

Pure Economic Loss: A Korean Perspective*

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Abstract

In general, pure economic loss is understood as economic loss without antecedent harm to plaintiff's person or property. Traditionally, pure economic loss was only a topic of interest in the limited number of countries such as Germany, England or the United States. Recently, pure economic loss began to be discussed intensively in the context of the harmonization of tort law, particularly in Europe. Finding out some common principles and rules regarding pure economic loss has been the most essential goal of this recent discussion. It may be difficult to come up with a single, clear-cut solution on this complicated issue. However, it is important to note that almost all the jurisdictions are concerned about the possible indefinite expansion of liability and chilling effect on the economic activity in a substantially similar manner. This explains various attempts to limit the liability for pure economic loss to a reasonable degree regardless of a jurisdiction. It may take different forms from nation to nation, yet substances are fundamentally similar. Korea is no exception to this. In principle, pure economic loss is recoverable under the open-ended tort liability regime under Korean tort law. Since the notion of pure economic loss has generally been used as a conceptual tool to deny or limit its recoverability in the jurisdictions where there is no comprehensive tort liability regime, this notion was hardly known in Korea. However, Korean judiciary also shares the same concern that imposing excessive liability on economic loss in a densely intertwined society may lead to excessively cautious society, curbing the scope of economic activity for fear of liability. Therefore, Korean judiciary has also been striving to limit the liability by using other conceptual tools such as unlawfulness, causation or damage.

This whole analysis leads to a conclusion that Korean tort law may reach a sensible and rational outcome just as other legal jurisdictions, though in somewhat different way and in slightly different conclusion. This commonness implies the feasibility of international collaborative works in this area of law. Therefore, bringing legal experiences in each nation together, discussing the differences and similarities of each approach, and striving to find the common foundation on which the doctrine of pure economic loss is based, is truly a meaningful task.

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I. Introduction

In general, pure economic loss is defined as economic loss without antecedent harm to plaintiff's person or property.¹⁾ Pure economic loss includes loss of income suffered by a family whose principal earner dies in an accident, loss of production suffered by an enterprise whose electricity is interrupted by a contractor excavating a public utility, loss of buyers of firms or shares resulting from a negligent misstatement made by the bank or the auditor,²⁾ or loss of income suffered by owners of hotels and restaurants at the beach that has been severely impacted by an oil spill in the near ocean.³⁾ However, loss arising from paying medical treatment due to the injury, or loss arising from the damage of property itself is not 'pure' economic loss, since the loss arises directly from the physical damage on person or property. This type of loss is generally called consequential economic loss as opposed to pure economic loss mentioned previously.⁴⁾

This notion of pure economic loss has been widely recognized in some countries including Germany, England, or the United States in order to limit or deny the compensability of economic loss. According to what we may call pure economic loss rule, these countries normally reject recovery for stand-alone economic loss by a negligently committed act, while granting recovery for economic loss that results directly from some other kind of injury to physical body or property. However, the term, pure economic loss, is rarely recognized and used in Korea. Perhaps most judges and practitioners may not be aware of this concept. Even most legal scholars, unless they have expertise in this field of law, may not have heard of this terminology. Since the term 'pure economic loss' itself is quite foreign to Korean jurists and scholars, there is relatively few Korean legal literature that directly focuses on this issue.⁵⁾ For the same reason, intense

1) BUSSANI AND PALMER, *PURE ECONOMIC LOSS IN EUROPE* 5 (2005).

2) See *Hedley Byrne & Co. Ltd v. Heller & Partners Ltd.* AC 465 (1964).

3) The Exxon Valdez oil spill occurred in Prince William Sound, Alaska in 1989 gave rise to this issue. For details on oil spill and pure economic loss, see Victor P. Goldberg, *Recovery for Economic Loss following the Exxon Valdez Oil Spill*, 23 J. LEGAL. STUD. 1 (1994).

4) Robert J. Rhee, *A Production Theory of Pure Economic Loss*, 104 NW. U. L. REV. 49 (2010).

5) See e.g. Sangjoong Kim, *A Study of the Liability for Pure Economic Loss* HUMAN RTS. AND

and in-depth discussions taking place abroad regarding the compensability of pure economic loss do not draw enough attention from Korean legal academia.

Yet, this notion is not useless in Korea. In reality, issues substantially related to pure economic loss are actually discussed, though in different forms. Korean tort law, as in tort law in other jurisdictions, confronts the sensitive conflict between the necessity to render a remedy to those who suffer from economic loss and the necessity to keep the floodgate shut against potential excessive lawsuits seeking for the protection of premature economic interests. In order to draw a fine borderline between recoverable and unrecoverable economic interests, the notion of 'unlawfulness,' 'causation' or 'damage' is often used. In short, these conceptual tools replace the pure economic loss doctrine in limiting the scope of tort compensation to a reasonable degree. Therefore, the rationales underlying the pure economic loss doctrine are taken into consideration in Korean tort law as well. Accordingly, gaining some comparative perspectives remains highly meaningful, even from the Korean stand point of view. For the same reason, introducing the approach employed by Korean courts and legal academia may play some significant role in the comparative study on pure economic loss.

Against this backdrop, I intend to introduce how Korean tort law deals with the issue of pure economic loss in this brief paper. This paper is structured as follows. Part II explains the pure economic loss rule in Germany, England and the United States, where this notion has been widely used. Part III gives a general account of pure economic loss rule from theoretical perspective. Part IV provides the general overview on Korean tort law, which is an essential prerequisite in understanding Korean approach toward pure economic loss. Part V deals with specific cases and related doctrines regarding pure economic loss in order to facilitate deepened understanding on Korean approach. Finally, part VI sums up the previous discussion and suggests what it implies.

JUST., Vol. 328 (2003) (S. Korean); Taeyoung Yoon, *Infringement on Business Interest and Unlawfulness*, CIVIL LAW JOURNAL, Vol. 30 (2005) (S. Korean).

II. Comparative Overview

Despite the ostensible clarity of the notion of pure economic loss, there is discrepancy on the rules governing this notion among jurisdictions. This does not necessarily follow the familiar common law/continental law divide.⁶⁾ For instance, Germany, definitely a continental law country, is hesitant toward the compensability of pure economic loss, as in common law countries like England and America.⁷⁾ Meanwhile, France, Italy or Japan do not recognize the notion of pure economic loss. Korea falls into the latter category. The decisive feature of the countries recognizing this peculiar notion is that they take a casuistic approach in tort law.

1. Germany

Germany enumerates the types of torts in German Civil Code (hereinafter 'BGB') § 823 and § 826. Negligent torts against pure economic interests do not qualify any of the requirements under these provisions.⁸⁾ Therefore, pure economic loss is normally not entitled to compensation under German tort law.

This attitude of BGB was based on Roman law tradition as well as prevailing opinion among scholars in the 19th century.⁹⁾ Although there was controversy whether or not to adopt a general tort provision as is found in French Civil Code § 1382 and § 1383, the First Commission which was in charge of drafting BGB in the late 19th century decided to take a different approach.¹⁰⁾

BGB § 823 (1) protects people from intentional or negligent act harming the life, body, health, freedom, property or other rights of another person.

6) Francesco Parisi, *Liability for pure financial loss: revisiting the economic foundations of a legal doctrine*, in *supra* note 1 at 75.

7) JAMES GORDLEY & ARTHUR TAYLOR VON MEHREN, AN INTRODUCTION TO THE COMPARATIVE STUDY OF PRIVATE LAW 309 (2006).

8) *Id.*, Vor §823 Rn 14f.

9) See. e.g., BERNHARD WINDSCHEID, LEHRBUCH DES PANDEKTENRECHTS 2, 7TH ED. (1891), § 451, 455.

10) JAMES GORDLEY, FOUNDATIONS OF PRIVATE LAW 271-272 (2006).

Pure economic interest does not have its place in this provision. Although it is theoretically feasible to categorize pure economic interest as a form of 'other rights,' courts and academia have not accepted this interpretation.¹¹⁾ Meanwhile, BGB § 823 (2) states that the breach of a statute that is intended to protect other people gives rise to liability, and § 826 goes on to say that a person who, in a manner contrary to public policy, intentionally damage on another person is liable for the damage. Since these provisions do not limit the form of rights or interests entitled to protection, even pure economic interests are entitled to protection. However, this is only so when there is a statute intended to protect pure economic interests or an intentional tortious act that is contrary to public policy. In this regard, the compensability of pure economic loss is significantly restricted.

2. England

In England, pure economic loss is normally not recoverable, as in Germany.¹²⁾ In the long-standing common law tradition, one has to have a specific cause of action in order to file a tort lawsuit. Traditionally, an independent cause of action for the recovery of pure economic loss by negligent act was unknown. It was only in the 19th century that an action for negligence in general was first recognized. However, whether or not one could recover for pure economic loss in negligence action was still not obvious. In the late 19th century throughout the 20th century, there were several court decisions where compensation for pure economic loss was denied.¹³⁾ The most cited decision in this regard is *Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors) Ltd.*¹⁴⁾ It was a typical blackout case where the plaintiff, the factory owner, was deprived of electricity due to the negligent act of the defendant who cut the electric cable leading to the plaintiff's

11) G. Wagner, in Münchener Kommentar zum Bürgerlichen Gesetzbuch, vol 5., Schuldrecht Besonderer Teil III, 5th ed (2009), §823, Rn 184.

12) See e.g. W.V.H ROGERS, WINFIELD AND JOLOWICZ ON TORT, 15th ED. 134 (1998).

13) *Cattle v. The Stockton Waterworks. Co.*, [1875] L.R. 10 Q.B. 453; *Simpson & Co., v. Thomson*, [1877] 3 A.C. 279 (H.L.)(U.K.); *Anglo-Algerian Steamship Co. Ltd. v. The Houlder Line, Ltd.*, [1908] 1 K.B. 659; *Morrison Steamship Co. Ltd. v. Greystoke Castle*, [1947] A.C. 25, 280 (H.L.)(U.K.).

14) [1973] 1 Q.B. 27.

factory in the process of excavating work. The judgment in this case has outlined that there are two types of economic loss: economic loss consequential on physical damage and pure economic loss. Only the first is in principle recoverable.

However, pure economic loss rule is not without exception. In *Hedley Byrne & Co Ltd. v. Heller & Partners Ltd.*,¹⁵⁾ the Court dealt with the case where the defendant negligently issued an erroneous statement on the financial status of a certain company and the plaintiff suffered economic loss by relying on this statement. The Court ruled that the relationship between the parties was “sufficiently proximate” as to create a duty of care, since the defendant could reasonably have known that the statement might be relied on by the plaintiff for entering into a contract of some sort. This would give rise to the negligence liability on the defendant even though the loss suffered by the plaintiff was purely economic. However, on the facts, the disclaimer was found to be sufficient enough to discharge any duty created by the defendant’s actions. Anyhow, this decision implies that the scope of the compensability of pure economic loss in England has the possibility of expansion through broadening of the duty of care.

3. United States

Like in England, the United States has also established the pure economic loss rule that normally denies compensation for pure economic loss. The rules in two countries are very similar to each other.¹⁶⁾

The pure economic loss rule in the United States derives its modern authority from Oliver Wendell Holmes’s opinion in *Robins Dry Dock & Repair Co. v. Flint*,¹⁷⁾ wherein the Supreme Court held that a charterer could not recover for economic loss resulting from negligent harm to the owner’s boat.¹⁸⁾ Federal Courts have generally accepted the broad interpretation of

15) [1964] A.C. 465.

16) Fleming James, Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 45-46 (1972).

17) 275 U.S. 303, 304 (1927).

18) Rhee, *supra* note 4 at 50.

the *Robins*, and rejected the most of the pure economic loss cases.¹⁹⁾ Another milestone case in this regard is *Ultramares Corporation v. Touche* handed down in 1932.²⁰⁾ This case, like *Hedley* in England, concerned the liability arising from misstatement. At issue was the liability of the defendant who issued a negligent audit statement relied on by the plaintiff. Here, Judge Cardozo held that the claim in negligence failed on the ground that the auditors owed the plaintiff no duty of care, there being no sufficiently proximate relationship. In his reasoning to the conclusion, he expressed his concern to “liability in an indeterminate amount for an indeterminate time to an indeterminate class.” This contains the core concern against compensation for pure economic loss.

However, a number of states began to allow new forms of claims in negligence that eventually led to compensation for pure economic loss.²¹⁾ For example, courts now widely recognize suits by non-client parties against “professionals.”²²⁾ Scholars have also raised their voices against strict limitation on the recovery for pure economic loss. Just to name one, Professor Richard Epstein rejected the traditional negligence rule that barred recovery for pure economic loss as “both unjust and inefficient.”²³⁾ Thus, pure economic loss rule is still in the process of formulation in the United States.

III. Theoretical Basis of Pure Economic Loss Rule

At a glance, discussion on pure economic loss looks highly diverse and complicated. However, it narrows down to a single question of how one should define the scope of compensation in economic interest related tort litigations. Corrective justice, perhaps the most important theoretical

19) For the list of federal court decisions, see Ronen Perry, *The Economic Bias in Tort Law*, U. ILL. L. REV. 1573, 1579 n.25 (2008).

20) 174 N.E. 441 (1932).

21) Jane Stapleton, *Comparative Economic Loss: Lessons from Case-Law-Focused “Middle Theory”*, 50 UCLA L. REV. 531, 536 (2002).

22) *Id.* at 537.

23) Richard A. Epstein, *Causation and Corrective Justice: A Reply to Two Critics*, 8 J. LEGAL STUD. 477, 502 (1979); quoted from *Id.* at 573.

foundation of tort law, calls for correcting the injustice that the defendant has inflicted on the plaintiff. Compensation of loss is a typical remedy against the wrong in this regard. However, it is not easy to say what loss is compensable and what is not. It is one thing to say that someone suffers from certain loss, while it is another thing to say that someone else should be held responsible for that loss. The notion of pure economic loss lies at the center of this sophisticated issue. It has been used, mainly in Germany and common law countries, to represent economic losses that cannot be recovered through tort lawsuits. There are several arguments to explain how this denial or restriction can be justified.

1. *Floodgates Argument*

In modern societies where so many interests are intertwined with each other in a close proximity, a single wrongdoing can make a series of negative impact on an endless chain of economic interests. For instance, a tortious act against an enterprise inflicting severe economic loss may in turn affect economic interests of its creditors, employees, or shareholders. Now, they may also have their own creditors, employees or shareholders whose interests are subsequently affected by this incident. There might be a spouse and children of the employee who are adversely affected as well. If these adverse outcomes can be labeled as economic losses, then one might say that the wrongdoer should be held liable for all the economic losses that would not have occurred if the wrongdoing had not taken place. However, imposing limitless liability on the act may chill general activities that people or enterprise carry out on a daily basis for fear of legal risks they might face. This consequently leads to over-deterrence, resulting in a chilling effect on non-negligence conduct.²⁴⁾ For this reason, it is too naïve to say that a wrongdoer is responsible for whatever loss he or she has incurred.

Rudolph von Jhering has eloquently put this concern in the following sentences.²⁵⁾

24) David B. Gaebler, *Negligence, Economic Loss, and the U.C.C.*, 61 *IND. L.J.* 593, 612 (1986). He argues that the line between negligent and non-negligent conduct is not clearly delineated, and this may lead to the deterrence of useful activity as well.

25) R. von Jhering, "Culpa in contrahendo oder Schadensersatz bei nichtigen oder nicht

‘Where would it lead if everyone could be sued, not only for intentional wrongdoing (dolus) but for gross negligence (culpa lata) absent a contractual relationship! An ill-advised statement, a rumor passed on, a false report, bad advice, a poor decision, a recommendation for an unfit serving maid by her former employer, information given at the request of a traveler about the way, the time, and so forth – in short, anything and everything would make one liable to compensate for the damage that ensued if there were gross negligence despite one’s good faith’

This fear for “liability in an indeterminate amount, for an indeterminate time, to an indeterminate class”²⁶⁾ justifies the doctrine of pure economic loss. This justification is often cited as “the floodgates argument,”²⁷⁾ meaning that the doctrine of pure economic loss functions as a floodgate against flood of unlimited and unreasonable liability or flood of lawsuits seeking for such remedy. This rationale is not only directed to protecting a tortfeasor from excessive liability, but also to providing the general public with a certain degree of assurance that they will not run incalculable risk of compensating endless chains of economic loss incurring from their negligent act.

2. Efficiency Argument

From the perspective of economic analysis of law, pure economic losses are not entitled to compensation because they are not social losses.²⁸⁾ At this point, one needs to remember that the ultimate purpose of tort law, from

zur Perfektion gelangten Verträgen,” JHERINGS JAHRBÜCHER 4, 12-13 (1861); quoted from GORDLEY & TAYLOR, *supra* note 7 at 309.

26) *Ultramares v. Touche*, 174 N.E. 441, 444 (N.Y. 1931).

27) For example, see Helmut Koziol, *Recovery for Economic Loss in the European Union*, 48 ARZ. L. REV. 871, 875 (2006).

28) Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735, 736-737 (2006). Also see W. Bishop, *Economic Loss in Tort*, 2 OXFORD J. LEGAL STUD. 1 (1982).

the law and economics viewpoint, is to minimize total social costs.²⁹⁾ According to this logic, economic harm to one often means economic gains to another, thereby not incurring any social costs.³⁰⁾

An illustration given by Richard Posner may facilitate understanding of this argument.³¹⁾ Suppose that A owns a store and B is a builder who is using a crane for the construction of a building next to A's store. Through B's negligence, the crane falls on the public sidewalk directly in front of the store, blocking the entrance and thereby forcing the store to close until the crane is removed and the sidewalk repaired, which might take several days. Should A be allowed to Sue B for the profits lost while the store is closed?

Judge Posner explains that the answer given by the pure economic loss rule is negative.³²⁾ He explains that A's lost profits are, in the language of economics, a 'private' cost rather than a 'social' cost.³³⁾ A social cost is a diminution in the total value of society's economic goods, while a private cost is a loss to one person that produces an equal gain to another.³⁴⁾ In the above illustration, A's lost profits are offset elsewhere and are therefore merely a private cost, since A's customer will shop elsewhere, thereby incurring profit to A's competitor.³⁵⁾ Therefore, A's pure economic loss cannot be compensated. This is not so if the crane has damaged A's property directly where social costs incur. This is not pure economic loss and thus compensable.

However, the above argument supposes certain conditions. In the first place, it presupposes perfect market, which is not always in existence in the real world. It also presumes that the transition of the customer from A to B does not incur any social costs, which may not be the case in a real transactional setting. Further, the above argument is based on the idea that

29) See generally, Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 *YALE L. J.* 499 (1961).

30) *Id.* at 737.

31) The illustration is from *Id.* at 736-737.

32) *Id.* at 736. Also see, e.g., 532 *Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*, 750 N.E.2d 1097, 1103 (N.Y. 2001).

33) *Id.* at 736-737.

34) *Id.* at 737.

35) *Id.*

the purpose of tort law is to minimize the social costs, as opposed to private costs, of accidents. Nevertheless, the adequateness of this perspective has long been fiercely debated.³⁶⁾ Here, it suffices to mention that the persuasiveness of the above argument is dependent on the soundness and the feasibility of these presumptions.

3. *Contract-related Argument*

Interestingly enough, at least from the viewpoint of civil law scholars, the rule of pure economic loss encourages parties to adopt contractual solution.³⁷⁾ This rule presupposes the following; contract offers protections to pure economic loss while tort law doesn't.

In contract law, the contracting parties are subject to liability for pure economic loss incurred from the breach of contract by one of parties, as long as it has been bargained for in the contract. This is unanimously accepted in every jurisdiction including England, United States and Germany where pure economic loss is, in principle, not compensable under their respective tort laws.

Then, why does tort law not extend protection to pure economic interest while contract law does? Underlying rationale is as follows. Individuals are the best judges of their own interests. This is no exception to interests that are pure economic. Therefore, the law should encourage people to make a contract over pure economic interests whenever they can. By making contract, they can optimally design in advance so that the risks of potential pure economic loss are duly allocated between them. This reduces the uncertainty and enhances efficiency. Denying the compensability of pure economic loss by tort law encourages people to negotiate and make a contract concerning pure economic loss.³⁸⁾ After all, this attitude presumes the primacy of contract over tort law.

This is sometimes described as the boundary-line function of pure economic loss rule. The pure economic loss rule is intended to maintain the

36) See *PHILOSOPHICAL FOUNDATIONS OF TORT LAW* (David G. Owen ed., 1995).

37) Dan B. Dobbs, *An Introduction to Non-statutory Economic Loss Claims*, 48 *ARIZ. L. REV.* 713, 716 (2006).

38) *Alejandre v. Bull*, 153 P. 3d 864, 868 (Wash. 2007).

boundary between contract law and tort law.³⁹⁾ By drawing a clear line between two areas of law, people are encouraged to handle the issue of pure economic loss on their own in the form of a contract, which is far more desirable than just leaving the issue to the tort law.

However, the above argument is valid only in cases where making a contract is feasible. In reality, there are a great number of other cases where making a contract in advance is nearly impossible. For example, it is nearly impossible for an oil carrier company to negotiate in advance with every single potential victim over possible pure economic loss that might incur from future oil spill. In this regard, the ambit of the above argument remains very narrow.

III. General Overview on Korean Tort Law

1. *Open-ended Tort Regime*

As I have described above, the approach toward pure economic loss is heavily dependent on the approach taken by tort law in respective countries. Therefore, it is necessary that one understand Korean tort regime in order to understand Korean approach toward pure economic loss.

Korean tort law is based on relevant provisions contained in Korean Civil Code. As it is the case with most continental law countries, this Code encompasses vast areas of private law, including the law of property and secured transaction, the law of obligation, the law of unjust enrichment, the law of torts, and even as far as family and inheritance law. Article 750 - 766 in the Code deal with various aspects of torts.

As shown in Article 1382 and 1383 of the French Civil Code, and in Article 709 of the Japanese Civil Code, Korean Civil Code also offers a general provision providing a comprehensive set of requirements for tort actions. The first Article that appears in the tort subsection, Article 750, states that anyone who causes losses to or inflicts injuries on another person by an unlawful act, either intentionally or negligently, shall be bound to

39) Level 3 Communications, LLC. v. Liebert Corp., 535 F.3d 1146, 1162 (10th Cir. 2008).

make compensations for damage. It states that the liability for torts require four elements; unlawfulness, willfulness or fault, damage and a causal connection between the act and the damage.⁴⁰⁾ This functions as a prevailing principle over the whole regime of Korean tort law.

This provision is wide and flexible enough to embrace the protection of a variety of legal rights and interests. Korean tort law not only protects what we call absolute rights, such as rights of liberty, bodily integrity or ownership over property, but also other legitimate interests including emotional or economic interests.⁴¹⁾ The substantive comprehensiveness, or emptiness to put it differently, gives enough room for differentiated judicial law-making in the process of adjudicating an individual case.

The comprehensive tort system, as is witnessed in Korean tort law, opens up the possibility of holding the defendant liable for any loss, be it emotional or economic. This is in contrast with a casuistic approach in common law countries or in Germany. In the first place, the compensability of non-pecuniary loss reveals the discrepancy between two approaches. For instance, common law countries as well as some civil law countries such as Germany, Greece and Netherlands limit the compensability as well as the scope of compensation for emotional loss.⁴²⁾ In contrast, there is no limit set forth by provision as to the compensability of non-pecuniary loss in Korean tort law like in Belgium, France and Spain.⁴³⁾ Same divergence can also be observed in the realm of pure economic loss. Article 750 of Korean Civil Code does not discriminate pure economic loss from other forms of damage arising out of physical injury or direct infringement on property. Here, the focus is not on the type of the damage. Rather, the focus is on the general requirements set forth by a general tort provision. According to the prevailing interpretation of Article 750 in Korea, the requirements for constituting a tort action are as follows; intention or negligence,

40) Besides these requirements set forth in Article 750, Article 753 and 754 presupposes the requirement of liability capacity.

41) Note that Article 750 of Korean Civil Code does not require infringement of 'rights.' (cf. see Article 709 of Japanese Civil Code).

42) See W.V.H. Rogers, *Comparative Report of a Project Carried Out By the European Centre for Tort and Insurance Law*; in W.V.H. ROGERS (ED.), *DAMAGES FOR NON-PECUNIARY LOSS IN A COMPARATIVE PERSPECTIVE* 246 (2001).

43) *Id.*

unlawfulness of the act, and the damage arising out of the act (causation and damage). If these requirements are satisfied, whether or not the loss is purely economic makes no difference.⁴⁴⁾

2. Key Factors Concerning Pure Economic Loss; Unlawfulness, Causation and Damage

Among the above-mentioned requirements, three factors play a key role in adjudicating cases concerning pure economic loss. They are unlawfulness, causation and damage. Since understanding these concepts is essential in understanding decisions regarding pure economic loss, I will explain these elements in turn.

1) Unlawfulness

Korean tort law explicitly requires unlawfulness for a tort. However, unlawfulness is a highly vague and abstract concept. Unlawfulness is generally construed as the state of being in violation of the legal order. In many cases, the existence of unlawfulness is easy to clarify since there are a great number of statutes that provide concrete, detailed rules and standards by which unlawfulness is determined. Yet, there are still many cases where no specific norms by which unlawfulness is measured are provided. In addition, certain legal provisions from different statutes even collide against each other, making it troublesome to determine unlawfulness. Further, it is widely accepted among jurists and scholars that the law in the context of 'unlawfulness' incorporate 'unwritten law' as well as 'written law,' which makes the notion of unlawfulness even more complicated. Even when there are clear legal standards by which unlawfulness is measured, it is not always easy to apply them to a specific case. In these gray areas, a judge has to decide the case relying on his or her notion of what the general legal order demands. This usually requires the balancing of relevant legal interests. Judges specify legal interests at issue and weigh these interests in light of the specific context of the case. This ad-hoc approach may impair predictability to a certain degree, but secures

44) In addition, there are individual legislations that explicitly recognize compensatory liability for pure economic loss in specific areas such as unfair competition and antitrust.

flexibility that may reach far enough to secure the adequate compensability of pure economic loss.

Some pure economic loss cases call for in-depth deliberation on unlawfulness. Intentional interference with contractual relationship is perhaps one of the most typical examples of this. Whether or not the interfering party is subject to tort liability is heavily dependent on the evaluation of the unlawfulness of the interfering act. This is examined more in detail later on in this paper.

2) *Causation and Damage*

Causation is another tricky concept. To begin with, factual causation is required to impute damage to the defendant. However, factual causation itself can be extended indefinitely. Theoretically speaking, the chain of factual causation can reach as far as the mother's act of giving birth to the wrongdoer. Yet, it does not make any sense to impute the damage to the wrongdoer's mother. Therefore, imposing liability on whoever provided a factor with factual causation may lead to ever-increasing scope of liability. With this in mind, Korean courts, in striving to define the reasonable scope of liability, have been using the notion of 'adequate causation.'⁴⁵⁾ According to this doctrine, there should be adequate causation between the tortious act and the damage. In other words, courts normatively evaluate the existence of causation.

Another concept to look at in this regard is damage. The section 1 of Article 393 provides that compensation for breach of contract is allowed for 'ordinary damage.' The section 2 of the same Article goes on to stipulate that 'special damage' is compensated only if it was foreseeable. Ordinary damage is damage that occurred according to the usual course of things. On the other hand, special damage is damage that occurred due to the unusual specific circumstances. The prevailing opinion interprets Article 393 in light of adequate causation. They explain that this Article embodies underlying rationale of adequate causation. Ordinary damage is damage that has adequate causation with the breach. Special damage is deemed to

45) This notion is believed to have been borrowed from Germany, where it has been used in order to limit the scope of compensation to the reasonable degree under total recovery principle.

have adequate causation only when the breaching party could have foreseen it. Historical research reveals that this provision might have been influenced by famous Hadley case in England⁴⁶⁾ via Article 416 of the Japanese Civil Code. Interestingly, Article 393 of the Korean Civil Code that governs the law of contract is also applied *mutatis mutandis* to the tort law by Article 763. Therefore, this ordinary/special damage divide plays a significant role in tort law.

3. Broad Judicial Discretion on Adjudicating Pure Economic Loss Cases

Unlawfulness, adequate causation, ordinary damage, and foreseeability requirement for special damage all function together to limit the scope of liability within a reasonable degree.⁴⁷⁾ These safety valves enable courts to exclude some types of economic loss cases, thereby preventing flooding of the frivolous cases and excessive liability.

Using these general concepts to deal with pure economic loss, rather than employing a separate doctrine for the issue, leads to the possibility of broader judicial discretion in tort litigations. In exercising judicial discretion, courts strive to balance interests of both parties; on one hand, the interest of the plaintiff for a remedy against loss he or she has suffered, and on the other hand, the interest of the defendant to pursue economic goal without fear of indeterminate and overwhelming liability. Within the flexible framework of Korean tort law, courts make evaluative judgments based on their policy decisions to come up with sound outcomes.

It is not certain if Korean judges, in adjudicating pure economic loss cases, take economic efficiency into consideration, as the law and economic approach suggests. As mentioned earlier in this paper, a key factor in determining the optimal economic loss rule is the relationship between pure economic loss and social loss, according to the economic analysis of law.⁴⁸⁾ The basic rationale is that economic loss should be compensable in

46) Hadley v. Baxendale, 156 Eng. Rep. 145 (1854).

47) Another floodgate against excessive expansion of the tort liability is the rule that damage should be certain, concrete, specific and real in order to be compensated. Mere speculative and unripe damages are not entitled to compensation.

48) See Francesco Parisi et al, *The comparative law and economics of pure economic loss*, 27 INT

torts only to the extent that it corresponds to a socially relevant loss.⁴⁹⁾ This explains the limited recoverability of pure economic loss. However, Korean judges do not seem to use the notion of private loss and social loss, at least explicitly. Instead, they seem to rely on the notion of corrective justice. That is, Korean judges will strive to work out a conclusion that satisfies their sense of justice. In this process, the limit will be set forth on the compensation for pure economic loss, thereby preventing boundless and intolerable expansion of liability. In doing so, judges flexibly use and weigh different factors in determining the outcome, as Walter Wilburg has stated in his famous idea of a flexible system.⁵⁰⁾

The breadth of judicial discretion by utilizing flexible concepts in tort law explains the lack of need to expand the contractual remedies to fill the gap in Korea. In some jurisdictions where difficulties in embracing pure economic loss in the narrow rule in tort law exist, they attempt to expand the law of contract, when necessary, in order to provide an adequate remedy.⁵¹⁾ This is not the case in Korea. Tort law is wide and flexible enough to embrace various types of pure economic loss disputes. One of the representative examples is the case regarding pre-contractual relationship. Instead of extending contractual obligation to the negotiation process, Korean courts regard it as a matter of tort when the would-be party negotiating for a contract breaks off the negotiation in violation of good faith.⁵²⁾

IV. Korean Cases and Legal Doctrines regarding Pure Economic Loss

Economic loss can arise in many different forms: interference with

L. REV. L. & ECON. 29, 37 (2007).

49) *Id.*

50) WALTER WILBURG, DIE ELEMENTE DES SCHADENSRECHTS (1941).

51) The example of gap-filling contractual remedies is found in Germany where the doctrine of *Schutzwirkung zugunsten Dritter* (prospective effect of a contract for the benefit of third party) has been employed to allow a third party to bring a contract claim against the infringer.

52) See 'B. Breaking off the Negotiation' part of this paper for further illustration.

contractual relationship, an employer deprived of the services of an employee; a child losing the financial support of her father; or factories suffering from blackout due to the negligent actions during road construction that damaged a municipality's electric cables. A common question out of these various types of accidents is if the parties harmed by these activities are entitled to compensation for their losses.

Given the diversity of the cases, dealing with every type of pure economic loss in this short paper seems unfeasible. For that reason, I will introduce four types of cases (including one hypothetical one) - intentional interference with contractual relationship, breaking off negotiation, blackout, and traffic congestion - to manifest the Korean approach toward pure economic loss.

1. Intentional Interference with Contractual Relationship

One of the most frequently disputed types of pure economic loss is intentional interference with contractual relationship.

To begin with, Korean legal doctrines, in principle, rely on the distinction between absoluteness and relativity of rights. This refers to the idea that there are two types of rights; absolute rights which can be claimed against everybody and relative rights that can only be claimed against a certain party. For instance, ownership of a thing belongs to the former type of rights since it can be claimed everybody, whereas contractual right belongs to the latter type of rights since it can only be claimed against the other contracting party. According to this doctrine, contractual rights are only to be interfered by the other party, but not by the third party outside the contractual relationship.

However, this rule is not always without exceptions. As mentioned above, Korean tort law provides a general provision that does not limit the scope or type of rights that are legally protected. Contractual rights, though not as conspicuous as proprietary rights, are undoubtedly legitimate rights worth protecting. In line with this, Korean courts recognize, though prudently, the interference with contractual relationship as one of the torts.⁵³⁾

53) See Supreme Court Decision 4285Minsang129, Delivered on Feb. 21, 1953. This is the

In adjudicating this type of tort, courts usually take two values into consideration; the need to protect legitimate contractual rights and the need to guarantee individual freedom and free competition. These two values are seemingly conflicting with each other. However, courts strive to figure out a proper solution in each individual case in the midst of this conflict.

According to the Supreme Court rulings,⁵⁴⁾ the obligee's rights are not preclusively protected. Thus, the basic rule is that the third party can make a contract with one of the contract party even when it may be in conflict with the pre-existing contractual right of the other contract party. This is reflection of free competition in the area of contract law. However, the principle of free competition in transactional affairs presumes fair and sound competition within the boundaries allowed by legal order. Accordingly, tort is found where the third party knowingly interferes with the obligee's rights by violating the statute or sound social policy and other social order, etc. On finding the tortious interference with contractual relations, the Court considers contents of obligation, attitude of tortfeasors, and existence of intention or intent to prejudice, and decide each case individually. The Court also considers economic and social policy factors such as freedom of transaction and public interests. Another notable feature of the Supreme Court decisions regarding interference with contract is that intention plays a key role in recognizing tort. So far, no Supreme Court decision ruling in favor of the plaintiff in case of negligent interference is found.

Since the liability for interference with contractual relationship is decided on an *ad hoc* basis, the Supreme Court denied liability in some decisions,⁵⁵⁾ but recognized liability in other decisions.⁵⁶⁾ Below are some notable cases where liability was recognized.

first decision that mentioned the possibility of the tortious interference of contractual relationship.

54) See *e.g.* Supreme Court Decision 2000Da32437, Delivered on Mar. 14, 2003.

55) See Supreme Court Decision 99Da38699, Delivered on May. 8, 2001.

56) See Supreme Court Decision 2004Da55320, Delivered on Sep. 8, 2006.

1) *Infringement of the Exclusive Right to Sell*

In this case,⁵⁷⁾ A, the sole supplier of goods, agreed to grant 'exclusive right to sell' to B, a seller. According to the contract, A would be in breach of the contract if A were to supply items to anyone other than B. B sold this exclusive right to C. Therefore, A was to supply goods to B under an original contract between A and B, and in turn B was to let C sell those goods under the second contract between B and C. In short, if every contract was performed soundly, C was to be the final and sole retailer of the goods. However, A knowingly supplied goods to a third party. This was in direct infringement of the original contract between A and B, consequently making it impossible for B to perform his duty to C under the second contract between B and C. C brought a lawsuit against A, claiming that he has suffered economic loss due to A's infringement of the contractual relationship between B and C.

The Supreme Court ruled that A's supply of the goods in breach of the contract between A and B also constituted a tortious action against C, on the basis of intentional interference with contractual relationship. The Court stated that mere knowledge of the exclusive contract was not sufficient to constitute a tortious interference. Rather the Court stated that intent to prejudice or another unlawful intent was required. In this case, according to the reasoning of the Court, "A's act of selling in the open market after the grant of exclusive right to sell cannot be anything but improper and wrongful." The Court specifically focused on A's culpability. In the above case, B together with C has warned A several times to stop distributing goods to the third party. However, A continued on with its transaction. This was also in violation of trademark act, since the items which were not to be sold to the third party other than B carried B's registered trademark. These factors altogether were key factors in determining A's act against C as unlawful.

2) *Boycott by Civic Organizations Resulting in the Breach of Contract*

Another intriguing case is about a nationwide boycott by civic

57) Supreme Court Decision 2000Da32437, Delivered on Mar. 14, 2003.

organization leaders.⁵⁸⁾ An entertainment company invited a world-famous singer, Michael Jackson, to have a concert in Korea. When this plan was known to the public, several civic organizations launched a nationwide boycott, claiming that having Michael Jackson in Korea would undermine the morality of Korean society because he was allegedly involved in child sex abuse at the time. They also asserted that minors who were to be the prospective audience for the concert would have to pay for expensive tickets, and this would eventually lead to the waste of foreign currency. Leaders of these organizations declared a boycott against all the companies related to this concert. Among them were two commercial banks that have been commissioned by the entertainment company to sell concert tickets on its behalf. The boycotters warned banks of a possible negative campaign if they did not stop selling tickets for the concert instantly. Accordingly, the banks repudiated the contract with the entertainment company and stopped selling tickets. Therefore, the company had to spend extra costs to hire extra persons to sell tickets manually.

The entertainment company sought compensatory damages against the leaders of the civic organizations, claiming that intimidating banks to stop selling tickets and causing consequential damages to the plaintiff constituted a tort. The Court of First instance denied the claim on the ground that the boycott activity was within reasonable boundary of legal order and the banks rather voluntarily made a decision to repudiate the contract for fear of leaving negative impression to people. This decision was also affirmed by the Appellate Court.

However, the Supreme Court reversed the decision by the lower courts. The Supreme Court especially noted the fact that the defendants intentionally interfered with the contractual relationship between the banks and the plaintiff. The fact that the defendants allegedly pursued public interest through this boycott did not give them a total exemption from the liability. They could have used other means to pursue their goal (i.e. directing the boycott to the entertainment company or holding a demonstration) than to interfere with contractual relationship.

The appropriateness of the outcome remains disputed. However, in the

58) Supreme Court Decision 98Da51091, Delivered on Jul. 13, 2001.

case where it is difficult to draw a line between lawful and unlawful boycotts, it is interesting to note that the Supreme Court used the criterion of 'intentional interference with contractual relationship' in affirming unlawfulness of the campaign.

2. *Breaking off the Negotiation*

Breaking off the negotiation is another economic loss case relating to contract. Generally, a contract is formed through negotiation between two parties. In light of the freedom of contract, it is totally up to parties whether or not to make a contract. Even when the decision of one party to break off the negotiation causes economic loss to the other party, this is not *per se* illegal. Therefore, a party is free to negotiate and is not liable for failure to reach an agreement.⁵⁹⁾

However, the Supreme Court suggests that the breaking party may be held liable when it is contrary to good faith. To be more specific, if a party has incurred economic loss to the other negotiating party by refusing to make a contract after he has created proper expectation or confidence to the other that the contract will certainly be made, the breaking party is liable under tort law.⁶⁰⁾ This is another form of pure economic case under Korean tort law.

Following is a case in which the Supreme Court held the defendant liable under this type of tort.⁶¹⁾ The plaintiff in this case was a sculptor. The defendant, the Korean Export Association, extended invitations to five sculptors including plaintiff to submit a tentative draft for a sculptural work commemorating total amount of export reaching 100 billion dollars. According to terms and conditions specified in the invitation to make an offer, the defendant was to enter into a contract with the successful applicant.⁶²⁾ The draft submitted by the plaintiff was chosen by the

59) See Principles of European Contract Law, Article 2:301 (1).

60) Supreme Court Decision 99Da40418, Delivered on Jun. 15, 2001.

61) Supreme Court Decision 2001Da53059, Delivered on Apr. 11, 2003.

62) In this case, the plaintiff argued that the contract was concluded when his draft was chosen by the defendant. On this ground, the plaintiff claimed that the defendant was liable for breach of contract. However, court ruled that the invitation made by the defendant toward five sculptors was only an invitation to make an offer, since key elements of the contract, such

defendant. However, the defendant has been deferring necessary measures to conclude a contract with the plaintiff for nearly three years. Finally, the defendant entered into a contract with another sculptor contrary to the expectation of the plaintiff. The Court ruled that this constituted a tort in light of the good faith principle.

Worth noting is that the Court has adopted tort approach instead of contractual approach in dealing with the case. Instead of recognizing some sort of quasi-contractual relationship between two negotiating parties, the Court chose to apply general tort law.⁶³⁾ This can be possible thanks to the comprehensive and flexible tort system in Korea.

3. *Blackout*

Blackout refers to the loss of light or power due to a specific accident regarding electricity facilities. When this happens, it does not only incur damages to the facility itself, but also to people who benefit from electricity. The secondary damages include damages that are purely economic. Therefore, a blackout case also raises the compensability issue. There have been a number of blackout cases in Korea so far. Following is one of them.⁶⁴⁾

In this case, the defendant's employee was driving a defendant's truck. He drove negligently, smashed into an electric pole. Due to this crash, the lower part of the pole was impaired, and this caused blackout in the nearby area for approximately 7 hours. The pole was located in a factory complex area, where plenty of factories were in operation at the time. Among these factories was the factory run by the plaintiff. Since the pole was used in delivering electricity to the factory, the plaintiff suffered from this unexpected blackout. In the first place, the machine in the factory was abruptly stopped and physically damaged. In addition, the plaintiff was not able to produce goods for a time being. This also incurred economic loss. The plaintiff brought a lawsuit against the defendant under Article 760

as price, time and place of performance, were lacking. Therefore, the acceptance by the defendant was additionally required. Unfortunately, it did not actually take place.

63) This approach is also taken in Supreme Court Decision 2002Da32302, Delivered on May. 28,2004.

64) Supreme Court Decision 94Da5472, Delivered on Dec. 26,1996.

of the Korean Civil Code,⁶⁵⁾ seeking for compensation of his loss.

It was evident that there was certain amount of damages to the plaintiff. The existence of a factual causation between the tort committed by the defendant's employee and the loss suffered by the plaintiff seemed quite clear. However, if the above losses were all compensable was still at issue.

The Supreme Court ruled that damages due to an impaired machine and loss to potential profit were special damages, as opposed to ordinary damages. According to Article 393, special damages are recoverable only when they could have been foreseen by the defendant. In this specific case, the Supreme Court held that the physical damages to the machine were foreseeable by the defendant's employee. The Court especially noted the fact that the electric pole was located in the midst of the factory complex, and inferred that the defendant's employee could have foreseen destructive impact caused by the accident on the machine in the factory that was in operation. However, the Court denied the foreseeability of consequential economic loss to the business profits that the plaintiff could have gained otherwise. The Court held that this economic loss was too remote and speculative to be compensated.

4. *Traffic congestion*

Although there is no case regarding traffic congestion inflicting economic loss, the short analysis of a hypothetical case might be helpful in understanding Korean attitude toward this type of tort.

Let us say that A caused a traffic accident negligently, and it consequently blocked the highway. As a matter of course, this accident gave rise to severe traffic congestion. B was one of many drivers and travelers on the highway who were unfortunately caught up by the traffic. At the time, B had an extremely important deal awaiting him. It was certain

65) According to Article 756, an employer or a master is vicariously liable for the act of an employee or a servant. Once a master-servant relationship is proved and the damage has been caused by the servant, it is highly improbable that the master be excused of the liability. Although the article allows the master to be exempted from the liability by showing either 1) he has properly selected and supervised the servant or, 2) the damage would have occurred even if he had fulfilled his duties mentioned above, Korean courts almost never accept these allegations in practice.

that this could bring him the profit of \$ 100,000. However, due to the traffic congestion, he was late for the deal and was not able to close it in his favor. For that reason, the important transaction that could have benefited B, did not take place. Now, B is suing A for suffering economic loss of \$ 100,000.

From B's point of view, it would be unfair for him to bear the risk incurred by A's negligent driving. Nevertheless, granting relief over this sort of loss is likely to result in the expansion of liability for the remote consequences of a wrongful act. Consequently, it would result in the flood of frivolous litigations and, in turn, the shrinking of economic activity for fear of bearing unforeseeable risks. It will also hike administrative costs of the society as well. Therefore, B is not likely to recover his loss from A, had it happened in Korea. Korean courts have several options in dismissing B's claim. It may deny B's claim for the lack of causation between the traffic accident and the B's failure to close the deal. It may also deny the claim stating that the loss does not qualify as ordinary damages, and that A could not foresee B's peculiar circumstance.

V. Conclusion

Traditionally, pure economic loss was only a topic of interest in the limited number of countries such as Germany, England or the United States. Recently, pure economic loss began to be discussed intensively in the context of the harmonization of tort law, particularly in Europe.⁶⁶⁾ Finding out some common principles and rules regarding pure economic loss has been the most essential goal of this recent discussion. It may be difficult to come up with a single, clear-cut solution on this complicated issue. However, it is important to note that almost all the jurisdictions are concerned about the possible indefinite expansion of liability and chilling effect on the economic activity in a substantially similar manner. This explains various attempts to limit the liability for pure economic loss to a reasonable degree. It may take different forms from nation to nation, yet substances are fundamentally similar. Korea is no exception to this. In

66) See BUSSANI AND PALMER, *supra* note 1.

principle, pure economic loss is recoverable under the open-ended tort liability regime under Korean tort law. Since the notion of pure economic loss has generally been used as a conceptual tool to deny or limit its recoverability in the jurisdictions where there is no comprehensive tort liability regime, this notion was hardly known in Korea. However, Korean judiciary also shares the same concern that imposing excessive liability on economic loss in a densely intertwined society may lead to excessively cautious society, curbing the scope of economic activity for fear of liability. Therefore, Korean judiciary has also been striving to limit the liability by using other conceptual tools such as unlawfulness, causation or damage.

This whole analysis leads to a conclusion that Korean tort law may reach a sensible and rational outcome just as other legal jurisdictions, though in somewhat different way and in slightly different conclusion. This commonness implies the feasibility of international collaborative works in this area of law. Therefore, bringing legal experiences in each nation together, discussing the differences and similarities of each approach, and striving to find the common foundation on which the doctrine of pure economic loss is based, is truly a meaningful task.

KEY WORDS: ?????????????????????????????

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