggest, to the court, that liability could be used to enhance incentives for care. The cost of this flexibility is the uncertainty it creates over the scope of liability and the potential costs of erroneous impositions of liability. It follows that a positive theory of the choice of duty doctrine as an alternative to proximate cause analysis is that it serves to minimize uncertainty costs. In other words, when a court, in the course of rejecting a claim for liability, uses the language of duty rather than that of proximate cause, it is implicitly saying that it considers the costs of uncertainty and erroneous impositions of liability to be greater than the flexibility and precision advantages of proximate cause analysis.

## 7. A Final Application: *Hadley v. Baxendale*, Economic Loss, and Third-Party Beneficiaries

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<sup>57</sup> Hylton, Theory of Tort Doctrine, supra note 16.

The final application of this paper's framework is to the economic loss problem. Consider a contract between *X* and *Y* to do something that affects *Z*. For example, suppose, as in *Robins Dry Dock v. Flint*,<sup>58</sup> the contract is between a ship owner, *X*, and a dry dock, *Y*, to repair a ship that is under contract to be leased to *Z*. The dry dock negligently damages the ship, causing a substantial loss to the owner *X* and to *Z*.

*Hadley v. Baxendale* provides the rule preventing *X* from recovering for the loss of revenue from his contract with *Z*, unless the prospect of that loss was brought clearly to the attention of *X*. In *X*'s action against *Y*, the court will disallow recovery for the loss of the revenue from the contract with *Z* on the ground that it is not a foreseeable component of damages.

Similarly, in *Z*'s tort action against *Y*, the court will deny any recovery whatsoever on the ground that *Y* is not under a duty of care to protect the economic returns of *Z*. That is the message of *Robins Dry Dock*. It is a variation of the rule of *Hadley*. The theory that explains *Hadley* also explains *Robins Dry Dock*. The difference between the two cases is that the economic loss component is just a portion of the plaintiff's claim in the *Hadley*-type setting, while it is the whole of the plaintiff's claim in the *Robins Dry Dock* case.

The general the rule (or rules) of *Hadley* and *Robins Dry Dock* can be defended on the ground that courts should relieve actors of a duty of care in instances when such a duty will distort market outcomes. *Hadley* is easily explained in view of the adverse selection problem.<sup>59</sup> Holding *Y* liable for the economic loss to *X* implies that *Y* will have to set a price that covers the mean economic loss. But that means contracting parties similar to *X* whose losses are relatively low will find the contract unattractive, which increases the mean economic loss among the contacting parties who appear similar to *X*, forcing another revision in the contract price, and so on. The adverse selection problem that justifies the rule of *Hadley* also justifies the economic loss rule.

It should be clear that the adverse selection theory also justifies the outcome in *Moch Co. v. Rensselaer Water Co.*<sup>60</sup> The defendant, a waterworks company, agreed to supply water to the city of Rensselaer, which would be used for sewer flushing, for service to public buildings, for service to fire hydrants, and other public purposes. The plaintiff's warehouse burned down after the waterworks company, after receiving notice of the fire, failed to supply sufficient water to extinguish the fire. Cardozo's opinion for the court held that the defendant did not have a duty to an entity that was not formally a party to the water supply contract.

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<sup>58</sup> 275 U.S. 303 (1927).

<sup>59</sup> Lucian Bebchuk and Steven Shavell, Information and the Scope of Liability for Breach of Contract, 7 J. Law, Econ. & Org. 284 (1991); Ayres and Gertner, Filling Gaps in Incomplete Contracts: An Economic theory of default Rules, 99 Yale Law Journal 87 (1989).

<sup>60</sup> 159 N.E. 896 (N.Y. 1928).

Cardozo's broad proposition in *Moch* is better understood in connection with the facts of the case. The waterworks company charged the city \$42.50 a year for each hydrant. If the city were held liable to city residents for the losses caused by fires, the fire-hydrant charge would have had to be set quite a bit higher, especially if the surrounding property included mansions or expensive commercial property. Moreover, the adverse selection process would immediately kick into gear: the higher the fire-hydrant charge, the higher the taxes necessary to cover the charges, and the less likely low-value properties would be capable of supporting the taxes.

The general proposition of *Moch* appears to be that if *A* is in a contract to supply services to *B* which in turn benefit *C*, *A* has no duty to take care to avoid a loss to *C*. However, this is probably too broadly stated. The Second Restatement's Section 324A, titled "liability to third person for negligent performance of undertaking," appears to contradict it.<sup>61</sup> The proposition of *Moch* should be understood to apply to the case in which *C* involves a large, difficult-to-define class of potential claimants, a setting in which the adverse selection problem is likely to arise.<sup>62</sup>

#### IV. Conclusion

A sense of skepticism toward the concept of duty pervades consequentialist analyses of tort law from Holmes to Posner. The purpose of this paper is show that duty, both as an abstract concept and as a set of detailed rules for channeling tort liability, is easily reconcilable with utilitarian or economic approaches to tort doctrine. Indeed, economic analysis provides perhaps the most thorough and consistent set of explanations for duty doctrine. Duty doctrine appears to serve essentially three economic functions: subsidizing activities that have substantial external benefits, supporting or complementing property rules (in the Calabresi-Melamed sense), and permitting the market to regulate activity levels without distortions created by liability.

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<sup>61</sup> The Restatement (Second) of Torts § 324A provides: One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking, if (a) his failure to exercise reasonable care increases the risk of such harm, or (b) he has undertaken to perform a duty owed by the other to the third person, or (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

<sup>62</sup> For an interesting duty case raising similar market-allocation issues, see *Great Central Insurance Co. v. Insurance Services Office Inc.*, 74 F.3d 778, 785 (7th Cir. 1996) (Posner, C.J., "If a person injures another through culpable conduct such as negligence, why should not the innocent victim be able to shift his loss to the culpable injurer? There is no altogether satisfactory answer to this question, but it is obvious that the law recoils from the full implications of it. Considerations of policy have persuaded courts of all states to place limits on the scope of tort liability through the concept of duty. The same considerations are in play here.... To subject [defendant] to unlimited liability for the consequences of ... mistakes might be to jeopardize its existence or make it unduly timid about proposing less than astronomical rates.")