The Frontier between Contractual and Tortious Liability in Europe: Insights from the Case of Compensation for Pure Economic Loss

Mauro Bussani
Vernon V. Palmer

Available at: https://works.bepress.com/mauro_bussani/29/
Chapter 40

The Frontier between Contractual and Tortious Liability in Europe: Insights from the Case of Compensation for Pure Economic Loss

Mauro Bussani* and Vernon Valentine Palmer**

1. INTRODUCTION

Pure economic loss is one of the most discussed topics in today’s tort law scholarship. Fascination with the subject has developed into a wealth of literature.¹


The reason is that recoverability of pure economic loss stands at the cutting edge of many crucial questions, such as: To what extent should tort rules be compatible with the market orientation of the legal system? Or, as some may phrase it, how far can tort liability expand without imposing excessive burdens upon individual activity? As a matter of policy should the recovery of pure economic loss be the domain principally of the law of contract? This paper pursues the modest goal of sketching possible answers to these questions. Thus, we will first (cc. 2-4) outline the notion and the factual situations where this loss is likely to occur. Then, we will discuss the broad spectrum of differing approaches to this kind of damage in Europe (cc. 5-7) as well as the basic arguments for an exclusionary rule (c. 8). We will come (c. 9) to the question whether, in methodological and substantive terms, a common core of agreement exists in Europe on this issue. Finally, we will try to set the scene for the recoverability of pure economic loss in the European Civil Code stage (c. 10).

2. THE DISTINCTION BETWEEN PURE AND CONSEQUENTIAL ECONOMIC LOSS

There has never been a universally accepted definition of "pure economic loss." What is universally clear instead is the negative cast and the patrimonial character of that loss.

In countries where the term is well recognized its meaning is essentially explained in a negative way. It is loss without antecedent harm to person or property. Here the word 'pure' plays a central role, for if there is economic loss that is connected to the slightest damage to person or property of the plaintiff (provided that all other conditions of liability are met) then the latter is called consequential economic loss and the whole set of damages may be recovered without question. Consequential economic loss (sometimes also termed parasitic loss) is recoverable because it presupposes the existence of physical injuries, whereas pure economic loss strikes the victim's wallet and nothing else.


5. Perhaps another way to describe pure economic loss is to say it does not arise as a consequence of some earlier physical loss, and it is not a court's substituted valuation of physical loss.
Thus, before going any further it will be useful to give some specific examples of the factual situations usually subsumed under the label `pure economic loss'.

3. THE STANDARD CASES: A TAXONOMY

Broadly speaking, pure economic loss arises out of the interdependence of relationships and interests. These relationships are sometimes two-dimensional and other times three-dimensional. Our aim is to draw up a taxonomy of the principal ways in which this loss arises within such relationships. This list will surely not exhaust all the conceivable ways in which such damage may arise. Our real interest lies in tracing the most recurrent and typical patterns which we simply call the `standard cases.'

With these provisos in mind, we venture to set forth four categories that seem to be functionally and relationally distinct.

3.1. `RICOCHET LOSS'

Ricochet loss classically arises when physical damage is done to the property or person of one party and that loss in turn causes the impairment of a plaintiff’s right — certain authors call this situation `relational economic loss.' A direct victim sustains physical damage of some kind, while plaintiff is a secondary victim who incurs only economic harm.

To illustrate, A has a contract to tow B’s ship. C’s negligent act of sinking the ship makes it impossible for A to perform his contract and thus deprives him of expected profits. A’s financial loss is the ricochet effect of C’s negligence toward B. The loss is purely economic since no property interest of A’s has been impaired.

Ricochet loss can also arise from the impairment of an employment contract. For instance, B is a key employee in A’s business or sporting team. C’s negligent driving leads to B’s death or incapacity, thus causing A’s team or business to lose profits and revenues. Here B’s injury is physical, but A’s loss is purely financial.

3.2. ‘TRANSFERRED LOSS’

Here C causes physical damage to B’s property or person, but a contract between A and B (or the law itself) transfers a loss that would ordinarily be B’s onto A. Thus a loss ordinarily falling on the primary victim is passed on to a secondary victim. The transfer of the loss from its ‘natural’ to an ‘accidental’ bearer differentiates this from a case of ricochet loss where the damage in question is not transferred but is a distinct damage to the interests of the secondary victim. These transfers frequently result either by operation of law or from leases, sales, insurance agreements and other contracts that separate property rights from rights of use or specifically reallocate risk bearing.

To illustrate, A is time charterer of a ship owned by B. The day before the time charter is to go into effect and while the ship is in B’s possession, C negligently damages the ship’s propeller, thus necessitating repairs and a two week delay, which causes A to lose all use of the ship. Here B suffers property damage and ordinarily B as owner would recover for the consequential loss of the ship’s use, but the right of use — and the risks related to it — were transferred to A by the boat charter. So A’s loss is purely pecuniary because he has no antecedent property loss.

A similar effect can result under a sales contract which reserves title in B (seller) while the goods are in shipment but places the risk of loss in transit upon the buyer A. If the goods (still technically owned by B) are damaged in transit by the carrier’s negligence, then a loss normally incurred by the owner has been transferred to A. A’s loss is purely financial since he has no property interest in the goods.
An equivalent result is reached when the transfer occurs by operation of law. For instance, B, A’s employee, may be injured by the negligent driving of C and thus find himself unable to work for three months. Nevertheless a statute requires A to continue to pay B’s salary, even though no work is received in return. Thus what ordinarily would have been B’s loss is statutorily transferred to A as a combined result of C’s negligence and the effects of the pay continuation statute.

3.3. Closures of Public Markets, Transportation Corridors and Public Infrastructures

Here economic loss arises without a previous injury to anyone’s property or person. There may be physical damage, but it is to ‘unowned resources’ that lie in the public domain. A single negligent act may necessitate the closure of markets, highways and shipping lanes which no person owns, yet the closure inflicts economic loss directly on individuals whose livelihoods closely depend upon the use of these facilities.

To illustrate, C negligently spills chemicals into the river, and all traffic on the waterway is suspended for two weeks during a cleanup effort. As a result shippers must take more expensive overland routes, and marinas, boat suppliers, hotel operators, and commercial fishermen in the area suffer severe economic loss.

The recent BP oil spill in the waters of the Gulf of Mexico, which has been called the greatest oil spill in history, is another example – but on a far greater scale – of pure economic losses stemming from damage to ‘unowned’ resources.

A similar chain of loss may arise when C negligently allows infected cattle to escape from his premises, and the government must order all cattle and meat markets to close. As a result the broad classes of plaintiffs will suffer pure economic loss, including cattle raisers who are unable to sell or deliver their stock to butchers who are unable to obtain supplies.

3.4. RELIANCE UPON FLAWED DATA, ADVICE OR PROFESSIONAL SERVICES

Those who furnish advice, prepare data or render services concerning financial matters often understand that the information will be furnished to a client and then relied upon by third persons with whom they have no contractual relation. If the advice, data or services are carelessly compiled or executed, this may not only breach the provider’s contract with his/her client but cause a relying third party to sustain pure pecuniary loss.

For instance, C, an accountant, carelessly conducts an audit of B, a publicly traded company, and vastly overstates the company’s net financial worth. Relying upon the accuracy of the audit, investor A buys shares in B at twice their actual value. Here A’s loss arises not in consequence of physical damage to B, but on the basis of misplaced reliance. Similarly, erroneous information about a client’s solvency may lead to financial losses. Thus, A, before extending credit to B, takes the precaution of asking C (the merchant bank where B kept its account) for an assessment of B’s creditworthiness. C carelessly replies that B is ‘good for its money’, and B accordingly obtains a loan. Here A’s loss is purely financial, not because it ricochets off or is transferred from someone else’s physical damage, but because it arises directly from A’s reliance.

Professional services for a client may cause pecuniary loss to a non-client. B, an elderly man, asks C, his lawyer, to prepare a will in which he will leave EUR
100,000 to A. C takes no action for six months, whereupon B dies intestate and A thereby receives nothing. A’s loss is purely economic.

4. PRESENT VERSUS FUTURE WEALTH

To the above taxonomy let us add an important distinction.

Examples given so far would suggest that patrimonial injury may take two distinguishable forms. It may relate to the existing as opposed to the anticipated wealth of the victim. In the first sense, plaintiff’s present wealth may be simply depleted by poor financial advice, or by wasting time and petrol taking overland routes because of the closure of a waterway. In the second sense, plaintiff may instead lose that which s/he expected to acquire, such as a testamentary legacy lost because of a defectively drawn instrument, or a sport club’s reduced gate receipts due to the accidental death of the club’s star player. Sometimes, when an expectation is destroyed in utero (and proof that it would have materialized is difficult, for instance: a commission unlawfully rejects a candidate’s application for a job or a fellowship), it is called the loss of a chance.

As between these types of wealth, it is the loss of expected wealth — unrealized profits, canceled legacies, loss of chances — which presents the sharpest question because of a defectively drawn instrument, or a sport club’s reduced gate receipts depleted by poor financial advice, or by wasting time and petrol taking overland routes because of the closure of a waterway. In the second sense, plaintiff may instead lose that which s/he expected to acquire, such as a testamentary legacy lost because of a defectively drawn instrument, or a sport club’s reduced gate receipts due to the accidental death of the club’s star player. Sometimes, when an expectation is destroyed in utero (and proof that it would have materialized is difficult, for instance: a commission unlawfully rejects a candidate’s application for a job or a fellowship), it is called the loss of a chance. As between these types of wealth, it is the loss of expected wealth — unrealized profits, canceled legacies, loss of chances — which presents the sharpest question for tort systems to deal with. The difficulty is not simply that the demand for proof is more exigent — by definition expectancies explore a future that only might have occurred. The difficulty also concerns the appropriateness of affording protection in tort. For when an economic expectation receives legal protection in tort, as in principle it does under French law, plaintiff may end up being compensated to the same extent as if he or she were protected by a contract with the tortfeasor.

In countries where the recovery of pure economic loss is barred by an exclusionary rule of tort law, there is a tendency to say that wealth expectancies should be

Note for example the tense unease in the following statement from a British judge: ‘I do not consider that damages for loss of an expectation are excluded in cases of negligence arising under the principle in Hadley Byrne, simply because the cause of action is classified as tortious. Such damages may in principle be recoverable in cases of contractual negligence; and I cannot see that, for present purposes, any relevant distinction can be drawn between the two forms of action... ’ Per Lord Goff of Chieveley in White v. Jones [1995] AC 207. On this subject see also J. Stapleton, The Normal Expectancies Measure in Tort Damages, 113 L. Q. Rev. 1997, 257; H. Reece, Loss of Chances in the Law, 59 MLR 1996, 188.


29. Pure Economic Loss

31. ‘Contract is productive, tort law protective.’
5. IRRELEVANCE OF LEGAL FAMILIES

The question of the recoverability of pure economic loss is a generic question for all European legal systems. Comparative law research shows that this is not just a civil law versus common law issue. Civil law countries are themselves divided, not from the common law, but between themselves and the common law. An important question is how to understand the various differences and similarities between these systems, but this will have little to do with the 'legal families' in which they happen to be placed. Instead, as indicated in the next section, there is a broad spectrum of approaches, methods and policies at work in Europe.

6. LIBERAL, PRAGMATIC AND CONSERVATIVE APPROACHES

Our studies reveal that five countries – France, Belgium, Italy, Croatia, Greece and Spain – take a liberal stance toward pure economic loss. A leading characteristic of their tort systems is the presence of a unitary general clause which does not, a priori, screen out pure economic loss. Another characteristic is that cases of this kind are resolved almost exclusively on the basis of extracontractual liability and not by crossing over to contract principles. These systems are liberal in appearance and liberal in the recoveries allowed. France permits (in principle) recoveries in delict in seventeen of the twenty cases in our study – Belgium in fourteen cases – whereas in more conservative systems like Portugal and Austria, the number of delictual recoveries is but five and seven respectively.

England, Scotland and the Netherlands display a pragmatic attitude. It is true that the judges of the Netherlands appear to be considerably more receptive to this form of loss than the judges of the United Kingdom, but it is the similarity in their reasoning, their technique and their candor which prompts us to group these three together. These systems are characterized by a cautious case-by-case approach which carefully studies the concrete socio-economic implications before granting or denying recovery for pure economic loss. Solutions are not driven by the dictates of wide tort principle, nor on the other hand by a checklist of absolute rights. The judges perform the role of gatekeeper, and their method of screening recoveries is through the ‘duty of care’ concept.

The tort law of Germany, Austria, Portugal, Denmark, Poland, Sweden and Finland is distinctly more conservative toward the issue. A striking characteristic in the first three is that pure economic loss is not among the so-called ‘absolute rights’ which are protected by their tort law.32 Recovery in tort, therefore, must be excluded as a general rule, and a remedy, if any exists, must be found elsewhere in the system, either on the basis of more specific tort provision or by an expansive application of contract principles. The latter is not infrequently the answer in Germany and Austria. In these jurisdictions, there is an extensive resort to the law of contracts (also special statutes) as a corrective for the narrowness of tort. Nevertheless, even with the lateral support of contract, recoveries are substantially fewer than in the liberal regimes.

Our spectrum of systems indicates that, contrary to what one distinguished writer has asserted,33 there is no ‘true Continental Divide’ on this issue in Europe. If any split is to be recognized, in our view it lies between those countries which have an overt system of protected interests in tort (such as Germany and Austria) and those like France and Belgium which do not. It is this criterion (along with vigorous policy debate in the background) which seems to underlie differences within the civilian camp and makes English law seem conceptually closer to German law.

7. AWARENESS OF THE TIME FACTOR

Any general assessment of common tendencies must take into account the factor of time. One can easily notice that legal attitudes toward pure economic loss are not always stable. Indeed some recent developments should serve as a warning that we could be describing a ‘provisional’ landscape in which some positions are still evolving and changing.

Just in the past forty years Italy in effect changed its stripes from a system of ‘protected interests’ to a general clause system. Within that same period England and Scotland admitted as many as five exceptions to the rule of no recovery. If we take an even longer view we may note that France abandoned in the twentieth century a more restrictive attitude that had been current throughout the previous century (grounded on a praeter legem resort to the unlawfulness conception) in order to match more closely its codistic liberal façade. Moving along an opposite path, Austrian history reveals a sharp departure from the liberal appearances of the ABGB in the second half of the nineteenth century, and since then its legal system has been accepting bodily German doctrinal thought on pure economic loss together with the usual justifications for its control.

Our point is simply that legal positions have not stood still and some have abruptly changed and may change again. Old, and even current, snapshots of the law, therefore, may be of limited utility if one is willing to determine once for ever the existence or non-existence of a common core as to the recoverability of pure economic loss.

32. The exclusion in § 823, s.1 BGB, is well known, but as developments in Austria and Portugal amply show, the influence of German doctrine has resulted in a philosophy of absolute rights superimposed upon those countries’ general clauses. See M. Bussani and V.V. Palmer (eds), Pure Economic Loss in Europe (2003), 148–156.

8. BASIC ARGUMENTS FOR THE EXCLUSIONARY RULE

Before discussing the possible existence of a ‘common core’ agreement across the legal systems about the recoverability of pure economic loss, we wish to consider the fundamental arguments which are usually presented in support of an exclusionary rule. These arguments are usually developed by jurists in legal systems which take the position that such losses should not be generally recoverable in tort, except in defined and limited circumstances. The experience of other countries, however, may suggest certain counterarguments. These viewpoints are worth considering in presenting a full picture of the recoverability of pure economic loss and in approaching any harmonization effort of European tort law.

8.1. THE FLOODGATES

This is the most important of the three arguments we will discuss. It is not only persuasive but has proved persuasive. It usually links up with and reinforces the other arguments. Though not always noticed, there are actually three distinct strands to the floodgates argument, and it is helpful to separate them.

The first strand is the belief that to permit recovery of pure economic loss in some cases would unleash an infinity of actions that would burden if not overwhelm the courts. If defendant’s negligence necessitates the closure of trading markets or shuts down all commerce traveling a busy motorway, there may be hundreds, perhaps thousand of persons who would be financially damaged. Assuming a large number of these cases reach the courts, there would be administrative overload. The justice system could not cope with the sheer numbers of claims.

The second strand is the fear that widespread liability would place an excessive burden upon the defendant who, for purposes of the argument, is treated as the living proxy of human initiative and enterprise. Von Jhering’s statement, ‘Where would it all lead if everyone could sue...!’34 is a famous rendition of the argument. The potentially staggering liability would be out of all proportion to the degree to which defendant was negligent. It is also said that it is manifestly impossible for defendant to predict in advance how many relational economic loss claims he might face when, for example, he injures the property of a primary victim. Whether there is a small or large class of secondary loss sufferers depends, fortuitously, upon the number of parties with economic interests linked to the exploitation of the property.35

35. The rationales of predictability and practicality are discussed in R. Bernstein, Economic Loss, 2nd ed. (1998), 201–203.

The danger of disproportionate consequences resulting from minor blameworthiness is of course an issue of fairness no matter what kind of damages have been caused36 but some scholars believe that the danger is far greater in pure financial loss cases. Financial harm is assumed to have a greater propensity to travel far and wide. It has often been pointed out that the laws of Newton do not apply on the road to financial ruin.37 Physical damage has at least a final resting point, but patrimonial harm is not slowed down by gravity and friction.38 The harm has often been compared to the recovery of damages for nervous shock, since there too the loss can be ‘pure’ as opposed to consequential, and there too the danger of reverberating impacts is commonly given as a reason for restrictive rules.39

The third strand of the argument maintains that pure economic loss is simply part of a broad modern trend toward greater and greater tort liability, a trend that must be kept under control. Allowing exceptions to the exclusionary rule is a

37. T. Weir, n. 14(d). This was also the view of Fleming Janes who stated that the ‘physical consequences of negligence usually have been limited, but the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended.’: Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal, 25 V and. L. Rev. 1972, 43. 45.
38. See, however, J. Stapleton, Legal Cause: Cause-in-Fact and the Scope of Liability for Consequences, 54 V and. L. Rev. 2001, 941, at 974: ‘The reference to the laws of physics reflects a long-standing fallacy in traditional running down cases that control of liability for consequences can be achieved by some “billiard ball” notion of the laws of physics. That is, this reference rests upon the faulty notion that “claims for physical damage, whether to person or property, are inherently limited by the laws of physics which teach that physical forces will ultimately come to rest. After I have run you over and broken your leg, we have “come to rest” in a crude sense. Yet if you later suffer negligent treatment at a hospital that damages your other leg, the law may well say this injury is within the appropriate scope of my liability for consequences. What is doing the work in this judgment is not some inherent limit on my liability set by the law of physics but a judgment about the appropriate scope of liability for consequences in light of, among other things, the perceived purpose underlying the recognition of the obligation in the first place.’
39. The analogy, however, must not be pressed too far. Courts in emotional shock cases have been troubled by a number of rather different concerns, particularly the difficulty of defining the threshold harm (what degree of shock should be cognizable? what manifestation of the harm should be required?) and the difficulty of detecting false or fraudulent claims. In the case of pure economic loss, however, the problem of defining the threshold of the harm is minimal, (the threshold of financial damage always begins at zero); the factual existence of loss is objectively demonstrable and its measurement and proof are not easy but perhaps less problematic. The characteristic uncertainty of financial loss does not consist in defining or verifying the harm but in establishing the causal link between it and defendant’s conduct. The threat of fraud is also of less concern because such loss is free of the danger that claimants may simulate its symptoms. Accordingly economic loss is less easily feigned than the manifestations of nervous shock. We therefore suggest that the most important similarity between the two areas centers upon judicial concern about expanding liability in favor of an indeterminate number of plaintiffs, for indeterminate amounts of damages. Cf. Ch. von Bar, The Common European Law of Torts, vol. II (2000), 76–84. For a discussion in American law, see R.L. Rabin, Tort Liability For Negligently Inflicted Economic Loss: A Reassessment, 37 Stan. L. Rev. 1985, 1513, at 1524–1525.
slippery slope that may lead to reversal of the rule and may also encourage the development of other types of tort liability.40 In assessing the cumulative weight of the argument, there are in our view a number of considerations to bear in mind. To begin with, it should be remembered that the floodgates argument has never purported to be a scientific claim nor a claim based upon comparative law research. It is not very easy to test whether the dire prophecy of the ‘nightmare scenario’ is dream or reality. Is it founded on blind conservatism or does it have a rational basis?41 For instance, the central assertion that physical damage is different than financial damage because it is more contained and judicially manageable seems increasingly difficult to understand in view of today’s mass torts which sometimes involve innumerable physically injured victims asserting claims sometimes amounting to billions of dollars.42 These disasters range from single-event catastrophes like the Exxon Valdez oil spill and the Bhopal gas leak, to multiple-event injuries like the asbestos and DES tragedies which extend over a wide geographic area, producing literally thousands of actual claims that stretched judicial resources to their limits.43 The outbreak of foot and mouth disease in Europe spread physical and/or financial loss by the same prevailing wind. The Exxon Valdez oil spill by itself produced more than thirty thousand litigated claims.44 The BP oil spill in 2010, which poured more than four million barrels of oil into the Gulf of Mexico and damaged the economies and natural resources of five coastal states, promises to dwarf all in terms of economic loss.

These examples would suggest that the law is normally content to impose liability even though the potential plaintiff class is large.45 It would sound very odd if the defendant could argue that s/he should not owe a duty because s/he would have too many victims.46 For many scholars, therefore, the justification for a no-recovery rule based upon a supposed difference in ripple effect or in the sheer size of the plaintiff class is hard to reconcile with the recovery of extremely large economic losses resulting from negligently caused physical injury.47

The geographical distribution of the floodgates argument is another interesting facet of its development. While a perennial in some soils and climates, the argument has failed to take root in others. We have no clear explanation why this occurs. One might say that the theme resonates better in particular legal cultures, but what makes one culture or legal infrastructure more receptive than another? The answer is not clear. Until research is available, the question is open to speculation and to discussion of interesting clues. For instance, litigation rates in Europe are known to be very variable, and it appears that some of the more litigation-friendly countries adhere to the no-recovery rule.

Is it coincidence that both the exclusionary rule and floodgates argument flourish in Germany and Austria where the rates are among the highest in Europe? Does this factor explain why in neighboring The Netherlands, where rates are remarkably low, there is no categorical rule against recovery, nor even — so far as an outside observer can judge — any particular fear of docket inundation?48

40. The European Group on Tort Law (established in 1992 within the Viennese European Centre of Tort and Insurance Law, and directed by H. Koziol and J. Spier), for example, argues that the floodgates must be kept shut in order ‘to dam crushing liability’ and to resist the general trend toward expansion of liability. Six of eight hypotheticals chosen for comparative study by the European Group on Tort Law deal with the subject of pure economic loss. The floodgates metaphor plays a central role in their orientation. See J. Spier (ed.), The Limits of Liability (1996) and also J. Spier, The Limits of Expanding Liability (1998). Their view may mean that the exclusionary rule should be invoked even in factual instances where there is no danger of a flood of claims or of disproportionate recovery. No compensation should be made for fear of establishing an exception that erodes the rule or any exception that may receive analogical extension in the future. On this point, see also below, fn. 50.

41. For example, in 1939 the eminent American torts scholar, William Prosser, forcefully argued: ‘It is the business of the law to remedy wrongs that deserve it, even at the expense of a “flood of claims”; and it is a pitiful confession of incompetence on the part of any court of justice to deny relief upon the ground that it will give the courts too much work to do’: Intentional Infliction of Mental Suffering: a New Tort, 37 Mich LR 1939, 874 at 877.

42. The point is repeatedly emphasized by H. Bernstein, Civil Liability for Economic Loss, 46 AJCL 1998, 111, at 126-128.

43. For a summary of the American scene, see C.H. Peterson and J. Zekoll, Mass Torts, 42 AJCL 1994, 79. For a valuable analysis of the doctrine of pure economic loss in relation to the Valdez and Amoco Cadiz oil spills, see V. Goldberg, Recovery for Economic Loss Following The Exxon Valdez Oil Spill, 23 J. of Leg. Studies 1994, 1. On its facts the Exxon Valdez accident caused enormous physical damage to the environment, that is, to things in the public domain such as shoreline, waters and wildlife. The individual litigants were directly affected as fishermen, tour operators, hotel owners. Their claims were viewed as a specie of pure economic loss. Such accidents, however, could just as well occur in places where thousands of private owners would suffer property losses and consequential economic losses. The threat of an avalanche of claims, therefore, is hardly reduced by the metaphysical nature of the damage, and it is questionable that the law can construct a sensible rule based upon such a distinction.

44. V.P. Goldberg, Recovery For Economic Loss Following the Exxon Valdez Oil Spill, 23 J. Legal Studies 1994, 1.

45. As Prof. Jane Stapleton wrote in a private communication to the authors of these pages: ‘we should not forget that modern procedural reforms, such as statutory provisions facilitating class actions, reflect society’s concern to address the barriers to justice that might otherwise face the mass of victims that can result in today’s complex society from a single piece of wrongdoing. They are a way of addressing, by lowering, the “costs of mass litigation” concern.’

46. The judgment of Griffiths v. British Coal Corporation (23nd Jan. 1998, Q.B.D.) upheld the largest personal injury claim in British history which led to a record settlement of GBP 2 billion being agreed for the benefit of 100,000 ex-miners suffering from a range of chest illnesses, a sum considerably more than government received from the privatization of the coal industry: see J. Stapleton, Legal Cause: Cause-in-Fact and the Scope of Liability for Consequences, 54 V and. L. Rev. 2001, 941 ff., 962, fn. 53.

47. See J. Stapleton, Duty of Care Factors: a Selection from the Judicial Menus, in: P. Cane and J. Stapleton (eds), The Law of Obligations: Essays in Celebration of John Fleming (1998), 59. The author, at 65-66, argues that ‘Concern that, in a particular context, imposition of a duty of care might expose defendants to a large volume of claims (as opposed to an indeterminate number of claims – see below) are unconvincing given that the law is content elsewhere to impose liability where the potential plaintiff class is large. Indeed, it would be very odd if a defendant could argue in favour of his argument that he should not owe a duty that he had many victims!’.

48. For relevant figures see E. Blankenburg, Civil Litigation Rates as Indicators of Legal Culture, in: D. Nelkin (ed.), Comparing Legal Cultures (1997), at 41 ff. where the author discusses the
Consider England and Scotland where the floodgates argument has enjoyed significant success. Should we be surprised that a historically small, close-knit coterie of judges may be sensitive to the question of administrative overload? Does institutional structure and conditioning play a role in this question?

Another relevant issue may be to investigate the way in which broad arguments of this kind circulate in international channels. The ruling ideas of influential exporting legal cultures (not merely substantive law ideas, but 'soft' formants such as the conventional wisdom and dominant policy arguments) clearly have extraterritorial scope and impact. It does not seem accidental that in countries where English and German legal cultures have a decisive sphere of influence (e.g., English influence in Commonwealth countries and the United States; Germanic influence in Austria and Portugal) the floodgates argument has been received almost unquestioned.

It is interesting that in countries where French leadership is acknowledged, one vainly searches for any trace or mention of floodgates anxiety. As stated earlier this discussion is purely speculative. The subject merits deeper investigation, to be carried out through a multidisciplinary approach.

8.2. **IN THE SCALE OF HUMAN VALUES**

A second argument is cast in terms of philosophical values. It maintains that intangible wealth is not and should not be treated on the same level as protecting bodily integrity or even physical property. People are more important than things, and things are more important than money. Our legal interest in liberty, bodily integrity, land, possessions, reputation, wealth, privacy and dignity are all good interests, but they are not equally good. The law protects the better interests better. And so 'a legal system which is concerned with human values (and the law is supposed to reflect the proper values of society) would be right to give greater protection to tangible property than to intangible wealth.'

The exclusionary rule is then a reflection of the lower value ascribed to unrefined wealth. It is important to notice that this view has a silent premise: these interests must be ranked because the law cannot simultaneously protect all interests fully. Even if one accepts, for sake of argument, that wealth is less important than other values, still there would be no justification for a rule restricting its recovery unless we had to do so in order to protect other, more meritorious interests. Thus the philosophical point is persuasive to the extent that: (1) there is indeed a finite limit to the law's ability to protect interests and (2) giving full protection to pure patrimonial wealth would clearly exceed that capacity and therefore impinge on other protections or the interests of third persons.

The first point may be less controversial than the second. No one doubts that resources are finite: Judicial resources are not unlimited; tort liability cannot be extended indefinitely without stifling human initiative; and responsible defendants can be bankrupted by financial claims that leave claims for bodily injury unsatisfied.

It may be argued, therefore, that if pure economic loss were freely protected and allowed to compete on an equal footing with other, worthier claims for limited resources, the effect might be to crowd out 'better' interests and leave them unsatisfied. That conclusion depends, however, on the answer to the second point, namely whether those limits would be surpassed by a presumption of recoverability. The answer to this question again seems to be conjectural since it ultimately depends to some extent upon the same unverified assumptions inherent in the floodgates rationale.

It also raises the question how countries like France and Belgium, which follow a rule of presumptive recovery of economic loss, have managed to avoid what the floodgates argument predicts. Is their experience proof that the argument...
is a gross exaggeration of the consequences, or does their experience tend to prove that these countries are simply using hidden and indirect means of controlling those consequences? There is an additional question.

The exclusionary rule is associated with the negligence standard. All systems, however, permit recovery when pure financial loss is inflicted intentionally. Thus the exclusionary rule cannot be seen simply as an abstract ordering of interests but as a rule tied to the gradations of blame. It would be difficult to say whether the nature of the interest or the nature of the fault is the more important factor in the equation.

Indeed we think it would be essentially misguided to assign such priorities, because the rule, when it is applied and to the extent that it is a rule, is really the outcome of many other interacting factors as well. Not the least of these are many metalegal considerations, such as the size of the plaintiff class, the potential scope of the damages, public policy toward professional standards and so forth, which have varying degrees of cogency in actual context. Only through study of these factors in their liability context will we understand why the alleged rule operates selectively and situationally, never mechanically, and indeed leaves untouched a number of defined situations where one may even speak (as we will see below) of a limited core of protection for pure economic loss.

8.3. IN HISTORICAL PERSPECTIVE

Some scholars assert as a historical matter that pure economic loss has traditionally been left unprotected by the law. If the assertion were generally true, it may have important normative implications for the present and the future. Professor Kötz deduces a teleological point in the evolution of tort law: The primary purpose of the law in England and Germany, he maintains, has ‘always been’ to provide protection against personal injuries and harm to physical property. Pure economic loss seems left out of historical development, at least in those two countries.

Another writer argues that the rules of tort based on foreseeability were developed for physical damage and are not workable outside of the context for which they were developed. The straightforward application of the foreseeability test to claims of pure financial loss would lead to ruinous levels of liability. Because they are products of history, tort rules today are ill-adapted to the problem of pure economic loss.

52. For a nuanced attempt to use various factors in a sliding scale to explain the lesser protection given to pure economic loss, see H. Koziol (ed.), Unification of Tort Law: Wrongfulness (1998), 29-30.
54. B. Feldhusen, Economic Negligence, 2nd ed. (1989), 10-11. The author asserts that the ‘remoteness’ of the damage from the initial conduct of the defendant is the characteristic and endemic issue which distinguishes pure economic loss, as a practical matter, from cases involving physical damage.

Whether these views do justice to the past, however, is open to question. James Gordley’s essay, which explores the history of pure economic loss in some detail, notes that many early civilians said that plaintiff could recover if he suffered ‘damage’ and damage meant simply a diminution of his patrimonium. They did not distinguish between loss of a physical asset and other kinds of loss. They occasionally put cases in which the plaintiff would recover what we today would regard as pure economic loss, though he cautions that they did not know or use this term and did not recognize an autonomous category by that name.

For instance there was the dependent’s action for loss of support due to wrongful death, which clearly existed on the continent in Grotius’ time. This was in effect an action for the recovery of pure economic loss sustained by wife and children, but it was not referred to in those terms. Evidence of this kind would suggest that there was no per se rule against compensation for pure economic harm in the civilian tradition. Indeed, Gordley’s account characterizes the rise of the exclusionary rule both in England and Germany as a late development of the nineteenth century and the peculiar outgrowth of analytical thinking. He concludes that the rule is an ‘accident’ of legal history, not a pervasive feature of it.

9. IN SEARCH OF A COMMON CORE

It is time to appraise to what extent arguments and counter-arguments about the recoverability of pure economic loss helped shape the actual rules of legal systems. Although a full review of the research we mentioned before is beyond the scope of this paper, the results of the study may be briefly summarized in methodological and substantive terms.

55. The Rule Against Recovery in Negligence for Pure Economic Loss: An Historical Accident, in: M. Bussani and V.V. Palmer (eds), Pure Economic Loss in Europe (2003), at 26-29, and ibid., the citations to the views of Daradis, Baldus, Brunnenmann, Lauterbach and Grotius.
57. Insurance practices tend also to show the late development of the rule. Development of business interruption insurance, often called ‘consequential loss insurance,’ belongs to the late nineteenth century, and even now the availability of such insurance is still rather limited. A prevalent restriction is that interruption insurance is essentially ‘follow-on’ coverage to another insured peril, such as fire. Under the wording of standard fire policies, there is no compensation for interruption unless it results from a fire. This is not really compensation for pure economic loss, however, but rather compensation for parasitic loss. See, e.g., G.J.R. Hickmott, Principles and Practice of Interruption Insurance (1982), 3-4; D.C. Jess, The Insurance of Commercial Risks, Law and Practice (1986), 244-251; C. Lahnstein, Pure Economic Loss and Liability Insurance, in W.H. van Boom, H. Koziol and C.A. Witting (eds), Pure Economic Loss (2004), 162: B. Dufta, Insurance in a European Tort Law Perspective, in M. Bussani (ed.), European Tort Law. Eastern and Western Perspectives (2006), 133.
9.1. **ABSENCE OF METHODOLOGICAL COMMON CORE**

Methodologically speaking, the tort scene strikes us as diverse and unsettled. Comparative research reveals that four principal methodologies dominate the European landscape. Though some countries resort to more than one of these methods (thus adding to the complexity) generally each has one characteristic means of dealing with the issue of pure economic loss.

Thus the compensation issue may be left to:

1. flexible causal determinations (the characteristic method found in Spanish, Italian and French regimes);
2. rigid causation techniques aiming straightforwardly to exclude ‘third party loss’ (Croatia, Poland, Sweden and Finland);
3. preliminary judicial screening using a ‘duty of care’ analysis (the approach particularly prominent in England, Scotland); and
4. a scheme – either explicit or covert – of absolute rights that, by deliberate omission, leaves this interest unprotected (the approach of Germany, Austria and Portugal).

Perhaps a simpler way to summarize the position is to say that some regimes rely upon general clauses and start from an inclusive position, but others impose a limited listing of protected interests and start from an exclusionary position. The first group allows recovery in principle, the second denies it on principle. The first grants recoveries through tort actions, the second must deny relief in tort if it cannot find an exception, and failing that, it must turn to para-contractual actions like culpa in contrahendo or contracts with protective effects for third parties. Indeed the resort to contractual actions as a means of overcoming the narrowness of tort protection reveals still another methodological split: Some countries deal with this issue solely in tort while others rely heavily on flexible contractual devices to palliate the sternness of their tort approach.

9.2. **A LIMITED SUBSTANTIVE COMMON CORE**

Whether there is a substantive common core of principles governing pure economic loss could depend to a large extent upon our unconscious reformulation of the question driven by our national traditions and cultures. Yet comparative law, if it teaches anything, teaches us to resist this.

Culture and tradition have summary ways of telling us to which field this question belongs (tort or contract?) and this may project a prejudice about its proper resolution and the coherence or incoherence of national solutions. To those who believe that pure economic loss is the natural preserve of tort, there may be little common core. But to those who would say that it is the natural preserve of contract we think there will appear to be even less common core.

Our comparative and fact-based approach to the question makes us skeptical of these labels. The issue is situated at the frontier of the law of obligations where there is both tort and contract, or where tort behaves like contract and contract behaves like tort. We believe that the existence of a common core can only be discussed in factual terms.

To place the matter in perspective, let us first isolate four areas: (a) consequential economic loss, (b) statutorily protected interests; (c) negligently inflicted economic loss, and (d) intentionally caused economic loss. Out of these will emerge the contours of a ‘limited common core’ on the recoverability of pure economic loss.

(a) Consequential economic loss is in principle recoverable in every system – whether the source of the loss is intentional or negligent conduct, or an activity subject to strict liability. Here is an area of common ground that is worth noting.

(b) The recovery of pure economic loss is not regarded as doubtful when such loss stems from the infringement of statutorily protected interests, such as those protected by antitrust, copyright and patent laws, as well as by State (and its employees) liability laws.

(c) As to negligently inflicted economic loss, we can sort out three areas of agreement.

Pure economic loss turns out to be a head of damage that faces no problem across European countries when plaintiff’s loss is due to negligently performed professional services. There is widespread agreement that the careless notaries, the negligent auditors or the negligent credit rating institutes will be responsible for the economic losses of some persons (beyond their clients) with whom they had no contractual tie. Although there may be specific requirements that must be met in some systems that others do not clearly impose (for example, German and English emphasis on the ‘reliance’ of the third party) still it seems fair to say that in many situations (provided indeterminate and excessive liability is excluded) plaintiffs may recover losses caused by negligent professionals regardless of the general features and traditions of a given legal system. This seems to reflect the collective view that a high standard of professional services can and ought to be maintained.

---

59. The same could be said as to some other fields, particularly the field of ‘business torts’. Although legal systems such as France, the Netherlands, the UK and Portugal handle these problems with the help of the general law of obligations (the 6th book of the Dutch civil code devotes an entire chapter to unfair advertising), these subjects were not dealt with in our general study. Since rules in these areas largely depend on policy factors which are only partially common to our field and would deserve detailed investigation, reasons of space compelled the editors to place limits on the research. For a general survey, Ch. von Bar, The Common European Law of Torts, vol. II (2000), 420-204, 245–249 and, more closely related to our issue, 52–56; W. van Gerven, J. Lever and P. Larouche, Tort Law (2000), 208–248, 358–394.
60. Discussed above, c. 3, s. d.
61. A breach of European Community law may entail liability for pure economic loss. The liability of the Community institutions and its servants in the performance of their duties finds its source in Art. 340(2) EU Treaty (ex Art. 288 (2) EC Treaty). The liability of a member State has its
tort regimes across the spectrum, permit recoveries in such cases. We believe that these results are surely influenced by the absence of the spectre of indeterminate or widespread liability.

(d) All systems agree that intentionally inflicted pure economic loss is recoverable where the conduct in question is regarded as culpable, immoral or contrary to public policy. The significance of this point is of more practical importance than may appear at first sight. Its range of application may be somewhat greater than the narrow liability which the words ‘intentionally inflicted’ harm suggests. In some systems a broad, flexible meaning is given to the ‘intention’ element.63

Besides, it is interesting to observe from the comparative point of view that the shift to higher degrees of culpability tends to broaden the scope of recovery in all systems. This suggests to us that the exclusionary rule should not be conceived as a simple rule based solely on the nature of plaintiff’s damage. The nonmaterial nature of the damage is no more than one element in a complex balancing which decides where and when limits will be imposed in tort. To set up reasonable limits to the recovery, judges, scholars and legislators must consider other important factors as well, including the actor’s state of mind.64

These are the contours of an area of substantive agreement on the protection of pure economic loss. While financial interests are not as comprehensively protected as other interests, there is indeed a considerable core frame of European protection. Should one judge by developments of the past forty years, when this frame has been increasing, one could guess it is likely to continue to grow.

10. THE RECOVERABILITY OF PURE ECONOMIC LOSS WITHIN THE PERSPECTIVE OF A EUROPEAN CODIFICATION

In tune with present European times, one may wonder how the above remarks and results might be of any use to the would-be codifiers of a European Civil Code.


64. The existence of a balancing process is not so apparent in open, liberal systems such as the French which appear to make little use of the distinction between intentional and careless fault, but the complex interaction of scienter with other factors clearly surfaces in the English and German systems. In those systems, where harm is intentionally inflicted, restrictions on the recoverability of the type of harm are dropped, and in addition, concepts of remoteness of causation are relaxed. As David Howarth correctly notes, the overall result is that intentionally removes restrictions on liability that do not exist in other jurisdictions.

To be sure, any codification attempt should be seasoned with – and this applies not simply to tort law but to all subjects – a certain amount of constructive scepticism. Yet, leaving aside any positive or negative bias vis-à-vis the very idea of the Code, as well as the many reasons put forward to deny, support or simply postpone its feasibility, the point is that the inquiry into ‘pure economic loss’ confirms how deeply conscious the code-drafters will need to be about the overall implications of remoulding the law of tort.

10.1. Pure Economic Loss Astride Private Law Frontiers

The kind of awareness that is required in legal debate can be shortly illustrated by consideration of the following.

Throughout our study we have seen the conceptual dependency which exists between underlying contract and property ideas and the law of tort. Suffice it to recall, for instance, the problems raised by the notion itself of pure economic loss, the flexible boundaries that comparative analysis enabled us to draw as to the so-called ‘consequential’ economic loss, as well as, in certain regimes, the great reliance upon contract rules to handle the issue.

Even more strikingly than in other domains, any attempt at codification concerning pure economic loss will therefore be closely dependent on the solutions which the same Code intends to offer in the other fields of private law, mainly with regard to contract and property.

To give further evidence of what I am referring to, I can return to some examples taken from our study. They concern the actual impact on our issue of the choices any legal system can make about the place and use of a series of legal tools, such as: (a) possession, (b) property rights, (c) contract law devices, and (d) rules governing transfer of ownership.

(a) If possession is included in the framework of property rights, or if it is at any rate protected by proprietary remedies, any infringement of possession will permit recovery of the economic loss, regardless that it is called consequential or pure. If possession is not included in the property framework, however, or if the power of control over the thing is not sufficient in and of itself for the holder to be deemed a possessor, then the recoverability of the economic loss caused to the holder (by interference with the thing itself) becomes an issue to be settled.65

(b) If the right to electricity (but the same could apply to hertzian or other electromagnetic waves)66 is deemed a right in rem whose transfer from the supplier to the user is completed as of the date of the agreement, any damage to the system supplying that energy (such as the cutting of power cables) will be considered an infringement of property rights and therefore will raise no problems in any of the European Legal systems.

(c) If the manner in which Germany and Austria apply the notions of ‘culpa in contrahendo’ or the ‘contract with protective effect to third parties’67 is adopted as a model for a European Code, it is beyond doubt that many of the issues raised in pure economic loss cases will be settled by contract principles, with little need to resort to tort law rules.68

(d) Any Code’s infrastructure regarding transfer of ownership would clearly have manifold effects in all the so-called ‘double sale’ cases (where the seller transfers the title to the same property to two different persons). Indeed, the right of the first buyer (solo consensu) to recover her/his pure economic loss from the second buyer depends on a variety of factors, the role of which is actually to define who has the property right in the thing. These factors include the presence of good or bad faith, the completion of delivery (for movables), compliance with formalities like registration and recording (for immovables), and the effects assigned to the registration itself.

10.2. A Destiny To Be Interpreted

All this, once more, shows nothing but what is the real and general problem to cope with, no matter the ‘façade’ of the Code, no matter the purposes of the debate.

Based on our research we agree with a leading comparative law scholar’s remark that whether pure economic loss is placed on the stage of tort or contract ‘is a point of legal technique and not of substance’.69 But precisely under the technical point of view the problem consists in the setting of systematically and socially acceptable boundaries to the shifting of losses incurred by the victim onto another party.70 Whenever this shifting is governed neither by property law nor by


67. The same could be said for notions such as the French concept ‘chaîne de contrats’. This refers to a series of contracts which, though distinct in law, form part of an economic complex. An example can be found in the chain which links a site owner to the contractor, the contractor to the sub-contractor and the latter to the supplier of the building materials. See H. Kötz and A. Flessner, European Contract Law, I, transl. by T. Weir (1997), 255 ff.; H. Beale, A. Hartkamp H. Kötz and D. Tallon (eds), Contract Law (2002), 47 ff. As to this technical notion and its actual impact on the recovery of pure economic losses, see G. Viney, Introduction à la responsabilité (1995), 338 ff.

68. Nevertheless, different technical rules could still exist in each liability regime of liability concerning, e.g., prescriptive periods or rules on the burden of proof. See, in general, J. Cartwright and M. Hesselinl (eds), Precontractual Liability in European Private Law (2009).


70. For a comparative survey of the boundaries between the law of unjust enrichment and tort law, see P Schlechtriem, C Coen and R Hornung, Restitution and Unjust Enrichment in Europe
contract law, it is up to tort law to provide the solution. Thus—and in spite of the positivistic approach some may take—the question of whether or not to award compensation to the victim falls to the interpreter charged with making the choice, that is, the judge and the scholar. Both of these actors have crucial tasks to perform. The scholar has primarily the role of uncovering whatever specific factors in each individual case are crucial to determining the liability. Whilst it may be acceptable for a judge to make conclusionary statements, at least in some systems, no scholar may merely assert that the plaintiff’s damage was proximate, that a duty was justified because the parties were in a ‘special relationship’ or entered into a contract with protective effect to third parties, or that the plaintiff had reasonably relied on the defendant or merely that it was ‘just, fair and reasonable’ to impose the liability. Unless given substantive content, these are just labels. Scholars in their role of decision-inspirers are bound to focus explicitly on why and whether that particular damage was proximate, the relation was special, the reliance was reasonable, and so on.

The judge too, of course, brings his or her own legal culture to bear. S/he has admired or criticized the judicial precedents, and s/he has learnt the opinions of the given authorities at law school. S/he has both an attitude of self-restraint and a reservoir of legal notions, ‘reactions’ and answers stemming from the legal tradition of the country in which s/he lives.

This repertoire may also include the role that the judiciary plays in the given legal framework: a role entailing a variable degree of respect paid to scholarly opinions, to superior court rulings, to the legislature’s prospective or actual choices. Hence, it is no surprise to find that decisions end up being grounded on the balance between the various circumstances of the given case, as qualified, i.e., sized, in legal terms through the overall interpretative culture of the decision maker.

All of this is possibly true of many fields of law. But within private law, at the frontier between contract and tort law in particular, it does seem to be the appropriate way to appraise what the making of law entails. Some might prefer to rephrase the same concept by saying that along this legal frontier there are policy factors which frame the technical outcomes according to changes in social demands. For our purposes, however, the choice of how to phrase the concept is neutral, insofar as the legal notions of change and tradition are essential to our issue too. The point is that the real life of the law constantly reveals its interpretative fate, its interpretative mode of existence. As we have seen, the issue of recoverability of pure economic loss does not escape this fate.

Bibliography


---


S. Lorenz and Th. Riehm, Lehrbuch zum neuen Schuldrecht (2002).
B.S. Markesinis, Litigation-mania in England, Germany and the USA: Are We So Very Different? 49 CLI 1990, 133.
S. Meier, Neues Leistungsstörungsrecht, Jura 2002, 118.
V.V. Palmer, The “Economic Loss Rule” in Global Perspective, With Special Reference to the BP Oil Spill Disaster” (publication forthcoming 2010).
R. Sacco, Diversity and Uniformity in the Law, 49 AJCL 2001, 171.
M. Schwab, Das neue Schuldrecht im Überblick, JuS 1 2002, 1.
R. Schwarz, Unmöglichkeit, Unvermögen und ähnliche Leistungshindernisse im neuen Leistungsstörungsrecht, Jura 2002, 73.
M. Serio, Studi comparatistici sulla responsabilità civile (2007).
Chapter 41
Economic Analysis of Tort Law and the European Civil Code

Michael Faure*

1. INTRODUCTION: THE CONTRIBUTION OF LAW AND ECONOMICS OF TORT LAW TO THE HARMONIZATION DEBATE

In this chapter I address the potential contribution of the economic analysis of law to the debate concerning the need for the harmonization of tort law in Europe. The focus of this chapter will indeed mainly be on this harmonization issue. It is important to stress this since the economic analysis of law could be useful to a study of European integration at various levels.

1.1. A SEARCH FOR PRINCIPLES

A first important advantage of the economic analysis of tort law is that it enables a debate concerning the economic functions of tort law. The economist will not immediately analyse all the legal refinements of the tort law system, which has

* Maastricht University and Erasmus University Rotterdam.