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Compensating Market Value Losses: Rethinking the Theory of Damages in a Market Economy

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COMPENSATING MARKET VALUE LOSSES: RETHINKING THE THEORY OF DAMAGES IN A MARKET ECONOMY

*Steven L. Schwarcz**

Abstract

The BP *Deepwater Horizon* oil spill and the Toyota car recalls have highlighted an important legal anomaly that has been overlooked by scholars: judicial inconsistency and confusion in ruling whether to compensate for the loss in market value of wrongfully affected property. This Article seeks to understand this anomaly and, in the process, to build a stronger foundation for enabling courts to decide when—and in what amounts—to award damages for market value losses. To that end, this Article analyzes the normative rationales for generally awarding damages, adapting those rationales to derive a theory of damages that covers market value losses, not only of financial securities (such as stocks and bonds) but also of ordinary products (such as automobiles and lightbulbs).

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INTRODUCTION

The turmoil in financial markets has revealed a fundamental legal anomaly that, notwithstanding its increasing practical importance, has been overlooked by scholars: judicial confusion and inconsistency in ruling whether to include the loss in market value (hereinafter, "market value loss" or "market value losses") of wrongfully affected property as legally compensable damages.

Although market value losses can arise in a multitude of contexts, the concept is perhaps easiest to understand by dividing the wrongfully affected property into two categories: financial-market securities (like stocks and bonds), and ordinary products (like automobiles and light bulbs). In the context of financial-market securities, market value loss represents a loss in the resale value of the securities, in contrast to a loss in the value of what the owner of the securities would be paid if the owner continues to hold the securities. In the context of ordinary products, market value loss represents a loss in the resale value of the product, in contrast to a loss in the value of the product's utility to its owner if the owner continues to hold the product. More generically, market value loss represents a loss in the resale value of *any* affected property, in contrast to a loss in the value of the property's utility to its owner if the owner continues to hold the property.

As discussed in Part I below, courts sometimes include, but often exclude, market value loss as legally compensable damages without meaningfully articulating the reasons for inclusion or exclusion. Indeed, most judicial opinions do not even explicitly recognize the concept of market value loss, at most giving it implicit recognition in the calculation of damages.

This Article seeks to derive a normative theory of when market value loss should be included in legally compensable damages. Part I of the Article reviews and examines the applicable judicial precedents. Parts II and III then attempt, informed in part by those precedents, to derive a more normative theory of when to compensate for market value loss. Finally, Part IV proposes a rule, based on this theory, that courts can use when considering market value losses and also provides examples of how that rule could be applied.

In the discussion below, one should not conflate market value loss with "pure economic loss" (sometimes called "economic loss"), a term used to refer to negligently caused financial losses to a person without other injury to that person—the classic example being an employee who loses wages when a negligent tortfeasor's action damages a factory where the employee is working.[1] Although some have argued that awarding damages for pure economic loss might create "disproportionate penalties for wrongful behavior"[2] and "raise[] the specter of *widespread tort liability*,"[3] most jurisdictions in the United States now allow at least some recovery for pure economic loss.[4] This Article does not, and it should not, engage that debate because market value loss and pure economic loss are fundamentally different concepts.[5] A market-value-loss inquiry can arise in connection

1. *See* Adams v. S. Pac. Transp. Co., 123 Cal. Rptr. 216, 217 (Ct. App. 1975).

2. Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513, 1534–36 (1985) (arguing that "the proximate cause limitation on negligence liability illustrates [this] concern about proportionality between act and responsibility," and that where there is an "exceedingly low risk of an extremely high magnitude of harm"—such as a careless driver causing a fender-bender accident that brings traffic to a standstill in the Brooklyn Battery Tunnel during rush hour, thereby causing massive financial losses—awarding negligence liability damages for those losses would "generally [be] a very poor candidate for deterrence").

3. *Id.* at 1514; *see also id.* at 1525 (inferring from the cases on pure economic loss concern over "the specter of collateral claims, virtually unlimited in number, as a result of any given accident").

4. *See, e.g.*, A.C. Excavating v. Yacht Club II Homeowners Ass'n, 114 P.3d 862, 866 (Colo. 2005) (holding that a claim for pure economic loss is viable if based on an independent duty of care); People Express Airlines, Inc. v. Consol. Rail Corp., 495 A.2d 107, 112 (N.J. 1985) (proposing that pure economic loss that is "particularly foreseeable" should be recoverable); Onita Pac. Corp. v. Trs. of Bronson, 843 P.2d 890, 896 (Or. 1992) (holding that a claim for pure economic loss can be maintained where it is based on duty beyond the common law duty of reasonable care); *cf.* Rabin, *supra* note 2, at 1514 ("[T]he reluctance to allow recovery in cases of negligent infliction of economic loss has come to be regarded as an aberration, if not an oddity, in many quarters."). For a history of the debate over pure economic loss, see George C. Christie, *The Uneasy Place of Principle in Tort Law*, 49 SMU L. REV. 525, 528–37 (1996).

5. This Article nonetheless references the pure-economic-loss debate insofar as aspects of that debate may have limited utility in informing the Article's analysis of market value loss. *See infra* Sections II.C & III.B.

with tort, contract, and fraud causes of action,[6] whereas a pure-economic-loss inquiry is limited to tort.[7] More substantively, a market-value-loss inquiry addresses whether to compensate for a specific type of financial loss (loss in market value), whereas a pure-economic-loss inquiry addresses whether to compensate for any type of financial loss in the absence of non-financial injury.[8] To the extent this Article's examples could involve issues of pure economic loss,[9] the discussion assumes that some form of compensation is otherwise appropriate under applicable law and focuses on whether that compensation should include market value loss.

I. JUDICIAL PRECEDENTS

The cases that grapple with market value loss can be based on legal causes of action variously classified as tort, contract, or fraud.[10] Section II.A of this Article will review the normative theories of damages underlying each of these causes of action, attempting to derive a theory of damages for market value loss. Thus, although fraud is normally classified as a tort cause of action,[11] this Article's analysis will not ultimately turn on cause-of-action classification but, instead, on the normative underlying theories. The judicial precedents are easiest to understand by again dividing the wrongfully affected property into the categories of financial-market securities and ordinary products.

A. *Financial-Market Securities*

Questions of market value loss are critically tied to financial markets and the securities traded therein. Courts tend to answer these questions

6. *See infra* note 10 and accompanying text.

7. *See supra* note 1 and accompanying text.

8. Thus, unlike pure economic loss, there may be a question of whether to compensate for market value loss when there is nonfinancial injury—such as where an employee, physically burned by a negligent tortfeasor's actions in setting fire to the employer's factory, finds that the market value of the employer's bonds, in which the employee is heavily invested, plummets due to the fire. Correlatively, there may a question of whether to compensate for pure economic loss where there is financial loss but no market value loss—such as the textual example of an employee losing wages when a negligent tortfeasor's action damages a factory where the employee is working. *See supra* note 1 and accompanying text.

9. *See, e.g.*, *infra* Section IV.B (examining the recent Toyota car recalls and the BP Gulf oil spill).

10. Tort and contract causes of action encompass products liability, implied warranty, and contract breach. *See, e.g.*, Maynard v. Gen. Elec. Co., 486 F.2d 538, 540 (4th Cir. 1973) (stating that in the context of products liability, "'[a]n implied warranty is an implied contract'" (quoting Hoge v. Ward, 155 S.E. 644, 647 (W. Va. 1930))); JCW Elecs., Inc. v. Garza, 257 S.W.3d 701, 704 (Tex. 2008) ("Conceptually, the breach of an implied warranty can either be in contract or in tort depending on the circumstances.").

11. E-mail from James Edelman, Professor of the Law of Obligations, Univ. of Oxford, to the author (Sept. 21, 2010) (on file with author) ("There is a big debate in England and Australia about whether there is a tort of fraud generally or just a tort of deceit. But all those who believe that there is a general action for fraud consider it to be a tort.").

differently depending on whether the securities in question are debt securities (like bonds) or equity securities (like stock).[12] First consider debt securities.

Only one judicial decision in the United States appears to focus explicitly on questions of market value loss in the context of debt securities. In *Metropolitan Life Insurance Co. v. RJR Nabisco, Inc.*,[13] plaintiff MetLife argued that RJR's leveraged buyout caused the RJR bonds held by MetLife to lose their investment-grade rating,[14] thereby violating an implied covenant to bondholders.[15] As a consequence of the rating downgrade, the resale value of the bonds plummeted.[16] MetLife argued that its damages should include this loss in market value.

The court was willing to "read an implied covenant of good faith and fair dealing into [the indenture governing issuance of the bonds] to ensure that neither party deprives the other of the fruits of the agreement."[17] Nonetheless, it declined to recognize the market value loss as legally compensable, reasoning that such loss did not constitute the "fruits of the agreement" under which the bonds were issued.[18] The court held that the "substantive 'fruits' [of a bond indenture only] include the periodic and regular payment of interest and the eventual repayment of principal."[19] Even after RJR's leveraged buyout, these payments were expected to continue.[20] The court also asserted that reformulating the bond indenture to (in effect) mitigate market value loss would "interfere with and destabilize the [bond] market" by ignoring the market expectation "that the terms of an indenture will be upheld."[21]

The reasoning of the *RJR Nabisco* court is questionable. Its formalistic rationale, that the "fruits" of a bond indenture only include payment of principal and interest, ignores that bonds are rarely held by any given investor to maturity.[22] And the court's seemingly policy-oriented rationale,

12. Virtually all financial-market securities can be divided, more or less, into debt or equity securities, although some securities may have aspects of both. *See, e.g.*, WILLIAM J. CARNEY, CORPORATE FINANCE: PRINCIPLES AND PRACTICE 196–202 (2005) (outlining the features of various financial instruments).

13. 716 F. Supp. 1504 (S.D.N.Y. 1989).

14. For a description of how bond ratings are structured, see Steven L. Schwarcz, *Private Ordering of Public Markets: The Rating Agency Paradox*, 2002 U. ILL. L. REV. 1, 7 ("[T]he highest rating on long-term debt securities is AAA, with ratings descending to AA, then to A, and then to BBB and below. . . . The higher the rating, the lower the rating agency has assessed the credit risk associated with the securities in question. . . . Ratings below BBB- are deemed non-investment grade, and indicate that full and timely repayment on the securities may be speculative." (internal quotation marks omitted)).

15. *RJR Nabisco*, 716 F. Supp. at 1516.

16. *Id.* at 1506.

17. *Id.* at 1517 (internal quotations omitted).

18. *Id.* at 1518.

19. *Id*.

20. *Id.* at 1519.

21. *Id.* at 1520.

22. GEORGE FONTANILLS, THE OPTIONS COURSE: HIGH PROFIT & LOW STRESS TRADING

that compensating for market value loss would interfere with and destabilize the bond market,[23] appears to ignore the much more profoundly destabilizing effect on bond markets that would result from ignoring the reality of bond trading.[24] Nonetheless, the case may well be decided correctly on its facts because RJR previously had negotiated the elimination of a covenant in the bond indenture that would have barred the leveraged buyout.[25] Oddly, the court did not articulate its decision based on that negotiation.

In contrast to debt securities, numerous judicial decisions address market value loss in the context of equity securities. Unlike the *RJR Nabisco* court's limited perception of the "fruits" of a debt security, the U.S. Supreme Court has recognized that "[s]hares are normally purchased with an eye toward a later sale."[26] Damages are therefore often awarded for losses in resale value of stock.[27]

A question remains, though, of how to measure these damages.[28] Many courts employ a benefit-of-the-bargain measure of damages.[29] Other courts, however, employ an out-of-pocket measure of damages,[30] based on the desire to avoid the "speculative nature of reconstructing a world in which the plaintiffs' expectations come true . . . ."[31]

B. *Ordinary Products*

The judicial precedents on compensating market value loss are likewise conflicted where the wrongfully affected property is ordinary products.[32]

METHODS 384 (2d ed. 2005).

23. *RJR Nabisco*, 716 F. Supp. at 1520.

24. Although freely reading covenants into bond indentures could interfere with bond markets, the court's reasoning appears to focus not on whether a covenant was breached but whether a breached covenant should entitle bondholders to market value damages.

25. *RJR Nabisco*, 716 F. Supp. at 1510–11.

26. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005).

27. *See id.* at 345 (indicating that the purpose of the securities laws is "to protect [investors] against those economic losses that misrepresentations actually cause"). Congress has gone so far as making market value loss a required element in an action for securities fraud. 15 U.S.C. § 78u-4(b)(4) (2006).

28. *See* Osofsky v. Zipf, 645 F.2d 107, 111 (2d Cir. 1981) (stating that out-of-pocket, benefit-of-the-bargain, or other alternative methods can be appropriate measures of damages).

29. *Id.* at 114. This measure of damages is often used, for example, in common-law deceit and misrepresentation actions, after which private securities fraud actions are generally patterned. *Dura Pharm.*, 544 U.S. at 342–43.

30. *See, e.g.*, Panos v. Island Gem Enters., Ltd., 880 F. Supp. 169, 175 (S.D.N.Y. 1995).

31. *Id*. at 176. This measure of damages is often used, for example, in implied securities fraud actions. *Id.* It may well be that the distinction between the measure of damages often used in implied securities fraud actions and the measure of damages often used in the actions referenced *supra* note 28 relate less to logic and more to path dependence in following earlier judicial precedent.

32. In some cases, like breach of contract for the sale of goods, a plaintiff has no opportunity to use the property at issue; the only measure of damages then depends on the market value of substitute goods. This Article, in contrast, addresses cases in which property which could render value to the plaintiff by either being sold or used is wrongfully affected.

The leading cases are *Miller v. William Chevrolet/GEO, Inc.*[33] and *Wallis v. Ford Motor Co.*[34] In *Miller*, an Illinois appellate court reversed a lower court's grant of summary judgment against the plaintiff who, in a consumer fraud case, had sought damages for the diminished resale value of an automobile.[35] The appellate court explained that "Illinois courts have generally allowed damages claims based on diminished value of a product regardless of whether it has yet malfunctioned . . . ."[36] In contrast, however, the Arkansas Supreme Court in *Wallis*, also a fraud case involving automobiles, refused to award damages for diminished resale value, reasoning that the car buyer only bargained for a safe and reliable vehicle.[37]

Although lacking precedential value, a recent settlement by Ford Motor Co. of products-liability and false-advertising lawsuits implicitly recognized damages for market value loss. The lawsuits alleged that Ford hid defects in the tires on its Explorer sport-utility vehicles, and that these SUVs lost resale value after a tire recall in May 2000. Ford settled by giving almost a million Explorer SUV customers $500 each toward a new model or $300 each toward other Ford vehicles.[38]

Judicial precedents regarding compensation for market value loss are thus inconsistent. Part II below seeks to derive a more coherent, normative theory of when courts should award damages for market value loss.

II. TOWARD A NORMATIVE THEORY OF DAMAGES FOR MARKET VALUE LOSS

Recall that the cases grappling with market value loss can be based on legal causes of action variously classified as tort, contract, or fraud.[39] Section II.A below compares the general theoretical basis for awarding damages—using *theoretical* in the sense of an abstract of general

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33. 762 N.E.2d 1 (Ill. App. Ct. 2001).

34. 208 S.W.3d 153 (Ark. 2005).

35. *Miller*, 762 N.E.2d at 4–5.

36. *Id.* at 10.

37. 208 S.W.3d at 159 ("[T]here is no allegation in the complaint that the Ford Explorer has not, to date, been exactly what Wallis bargained for; that is, he does not allege that the vehicle has actually malfunctioned or that the defect has manifested itself."); *see also id.* at 156 ("In sum, the principle undergirding our case law is that benefit-of-the-bargain damages are only awarded in fraud cases where a party proves that the product received is not what was bargained for; that is, the product received in fact manifests that it is different from that which was promised."). Just as the *RJR Nabisco* court narrowly interpreted the "fruits" of a debt security, the reasoning of the *Wallis* court exhibits a limited understanding of what purchasers "bargain" for in a new car (that the bargain is merely for a safe and reliable vehicle). As this Article will later show, the expected resale value is one of the "benefits of the bargain" often considered by car buyers. *See infra* notes 90–92 and accompanying text.

38. Settlement Agreement and Release at 22, Ford Explorer Cases, Nos. 4266 & 4270 (Cal. Sup. Ct. 2007), *available at* http://www.saccourt.ca.gov/coordinated-cases/ford-explorer/ford-explorer.aspx (click on "Online Document Viewer") (compiling information on the Bridgestone/Firestone Tire cases settlement).

39. *See supra* note 10 and accompanying text.

understanding, as opposed to an independent normative analysis[40]—with the more specific theories for awarding damages associated with those causes of action. Section II.B then uses these theories to model a normative theory of damages for market value loss. Although this approach might be criticized as deriving an "ought" from what is,[41] I believe that the transparent articulation of the approach gives it legitimacy.[42]

A. *The Theoretical Basis for Awarding Damages*

In general, "the object of the law in awarding damages for civil injury and breach of contract is to put the plaintiff in the same position . . . as he would have been had there been no injury or breach; that is to compensate him for the injury actually sustained."[43] Various theories have been advanced to try to explain *why* damages should be equal to the injury.[44]

One such theory, which forms the basis of tort damages, is that damages should be equal to the injury in order to avoid private retribution, such as "'blood feuds.'"[45] Damages equal to the injury restore a sense of fairness, making private retribution unlikely.[46] Another such theory is economic: that imposing damages equal to the injury incentivizes people to internalize the social costs of their behavior.[47] In the absence of damages, rational people will consider taking an action if the utility they derive from the action outweighs its costs, ignoring costs the action might impose on others.[48] Imposing tort damages equal to the injury sustained motivates rational people to consider the total costs of their actions, thereby more

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40. I thank my colleague Timothy Endicott for helping to articulate this distinction.

41. *Cf.* ALAN SCHWARTZ & ROBERT E. SCOTT, COMMERCIAL TRANSACTIONS: PRINCIPLES AND POLICIES 18 (2d ed. 1991) (contending that "'oughts' cannot be derived from what is") (citing G.E. MOORE, PRINCIPIA ETHICA §§ 10–14 (Thomas Baldwin ed., Cambridge Univ. Press 1993)).

42. *Cf.* Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 776–77 (1988) (grafting a normative analysis onto a positive assumption—in this case, taking the existence of corporate reorganizations in bankruptcy law as a given to put forth a suggestion to improve the reorganization process).

43. WALLACE HUGH WIGMAN ET AL., THE ESSENTIALS OF COMMERCIAL LAW 82 (1913) (citing Rockwood v. Allen, 7 Mass. 254, 256 (1811)); *see also* Miller v. Robertson, 266 U.S. 243, 257 (1924); Lee v. S. Home Sites Corp., 429 F.2d 290, 293 (5th Cir. 1970); Ballow v. PHICO Ins. Co., 878 P.2d 672, 677 (Colo. 1994); Hanna v. Martin, 49 So. 2d 585, 587 (Fla. 1951).

44. For a parallel discussion of why damages should be awarded under English law for civil injury and breach of contract, see ANDREW BURROWS, REMEDIES FOR TORTS AND BREACH OF CONTRACT 9–10 (3d ed. 2004).

45. Benjamin Zipursky, *Rights, Wrongs, and Recourse in the Law of Torts*, 51 VAND. L. REV. 1, 83 (1998) (citations omitted) (discussing German blood feuds). Although this rationale should be equally applicable to bodily and non-bodily injury, tort damages for bodily injury are often closely tied to societal expectations regarding that special context. E-mail from George Christie, James B. Duke Professor of Law, Duke Law School, to the author (Sep. 22, 2010) (on file with author). My Article does not purport to address bodily injury damages.

46. Zipursky, *supra* note 45, at 84–85 (generally observing that damages equal to the injury are necessary to avoid unfairness to the tort victim).

47. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 6–8 (1987).

48. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 340 (5th ed. 2008).

efficiently allocating societal resources.[49]

Damages for breach of contract are likewise held to be equal to the injury. Under the autonomy theory of contracts, that measure of damages is needed to make contractual promises credible.[50] Law and economics scholars take a similar view. Damages are meant to induce the optimal level of performance, and damages that are too high or too low will cause parties to over- or under-rely on the contract.[51] Damages therefore need to be just right, or equal to the injury.[52]

It therefore is clear in tort and contract that damages should be equal to the injury, but that begs the question of what "equal to the injury" means. In a tort context, injury appears to be measured by the loss in the victim's reasonable expectations caused by the tort—such as mental and physical suffering, lost working time, necessary expenditures to treat physical harm, and compensation for a decrease in earning power resulting from the harm.[53] In effect, the victim reasonably expects not to be injured by tortious action; compensating the victim for these amounts is deemed to be equivalent to restoring that expectation.[54]

In a contract context, the injury is the lost expectations suffered by the party who has been subjected to the breach, based on what the contract would have provided.[55] Indeed, courts commonly refer to contract-breach damages as expectations damages: "Ordinarily, when a court concludes that there has been a breach of contract, it enforces the broken promise by *protecting the expectation* that the injured party had when he made the contract."[56] In practice, courts limit expectations damages by a reasonableness standard, to expectations that were reasonably foreseeable (such as expectations arising in the ordinary course of business or that were specifically disclosed when the contract was formed)[57] and could be objectively valued.[58]

The damages rule for fraud is similar to that of tort and contract.[59] The

49. *Id.*

50. *See* LANDES, *supra* note 47 and accompanying text. CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 20–21 (1981).

51. *See* FRIED, *supra* note 50, at 20–21 (1981).

52. COOTER & ULEN, *supra* note 48, at 245.

53. *See, e.g.*, Kapuschinsky v. United States, 259 F. Supp. 1, 6 (D.S.C. 1966); Ariz. Copper Co. v. Burciaga, 177 P. 29, 33 (Ariz. 1918), *overruled on other grounds by* Consol. Ariz. Smelting Co. v. Egich, 199 P. 132, 136 (Ariz. 1920).

54. St. Louis Sw. Ry. Co. v. Dickerson, 470 U.S. 409, 412 (1985) (per curiam) (holding that damages should be equal to the "deprivation of the reasonable expectation" of future benefits caused by the injury) (quoting Chesapeake & Ohio Ry. Co. v. Kelly, 241 U.S. 485, 489 (1916)).

55. RESTATEMENT (SECOND) OF CONTRACTS § 344 (1981).

56. *Id.* cmt. a (emphasis added).

57. *Id.* § 351.

58. *Id.* § 344 cmt. b. Although limiting expectations damages to expectations that can be objectively valued might seem an artificial restriction, objective indicators (such as market pricing) often serve as the starting point for forming expectations.

59. In the United Kingdom, the damages rule for fraud may be different. *See* Doyle v. Olby (Ironmongers) Ltd., [1969] 2 Q.B. 158 at 159 (distinguishing the proper measure of damages for

majority of U.S. courts grant benefit-of-the-bargain damages,[60] recognizing the injury as "what an individual might reasonably expect to receive based upon the representations of another."[61] The injury is therefore the difference between the victim's reasonable expectations, which were formed in reliance on the representations of the injurer, and what the injurer actually delivered.[62] Like damages in tort and contract, damages for fraud thus preserve the reasonable expectations of the defrauded party.

B. *Modeling a Normative Theory of Damages for Market Value Loss*

Damages should thus theoretically preserve the reasonable expectations of an injured party. My normative theory of damages for market value loss therefore starts with the framework that such damages should be equal to the lost expectations of a reasonable person in the same circumstances as the injured party ("lost reasonable expectations").[63] Hence, the first inquiry is what constitutes these lost reasonable expectations. Section II.C will then examine the practical concerns associated with contract cases—foreseeability and the need to achieve certainty in determining the amount of damages—asking whether those concerns should be applicable in market-value-loss cases and if so, whether they should be limited to contract cases.

A central claim of this Article, the normative basis for which will be further explained below,[64] is that a loss in market value should constitute lost reasonable expectations, at least for property that customarily is resold as a way to realize its full value.[65] The motivation for these sales turns on the discrepancy between the economic lifetime of an asset and the investment horizon of investors in, or purchasers of, that type of asset.[66] The greater that discrepancy, the more likely a custom will develop to resell that type of asset in order to realize its full value. To understand why, consider the following types of property, first focusing on financial-market securities and then on ordinary products.

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deceit from those for breach of contract).

60. RESTATEMENT (SECOND) OF TORTS § 549 REPORTER'S NOTE (1981).

61. Foley v. Parlier, 68 S.W.3d 870, 884 (Tex. App. 2002) (citing Hart v. Moore, 952 S.W.2d 90, 97 (Tex. App. 1997)).

62. Morris v. Harbor Boat Bldg. Co., 247 P.2d 589, 593 (Cal. App. 1952).

63. *See supra* notes 39–42 and accompanying text (articulating that this Article starts with an abstract of general understanding, as opposed to an independent normative analysis, of damages to model a normative theory of awarding damages for market value loss).

64. *See infra* notes 93–102 and accompanying text (discussing foreseeability).

65. By "customarily," this Article does not mean exclusively.

66. *Cf.* Martin Hellwig, *Systemic Risk in the Financial Sector: An Analysis of the Subprime-Mortgage Financial Crisis* 7 (Max Planck Inst. for Research on Collective Goods, Preprint No. 2008/43, Nov. 2008), *available at* http://www.coll.mpg.de/pdf_dat/ 2008_43online.pdf ("The discrepancy between the economic lifetimes of [long-term] assets and the investment horizons of most investors poses a dilemma.").

1. Lost Reasonable Expectations for Financial-Market Securities

Recall that these securities are divided into debt and equity.[67] Whether debt securities customarily are resold as a way to realize their full value is an empirical question, the answer to which (at least currently) turns on the maturity of the securities. For example, short-term debt securities, such as commercial paper with maturities between 30 and 270 days,[68] are almost always held by investors to maturity and rarely are resold.[69] Therefore, a loss in market value of commercial paper should not constitute lost reasonable expectations.

The analysis is more complex, however, for long-term debt securities, partly because of the evolution of the custom of holding-versus-selling such debt securities to realize their value. Historically, most long-term debt securities were held by investors to maturity.[70] Investors expected to receive their value through the periodic receipt of principal and interest payments.[71]

The ability to resell long-term debt securities, however, would give investors liquidity that may be needed to pay obligations coming due.[72] It would also give investors the flexibility to invest in other projects.[73] As a result, there is a discrepancy between the economic lifetime of long-term debt securities and the investment horizon of many investors in those securities.

To minimize this discrepancy, resale (or "secondary") markets for long-term debt securities have developed,[74] enabling investors to resell these types of securities in order to realize their full value.[75] The ability to resell

67. *See supra* note 12 and accompanying text.

68. Commercial paper is a market term for short-term debt securities that typically have maturities of 270 days or less. Securities Act of 1933, § 3(a)(3), ch. 38, 48 Stat. 74, 76 (codified as amended at 15 U.S.C. § 77c(a)(3) (2006)).

69. TIMOTHY Q. COOK & ROBERT K. LAROCHE, INSTRUMENTS OF THE MONEY MARKET 113 (7th ed. 1993).

70. JANE W. D'ARISTA, THE EVOLUTION OF U.S. FINANCE 124 (1994).

71. MAUREEN BURTON, REYNOLD NESIBA & BRUCE BROWN, AN INTRODUCTION TO FINANCIAL MARKETS AND INSTITUTIONS 56 (2d ed. 2010).

72. DEAN CROUSHORE, MONEY & BANKING: A POLICY ORIENTED APPROACH 116 (2007).

73. *Id.* The inability to invest in other projects is an opportunity cost with intrinsic value, as demonstrated by hedonic analysis. The hedonic price method is used to estimate the effect on property value of individual property assets by estimating the prices of the property's closest market substitutes which do not possess that particular asset (i.e., market substitutes that possess a near-identical array of assets *except* for the asset being valued). The hedonics method can be used to establish the specific value of opportunity costs from additional commute time to inaccessible debt securities. *See, e.g.*, Patrick Bajari & Matthew E. Kahn, *Estimating Hedonic Models of Consumer Demand with an Application to Urban Sprawl, in* HEDONIC METHODS IN HOUSING MARKETS: PRICING ENVIRONMENTAL AMENITIES AND SEGREGATION 129, 144 (Andrea Baranzini et al. eds., 2008).

74. Charles W. Calomiris, *Banking and Financial Intermediation*, *in* TECHNOLOGICAL INNOVATION & ECONOMIC PERFORMANCE 285, 298 (Benn Steil et al. eds., 2002).

75. *See, e.g.*, RICHARD A. BROTT, BASIC PRINCIPLES OF CONSERVATIVE INVESTING: 9 PRINCIPLES YOU MUST KNOW! 51 (2007).

long-term debt securities has become so customary and important that more freely salable long-term debt securities typically bear a lower interest rate—meaning such securities are more attractive to investors by reason of their salability—than less freely salable long-term debt securities.[76] The U.S. Securities and Exchange Commission (SEC) has even issued special rules enabling investors to more freely resell otherwise resale-restricted long-term debt securities.[77]

Because long-term debt securities are customarily resold as a way to realize their full value, a loss in market value of wrongfully affected long-term debt securities should theoretically be legally compensable.[78] This result is directly contra to the decision in the *RJR Nabisco* case—a decision arguably explainable by the court's failure to recognize the changing market practice.[79]

Next, consider equity securities. As before, whether these securities customarily are resold as a way to realize their full value is an empirical question, but one that has a more obvious answer. Equity securities are almost always resold to realize their full value because, as presently structured, equity securities generally pay investors only dividend payments, which represent a rate of return,[80] and do not return the underlying equity investment until the corporate issuer of the securities liquidates.[81] Investors are usually unwilling to wait until that time; they typically want repayment of their investment within months or years, whereas most corporations have unlimited lives.[82]

Shareholders, therefore, customarily look to resale of the securities for

76. R. CHARLES MOYER, JAMES R. MCGUIGAN & WILLIAM J. KRETLOW, CONTEMPORARY FINANCIAL MANAGEMENT 32 (11th ed. 2009).

77. *See, e.g.*, 17 C.F.R. § 230.144A (2010) (enabling privately placed long-term debt securities to be freely resold to qualified institutional buyers).

78. Although long-term debt securities are sometimes held by investors to maturity, that does not obviate the fact that long-term debt securities are customarily sold as a way to realize their full value. *Id*.

79. The case may also be explainable on its facts, insofar as no covenant appeared to be breached. *See supra* notes 22–25 and accompanying text.

80. Modigliani and Miller's Irrelevance Hypothesis bears out that dividend payments on equity securities are akin to payment of interest, but not principal, on debt securities. *See* CARNEY, *supra* note 12, at 210–19.

81. *See, e.g.*, ALAN S. GUTTERMAN, THE LAW OF DOMESTIC AND INTERNATIONAL STRATEGIC ALLIANCES: A SURVEY FOR CORPORATE MANAGEMENT 324 (1995); KAROLINE JUNG-SENSSFELDER, EQUITY FINANCING AND COVENANTS IN VENTURE CAPITAL: AN AUGMENTED CONTRACTING APPROACH TO OPTIMAL GERMAN CONTRACT DESIGN 22 (2006).

82. *See* JAMES B. HERENDEEN, ISSUES IN ECONOMICS: AN INTRODUCTION 231–32 (2008). Even an institutional investor will typically match its investments to statistically anticipated payouts, such as an insurance company matching its investments to statistically anticipated insured losses or a pension fund matching its investments to statistically anticipated retirements. JEFF MADURA, FINANCIAL MARKETS AND INSTITUTIONS 58 (8th ed. 2008). However, absent the corporation's liquidation, investors will not be repaid unless they have the right to require the corporation to redeem the securities, which is rare. ASHEESH ADVANI, INVESTORS IN YOUR BACKYARD: HOW TO RAISE BUSINESS CAPITAL FROM THE PEOPLE YOU KNOW 348 (2006).

return of their investment.[83] Indeed, the trading price of stock is regularly used, and thus perceived, as a proxy for the measure of the value of the stock.[84] This may help explain why courts traditionally have been willing to recognize market-value-loss damages for wrongfully affected equity securities.

2. Lost Reasonable Expectations for Ordinary Property

Whether ordinary property is customarily resold as a way to realize its full value is, as before, an empirical question. Consider light bulbs. People almost always use them until they stop working.[85] As a result, they are not customarily resold as a way to realize their full value, and no real secondary market for used light bulbs has developed.[86] Therefore, a loss in market value of wrongfully affected light bulbs should not be legally compensable.[87]

But contrast light bulbs with houses. Houses *are* customarily resold as a way to realize their full value. This mitigates the discrepancy between the economic lifetime (i.e., the useful life) of houses and the investment horizon (i.e., the period of time an owner wishes to remain in a given house—owners may move away, or they may die) of most homeowners. Indeed, without the ability to resell a house, it would almost always be more economically rational to rent rather than to buy housing.[88] Therefore, a loss in market value of wrongfully affected houses should be, and generally is,[89] legally compensable.

Next consider automobile ownership, an example somewhat in between light bulbs and houses. There is a moderate discrepancy between the economic lifetime of automobiles and the investment horizon of

83. *See* JOHN E. MOYE, THE LAW OF BUSINESS ORGANIZATIONS 294 (6th ed. 2005).

84. The financial media, for example, often focus on whether actions of a firm's management increase share price. IMS RISK SOLUTIONS LTD, INTEGRATED MANAGEMENT SYSTEMS SERIES, IMS: CONTINUAL IMPROVEMENT THROUGH AUDITING 70–71 (David Smith ed., 2004).

85. The above discussion focuses on *using* light bulbs, not on holding light bulbs as inventory to sell.

86. There might perhaps be a very limited resale market on eBay. *See* EBAY, http://www.ebay.com (last visited May 5, 2011).

87. As technology advances, the useful life of light bulbs has been lengthening, and the cost of extremely long-life light bulbs is not insignificant. It is therefore conceivable that a robust secondary market in used light bulbs might arise in the future, potentially changing the damages analysis. *See* Steve Forbes, *Ban Bulb Lunacy*, FORBES.COM (Mar. 28, 2011, 6:00 PM), http://www.forbes.com/forbes/2011/0328/billionaires-11-fact-comment-steve-forbes-ban-bulb-lunacy.html (disputing the notion that long-life light bulbs will save people money in the long run).

88. Indeed, where the economic lifetime of any property extends beyond an owner's investment horizon, it would be more economically rational to rent rather than to buy such property, absent a secondary market for resale. *See, e.g.*, Miranda Marquit, *Rent vs. Owning: When Does it Make Sense to Buy?*, GOODFINANCIALCENTS.COM (Aug. 3, 2010), http://www.goodfinancialcents.com/rent-vs-owning-when-does-it-make-sense-to-buy/.

89. *See, e.g.*, Bauman v. Ross, 167 U.S. 548, 574 (1896) (holding that the owner's "just compensation" in a partial government taking is not only the value of the land taken but also the incidental loss in value caused to the property not taken).

automobile purchasers. Many people continue to drive their cars until they stop working. But a significant number of people resell their cars after several years and purchase new cars.[90] The latter behavior is sufficiently widespread that it is now almost certainly "customary" for owners to resell their cars in order to realize their full value. Indeed, robust de facto used car markets have arisen to facilitate these sales.[91] Accordingly, a loss in market value of wrongfully affected automobiles should, at least theoretically, be legally compensable. This helps to explain, at least implicitly, the recent Bridgestone/Firestone Tire Cases settlement.[92]

C. *Practical Concerns*

The discussion above models a normative theory of damages for market value loss, arguing that such loss should be compensable for wrongfully affected property that customarily is resold as a way to realize its full value. This Section examines the practical concerns associated with contract cases—foreseeability and the need to achieve certainty in determining the amount of damages—and asks whether those concerns should be applicable in market-value-loss cases and if so, whether they should be limited to contract cases.

1. Foreseeability

In contract cases, unlike tort cases generally, courts impose a requirement of foreseeability *beyond the injured party's lost reasonable expectations*.[93] For example, a purchaser of widgets might reasonably expect to receive a million-dollar contract with a third party if widgets contractually promised by a seller arrive in time. But the seller, in breach, would not be liable for the purchaser's loss of the third-party contract unless the purchaser told the seller that the third-party contract is expected.[94] The lost-reasonable-expectations requirement is thus effectively made bilateral. The articulated rationale is that, in a contract context, expectations are bilateral and damages for lost expectations must be reasonable from the standpoint of both parties.[95]

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90. *See, e.g.*, *True Cost to Own Calculator*, EDMUNDS.COM, http://www.edmunds.com/apps/cto/CTOintroController (last visited May 5, 2011) (allowing car buyers to factor in resale value depreciation rates when choosing a new vehicle).

91. *See, e.g.*, KELLEY BLUE BOOK, http://www.kbb.com (last visited May 5, 2011) (valuing used cars based on odometer readings).

92. *See supra* note 38 and accompanying text.

93. *See supra* note 57 and accompanying text.

94. NEIL C. BLOND & LOUIS PETRILLO, CONTRACTS 189 (7th ed. 2009); *accord* Miss. Chem. Corp. v. Dresser-Rand Co., 287 F.3d 359, 371 (5th Cir. 2002); Lewis v. Mobil Oil Corp., 438 F.2d 500, 510 (8th Cir. 1971). English courts express foreseeability in terms of the scope of the duty that is assumed. E-mail from Edelman, *supra* note 11.

95. In contrast to contract, where expectations are bilateral, expectations in tort are said to be formed unilaterally and, thus, foreseeability of the amount of harm is not considered. *See, e.g.*, Vanderbeek v. Vernon Corp., 50 P.3d 866, 871 (Colo. 2002) (explaining that where a contracting

One might question, however, why that rationale—at least insofar as it restricts damages by a bilateral reasonableness requirement—should be limited to contract. For example, a tortfeasor might well have expectations about the consequences of the tort. An implicit rationale for not taking into account the tortfeasor's expectations in assessing damages is that a tort—unlike a contract breach—is a wrongful action, and thus only the injured party's expectations should be considered.[96] But even that distinction between tort and contract might be questioned, because at least some contractual breaches are arguably wrongful.[97] Absent that distinction, market value damages should be generally restricted by a bilateral reasonableness requirement, at least if they are not intentionally inflicted.[98]

Another rationale for restricting market value damages by a bilateral, or at least more demanding, reasonableness requirement is to discourage disproportionate penalties and limit the potential for widespread liability. Indeed, courts already apply a more demanding lost-reasonable-expectations requirement in the tort context of pure economic loss, where a requirement for imposing damages is that the loss be "particularly foreseeable."[99] Imposing some form of bilateral lost-reasonable-expectations requirement for awarding market-value-loss damages would similarly help discourage disproportionate penalties and limit the specter of widespread liability.[100]

This Article has argued that market-value-loss damages should require

party can foresee the damages that may arise in consequence of breach, "he presumably will take into account the risk that these contingencies will occur while negotiating the contract. Thus, by limiting contractual liability to those damages foreseen by the parties at the time the contract was formed, [we] ensure[] that the bargain struck reflects a mutually agreeable allocation of the risks and costs of breach. In other words, [we] guarantee[] the fairness of a bilateral agreement by protecting the parties from unanticipated liability arising in the future. But a tortious act is a unilateral invasion of a right taken without regard to any agreement or contract. . . . The victim of a tort has no opportunity to negotiate with the tortfeasor—no opportunity to allocate the risk that a particular consequence will occur or evaluate the cost if it should. Therefore, whether he reasonably contemplated a particular consequence as the probable result of the tort at the time it occurred is irrelevant." (citations omitted) (internal quotation marks omitted)). *Cf.* RESTATEMENT (SECOND) OF TORTS § 435(1) (1965) (contrasting contract, where expectations are bilateral, with tort, where expectations are said to be formed unilaterally and, thus, foreseeability of the amount of harm is not considered).

96. *Cf.* Glanville L. Williams, *The Aims of the Law of Tort*, 4 CURRENT LEGAL PROBS. 137 (1951) (drawing on the Kantian notion of moral necessity to develop the idea that one underlying tenet of tort law is "ethical retribution"—punishing tortfeasors for the detrimental results of their wrongful acts).

97. Steven Shavell, *Is Breach of Contract Immoral?*, 56 EMORY L.J. 439, 452 (2006) (arguing that contract breach should be considered immoral in cases where breach damages are insufficient to fully protect expectations).

98. This Article does not examine the extent to which courts should be more willing to award damages for *intentionally* inflicted—as opposed to negligently inflicted—market value loss. *Cf.* Lamb v. Camden London Borough Council [1981] 1 Q.B. 625 (inversely correlating degree of fault and the need for foreseeability).

99. *See, e.g.*, People Express Airlines, Inc. v. Consol. Rail Corp., 495 A.2d 107, 112 (N.J. 1985) (proposing that pure economic loss that is "particularly foreseeable" be recoverable).

100. *See supra* notes 2–4 and accompanying text.

some form of bilateral lost reasonable expectations. Bilateral reasonable expectations are implicit in the claim that a loss in market value should constitute lost reasonable expectations, "at least for property that customarily is resold as a way to realize its full value."[101] For such property, even the defendant should be aware that resale could be within the plaintiff's reasonable expectations.[102]

2. Need for Appropriate Certainty

The theoretical basis for awarding damages also must be tempered by the need for a court to achieve appropriate certainty.[103] In the context of market value losses, there are at least two ways this need can arise. The first is in measuring the amount of the loss. That should not present difficulty in most cases, because the very idea of a market value loss assumes there is a de jure or de facto market.[104] A more difficult problem, however, is temporal: the need to fix in time the amount of the loss.

For example, if the market value of wrongfully affected property falls but then later increases, the loss would have merely been temporary. A possible solution might be to require that an objective event occurs—such as actual resale of the property[105]—that fixes the market value loss to the injured party. This requirement would also limit windfall payments to parties who hold their properties through the property's economic lifetime. Admittedly, an injured party who believes the market value may increase might try to "game" the system, such as by reselling the property to fix the loss while concurrently buying back similar property; but the law already deals with similar manipulation in other contexts.[106]

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101. *See supra* notes 64–65 and accompanying text.

102. Should a loss in market value constitute lost reasonable expectations, at least in a tort context, for property that is in fact resold to realize its full value, even though resale is not customary? Professor Andrew Burrows raises this question, but he observes that even such a lower threshold for obtaining market value damages should be subject to a requirement of "remoteness." E-mail from Andrew Burrows, Professor of the Law of England, All Souls College, University of Oxford, to the author (Oct. 30, 2010) (on file with author). I would argue that the requirement that the property be of the type that is customarily resold is the equivalent of a remoteness requirement. *Cf.* Jolley v. Sutton London Borough Council [2000] 1 W.L.R. 1082, 1091 ("Unless the injury is of a description which was reasonably foreseeable, it is . . . 'too remote' [to be compensable]. It is also agreed that what must have been foreseen is not the precise injury which occurred but injury of a given description. The foreseeability is not as to the particulars but the genus.").

103. *See supra* notes 63–64 and accompanying text.

104. *See supra* Section III.B. In some cases, however, there may be difficulty measuring the amount of the loss, such as when property is sold long after the event that reduces its market value has occurred. To some extent, statutes of limitation will mitigate this practical concern.

105. Could that create a perverse incentive, however? For example, if a holder of wrongfully affected bonds must sell the bonds at a loss in order to be compensated, might that sometimes contribute, even if only marginally, to further depressing the resale price of those bonds?

106. The U.S. Internal Revenue Code, for example, disallows recognition of a tax loss if a taxpayer sells stock that has suffered a loss, replacing it with "substantially identical stock." 26 U.S.C. § 1091(a) (2006). *Cf.* Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 229 (2010) ("Some arbitrage techniques are pervasive and grudgingly accepted as part of the system, like harvesting tax losses at year-end by holding the winners in one's stock portfolio while selling

This Article, therefore, proposes that a loss in market value of wrongfully affected property should be legally compensable if the property is customarily (although not necessarily exclusively) resold as a way to realize its full value. Because the motivation to resell property to realize its full value turns on the discrepancy between the economic lifetime of the property and the investment horizon of investors in, or purchasers of, that type of property, what is customary will be an empirical question that may change over time. To minimize the practical problem of computing damages where the fallen market value of wrongfully affected property later increases, the amount of otherwise appropriate damages should be tied to an objective event, such as an actual resale of the affected property.

Part III examines how this largely normative approach should be informed, if at all, by how courts have treated market value loss.

III. Judicial Precedents as Informing Normative Theory

Any rule for awarding damages, being administered by judges, should be informed by the realities of judicial behavior. To that end, this Part attempts to examine what types of considerations have affected judicial decisionmaking in market-value-loss cases and to analyze how a rule for compensating market value losses should address those considerations.

A. *Asymmetric Information*

Judges, like many others, often buy and sell stock. Recognizing that equity securities are "purchased with an eye toward a later sale," judges are usually willing to compensate investors for market value losses.[107] In contrast, judges are not always fully informed about markets for debt securities. In the *RJR Nabisco* case, for example, the court was apparently unaware, or at least unappreciative, of the importance to investors of bond trading.[108] This is not completely surprising. The minimum amount to purchase a bond tends to be high,[109] so judges may be personally unfamiliar with them. Furthermore, many bonds are traded only among institutional investors,[110] so individual judges would have no personal familiarity with that market.[111]

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the losers and replacing them with similar [though not substantially identical] stocks." (citations omitted)).

107. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005).

108. *See, e.g.*, 716 F. Supp. 1504, 1518 (S.D.N.Y. 1989) (declining to recognize market value loss as legally compensable, reasoning that such loss did not constitute the "fruits of the agreement" under which the bonds were issued).

109. *See, e.g.*, *Types of Bonds*, WELLS FARGO, https://www.wellsfargo.com/investing/bonds/types (last visited Mar. 28, 2011) (stating that the minimum purchase price of a corporate bond is typically $5,000).

110. *See supra* note 77 and accompanying text (referencing the market for large institutional investors pursuant to 17 C.F.R. § 230.144A (2010)).

111. To some extent, this may reflect a corollary to the availability heuristic. Under that heuristic, people overestimate the frequency or likelihood of an event when examples of, or

To reduce this information asymmetry, a judge facing the question of whether to compensate for market value losses should engage in a factual inquiry as to whether the wrongfully affected property is customarily—though not necessarily exclusively—resold as a way to realize its full value.

B. *De Facto and De Jure Markets*

Information asymmetry is not the full story, however. In the *RJR Nabisco* case, even though the court explicitly recognized that investors had the right to sell their bonds at any time in a secondary market (and therefore implicitly recognized that they were purchased with an eye toward a later sale),[112] the court refused to compensate for the loss in market value of the bonds.[113] This may reflect ignorance of the importance of de facto secondary markets.

De facto secondary markets can be as legitimate and important to commerce as de jure markets. Although equity securities are usually traded on formal markets like the New York Stock Exchange and the NASDAQ, bonds and other debt securities are almost always traded on de facto markets.[114] In the case of debt securities, these are informal markets operated through computers of brokerage houses and banks.[115] Similarly, car owners commonly sell their automobiles in de facto markets.[116] To the extent de facto markets facilitate the transfer of property from willing sellers to willing buyers, they should be as important to advancing commerce, and therefore as legitimate as de jure markets.[117]

Nonetheless, some de facto markets may be so obscure that the possibility of wrongfully affected property falling in market value may not be foreseeable. The limitation on compensating for wrongfully affected property that is *customarily* resold in that market as a way to realize its full value should help obviate this concern.[118]

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associations with, similar events are easily brought to mind. Paul Slovic, Baruch Fischhoff & Sarah Lichtenstein, *Facts Versus Fears: Understanding Perceived Risk*, *in* JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 463, 465 (Daniel Kahneman et al. eds., 1982). The corollary is that people undervalue the importance of things with which they are unfamiliar.

112. Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1508 (S.D.N.Y. 1989).

113. *Id.* at 1518.

114. ANNETTE THAU, THE BOND BOOK: EVERYTHING INVESTORS NEED TO KNOW ABOUT BONDS 7–8 (2d ed. 2001).

115. NORMAN M. SCARBOROUGH, BUSINESS: GAINING THE COMPETITIVE EDGE 524 (1992).

116. *See supra* notes 90–91 and accompanying text.

117. *Cf.* HERENDEEN, *supra* note 82, at 231–32 (arguing that de jure stock markets and de facto bond markets provide the same six key contributions to commerce: (1) converting illiquid assets into relatively liquid assets; (2) reducing the cost of funds to borrowers, especially long-term borrowers; (3) allowing for the separation of ownership and control; (4) permitting the separation of saving and investing decisions; (5) making possible a market for corporate control; and (6) facilitating the determination of a firm's value).

118. *See supra* Section II.C.

C. *Administrative Ease*

Another consideration that may affect judicial decisionmaking in market-value-loss cases is administrative ease. This consideration could tie into the foregoing distinction between de jure and de facto markets; a court might fear that pricing—and thus ascertaining the amount of losses—is more certain in de jure than de facto markets. To the extent that concern exists, it is probably unfounded; pricing in de facto markets should be reliable and ascertainable because it is the increased liquidity common to both de facto and de jure secondary markets that facilitates the determination of an asset's current worth (or at least what the market thinks the asset is worth).[119]

Courts also may be concerned that compensating for market value loss could raise other valuation questions.[120] This Article has examined what appears to be the most difficult valuation question, concluding it should be manageable.[121] Judges nonetheless should be circumspect when making valuations, ensuring that the judicial system does not inadvertently function as insurance for inherently risky investments.

D. *Reluctance to Interfere with Management Discretion*

When the wrongfully affected property consists of corporate securities, judges may sometimes be concerned that compensating investors for market value losses could interfere with corporate governance. In the *RJR Nabisco* case, for example, the alleged wrongful action was that RJR's management caused the corporation to undergo a leveraged buyout.[122] A decision to award damages might then be seen as interfering with the business judgment rule, in which managers who essentially act in good faith and without conflicts will not be subject to liability.[123]

The rationale for the business judgment rule, however, is to enable corporate managers to take reasonable business risks.[124] If a judge awards market-value-loss damages against the corporation itself, rather than against its individual managers, investors would be protected without (at least directly) jeopardizing management business judgment. Furthermore, any award of damages presumes a threshold inquiry into whether the

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119. *See, e.g.*, HERENDEEN, *supra* note 82, at 232; *supra* note 91 (observing the reliability of pricing in the de facto used car market). *Compare* JONATHAN BERK & PETER DEMARZO, CORPORATE FINANCE § 8.2 (2007) (discussing how to accurately price bonds), *with* ESME FAERBER, ALL ABOUT BONDS, BOND MUTUAL FUNDS, AND BOND ETFS 14–15 (3d ed. 2009) (discussing relatively small price variations in the de facto bond market).

120. *Cf. supra* notes 103–06 and accompanying text.

121. *See supra* notes 105–06 and accompanying text (examining the temporal valuation problem of fixing the amount of the loss in time).

122. Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1520 (S.D.N.Y. 1989).

123. Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

124. Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996).

property was wrongfully affected in the first place. If the answer is no, a court would not even get to the issue of damages.[125]

IV. SYNTHESIS AND APPLICATIONS

A. *Synthesis of a Rule to Compensate for Loss of Market Value*

This Article proposes that a loss in market value of wrongfully affected property should be legally compensable if the property is customarily (although not necessarily exclusively) resold as a way to realize its full value.[126] The motivation to resell property to realize its full value turns on the discrepancy between the economic lifetime of the property and the investment horizon of investors in, or purchasers of, that type of property (such as the discrepancy between the long-term maturity of corporate bonds and the investment horizon of most bondholders); therefore, what is customary is an empirical question that may change over time. A judge facing the question of whether to compensate for market value losses should therefore engage in a factual inquiry as to whether resale is a customary way to realize the wrongfully affected property's full value. In making this inquiry, judges should be aware that de facto secondary markets can be as legitimate and important to commerce as more formal de jure markets.

In assessing damages, judges should be aware of certain practical considerations, perhaps the most significant of which is deciding how to compute damages where the fallen market value of wrongfully affected property could later increase. One solution would be to tie that computation to an objective event, such as an actual resale of the affected property.

B. *Application of the Rule*

1. Toyota Car Recalls

As a result of recent well-publicized safety violations, the resale value of certain models of Toyota automobiles has fallen significantly.[127] In a lawsuit by a car owner against Toyota, how should a court assess a claim for market value damages?

A threshold question is whether Toyota acted wrongfully and thus

125. *See, e.g.*, Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 347 (2005).

126. One colleague observed the potential for a procyclical feedback effect between a rule implementing market value damages, such as the rule articulated here, and the creation of markets for resale. Comment of Joshua Getzler, Reader in Legal History, St. Hugh's College, University of Oxford, at University of Oxford Law and Finance Workshop (Nov. 16, 2010). I think that any such feedback effect would have marginal impact.

127. U.S. News & World Report, *Best Cars: Toyota Resale Values Take Another Hit*, USNEWS.COM (Feb. 9, 2010, 10:33 AM), http://usnews.rankingsandreviews.com/cars-trucks/daily-news/100209-Toyota-Resale-Values-Take-Another-Hit/.

should be liable, in principle, for damages resulting from the safety violations. That question is beyond this Article's scope.[128] Assuming, however, that Toyota did act wrongfully, this Article's question is whether Toyota should be liable to Toyota car owners for that fallen resale value.

In answering this question, a judge should first engage in a factual inquiry as to whether resale is a customary way to realize an automobile's full value. Without independently engaging in that inquiry, it would appear that although many people continue driving their cars until they stop working, a significant number resell their cars after several years and purchase new cars—reflecting the discrepancy between the relatively long useful life of automobiles and the shorter timespan that many individuals want to own a particular car. Resale, therefore, would appear to be a customary way to realize an automobile's full value.

Toyota should therefore be liable, in theory, to Toyota car owners for that fallen resale value.[129] But requiring Toyota to pay that market value differential to all affected car owners would provide a windfall, at Toyota's expense, to car owners that either continue driving their Toyotas until they stop working or resell their Toyotas at a time when the market value of their cars has risen. To mitigate these windfalls, damages for fallen market value should be computed only if and when the cars are resold. Toyota should not be liable for the fallen market value of a car that is not resold. And Toyota should only be liable for the incrementally fallen market value if a car is resold at a price above the originally fallen market value.[130] The fact that a car owner may resell a car in a de facto market should not limit the assessment of market value damages, so long as the de facto market allows reasonably determinable pricing.[131]

2. BP *Deepwater Horizon* Gulf Oil Spill

The BP *Deepwater Horizon* Gulf oil spill resulted from an explosion on April 20, 2010 on BP's *Deepwater Horizon* drilling rig in the Gulf of

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128. Similarly, to the extent that question involves issues of pure economic loss, the analysis assumes that some form of compensation is otherwise appropriate under applicable law and focuses on whether that compensation should include market value loss. *See supra* note 9 and accompanying text.

129. In practice, however, whether Toyota would be liable to Toyota car owners for that fallen resale value may depend on the particular cause of action. The Restatement (Third) of Products Liability, for example, states that there is no recovery under the tort law of products liability for the loss of value suffered by someone who has been sold a defective product. RESTATEMENT (THIRD) OF PRODUCTS LIABILITY § 21 cmt. d (1998). A Toyota purchaser might, however, be able to assert an additional cause of action for misrepresentation. E-mail from Christie, *supra* note 45.

130. For example, if a particular Toyota car's resale value falls from $12,000 to $10,000 as a result of a recall caused by Toyota's wrongful action, and the car owner sells the car at a time when its market value has increased by $1,000 (possibly as a result of the recall becoming a distant memory or questions as to whether the recall was really necessary), then the amount of market value damages should be $1,000, not $2,000.

131. Such as would be the case for selling used cars. *See* KELLEY BLUE BOOK, *supra* note 91.

Mexico.[132] The spill caused extensive damage to the Gulf ecosystem and to the area's tourism and fishing industries.[133] BP and the U.S. Government are in accord that BP's mistakes led to the spill,[134] but questions remain as to how to compensate for losses.

This Article's analysis can help to inform this determination for property that has a de jure or de facto market value that was lowered by the oil spill. Such property might include, for example, financial securities in affected fisheries, hotels, and restaurants and affected fishing boats, hotels, and restaurants owned directly by individuals or other third parties.

A threshold question is whether BP acted wrongfully and thus, in principle, should be liable for damages resulting from the oil spill. That question is beyond this Article's scope,[135] although BP appears to have acknowledged responsibility. Assuming that BP did act wrongfully, this Article's question is whether it should be liable for the fallen market value of affected property.

In answering this question, a judge should first engage in a factual inquiry *for each type of affected property* as to whether resale is a customary way to realize its full value. The fact that equity securities and long-term debt securities are generally customarily resold as a way to realize their full value[136] does not necessarily mean that all types of those securities are customarily resold.[137] To the extent the judge finds that resale is a customary way to realize the full value of that type of property, BP should be liable, at least theoretically, for the property's fallen resale value.

For those properties, however, BP should be required to pay compensation only if and when a property owner actually resells the property.[138] Furthermore, BP should then be required to pay only the incrementally fallen market value if the property is resold at a price above the originally fallen market value.[139] The fact that property may be resold

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132. Campbell Robertson, *Search Continues After Oil Rig Blast*, NYTIMES.COM (Apr. 21, 2010), http://www.nytimes.com/2010/04/22/us/22rig.html?_r=1&ref=gulf_of_mexico_2010.

133. David A. Fahrenthold & Steven Mufson, *Oil Spill Threatens Gulf Region's Ecosystem and Fishing, Tourism and Shipping Industries*, WASH. POST, May 2, 2010, at A01.

134. Steven Mufson, *Gulf Oil Spill: BP Briefs on Breakdowns, Mistakes*, WASHPOST.COM (May 26, 2010, 7:59 PM), http://www.washingtonpost.com/wp-dyn/content/article/2010/05/26/AR2010052604888.html.

135. Again, to the extent that question involves issues of pure economic loss, the analysis assumes that some form of compensation is otherwise appropriate under applicable law and focuses on whether that compensation should include market value loss. *See supra* note 9 and accompanying text.

136. *See supra* Section II.B.

137. *See supra* text accompanying notes 68–69.

138. Recall that this limitation helps to mitigate windfall payments. One may ask whether damages should be further mitigated by requiring a property owner who knows or should know that the property itself will receive direct compensation should wait until that occurs to engage in a resale. At least under the so-called efficient market hypothesis, market prices should adjust rapidly if not virtually immediately based on new information (such as knowledge of the future direct compensation), obviating any need to wait until the direct compensation actually occurs.

139. Again, this is to mitigate windfall payments.

in a de facto, not de jure, market should not limit the assessment of market value damages, so long as the de facto market allows reasonably determinable pricing.[140]

Any concern that imposing market-value-loss damages would create disproportionate penalties or widespread liability should, at least to some extent, be mitigated by compensating only for wrongfully affected property that is customarily resold as a way to realize its full value.[141] Nonetheless, given the extraordinary potential scope of damages from the BP oil spill, it seems reasonable for a court to consider, at least on a case-by-case basis, whether a further foreseeability limitation—perhaps akin to the "particularly foreseeable" limitation that is sometimes applied in the pure-economic-loss context to discourage disproportionate penalties and limit the specter of widespread liability[142]—should also apply to market value losses in this context.

CONCLUSION

This Article explored a new way to think about property rights by applying the fundamental proposition that damages should be equal to the lost reasonable expectations of a person in the same circumstances as the injured party to the question of whether damages should include losses in market value caused by wrongful actions. The Article argued that for property that is customarily resold as a way to realize its full value, damages should include those losses.

Whether property is customarily resold as a way to realize its full value is ultimately an empirical question. The greater the discrepancy between the economic lifetime of an asset and the investment horizon of investors in, or purchasers of, that type of asset, the more likely that custom will develop.

For example, people almost always use light bulbs until they stop working. Therefore, a loss in market value of wrongfully affected light bulbs should not be legally compensable. Similarly, short-term debt securities, such as commercial paper, are almost always held by investors to maturity and are rarely resold. Therefore, damages should not include alleged losses in market value of commercial paper.

On the other hand, long-term debt securities, such as bonds, are now rarely held by investors to maturity but instead are commonly resold, giving investors liquidity to pay their obligations and the flexibility to

140. *See supra* Section IV.A.

141. *See supra* notes 93–95 and accompanying text (describing this, effectively, as a bilateral lost-reasonable-expectations requirement).

142. *See, e.g.*, People Express Airlines, Inc. v. Consol. Rail Corp., 495 A.2d 107, 112 (N.J. 1985) (proposing that pure economic loss that is "particularly foreseeable" be recoverable). While the "particularly foreseeable" limitation may provide one framework for judges applying market-loss-value damages, the limitation in the context of pure economic loss is beyond the scope of this Article.

invest in other projects. A very significant discrepancy has developed between the economic lifetime of long-term debt securities and the shorter investment horizon of many investors in those securities. A loss in market value of wrongfully affected long-term debt securities should therefore be legally compensable. This result parallels the well-established case law that compensates homeowners and shareholders for the loss in market value of such property caused by wrongful actions. The case law's implicit normative justification is that both houses and shares of stock are customarily resold as a way to realize their full value because of the very significant discrepancy between the economic lifetime of houses and stock and the shorter investment horizon of purchasers of such assets.

For some property, like automobiles, there is a more moderate but still significant discrepancy between the property's economic lifetime and the investment horizon of purchasers. Some people drive their cars until they stop running, whereas others resell their cars after several years. The latter behavior has become quite customary (though not exclusive), and indeed robust de facto used car markets have arisen to facilitate resales. Therefore, a loss in market value of wrongfully affected automobiles should be legally compensable.

This Article has examined the process by which courts should make these types of determinations, including addressing problems of foreseeability and achieving certainty in measuring damages. In that latter context, the Article finds that de facto resale markets can be as legitimate and important to commerce as more formal de jure markets, and that pricing in de facto markets should be reliable and ascertainable.