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Reconstructing the Taiwanese Rule on Pure Economic Loss: Establishing a General Standard for Recovery for Pure Economic Loss in Unintentional Torts

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RECONSTRUCTING THE TAIWANESE RULE ON PURE ECONOMIC LOSS:

ESTABLISHING A GENERAL STANDARD FOR RECOVERY FOR PURE ECONOMIC LOSS
IN UNINTENTIONAL TORTS

Wen-Hsuan Yang

Submitted to the faculty of Indiana University Maurer School of Law

in partial fulfillment of the requirements

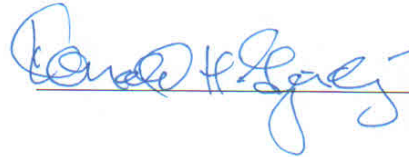
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Master of Laws – Thesis

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Thesis Committee



Professor Donald H. Gjerdingen

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For My Parents

Chien-Lung Yang and Yu-Chin Lee

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Abstract

An important issue in Taiwan today is whether pure economic loss can be recovered as a right under the former part of first paragraph of Article 184 in Civil Code of Taiwan, thereby making it recoverable in unintentional torts. Contrary to most scholars in Taiwan, this Thesis argues that 1) pure economic loss should be a recognizable harm under the former part of first paragraph of Article 184; and 2) economic loss should be considered on a category-by-category basis, rather than the traditional all-or-none basis presently used in Taiwan.

Traditionally, two arguments are made against recovery for pure economic loss in Taiwan. First, it creates an unnecessary conflict between tort law and contract law. Second, it potentially creates indeterminate liability for the defendant. Based on practices with pure economic loss in foreign jurisdictions (particularly the United States), however, both concerns can be accommodated. This Thesis argues that Taiwan should adopt, by statute, a category-by-category approach for recovery for economic harm as the best way to protect rights of innocent victims without risking indeterminate liability for defendants.

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Introduction

Under the law in Taiwan today, an important issue is whether the unintentional infliction of pure economic loss of a person is recovered as a right under the former part of first paragraph of Article 184 in Civil Code of Taiwan. In response, this Thesis argues that pure economic loss should be recognized as harm under the former part of first paragraph of Article 184 and also suggests a proper standard for recovery.

Generally, pure economic loss refers to pecuniary loss that does not flow from physical harm to a victim's person or property.¹ For example, assume a company hires a public accountant to do auditing works and to issue financial reports to satisfy potential buyers of its solid financial status. The financial statements are negligently made and fail to disclose the company's insolvency. Relying on the report, a potential buyer invests in the company and later suffers a loss when, soon after, the company files for bankruptcy.² The lost profit by the potential buyer is an example of pure economic loss.

Recovery for pure economic loss is an open issue in Taiwan. Courts and scholars are divided.³ Moreover, even if we defer to Taiwanese Supreme Court's decisions to grant such recovery,⁴ the standard for recovery is open to debate.

¹ For more details on common law definition of pure economic loss, see *Indianapolis-Marion Cnty. Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722 (Ind. 2010); *Harris v. Suniga*, 149 P.3d 224 (Or. App. 2006); and RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM §2 (Tentative Draft No.1, 2012).

² For similar cases, please refer to *Ultramares v. Touche*, 174 N.E 441 (N.Y. 1931); *Bily v. Arthur Young & Co.*, 834 P.2d 745 (1992); *Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913 (Tex. 2010); *Nycal Corp. v. KPMG Peat Marwick LLP*, 668 N.E.2d 1368 (1998); and *First Nat'l Bank v. Crawford*, 386 S.E.2d 310 (1989).

³ Although Supreme Court of Taiwan implied that pure economic loss could be recoverable under negligence according to the former part of first paragraph of Article 184 in Civil Code of Taiwan, Professor Tzechien Wang, an outstanding scholar in the field of the Civil Code of Taiwan, argued against such interpretation. See Zuigao Fayuan, 77 Nian 19 Tze Minschi Di Er Chuehyi (Supreme Court of Taiwan, The

To solve the issue, looking at American common law on recovery for economic harm is helpful.⁵ Under the American common law, pure economic loss generally is not recoverable unless accompanied by physical harm to the victims;⁶ however, it is recoverable where professionals such as accountants or attorneys negligently issue opinions and others rely, to their detriment, on their work.⁷ In all, three approaches are used. First, some cases use the usual foreseeability test in tort law.⁸ Second, others require privity between the professionals and the third parties.⁹ Finally, others rely on § 552 of the *Restatement (Second) of Torts* and limit the professional's liability to intended third parties.¹⁰

Because of the current ambiguity in Taiwan about recovery for pure economic loss, this Thesis proposes the adoption of a statute to clarify the standard and to protect individual rights. In turn, the main focus of this Thesis will be which is these three common law standards for recovery of pure economic loss best conforms to the policy concerns and the spirit of Civil Code of Taiwan.¹¹

Second Decision of 19th Civil Case Convention, Nov. 01, 1988) CHUEHYI HUIBIAN vol. 1, 1040 (2001) and Wang Tzechien, *Chin Chuan Hsing Wei Fa* (Tort Law) 375-426 Taipei: San Min Book Co., Ltd., 2011.

⁴ Supreme Court of Taiwan once held a defendant liable for a shop owner's lost profits resulting from the defendant's negligent infliction of the shop's electrical cables during construction works. *Zuigao Fayuan*, 91 Nian Tai Shang Zi No. 2096. (Tai Shang Zi No. 2096 by Supreme Court of Taiwan, Mar. 17, 2002).

⁵ Although Professor Tzechien Wang claimed that pure economic loss is hardly a question in the American common law, research into this topic may suggest otherwise. See *supra* footnote 3 for Prof. Wang's book at 390.

⁶ See RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY §21 (1998).

⁷ See *supra* note 2.

⁸ *H. Rosenblum, Inc. v. Adler*, 93 N.J. 324 (1983).

⁹ *Ultramares v. Touche*, 174 N.E. 441 (N.Y. 1931).

¹⁰ *Nycal Corp. v. KPMG Peat Marwick LLP*, 668 N.E.2d 1368 (1998) (Supreme Court of Massachusetts applied RESTATEMENT (SECOND) OF TORTS § 552 (1977)).

¹¹ Readers may also find a liability for accountant malpractice in Article 20 in Securities and Exchange Act of Taiwan. However, this Thesis will not discuss the liability in Securities and Exchange Act because of its purpose of proposing a general standard for recovery for pure economic loss in several other civil cases.

For English version of this rule, see the website below:

<http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=G0400001>.

This Thesis focuses on a comparative review of Taiwanese tort law and the American common law for option on how best to implement the spirit of Civil Code of Taiwan.¹² First, this Thesis analyzes Article 184,¹³ Article 213,¹⁴ and Article 216¹⁵ in Civil Code of Taiwan, along with judicial opinions, law review articles, and other secondary authorities to survey the present status of recovery for pure economic loss in Taiwan and why it's insufficient. Second, this Thesis compares the law on recovery for economic loss in Taiwan with the American common law. In part, this is done because the pure economic loss rule has a deeper and more comprehensive history in the American common law. Third, this Thesis will use Economic Analysis of Law to study and justify both the imposition of duties on professionals and the limits of that liability.¹⁶ Finally, this Thesis will determine which of the three American approaches for pure economic loss in professional malpractice is the best for Taiwan.

Chapter One first reviews the current treatment of pure economic loss under Article 184 of the Civil Code of Taiwan. Chapter One then will briefly address the need for legislation to stipulate a clear rule to protect individual rights. Finally, Chapter One also illustrates how recovery for pure economic loss matters in daily business matters and why providing clear standards here serve the general public.

Chapter Two briefly introduces the tort law of Taiwan. Since Taiwan is a Civil Law country, this chapter focuses on several general statutes — including Article 184, Article

¹² For more comparisons on pure economic loss rule in countries in addition to the United States, please refer to Vernon V. Palmer & Mauro Bussani, *PURE ECONOMIC LOSS: NEW HORIZONS IN COMPARATIVE LAW* (2009).

¹³ It is a rule about tort cause of action in Civil Code of Taiwan.

¹⁴ It is a rule about methods of compensation in Civil Code of Taiwan.

¹⁵ It is a rule about coverage of recovery in Civil Code of Taiwan.

¹⁶ Economic Analysis of Law is generally applied to tort law to define duty. See *United States v. Carroll Towing Co.*, 159 F.2d 169 (2d Cir. 1947) for Judge Hand's famous Hand Formula, B<PL test.

213, and Article 216 in the Civil Code of Taiwan¹⁷ — to consider recovery for pure economic loss in unintentional torts. This Chapter also considers the *Second Decision of 19th Civil Case Convention* in which Taiwanese Supreme Court addressed the relationship between Taiwanese contract law and Taiwanese tort law.¹⁸ Finally, this Chapter considers whether the Court’s decision and the Civil Code of Taiwan is adequate for pure economic loss.

Chapter Three gives an overview of American common law Torts. This Chapter first describes the structure of American tort law, along with how recovery for pure economic loss has been treated in different areas. This includes unintentional torts (including products liability), public nuisance,¹⁹ and negligent malpractice. Finally, this Chapter considers various policy arguments of recovery for pure economic loss under professional malpractice, as well as three different standards for recovery.²⁰

Chapter Four is heart of the Thesis. First, the Chapter identifies several possible approaches to recovery for pure economic loss. Second, it uses Economic Analysis of Law to provide justification for imposing a duty to prevent pure economic loss of another as well as limits on the scope of liability.²¹ Third, it suggests policy arguments for imposing a duty to prevent economic harm on professionals, thereby making it a Tort. Fourth, after comparing the Civil Code of Taiwan and American Tort law, it argues for the adoption of the common law pure economic loss rule by Taiwan. Fifth, it argues, based

¹⁷ See *supra* note 13-15.

¹⁸ Zuigao Fayuan, 77 Nian 19 Tze Minschi Di Er Chuehyi (Supreme Court of Taiwan, The Second Decision of 19th Civil Case Convention, Nov. 01, 1988) CHUEHYI HUIBIAN vol. 1, 1040 (2001).

¹⁹ Generally, all offenses one suffers in public nuisance involve an interference with the interests of the community at large- interests that were recognized as rights of the general public entitled to protection. *State v. Lead Indus., Ass'n, Inc.*, 951 A.2d 428, 444 (R.I. 2008). See also RESTATEMENT (SECOND) OF TORTS §821B (1979).

²⁰ See *supra* notes 8-10.

²¹ See *supra* note 16.

on the experience of foreign jurisdictions, that a statute is the best method of clarifying recovery for pure economic loss in Taiwan. Finally, after proposing a tentative rule, this Chapter will illustrate how the new proposed rule will apply, using hypotheticals from real cases.

Chapter Five then summarizes how Taiwanese courts should treat pure economic loss before and after the proposed legislation.

Chapter One

The Problem of Pure Economic Loss

1.1 The Origin and Importance of Recovery for Pure Economic Loss

Pure economic loss refers to pecuniary loss that does not flow from physical harm to a victim's person or property.²² Although no issues on recovery for pure economic loss arise in intentional tort because scienter of the tortfeasor satisfies the requirement of foreseeability of harm to particular victims, recovery for pure economic loss in unintentional tort is more controversial.²³ Professor Tzechien Wang, an outstanding scholar in the field of the Civil Code of Taiwan, argues that pure economic loss is not recoverable in unintentional tort. He relies upon the first paragraph of Article 184 in the Civil Code, the tort cause of action in Taiwan, provides as follows:

A person who, intentionally or negligently, has wrongfully damaged the *rights* of another is bound to compensate him for any injury arising therefrom; the same rule shall be applied when the injury is done intentionally in a manner against the rules of morals.²⁴

Professor Wang notes the former part of the rule protects one's individual *rights* from harm and the latter part of the rule protects one's *interests*.²⁵ As pure economic loss is the harm to *interests* rather than individual rights, he argues that pure economic loss is not recoverable harm under the former part of first paragraph of Article 184.²⁶ In addition, he argues that pure economic loss can be recovered in contract law and that since contract

²² See *supra* note 1.

²³ The Thesis uses unintentional tort to distinguish it from intentional tort in order to include the discussion on recovery for pure economic loss in strict products liability. The term "negligence" may not effectively serve this task.

²⁴ CIVIL CODE (Taiwan), <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=B0000001>.

²⁵ Wang Tzechien, *Min Fa Shiue Shuo Yu Pan Li Yan Jiou Di Ba Tse* (Research of Civil Law Theory and Cases, Volume Eight) 246. Taipei: San Min Book Co., Ltd., 2009.

²⁶ *Id.*

law provides a more efficient way to protect economic interests, recovery for pure economic loss in unintentional tort is unnecessary.²⁷ Taiwanese courts are divided on the issue. While some court opinions follow Professor Wang’s approach,²⁸ the majority interprets “rights” to include recovery for pure economic loss.²⁹

The issue of recovery for pure economic loss is a challenging topic because of a conflict between two strong and separate policy concerns — protecting innocent victims and preventing indeterminate liability.³⁰ Although it is natural for victims to claim damages when harmed, it also is difficult to ignore concerns about indeterminate liability, especially when the plaintiff recovers for such intangible harm.³¹ As Justice Cardozo suggested in *Ultramares v. Touche*, “if liability for negligence exists [in recovery for pure economic loss], a thoughtless slip or blunder may expose the defendant to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.”³² As a matter of fact, indeterminate Tort liability harms society because the interests and risks of taking certain actions will be difficult to predict.³³

While Professor Wang’s argument against recovery for pure economic loss is based on his interpretation of “interests” under Article 184, it’s also possible to recognize economic loss under the “rights” language of Article 184. For example, pure economic

²⁷ *Id.* at 300-01.

²⁸ Taipei Ti Fang Fa Yuan 93 Nian Lao Su Zi No. 106 (Lao Su Zi No. 106 by Taiwan Taipei District Court, Sept. 14, 2004).

²⁹ Zuigao Fayuan, 91 Nian Tai Shang Zi No. 2096 (Tai Shang Zi No. 2096 by Supreme Court of Taiwan, Mar. 17, 2002); Zuigao Fayuan, 88 Nian Tai Shang Zi No. 1827 (Tai Shang Zi No. 1827 by Supreme Court of Taiwan, Aug. 13, 1999); Taichung Ti Fang Fa Yuan 93 Nian Su Zi No. 951 (Su Zi NO. 951 by Taiwan Taichung District Court, Mar. 30, 2005); and Zuigao Fayuan, 77 Nian 19 Tze Minschi Di Er Chuehyi (Supreme Court of Taiwan, The Second Decision of 19th Civil Case Convention, Nov. 01, 1988) CHUEHYI HUIBIAN vol. 1, 1040 (2001).

³⁰ See *supra* note 3 for Prof. Wang’s book at 377-78.

³¹ *Id.*

³² See *supra* note 2 for *Ultramares v. Touche* at 444.

³³ This argument derives from the application of Economic Analysis of Law. Please see *Infra* chapter four for analysis.

loss is recoverable, in limited cases, in the American common law where a professional negligently performs services knowing a limited group of parties intend to rely on his work and do to their detriment.³⁴ Also, Professor Wang argues that contract law provides a more efficient forum for pure economic loss. Indeed, if parties are in privity of contract, indeterminate liability in tort may devour the law of contract.³⁵ However, if a plaintiff not in privity suffers pure economic loss, such as the negligent misrepresentation case mentioned earlier, imposing a tort liability may a better alternative.³⁶

Thus, under the current approach, a victim's recovery for pure economic loss is considered on an all-or-nothing basis under Article 184. If the court declines to allow recovery for pure economic loss, the result may be unfair and unjust to the victims since the magnitude of economic harm to them may sometimes be too large to absorb.³⁷ The goal of this Thesis, therefore, is to provide an interpretation that both protects innocent victims and avoids unlimited liability in tort. Three claims will be proposed:

- 1) Not allowing recovery for pure economic harm under the former part of first paragraph of Article 184 in Civil Code of Taiwan unfairly limits recovery for innocent victims;
- 2) Recovery for pure economic loss, properly understood, is about policy concerns about coverage of recovery rather than whether pure economic loss is harm to individual rights or interests; and
- 3) A proper standard for recovery for pure economic loss should be established under a category-by-category basis to properly balance concerns over indeterminate liability with protection of innocent victims.

³⁴ See *supra* note 2 for *Nycal*.

³⁵ Grant Gilmore, *THE DEATH OF CONTRACT* 87-94 (1974).

³⁶ The accountant's liability for negligent misrepresentation in Securities and Exchange Act is also a tort liability to third parties. See *supra* note 11.

³⁷ In arguing against recovery for pure economic loss in unintentional tort, Professor Wang takes pure economic loss suffered through the interruption of electricity for example and suggests that such harm is usually minor. See Wang Tzechien, *Min Fa Shiue Shuo Yu Pan Li Yan Jiou Di Ba Tse* (Research of Civil Law Theory and Cases, Volume Eight) 296 Taipei: San Min Book Co., Ltd., 2009.

1.2 Constitutional Obligations for the Legislature to Stipulate Clear Rules Regulating Recovery for Pure Economic Loss in Unintentional Torts

It is natural for an injured person to claim recovery, whether that injury is physical harm or intangible harm.³⁸ Pure economic loss is intangible harm, a kind of pecuniary loss which does not flow from one's person or property.³⁹ Although this Thesis argues for the recovery for pure economic loss, it does not argue for recovery in every unintentional tort case. The core issues, instead, are what the standard for recovery should be and how that standard best protects individual rights.⁴⁰ Here, two relevant constitutional claims help frame and clarify why the legislature should clarify the standard for recovery for pure economic loss in unintentional tort.

A. The Requirement of Protecting Individual Rights — The Right of Property Defined

According to Article 15 in the Constitution of the Republic of China,⁴¹ the right of existence, the right of work, and *the right of property* shall be guaranteed to the people. Since the right of property is the basis of social and economic development of a country, the government needs not only to refrain from interfering with the right but also to establish a legal system to protect it.⁴² According to *SHIZI No. 400*,⁴³ the guarantee of right of property under Article 15 in Constitution of the Republic of China is to guarantee

³⁸ See *supra* 7.

³⁹ See *supra* note 1.

⁴⁰ A clear and well-developed legal system helps protect individual rights, and a government has a duty to stipulate required legislations. See Lee Huitsung, Xianfa Yao Yi (Essentials of Constitution) 253-78, 279-94 Taipei: Angle Publishing Co., Ltd., 2006.

⁴¹ MINGUO XIANFA art. 15 (1947) (Taiwan).

⁴² See *supra* note 40 at 254-55.

⁴³ Grand justices make up a committee and enjoy the unique authority of interpreting the Constitution of the Republic of China. After they decide a case, they issue a *SHIZI* with a series of number coming after the name. Therefore, *SHIZI* is the most authoritative document for research on Constitution of the Republic of China. See Article 5 in the ADDITIONAL ARTICLES of the CONSTITUTION OF THE REPUBLIC OF CHINA.

an individual the right to use his property, to profit from it, and to dispose of it freely. This function allows the individual to claim the removal of the interference to his right of property.⁴⁴ With the development of society, however, a claim of obligation is also included in the right of property.⁴⁵ Thus, the right of property should include every right the law intends to give a person, including the right to enjoy the economic value of property.⁴⁶ This would include the right to claim pure economic loss.⁴⁷ In addition, the limitation on right of property should be done in accordance with Article 23 in Constitution of the Republic of China, which limits restrictions on property to those necessary to protect the rights of others.⁴⁸

B. The Requirement of Clearly-defined Legal System — To Protect Individual Rights

The Constitution also requires a clearly defined legal system. According to Article 16,⁴⁹ the people shall have the right to present petitions, lodge complaints, or institute legal proceedings. The right to institute legal proceedings, as right of property does, requires the government to establish law to carry out that protection.⁵⁰ Such rights originate from the basic premise that where there is a right, there is a remedy.⁵¹ Thus, the government has a duty to establish fair litigating proceedings.⁵² As was stated by grand

⁴⁴ See also Article 767 in CIVIL CODE of Taiwan.

⁴⁵ See SHIZI No. 106 and SHIZI No. 292.

⁴⁶ See *supra* note 40 at 257 and SHIZI No. 451.

⁴⁷ How the standard for recovery for pure economic loss should be is a question of law and is the core issue of the Thesis.

⁴⁸ All the freedoms and rights enumerated in the preceding Articles shall not be restricted by law except by such as may be necessary to prevent infringement upon the freedoms of other persons, to avert an imminent crisis, to maintain social order or to advance public welfare. MINGUO XIANFA art. 23 (1947) (Taiwan). See also *supra* note 40 at 268.

⁴⁹ MINGUO XIANFA art. 16 (1947) (Taiwan).

⁵⁰ See *supra* note 40 at 283

⁵¹ *Id.* at 280. See also SHIZI No. 396.

⁵² SHIZI No. 442.

justices in *SHIZI No. 574*, the essential of right to institute legal proceedings is to ensure that people could enjoy due process and get remedies when their rights are violated. Thus, to implement a remedy for every right, the government should establish a well-developed legal system to help people recover damages when there is harm to individual rights and to help people exercise their rights when there is interference.⁵³ Finally, similar to the limitation on right of property, the restriction on rights to institute litigations should also conform to Article 23 in Constitution and is subject to proportionality.⁵⁴

1.3 Categories and Illustrations of Economic Harm: Solving the Issue of Pure Economic Loss Serves the Interests of the General Public

For laypeople, economic harm happens every day. For example, assume a person is hit by a motor vehicle, taken to a hospital, and then received a bill for medical expenses. The economic harm here suffered here came from injury to his person, for example, if his arms or his legs were broken. As another example, assume a person crashed his friend's laptop. Here, the friend also suffered economic harm from injury to his property. In both cases, the economic harm victims suffered by the victims is *physical* harm to their person or property, not pure economic loss.⁵⁵

In contrast, pure economic loss is pecuniary loss which does *not* flow from physical harm to person or to property.⁵⁶ A few illustrations can illustrate what “pure” economic harm is.

⁵³ See *supra* note 40 at 281-83.

⁵⁴ The Principle of Proportionality requires that the method and the purpose should fit. See *supra* note 40 at 111 and *SHIZI No. 507*.

⁵⁵ See *supra* note 1.

⁵⁶ *Id.*

A. Harm to Product Itself: Economic Harm in Products Liability

A buyer brings a tort claim for recovery for loss of use suffered and personal injuries caused by the defendant's negligent design of a vehicle.⁵⁷ The loss of use is usually called harm to property itself, and is recognized as pure economic loss.

B. Economic Harm in Public Nuisance⁵⁸

Because of the constructor's negligence, an underground railway collapses and a shop nearby must shutdown down for several weeks. The owner of the shop brings a tort claim for recovery for lost income during the shut down.⁵⁹ In another case, a business owner is trapped at the scene of a car accident and, as a result, fails to meet a contract and loses millions of dollars. Both cases illustrate pure economic loss.

⁵⁷ See also *East River Steamship Corp. v. Transamerica Delaval Inc.*, 106 S. Ct. 2295 (1986).

⁵⁸ See *supra* note 19.

⁵⁹ See also *532 Madison Ave. Gourmet Foods, Inc.*, 96 N.Y.2d 280 (2001).

C. Economic Harm in Negligent Misrepresentation

Company A hires B, an accountant, to do audit works and issue financial reports for Company A. When agreeing to do the works, the accountant knows the report will be disseminated to potential buyers of the company. However, B negligently made the auditing reports and fails to disclose Company A's insolvency in the reports. A relying third party then invests in Company A and lost profits in his investment.⁶⁰ The harm to the third party is pure economic loss.

D. Economic Harm in Negligent Performance of Service

An attorney negligently drafts a will, causing a beneficiary to lose a gift of \$50,000.⁶¹ Since the beneficiary does not become the owner of the property because of the error, the harm suffered by the beneficiary is not physical harm to properties but pure economic loss.

⁶⁰ See also *Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913 (Tex. 2010) and Illustration 7 to RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM §5 (Tentative Draft No.1, 2012).

⁶¹ See also *Id.* at Illustration 1 to §1 in tentative draft of Restatement.

Chapter Two

Tort Law and Pure Economic Loss Rule — A Summary of Law in Taiwan

2.1 Negligence Law Under Article 184 of the Civil Code

A. Overview:

This chapter summarizes Taiwanese tort law. Taiwan inherits Civil Law system from Germany and thus has statutes governing all civil liabilities.⁶² For Torts, these include the tort cause of action,⁶³ methods of recovery,⁶⁴ and coverage of recovery.⁶⁵ In addition, since pure economic loss, at times, involves conflicts between contract law and tort law,⁶⁶ this chapter also covers Taiwanese court opinions about that relationship.

B. Taiwanese Tort Law — What a Plaintiff Needs to Prove

Article 184 of the Civil Code of Taiwan establishes the basis of tort cause of action. It provides that:

A person who, intentionally or negligently, has wrongfully damaged the *rights* of another is bound to compensate him for any injury arising therefrom. The same rule shall be applied when the injury is done intentionally in a manner against the rules of morals.

A person, who violates a statutory provision enacted for the protection of others and therefore prejudice to others, is bound to compensate for the injury, except no negligence in his act can be proved.

⁶² See *supra* note 24.

⁶³ Article 184 in CIVIL CODE (Taiwan).

⁶⁴ Article 213 in CIVIL CODE (Taiwan).

⁶⁵ Article 216 in CIVIL CODE (Taiwan).

⁶⁶ For example, pure economic loss is generally not recoverable in strict products liability because harm to product itself should be the question for contract law or warranty law. See *supra* note 6 and note 57.

Under this provision, therefore, a plaintiff who brings a tort action must prove seven elements.⁶⁷

1) Defendant's Acts:

Society values liberty and individualism. Thus, no one could be held liable for the actions of another person.⁶⁸ Therefore, the plaintiff's injury must be caused by the defendant's acts. This includes situations where the defendant aggressively hurts the plaintiff; where the defendant uses another person to achieve his goal of hurting the plaintiff; and where the plaintiff is under a duty to act but fails to do so, harming the plaintiff.

2) Defendant's Acts Are Tortious

Whether the defendant's acts are tortious depends on whether there are affirmative defenses such as self-defense or plaintiff's consent. For example, in self-defense, the defendant hurt the plaintiff because the plaintiff hurt him first. Under such circumstances, the defendant's act was not tortious because it was self-defense.

⁶⁷ The following text about requirements of tort law of Taiwan is cited and modified from Liu Cheuntang, Pan Jie Min Fa Jai Bian Tung Tze (Case Analysis on General Prov. of Obligation of the Civil Code) Taipei: San Min Book Co., Ltd., 2001, 76-83. Please refer to it for more details.

⁶⁸ An exception to individualism in tort law is vicarious liability, the responsibility of the superior for the acts of their subordinate. For example, an employer shall be jointly liable for his employee's negligence according to Article 188 in the Civil Code of Taiwan.

3) Defendant's Acts Hurt Plaintiff's Rights or Interests

Article 184 protects everyone against three categories of Torts. The first is harm to individual rights. Under the former part of first paragraph of Article 184, every person who suffers recognizable injuries can bring suit in Tort, whether as an intentional tort or negligence.⁶⁹ The second is intentional harms because of a violation of the “rules of morals.” For example, the plaintiff has a tort action when his opportunity to make a deal or contract with others was intentionally harmed by the defendant. The final category is harm through statutory violation where the statute intends to protect people, such the Road Traffic Management and Penalty Act.⁷⁰

4) Damage

The goal of civil liability is to deter harm and provide compensation for actual loss. If no one is harmed by the defendant's acts, there should be no recovery. The type of harm includes personal injuries, property damages, and harms not recognized in former part of first paragraph of Article 184.

5) Damage Was Proximately Caused by Defendant's Acts

Taiwan tort law also uses proximate cause. Therefore, the defendant's acts not only must pass the “but for” test (i.e., that if *X* had not occurred, *Y* would not have happened) or “substantial factor” test (i.e., where each of several defendants was a

⁶⁹ This Thesis argues, however, that harm to economic interests is also a recognizable harm under the former part of first paragraph of Article 184 in Civil Code of Taiwan.

⁷⁰ For English version of this act, see:
<http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=K0040012>.

substantial factor in causing injury)⁷¹ but also the foreseeability test (i.e., whether the defendant's acts usually cause the same kind of harm to the plaintiff).

6) Defendant Was Intentional or Negligent

Whether a tort is intentional or negligent is based on the defendant's state of mind. It's a core issue and also the most difficult one for the plaintiff to prove. The defendant acts "intentionally" when he knowingly and intentionally causes an injury. The act also is intentional if he knows the act will result in the elements of the offense and if the act is not against his will.⁷² As for negligence, an act is negligently if the defendant fails to exercise the duty of care he should have in the circumstances.⁷³

7) Defendant Had the Legal Capacity When He Hurt Others:

Article 187 also requires the defendant must be legally competent at the time he commits the Tort:

A person of no capacity or limited in capacity to make juridical acts, who has wrongfully damaged the rights of another, shall be jointly liable with his guardian for any injury arising therefrom if he is capable of discernment at the time of committing such an act. If he is incapable of discernment at the time of committing the act, his guardian alone shall be liable for such injury.

⁷¹ The substantial factor test was developed to address a situation in which there were two or more causes of the harm to plaintiff and either of the causes alone would have been sufficient to bring about the harm. In this situation, because a strict application of the cause-in-fact "but-for" test "would allow both tortfeasors to avoid liability, courts made the policy decision to nevertheless impose liability 'if [the defendant's conduct] was a material element and a substantial factor in bringing [the event] about.'" *Gerst v. Marshall*, 549 N.W.2d 810, 815 (1996).

⁷² For full text defining intentional harm, see Article 13 in the CRIMINAL CODE OF THE REPUBLIC OF CHINA. Full English version may be found at this website: <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=C0000001>.

⁷³ For full text defining negligent harm, see Article 14 in the CRIMINAL CODE OF THE REPUBLIC OF CHINA at <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=C0000001>.

Thus, whether one has the capacity to make juridical acts depends on whether the defendant is capable of discernment at the time he acts.

2.2 Rules about Methods and Coverage of Recovery — Articles 213 and 216 — No Present Rules for Recovery for Pure Economic Loss⁷⁴

In addition to discussing whether recovery for pure economic loss is a recognizable right under the former part of first paragraph of Article 184, an overview of the methods and coverage of recovery also helps frame whether pure economic loss is recoverable in unintentional tort in Taiwan.

A. Methods of Recovery

In Taiwan, the primary goal of compensation is to restore the status quo before the harm to an injured party. Article 213 in Civil Code provides that:

Unless otherwise provided by the act or by the contract, a person who is bound to make compensation for an injury shall restore the injured party to the status quo before the injury.

If the restoration of the status quo ante shall be paid in money, interest shall be added from the time of the injury.

Under the circumstances of the first paragraph, the creditor may claim the necessary expenses for restoration instead of the restoration.

Therefore, damages other than restoring the victim to the status quo are possible only when the law or the contract provides otherwise.⁷⁵ For tort actions, four methods of

⁷⁴ The following context about method and coverage of recovery is also modified from Prof. Liu's book. See *supra* note 67 at 152-153, at 119-23, and at 155-56.

⁷⁵ *Id.* at 152.

recovery are available. None, however, explicitly refer to recovery for pure economic loss in tort.⁷⁶

1) Harm to Body or Health

With regard to harm to another's body or health, Article 193 provides that:

If a person has wrongfully damaged to the body or health of another, and caused the injured person to lose or decrease his laboring capacity, or to increase the need in living, the tortfeasors shall be bound to make compensation to the injured person for any injury arising therefrom.

The court may, on the application of the parties, order the compensation of the preceding paragraph to be made in periodical payments of money, but the court shall compel the tortfeasor to furnish security.

2) Harm to Personality

Damages can be recovered for harm to personality, such as reputation, credit, or privacy. Here, the victim can recover even if the injury is not a pecuniary loss. The first paragraph of Article 195 provides that:

If a person has wrongfully damaged to the body, health, reputation, liberty, credit, privacy or chastity of another, or to another's personality in a severe way, the injured person may claim a reasonable compensation in money even if such injury is not a purely pecuniary loss.

If it was reputation that has been damaged, the injured person may also claim the taking of proper measures for the rehabilitation of his reputation.

However, since personality may not be transferred or inherited, neither can claims for harm arising from it.⁷⁷ Thus, under the second paragraph of Article 195, the claim in the

⁷⁶ *Id.* at 119-23.

⁷⁷ *Id.* at 122.

first paragraph may not be transferred or inherited unless the claim has been promised by contract or has been commenced.⁷⁸

3) Harm to Status Based on the Relationship to Close Relatives

Consortium claims also are covered under the third paragraph of Article 195. It provides that the provisions of the first two paragraphs shall be *mutatis mutandis* applied when a person has been damaged in a severe way based on their relationship to their father, mother, sons, daughters, or spouse.⁷⁹

4) Harm to Property

Harm to property is covered under Article 196. Here, an injured person may claim compensation for the diminution of the value of their property caused by a tortfeasor.⁸⁰ This is a key issue for debate about recovery for pure economic loss in unintentional tort. Most legal scholars in Taiwan argue that diminution of the value of a property is not recoverable in unintentional tort.⁸¹ This Thesis considers this issue in depth in Chapter Four.

B. Coverage of Recovery

Under Taiwanese law, a default rule of coverage of recovery is provided, unless otherwise changed by contract. The language of Article 216 states that:

⁷⁸ See Article 195 in CIVIL CODE of Taiwan.

⁷⁹ See also BLACK'S LAW DICTIONARY 1177 (10th ed. 2014) for "*mutatis mutandis*".

⁸⁰ See Article 196 in CIVIL CODE of Taiwan.

⁸¹ See *supra* note 37 for Prof. Wang's book at 273.

Unless otherwise provided by the act or by the contract, the compensation shall be limited to the injury actually suffered and the interests which have been lost.

Interests which could have been normally expected are deemed to be the interests which have been lost, according to the ordinary course of things, the decided projects, equipment, or other particular circumstances.

This rule adopts the principle of full recovery. The coverage of recovery includes two spheres.⁸² First, the tortfeasor must compensate the victim for harm to property or interests existing at the time of injury.⁸³ Second, the tortfeasor also must pay for interests the injured should have received but for the tort.⁸⁴ Furthermore, these expected interests are valued in accordance with the ordinary course of things, the decided projects, equipment, or other particular circumstances.⁸⁵

2.3 Recovery for Pure Economic Loss When Parties Are in Privity of Contract — An Overview on Supreme Court of Taiwan, *The Second Decision of 19th Civil Case Convention, Nov. 01, 1988*

Unlike the common law, which has separate rules for Contracts and Torts, the Civil Code of Taiwan has a single set of rules for both. The relationship between Contract and tort law in the Civil Code, however, is uncertain. As mentioned earlier, a key issue in pure economic loss is the possible conflict between contract law and tort law.⁸⁶

The issue was considered by the Supreme Court of Taiwan in the *Second Decision of 19th Civil Case Convention of 1988*. The case involved an employee who breached his duty and misrepresented the financial status of another. Based on this representation, his employer made a loan and suffered pure economic loss. The employer then sued the

⁸² See *supra* note 67 at 155.

⁸³ *Id.*

⁸⁴ *Id.* at 156.

⁸⁵ See the second paragraph of Article 216 in CIVIL CODE of Taiwan.

⁸⁶ See *supra* 14.

employee for recovery under the former part of first paragraph of Article 184.⁸⁷ The decision by the Court implied recovery for pure economic loss is permitted under Article 184 and that pure economic loss is, therefore, recoverable in unintentional tort.

2.4 Recovery for Pure Economic Loss in Unintentional Torts: Does A Defendant Have a Duty to General Public to Prevent Pure Economic Loss?

While most courts in Taiwan argue against recovery for pure economic loss in unintentional tort, those same courts also seem to recognize the need to protect innocent victims from harm, even when the damage suffered is pure economic loss. Here, the courts interpret Article 184 to allow recovery for pure economic loss. For example, in *Zuigao Fayuan, 91 Nian Tai Shang Zi No. 2096*,⁸⁸ the defendant intentionally shut off the electricity going to the victim's restaurant. As a result of the power failure, the victim had to shut down his restaurant. Here, the court found the defendant harmed the victim's right to operate the restaurant and allowed recovery for lost profits under the former part of first paragraph of Article 184. In so holding, the court allowed recovery for pure economic loss in an unintentional tort case. In another case, a defendant famous for appraisal of expensive watches (such as Rolex) conspired with other defendants to cheat the plaintiffs by falsely certifying a fake watch as genuine.⁸⁹ The plaintiff sued for recovery for pure economic loss because after buying five fake Rolex watches based on the defendant's appraisal. The court reasoned recovery for pure economic loss is a recognizable right under the former part of first paragraph of Article 184, thereby making pure economic loss recoverable in unintentional tort.

⁸⁷ See *supra* note 3 for the Second Decision of 19th Civil Case Convention made by Supreme Court of Taiwan.

⁸⁸ Tai Shang Zi No. 2096 by Supreme Court of Taiwan, Mar. 17, 2002.

⁸⁹ Su Zi No. 951 by Taiwan Taichung District Court, Mar. 30, 2005.

2.5 Summary: The Uncertain State of Recovery for Pure Economic Loss in Taiwan

Thus, the current state of law in Taiwan is uncertain. The current rules either fail to clarify whether recovery for pure economic loss is recoverable under Article 184 or fail to stipulate whether pure economic loss is included within coverage of recovery.

Although courts usually find recovery for pure economic loss is allowed under Article 184,⁹⁰ they fail to provide a clear standard. As such, recovery for pure economic loss is an all-or-nothing result. Either it applies to *no* cases for unintentional torts or, if it does, it applies to *all* kinds of unintentional tort cases. In Chapter Four, this Thesis will explain, in greater detail, the shortcoming of the current rules in Taiwan about recovery for pure economic loss.

⁹⁰ See *supra* note 87-89.

Chapter Three

Tort Law & Pure Economic Loss Rule in the American Common Law

3.1 The General Concept of Negligence in the American Common Law

A. Overview

The goal of this Chapter is two-fold. First, it summarizes the common law of negligence. This helps provide a comparison between tort law in Taiwan and the United States. Second, pure economic loss rule is comprehensively discussed in American law.⁹¹ This Chapter surveys several approaches to recovery for pure economic loss used by American courts. Together, both can be used in order to shed light on possible solutions for Taiwanese legal scholarship.

B. What Does a Plaintiff Need to Prove in Negligence?

1) Duty: Standard of Care

To prove a negligence case, American tort law requires a plaintiff to prove breach of duty, causal connection, and damages.⁹² The first issue here is what the standard of care means. Generally, a person must act as an ordinarily careful person or a reasonably prudent person under similar circumstances.⁹³ As stated by William Prosser:

In negligence cases, the duty is always the same, to conform to *the legal standard of reasonable conduct* in light of the apparent risk. What the

⁹¹ See *supra* note 5.

⁹² RESTATEMENT (SECOND) OF TORTS §433B(1) (1965).

⁹³ *Jones v. Chicago HMO Ltd. of Illinois*, 191 Ill. 2d 278, 295, (2000).

defendant must do, or must not do, is a question of the standard of conduct required to satisfy the duty.⁹⁴

In a usual case, expert testimony is not required to establish the standard of care.

However, where a the defendant is a professional,⁹⁵ expert testimony is generally necessary to establish the required standard of care owed by the professional unless the alleged negligence is so obviously shown that the trier of fact could recognize it without expert testimony.⁹⁶ Such expert testimony is necessary to establish the relevant standard for the trier of fact because professional standards are often beyond the knowledge of the average person.⁹⁷

In addition to the need of expert testimony, locality rule helps delineate the standard of care of a professional. For example, in an accountant malpractice case where the plaintiff suffers pure economic loss, the plaintiff has to establish the standard of care of the accountant. This may include the general expectation that the accountant will render his services with certain degree of skill, care, knowledge, and judgment usually possessed and exercised by members of the profession in the particular locality.⁹⁸ Thus, in professional malpractice cases, the “locality rule” requires the professional to act with ordinary and reasonable care in accordance with the customs or practices of professionals from a particular geographic region. Such standard can be the same community standard,⁹⁹ a regional standard¹⁰⁰ or a national standard,¹⁰¹ depending on what law the state court applies.¹⁰²

⁹⁴ *Id.* See also W. Prosser, TORTS, 324 (4th ed. 1971).

⁹⁵ Many cases about recovery for pure economic loss involve professional malpractice. See *supra* note 2.

⁹⁶ *Schultz v. Bank of Am., N.A.*, 990 A.2d 1078 (2010).

⁹⁷ *Id.* at 1086.

⁹⁸ *Kemmerlin v. Wingate*, 261 S.E.2d 50 (1979).

⁹⁹ *Noll v. Rahal*, 219 Va. 795, 250 S.E.2d 741 (1979).

¹⁰⁰ *Shiple v. Williams*, 350 S.W.3d 527 (Tenn. 2011).

2) Breach of Duty

A plaintiff in a negligence action first must establish a duty. Often this is based on the reasonable person standard.¹⁰³ The test here is what a reasonable person would do or not do under similar circumstances.

3) Causation

After duty and breach, the plaintiff also must prove a casual connection between the defendant's acts and the plaintiff's injuries — both legal cause and proximate cause. The plaintiff first must prove either the “but for” test (i.e., if the defendant had not been negligent, the plaintiff would not have suffered injuries)¹⁰⁴ or the “substantial factor” test (i.e., where each of several defendants was a substantial factor in causing injury).¹⁰⁵ The plaintiff next must prove proximate cause, which generally is based on whether the defendant's injury is reasonably foreseeable or whether the plaintiff is within a zone of danger.¹⁰⁶

¹⁰¹ *Nwaneri v. Sandidge*, 931 A.2d 466 (D.C. 2007).

¹⁰² The standard of care applicable to accountants is the same as that applied to doctors and other professional men furnishing skilled services for compensation and that standard requires reasonable care and competence therein. See *Gammel v. Ernst & Ernst*, 72 N.W.2d 364, 365 (1955).

¹⁰³ *Bethel v. New York City Transit Authority* 92 N.Y.2d 348 (1998).

¹⁰⁴ “But For” test of negligence is appropriate test for actual causation in majority of circumstances. *Vincent by Staton v. Fairbanks Mem'l Hosp.*, 862 P.2d 847 (Alaska 1993).

¹⁰⁵ See *supra* note 71.

¹⁰⁶ *Palsgraf v. Long Island R.R. Co.* 248 N.Y. 399, 162 N.E. 99 (1928).

4) Damage

As mentioned in Chapter Two, if no one suffers harm through the defendant's act, there should be no recovery.¹⁰⁷ Thus, the plaintiff also has to prove damages because of the defendant's negligence and how much he should recover.

3.2 Recovery for Pure Economic Loss in Unintentional Torts: A Category-by-category Approach Under the American Common Law

Unlike the all-or-nothing approach in Taiwan, American law considers pure economic loss rule under a *category-by-category* basis. The following section will cover the content of pure economic loss rule generated by the American common law in different kinds of scenarios. When dealing with recovery for pure economic loss in unintentional tort, the American courts begin by asking whether the defendant owed the plaintiff victim a duty to prevent such harm.

A. Recovery for Pure Economic Loss in Products Liability

Pure economic loss is generally recoverable in contract law or warranty law.¹⁰⁸ Here, the victim often may base recovery on strict products liability because he would not have to prove either privity of contract or be subject to disclaimers.¹⁰⁹ Whether pure economic loss is recoverable in strict products liability is an open question. During the early years of products liability, some American courts held pure economic loss was

¹⁰⁷ See *supra* 16.

¹⁰⁸ James A. Henderson, Jr. & Aaron D. Twerski, *PRODUCTS LIABILITY PROBLEMS AND PROCESS* 619 (2011).

¹⁰⁹ For more details about advantages for a plaintiff victim to sue a defendant manufacture in strict products liability rather in contract law or in warranty law, see *Id.*

recoverable in strict products liability¹¹⁰ while the majority of courts held otherwise.¹¹¹ The basis for the dispute was whether, under *Restatement (Second) of Torts* §402A, a defendant was liable for harm to the product itself.¹¹²

Recently, Supreme Court of the United States answered this question in the negative.¹¹³ In *East River Steamship*,¹¹⁴ charters of four tankers brought suit against the defendant Delaval for damages suffered because turbines manufactured by Delaval were negligently designed, manufactured, and installed in their tankers. In finding no recovery for economic harm, the Court distinguished between contract and tort remedies. When a product injures only itself, the Court reasoned, the victim could bring suit in contract law for redress. In turn, the tort concern with safety is reduced when an injury is only to the product itself because the users stand to lose the value of products, unsatisfied expectation,¹¹⁵ or increased costs in using the products.¹¹⁶ Until then, pure economic loss is considered not recoverable in strict products liability, and *Restatement (Third) of Torts: Products Liability* §21 also adopts the rule from *East River Steamship*:¹¹⁷

For purposes of the Restatement, harm to persons or property includes economic loss if caused by harm to (a) the plaintiff's person; (b) the person of another when harm to the other interferes with an interest of the plaintiff protected by tort law; or (c) the plaintiff's property other than *the defective product itself*.

¹¹⁰ *Santor v. A and M Karagheusian, Inc.*, 44 N.J. 52, 66-67 (1976).

¹¹¹ *Seely v. White Motor Co.*, 403 P.2d 145, 151 (1965).

¹¹² RESTATEMENT (SECOND) OF TORTS § 402A (1965).

¹¹³ See *supra* note 57.

¹¹⁴ *Id.*

¹¹⁵ The court noted such harm should be understood as warranty claim, rather than as tort. *Id.* at 2302.

¹¹⁶ *Id.*

¹¹⁷ See *supra* note 108 at 627.

B. Recovery for Pure Economic Loss in Public Nuisance

When a person suffers pure economic loss because of a public nuisance,¹¹⁸ an action in tort is expected because privity of contract rarely exists between victim and tortfeasor. For example, a company negligently blocks a bridge and cuts off traffic between islands, thereby causing business interruption in nearby areas.¹¹⁹ Like in products liability cases, pure economic loss here generally cannot be recovered unless there's also been physical harm to the plaintiff victims. At the same time, it seems unfair to deny damages here because — unlike product liability cases — the plaintiff here has no way to seek contractual remedies. A case from Court of Appeals of New York may help to clarify this rule and its policy concerns. In *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*,¹²⁰ a commercial tower collapsed as a result of the defendant's negligence and caused nearby areas to close for at least two weeks. The owners of nearby stores brought a tort case for recovery for lost profits arising from the interruption of their business. The court denied recovery, reasoning if the presence of members of public or other people traveling nearby was fortuitous, any economic loss they suffered would be unpredictable.¹²¹ To avoid indeterminate liability and to avoid unfairness between geographically similar plaintiffs, the court limited recovery to plaintiffs who suffered personal injury or property damage.¹²²

¹¹⁸ See *supra* note 19.

¹¹⁹ See also *Kinsman Transit Co. v. City of Buffalo*, 388 F.2d 821 (2d Cir. 1968).

¹²⁰ 96 N.Y.2d 280, 750 N.E.2d 1097 (2001).

¹²¹ *Id.*

¹²² *Id.* at 1103. See also RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM §8 (Preliminary Draft No.2, 2013) in which the rule allows the recovery for pure economic loss within a public nuisance scenario only when a plaintiff suffered loss distinct from that suffered by the public at large.

C. Recovery for Pure Economic Loss in Professional Malpractice: Three Approaches Identified

A final case where victims may suffer pure economic loss is professional malpractice. This includes negligent misrepresentation and negligent performance of service.¹²³ When dealing with recovery for pure economic loss in professional malpractice, American courts have taken three different approaches.¹²⁴

1) From Strict Privity Rule to Near Privity Rule

In *Ultramares v. Touche*,¹²⁵ Justice Cardozo held an accounting firm not liable for pure economic loss suffered by plaintiff's reliance on an auditing report. The defendant was hired by Fred Stern, a company not in the litigating process, to do auditing, but negligently failed to disclose the company's insolvency in the certified balance sheet. Relying on the audit, the plaintiff made several loans to the company. After the company filed for bankruptcy, the plaintiff brought a negligence action for recovery for pure economic loss. In finding the defendant owed the plaintiff no duty of care, the court reasoned that a thoughtless slip or blunder, or the failure to detect a theft or forgery may expose accountants to an indeterminate liability for an indeterminate time to an indeterminate class.¹²⁶ Thus, the court held that unless the accountant expressly assumes a duty by contract, pure economic loss in negligence is not recoverable.¹²⁷

¹²³ Bruce P. Feldthusen, *ECONOMIC NEGLIGENCE: THE RECOVERY OF PURE ECONOMIC LOSS* (6th ed. 2012)

¹²⁴ See *supra* 2.

¹²⁵ See *supra* note 9.

¹²⁶ *Id.* at 444.

¹²⁷ *Id.* at 445 (citing *Moch Co. v. Rensselaer Water Co.*, 247 N.Y. 160, 164 (1928)).

This strict privity requirement was relaxed by *Credit Alliance Corp. v. Arthur Anderson & Co.*¹²⁸ In *Credit Alliance*, the plaintiff relied on financial reports negligently made by the defendant accounting firm and suffered economic harm because of loans to the company. Modifying the strict privity requirement in *Ultramares*,¹²⁹ the court held the accountants liable to noncontractual parties for negligent misrepresentation¹³⁰ if the victim could show: 1) the accountant knew the financial reports would be used for a particular purpose; 2) in the furtherance of which a known party intended to rely; and 3) there was conduct by the accountants linking them to that party, which evidenced the accountant's knowledge of that reliance.¹³¹

2) Foreseeability Rule

A second, and more liberal, approach used by a few states is to find the defendant owes a duty to third parties in preventing pure economic loss¹³² and then apply the usual foreseeability rule in an accountant malpractice case. Under this rule, an independent auditor has a duty to all persons the auditor reasonably should foresee as recipients of the statements for proper business purposes when issuing an opinion.¹³³

¹²⁸ 65 N.Y.2d 536 (1985).

¹²⁹ See *supra* note 9.

¹³⁰ Although some courts distinguished negligence from negligent misrepresentation, this Thesis argues that they are the same. See *Infra* chapter four for explanations.

¹³¹ See *supra* note 128 at 551.

¹³² For example, high courts from State of New Jersey, from State of Wisconsin, and from State of Mississippi adopt the foreseeability rule: *H. Rosenblum, Inc. v. Adler*, 93 N.J. 324 (1983); *Citizens State Bank v. Timm, Schmidt & Co.*, 113 Wis.2d 376 (1983); and *Touche Ross & Co. v. Commercial Union Ins. Co.*, 514 So.2d 315 (Miss. 1987).

¹³³ *Id.* for *Rosenblum* at 351.

3) Intended Third Parties Rule

The majority of states use the rule adopted by the *Restatement (Second) of Torts* for liability to third parties for professional malpractice when the work was intended to influence and supply the information.¹³⁴ The text of § 552 of *Restatement (Second) of Torts* provides as follows:¹³⁵

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

3.3 The Future of Recovery for Pure Economic Loss Under the American Common Law: The *Restatement (Third) of Torts: Liability for Economic Harm – Tentative Rule*

A. Overview

With intensive discussions and rapid growth of pure economic loss rules in the past few decades, the American Law Institute began to draft a new Restatement specifically addressing liability for economic harm.¹³⁶ For negligent infliction of

¹³⁴ For example: *Nycal Corp. v. KPMG Peat Marwick LLP*, 668 N.E.2d 1368 (1998); *Bily v. Arthur Young & Co.*, 834 P.2d 745 (1992); and *First Nat. Bank of Bluefield v. Crawford* 386 S.E.2d 310 (1989).

¹³⁵ RESTATEMENT (SECOND) OF TORTS § 552 (1977).

¹³⁶ RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM §§1-6 (Tentative Draft

economic harm, Section 1 to Section 6 are particularly instrumental in which the *Restatement* clearly imposes no duty in general to avoid economic harm;¹³⁷ defines what pure economic loss is¹³⁸ and regulates liability in the performance or negotiation of a contract¹³⁹ in negligent misrepresentation¹⁴⁰ and in negligent performance of service.¹⁴¹ Sections 3 to 6 of the *Restatement*, which follow, are particularly important:¹⁴²

B. Proposed *Restatement* Rules for Recovery for Pure Economic Loss in Unintentional Torts

1) §3: Preclusion of Tort Liability Arising from Contract¹⁴³

Except as provided elsewhere in this Restatement, there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties.

2) §4: Professional Negligence Resulting in Economic Loss¹⁴⁴

A professional is subject to liability in tort for economic loss caused by the negligent performance of an undertaking to serve a client.

3) §5: Negligent Misrepresentation¹⁴⁵

(1) One who, in the course of his business, profession, or employment, or in any transaction in which he has a pecuniary interest, *supplies false information for the guidance of others*, is subject to liability for pecuniary loss caused to them by their *reliance upon the information*, if he fails to use reasonable care *in obtaining or communicating it*.

No.1, 2012).

¹³⁷ *Id.* at §1.

¹³⁸ *Id.* at §2. See also *supra* note 1.

¹³⁹ *Id.* at §§3 and 4.

¹⁴⁰ *Id.* at §5.

¹⁴¹ *Id.* at §6.

¹⁴² Although the proposed Restatement has not taken effect, it nevertheless provides instrumental rules and policy arguments for those interested in negligent economic harm.

¹⁴³ See *supra* note 139.

¹⁴⁴ *Id.*

¹⁴⁵ See *supra* note 140.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for *whose guidance* the actor intends *to supply the information*, or for whose guidance he knows the recipient intends to supply it; and (b) through *reliance upon the information* in a transaction that the actor *intends to influence*, or that he knows the recipient intends to influence, or in a substantially similar transaction.

(3) The liability of one who is under a public duty to supply the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

(4) A plaintiff's recovery under this Section is subject to the same principles of comparative responsibility that apply to other claims of negligence.

(5) This Section does not recognize liability for negligent misrepresentation made in the course of negotiating or performing a contract between the parties.

4) §6: Negligent Performance of Services¹⁴⁶

(1) One who, in the course of his business, profession, or employment, or in any other transaction in which he has a pecuniary interest, *performs a service for the benefit of others*, is subject to liability for pecuniary loss caused to them by their *reliance upon the service*, if he fails to exercise reasonable care *in performing it*.

(2) The liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for *whose benefit* the actor *performs the service*; and (b) through *reliance upon it* in a transaction that the actor *intends to influence*.

(3) A plaintiff's recovery under this Section is subject to the same rules of comparative responsibility that apply to other claims of negligence.

(4) This Section does not recognize liability for negligence in the course of negotiating or performing a contract between the parties.

3.4 Summary: The Category-by-category Approach in the *Restatement (Third) of Torts as a Model for Taiwan*

Rather the all-or-nothing approach used in Taiwan, the American common law uses a category-by-category approach for economic harm.¹⁴⁷ Generally, duties of care for

¹⁴⁶ See *supra* note 141.

¹⁴⁷ Section 2 in the proposed tentative Restatement uses economic loss rather than pure economic loss to define the pecuniary damage not arising from injury to the plaintiff's person or property. See *supra* note 136.

pure economic loss are only recognized in specific circumstances.¹⁴⁸ In addition, limiting tort liability is especially powerful when parties are in privity of contract.¹⁴⁹ Therefore, a defendant is not liable in negligence for the plaintiff's pure economic loss in either a public nuisance case¹⁵⁰ or a products liability case.¹⁵¹ In contrast, where a plaintiff suffers pure economic loss because of professional malpractice, courts in the United States apply three different rules — the near-privity rule, foreseeability test, and the *Restatement* approach.

The proposed tentative draft of *Restatement (Third) of Torts: Liability for Economic Harm* also covers pure economic loss suffered through professional malpractice.¹⁵² Under this standard, a professional is liable for a plaintiff's pecuniary loss suffered through his negligent performance of an undertaking to serve a client even if privity of contract exists between parties.¹⁵³ When the professional is not in privity of contract with the victim — and unlike the *Restatement (Second) of Torts* — the proposed draft of the *Restatement (Third) of Torts* holds professionals liable in tort both for negligent misrepresentation and negligent performance of service.¹⁵⁴ Similar to the rule in *Restatement (Second) of Torts*, the proposed *Restatement (Third) of Torts* limits the defendant's liability to third parties to whom the defendant meant to supply information

¹⁴⁸ *Comment b.* to Section 1 in RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM (Tentative Draft No.1, 2012).

¹⁴⁹ *Comment a.* to Section 3 in RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM (Tentative Draft No.1, 2012). See also RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 (1998).

¹⁵⁰ See *supra* note 19.

¹⁵¹ See *supra* note 57.

¹⁵² See *supra* notes 139-141 for §§3-6.

¹⁵³ See *supra* note 139 for §4. The policy concern is that a client may not understand the professional's methods sufficient to negotiate a contract and that the community expects due care of the practitioner separated from contractual duties. *Comment b.* to Section 4 of the proposed new draft. See also *Comment f.* to Section 4 in RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM (Tentative Draft No.1, 2012) in which it explains: "Section 4 is an exception to Section 3."

¹⁵⁴ See *supra* note 140 and note 141 for §§5 and 6. See also RESTATEMENT (SECOND) OF TORTS §552 (1977).

or provide service either for the plaintiff's benefits or with the intent to influence the plaintiff's action.¹⁵⁵ In summary, the American common law has generated a well-developed rule for pure economic loss rule and such development may be the key to finding solutions to recovery for pure economic loss in unintentional tort in Taiwan.

¹⁵⁵ As Justice Cardozo mentioned in *Ultramares v. Touche*, if liability [for negligence] sustains, a thoughtless slip or blunder, or the failure to detect a theft or forgery beneath the cover of deceptive entries may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. See *supra* note 9.

Chapter Four

Analysis and Proposed New Rules

4.1 Overview

This Chapter proposes Taiwan should adopt the American common law rule on recovery for pure economic harm.¹⁵⁶ Article 1 of the Civil Code of Taiwan provides:¹⁵⁷

If there is no applicable act for a civil case, the case shall be decided according to customs. If there is no such custom, the case shall be decided according to the jurisprudence.

Thus, before this Thesis discusses whether Taiwan needs to inherit the laws from a foreign jurisdiction, it has to analyze whether the current rules are sufficient to solve the issue of recovery for pure economic loss in unintentional tort.

4.2 The Uncertain State of Pure Economic Loss in Taiwan

As mentioned in Chapter Two, this Thesis argues that both Article 216 and Article 184 are insufficient to handle the problem of pure economic loss in Taiwan.¹⁵⁸ Adopting the principle of full recovery, pure economic loss is recoverable because it requires the tortfeasor to compensate not only for the harm to the property or interests of the injured but also interests the injured should have received but for the tort action.¹⁵⁹ For example, in the accountant malpractice case mentioned in Chapter One,¹⁶⁰ the potential buyer

¹⁵⁶ By talking about the current rule, this Thesis focuses its discussion on liability in Civil Code of Taiwan because of its purpose of proposing a standard for recovery for pure economic loss in several other civil cases. See *supra* note 11.

¹⁵⁷ See *supra* note 24.

¹⁵⁸ See *supra* 23.

¹⁵⁹ See *supra* note 67 at 155.

¹⁶⁰ See *supra* 13.

failed to receive the expected interests because of the negligent misrepresentation of the accountant. Such lost interests are categorized as pure economic loss by the injured party that would have suffered but for the accountant's negligent misrepresentation. If the court only applies Article 216 in this case, it may conclude that the potential buyer can recover for his economic harm.

However, when dealing with the issue of recovery for pure economic loss, the court also needs to discuss the second relevant rule, Article 184. As mentioned in Chapter One, the issue of recovery for pure economic loss mostly arises from the interpretations of Article 184.¹⁶¹ If a person's economic interest is not a recognizable right under the former part of first paragraph of Article 184, pure economic loss is not recoverable in unintentional tort, and vice versa.¹⁶² Determining whether one's economic interest is a recognizable right under the former part of first paragraph of Article 184, however, is a challenging task because whether an interest is protected depends on various policy reasons. For example, in the American common law, recovery for pure economic loss in unintentional tort is determined under a category-by-category basis.¹⁶³ In a products liability case, pure economic loss is generally not recoverable if unaccompanied by physical harm because the court fears that contract law might drown in the sea of tort.¹⁶⁴ In addition, in the American common law, recovery is allowed under limited circumstances because of concerns about indeterminate liability.¹⁶⁵ On the contrary, Article 184 offers an all-or-nothing approach for pure economic loss in unintentional tort

¹⁶¹ See *supra* 6-8.

¹⁶² See *supra* note 25.

¹⁶³ See *supra* 27-32.

¹⁶⁴ See *supra* note 57 and note 35.

¹⁶⁵ See *supra* note 28.

and makes it difficult to use as a standard for recovery.¹⁶⁶ Since Taiwanese courts usually hold that one's economic interest is a recognizable right under the former part of first paragraph of Article 184, pure economic loss is recoverable in every unintentional tort case.¹⁶⁷ However, the appropriateness of such holding is open to debate because it may subject the tortfeasor to indeterminate liability.¹⁶⁸ Furthermore, it is the statutes rather than court decisions that are the primary sources of law of Taiwan because Taiwan inherits Civil Law system from Germany.¹⁶⁹ Even if Article 1 of the Civil Code of Taiwan allows supplementation with customs and jurisprudence when statutes are insufficient, neither the scholars nor the courts identify any of them.¹⁷⁰ With a careful analysis on the current rules in Civil Code of Taiwan, this Thesis argues that Taiwanese laws are insufficient to answer whether pure economic loss is recoverable in unintentional tort.

4.3 Applying Economic Analysis of Law to Justify a Duty to Prevent Economic Harm and the Limitation on Coverage of Recovery

In addition to the American common law, Economic Analysis of Law can also provide helpful analysis for rules of recovery of pure economic loss.¹⁷¹

¹⁶⁶ See *supra* 6-8.

¹⁶⁷ See *supra* note 87-89.

¹⁶⁸ See *supra* note 2 for *Ultramares*.

¹⁶⁹ In countries adopting Civil Law system, the court decisions are not binding opinions. See Cheng Yupo & Huang Tsungle, *Min Fa Tsung Tze (General Principles of Civil Code)* 17 Taipei: San Min Book Co., 2005.

¹⁷⁰ Professor Tzechien Wang identified from foreign jurisdiction the arguments against recovery for pure economic loss in unintentional tort. For example: the fear of indeterminate liability of the tortfeasor. However, since the application of the foreign jurisprudence to interpretation of the rule is subject to the all-or-nothing approach under Article 184 in Civil Code of Taiwan, Professor Wang's interpretation of the law makes it impossible for a victim to claim for recovery for pure economic loss under every unintentional tort case and thus fails to protect individual rights. See *supra* 6-8.

¹⁷¹ For a discussion on criticism of Economic Analysis of Law, see Lawrence A. Cunningham, *Traditional versus Economic Analysis: Evidence from Cardozo and Posner Torts Opinions*, 62 Fla. L. Rev. 667 (2010).

A. Does One Owe A Duty to General Public to Prevent Pure Economic Loss?

Whether pure economic loss is recoverable in unintentional tort depends on whether a duty exists to prevent pure economic loss. In *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc.*,¹⁷² the court reasoned that pure economic loss is recoverable only when the victim also suffers personal injuries or property damages.¹⁷³ The court in *Union Oil Co. v. Oppen* also reasoned that, as a general rule, no cause of action lies against a tortfeasor whose negligence prevents the plaintiff from obtaining a prospective pecuniary advantage.¹⁷⁴ In this regard, no one owes a duty to general public to prevent pure economic loss. However, this Thesis argues that a duty should be imposed to prevent pure economic loss in a professional malpractice case because the professional is best able to avoid pure economic loss in the most economical way.¹⁷⁵

Judge Hand illustrated how Economic Analysis of Law works in determining the duty in *United States v. Carroll Towing Co.*¹⁷⁶ According to Hand Formula, if the probability be called P; the injury L; and the burden B; then liability depends upon whether B is less than L multiplied by P, i.e., whether B less than PL.¹⁷⁷ Under this test, if $B > PL$, a reasonable person may not take the precaution.¹⁷⁸ If, however, $B < PL$, legal liability may be imposed to induce the party to prevent accidents, thereby avoiding

¹⁷² See *supra* note 59.

¹⁷³ *Id.* at 1103.

¹⁷⁴ 501 F.2d 558, 563 (9th Cir. 1974) (citing *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927))

¹⁷⁵ One of the functions of tort law is to find the most economical way to prevent harm. Fan Hsiaolin & Wang Yuanhsun, *Kuo Shih So Chih Chun Ching Chi Shang Sun Shih – Part 1 – Tsung Lu Shih Kuai Chi Shih Tze Jen Tan Chi* (Part 1 of Pure Economic Loss Suffered through Negligence – Starting from Attorney and Accountant Malpractice), *Taiwan Jurist* Vol.26 at 95-101(1997).

¹⁷⁶ 159 F.2d 169 (2d Cir. 1947).

¹⁷⁷ *Id.*

¹⁷⁸ Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* 214 (8TH ed. 2011).

damages in a civil judgment equal to PL.¹⁷⁹ Thus, assuming a victim can do nothing to prevent the accident, a potential injurer is negligent if $B < PL$.¹⁸⁰

Hand Formula works on two assumptions. First, it assumes that risks are neutral.¹⁸¹ Second, it assumes that calculable risks exist.¹⁸² However, where risks can not generally be estimated, courts usually justify the exemption of duty with B and L where B is extremely high and L is only moderate.¹⁸³ It should be noted that one may argue that it is unrealistic to expect a layperson to calculate whether B is less than PL before he acts.¹⁸⁴ However, when applying the $B < PL$ test, courts typically estimate the accident-avoidance costs of the average person in each party's situation.¹⁸⁵ Applying an average person standard to determine whether B is less than PL not only conforms to experience of layperson but also prevents courts from using higher costs.¹⁸⁶

Under an Economic Analysis of Law, professionals are the cheapest cost avoiders are best able to spread the costs of accidents. For example, to avoid pure economic harm to another, an attorney needs to invest more hours in research.¹⁸⁷ In contrast, it costs much more for a layperson without professional knowledge to identify mistakes within professional opinions.¹⁸⁸ The situation is the same when an accountant conducts auditing work and misrepresents.¹⁸⁹ In addition, professionals have greater bargaining power to

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.* at 215.

¹⁸² *Id.* at 216.

¹⁸³ *Id.*

¹⁸⁴ Fan Hsiaolin & Wang Yuanhsun, *Kuo Shih So Chih Chun Ching Chi Shang Sun Shih – Part 2 – Tsung Lu Shih Kuai Chi Shih Tze Jen Tan Chi* (Part 2 of Pure Economic Loss Suffered through Negligence – Starting from Attorney and Accountant Malpractice), *Taiwan Jurist* Vol.27 at 78-82 (1997).

¹⁸⁵ See *supra* note 178 at 218.

¹⁸⁶ *Id.*

¹⁸⁷ See *supra* note 184 at 81-82.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

limit distribution of information by contract.¹⁹⁰ Similarly, they can simply put a disclaimer on their work. This, in turn, decreases the reasonableness of reliance by third persons.¹⁹¹ Furthermore, unless liability is imposed, innocent victims must absorb possibly large economic loss which punishes innocent victims for trusting independent audits.¹⁹²

To further the goals of tort law — to protect innocent victims — this Thesis argues that a duty should be imposed on professionals to prevent pure economic loss of another. Professionals assume the risks of reliance by third parties.¹⁹³ Other applications to professionals are possible as well.¹⁹⁴

B. Limitation on Liability for Pure Economic Loss

After arguing that a professional has a duty to prevent pure economic loss of another, the next question is how extensive the liability should be. One of the principle functions of accident law, especially tort law, is to reduce the costs of accidents.¹⁹⁵ If costs of Activity A exceed those of Activity B, then reasonable people would forgo Activity A, and accidents arising from Activity A will be reduced.¹⁹⁶ This assumes individuals know best for themselves.¹⁹⁷ Guido Calabresi, an outstanding legal scholar specializing in Economic Analysis of Law, further notes that the function of the prices of various goods must reflect the relative costs to society of producing them. If prices perform this function properly, the price the buyer pays reflects the true social cost of the

¹⁹⁰ See dissenting opinion of *Bily v. Arthur Young & Co.*, 834 P.2d 745, 785-86 (1992).

¹⁹¹ *Id.*

¹⁹² *Id.* at 785.

¹⁹³ See *supra* note 184 at 82.

¹⁹⁴ See also *supra* note 184, at 81-82.

¹⁹⁵ Guido Calabresi, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* 26 (1970).

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* at 70.

purchase.¹⁹⁸ Thus, if all activities reflect the costs of accident they cause, each person can best choose whether to engage in an activity.¹⁹⁹ The sum of these choices determines which accident-prone activities are engaged in, how they are engaged in, and who will engage in them.²⁰⁰ For example, if the price for alternative to owning a second car (e.g., taking trains or taxis) is \$250 a year, owning a second car for \$400 (car plus insurance) a year will be forgone.²⁰¹

As mentioned above, if liability for a professional activity is too great or burdensome, reasonable persons may simply forgo that activity. This could be detrimental to the society if that activity plays an important social function. For example, if liability for negligent auditing is too great, auditors may rationally respond by reducing audit services in fledging industries where business failures are high, assuming they will inevitably be singled out and sued if clients go into bankruptcy.²⁰² In addition, the number and the character of the persons and, in particular, the type of proposed transaction affects the risks of liability.²⁰³ Unlimited liability for negligence therefore could lead to an increase in the cost of audits without a compensating improvement in audit quality.²⁰⁴ Thus, while this Thesis argues for a duty on professionals to prevent pure economic loss, it also argues for a proper limit on the scope of liability.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.* at 71.

²⁰² *Bily v. Arthur Young & Co.*, 834 P.2d 745, 766 (1992).

²⁰³ *Id.* at 769 (citing *comment (h)* to §552 in RESTATEMENT (SECOND) OF TORTS).

²⁰⁴ *Id.* at 766 (citing Siliciano, 86 Mich. L. Rev. 1960-65 (1988)).

4.4 Can Taiwan Use the Pure Economic Loss Rule of the American Common Law?

As previously mentioned, Taiwan inherits Civil Law system from Germany and relies on statutes.²⁰⁵ In contrast, courts play an important role in the American common law. Courts make law and modernize tort law in the United States.²⁰⁶ In deciding cases between individual parties, a court needs to take into account public policy, social welfare, or other interests outside and beyond interests of the immediate parties to the litigation. This makes American common law similar to public law.²⁰⁷ Thus, before pure economic loss rule of the American common law is adopted in Taiwan, the difference between the two systems should be considered. This Thesis argues that the central concerns in both systems are the same — possible conflicts between contract law and tort law and the fear of indeterminate liability.²⁰⁸ Thus, it is still useful for Taiwan to use the pure economic loss rule from the American common law.

4.5. Comparison between Tort Law in the American Common Law and in Taiwan – Are Taiwanese Negligence Laws Similar Enough to American Negligence Laws to Justify Use of the American Common Law Rule on Pure Economic Loss?

A. The Major Difference: Source of Law

In comparing tort law in America and Taiwan, this section focuses on negligence. In Taiwan, negligence is based on the former part of first paragraph of Article 184. Here the plaintiff must prove seven statutory elements to recover.²⁰⁹ On the other hand,

²⁰⁵ See *supra* note 169.

²⁰⁶ See *supra* note 3 for Prof. Wang's book at 64.

²⁰⁷ Leon Green, *Tort Law Public Law in Disguise*, 38 Tex. L. Rev. 1, 2 (1959).

²⁰⁸ See *supra* 7-8.

²⁰⁹ See *supra* 14-18.

negligence in America is established by case law.²¹⁰ Thus, the primary difference between negligence law in Taiwan and in the United States is the source of law: Taiwan establishes its rule by statute, while the United States uses case law.

B. Similarities:

1) Functions of Tort Law

While tort law in Taiwan and the United States has different sources, both share similar characteristics. First, both try to balance individual freedom of action with protection of individual rights.²¹¹ Section 767 in the *Restatement (Second) of Torts* illustrates the balancing test:²¹²

In determining whether an actor's conduct in intentionally interfering with a contract or a prospective contractual relation of another is improper or not, consideration is given to the following factors:

- (a) the nature of the actor's conduct,
- (b) the actor's motive,
- (c) the interests of the other with which the actor's conduct interferes,
- (d) the interests sought to be advanced by the actor,
- (e) the social interests in protecting *the freedom of action* of the actor and *the contractual interests* of the other,
- (f) the proximity or remoteness of the actor's conduct to the interference and
- (g) the relations between the parties.

²¹⁰ See *supra* 24-27.

²¹¹ See *supra* note 3 for Prof. Wang's book at 7.

²¹² RESTATEMENT (SECOND) OF TORT §767 (1979) (emphasis added).

Second, both tort law in Taiwan and in the American common law serve to make the tortfeasor compensate for actual loss.²¹³ Article 184 explicitly requires the tortfeasor to compensate the victim for injury arising from tort to carry out justice.²¹⁴ The same concern is found in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, where the court argued that tort damages generally compensate the plaintiff victim for loss and return him to the position he occupied before the injury.²¹⁵ Finally, both Taiwanese tort law and American tort law serve to deter future harm.²¹⁶ By establishing clear rules about what a person could and could not do, tort law facilitates deterrence.²¹⁷

2) Definitions of Negligence

In the American common law, negligence is defined as a breach of duty.²¹⁸ Although Civil Code of Taiwan does not define negligence, courts and scholars generally refer to Article 14 in the Criminal Law of The Republic of China:

A conduct is committed negligently if the actor fails, although not intentionally, to exercise his duty of care that he should and could have exercised in the circumstances.

A conduct is considered to have been committed negligently if the actor is aware that his conduct would, but firmly believes it will not, accomplish the element of an offense.

While negligence in tort is different from Criminal Law,²¹⁹ this Thesis argues that they are similar enough because both criminal and tort actions cause harm to individual rights

²¹³ See *supra* note 67 at 75.

²¹⁴ See *supra* 14.

²¹⁵ See *supra* note 57 at 2303.

²¹⁶ See *supra* 16. See also *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996), *Dickhoff ex rel. Dickhoff v. Green*, 836 N.W.2d 321 (2013), and *Mohr v. Grantham*, 262 P.3d 490 (2011).

²¹⁷ See *supra* note 3 for Prof. Wang's book at 10.

²¹⁸ See *supra* 26.

²¹⁹ See *supra* note 3 for Prof. Wang's book at 307.

and to society.²²⁰ Negligence occurs when a defendant fails to exercise reasonable care under the circumstances.²²¹ Whether the defendant exercises this duty is based on the reasonable person standard.²²²

Therefore, this Thesis argues that both Taiwanese law and American common law share common characteristics about negligence laws even though they use different sources of laws. Therefore, it is possible for Taiwan to use pure economic loss rule from the American common law.

4.6 The Need for Legislation on Recovery for Pure Economic Loss – A Written Rule to Clarify the Law

If Taiwan should adopt the pure economic loss rule from the American common law, the next question is how it should be done.²²³ This Thesis argues that legislation is a better way to clarify the issue of recovery for pure economic loss because a written rule provides the general public and the courts with clear guidelines.

Using statutes or written rules as a source of pure economic loss rule is not uncommon. For example, Sweden, a Civil Law country, defines pure economic loss in Chapter One of the Swedish Tort Liability Act.²²⁴ This provision allows recovery for pure economic loss and holds a person liable who caused pure economic loss because of the commission of a crime.²²⁵ Similarly, in the United States, the American Law Institute

²²⁰ See *supra* note 67 at 82.

²²¹ See *supra* note 73.

²²² See Article 222 in TAIWAN CODE OF CIVIL PROCEDURE, <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=B0010001>.

²²³ See *supra* 37 for customs and jurisprudence as supplements to laws of civil..

²²⁴ See Chapter One, §2 of SWEDISH TORT LIABILITY ACT (1972).

²²⁵ See Chapter Two, §2 of SWEDISH TORT LIABILITY ACT (1972) and Linn Wredström, *Liability for Pure Economic Loss in English and Swedish Law of Tort — A Comparative Analysis with Special Regard to Problems Concerning Misrepresentation in Non-Contractual Relations*. Master's Thesis, Faculty of Law, Lund University (2004).

adopted and published written rules for pure economic loss in both the *Restatement (Second) of Torts* § 552 (1977) and *Restatement (Third) of Torts: Products Liability* § 21 (1998).²²⁶ In 2012, the American Law Institute further published Tentative No.1 of *Restatement (Third) of Torts: Liability For Economic Harm* §§1-6. This demonstrates that the rules for pure economic loss are important enough to use written statutes or rules.²²⁷

In Taiwan, no rule defines pure economic loss or the standards for recovery for pure economic loss.²²⁸ While Article 1 of the Civil Code allows both domestic and foreign jurisprudence to supplement deficient civil principles, the all-or-nothing approach used in Article 184 prevents Taiwanese courts from utilizing the foreign jurisprudence to supplement a standard for recovery for pure economic loss.²²⁹ To overcome this dilemma, this Thesis argues that Taiwanese pure economic loss rule should be interpreted as follows:

- First, economic interest is a recognizable right under the former part of first paragraph of Article 184 and pure economic loss is recoverable in unintentional tort.
- Second, whether pure economic loss is recoverable under certain circumstances is a matter of coverage of recovery. Here, if policy requires, the legislature could enact a new provision in the Civil Code defining pure economic loss and making clear that one's economic interest is a recognizable right under the former part of first paragraph of Article 184.

²²⁶ See *supra* 32 and 27-28.

²²⁷ See *supra* 32-34.

²²⁸ See *supra* 23.

²²⁹ See *supra* 37-39.

4.7 Choosing Among Approaches: The Proposed Rules and Their Legal Bases

A. A More Workable Way: The Category-by-category Standard for Recovery

So far, this Thesis has argued several claims: First, the current rules in Civil Code of Taiwan are insufficient to deal with recovery for pure economic loss in unintentional tort.²³⁰ Second, the Economic Analysis of Law justifies both the imposition of a duty on a professional to prevent pure economic loss and limitation on that liability to third parties.²³¹ Third, to implement a new rule for pure economic loss in Taiwan, legislation is preferred.²³² Fourth, in Chapter Three, this Thesis surveyed the American common law rules where pure economic loss is generally not recoverable in products liability and in public nuisance cases.²³³ Similarly, for professional's liability for pure economic loss, the American common law provides three different approaches.²³⁴ This category-by-category approach, rather than an all-or-nothing rule presented used, thus presents a better standard for recovery for pure economic loss tort.²³⁵ Finally, the rest of the Chapter will consider which of the various rules used in the United States Taiwan should use.

1) Near Privity Rule

Because of fears of indeterminate liability in tort, some American courts do not allow recovery for professional malpractice unless privity exists.²³⁶ An example is the accountant misrepresentation case in Chapter Three.²³⁷ Here, victims must show: 1) the

²³⁰ *Id.*

²³¹ See *supra* 39-43.

²³² See *supra* 47-48.

²³³ See *supra* 27-29.

²³⁴ See *supra* 30-32.

²³⁵ See *supra* 8.

²³⁶ *Id.*

²³⁷ See *supra* 30.

accountant was aware the financial reports would be used a particular purpose; 2) in the furtherance of which a known party intended to rely; and 3) there was conduct by the accountants linking them to that party, which evinces the accountant's knowledge of that party reliance.²³⁸

However, requiring a near privity between the parties may obscure the line between contract law and tort. As stated in *State Farm Mut. Auto. Ins. Co. v. Ford Motor Co.*, it is important to maintain the distinction between tort law and contract law because the two theories serve different purposes.²³⁹ While tort law protects societal interests in human life, health, and safety, Contract law protects the parties' bargain.²⁴⁰ In addition, if the requirements for near privity rule are satisfied, the victims can sue the defendants for breach of contract on the theory of third party beneficiaries.²⁴¹ Here, if the plaintiff sues the defendant for breach of contract rather than for tort, and if the courts obscure the distinction, contract law will drown in the sea of tort.²⁴² Finally, such a restricted rule cannot fully protect individual rights because it denies recovery for pure economic loss in almost every unintentional tort case.²⁴³

²³⁸ See *supra* note 128.

²³⁹ 592 N.W.2d 201, 214 (1999).

²⁴⁰ *Id.*

²⁴¹ The full text of Article 269 in CIVIL CODE of Taiwan:

When it is provided in a contract that an obligation shall be performed to a third party, the offeror may demand the debtor to perform the obligation to the third party, and such third party also has the right to demand performance direct from the debtor.

So long as the third party has not expressed his intent to take advantage of the contract specified in the preceding paragraph, the parties may modify the contract or revoke it.

If the third party expresses to either of the parties his intent not to take advantage of the contract, he is deemed to never have any right under the contract.

²⁴² See *supra* note 35.

²⁴³ Privity is not necessary to maintain a tort action for negligent representation; the tort of negligent representation defines an independent duty for which recovery in tort for economic loss is available. *Presnell Const. Managers, Inc. v. EH Const., LLC*, 134 S.W.3d 575, 590 (Ky. 2004).

2) Foreseeability Rule

The most liberal approach is to apply a foreseeability test to determine whether the defendant is liable.²⁴⁴ Under the foreseeability rule, a defendant is liable if he should have reasonably foreseen the harm.²⁴⁵ Currently, Taiwanese courts usually hold a victim's economic interest a recognizable right under the former part of first paragraph of Article 184 and apply the foreseeability rule to determine the defendant's liability.²⁴⁶ However, foreseeability rule may be too liberal for the Taiwanese legal system. For example, assume during auditing work, the auditor's report is completed and given to the client, who controls its dissemination.²⁴⁷ If the foreseeability test is used to determine pure economic loss, a thoughtless slip or blunder, or the failure to detect a theft or forgery may expose accountants to an indeterminate liability for an indeterminate time to an indeterminate class.²⁴⁸

3) *Restatement* Approach: The Intended Third Party Rule

The *Restatement* approach limits professional's liability to third parties whom the professional intended to influence.²⁴⁹ Under this rule, the defendant is not subject to a contract-like liability.²⁵⁰ In addition, restricting liability to intended third parties avoids exposing the professional to indeterminate liability to the general public.²⁵¹

²⁴⁴ See *supra* 31.

²⁴⁵ *Id.*

²⁴⁶ See *supra* 23.

²⁴⁷ See *supra* note 2 for *Nycal* at 1370 (citing *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 400 (1992)).

²⁴⁸ See *supra* note 2 for *Ultramares* at 444.

²⁴⁹ See *supra* 32.

²⁵⁰ See *supra* 49-50.

²⁵¹ See *supra* 42-43 for limitation of liability on the basis of Economic Analysis of Law.

The *Restatement* approach is not free from criticism. It could be argued that the *Restatement* rule penalizes knowledge and reward ignorance.²⁵² To avoid liability under this rule, accountants need only agree with clients to remain blissfully unaware of the reports' proposed distribution and uses.²⁵³ However, such conducts could be considered intentional conduct under of Article 13 in Criminal Code of The Republic of China if the accountant knows the act will complete the offense and the acts is not against his will.²⁵⁴ Thus, if the accountant purposely tried to stay unaware of the distribution and uses of the information, he may be subject to liability for intentional harm.²⁵⁵ Instead, the defendant victim should bring suit under the former part of first paragraph of Article 184.²⁵⁶

Under the *Restatement* rule, it also could be argued that liability turns on merely fortuitous event — whether the client of the accountant happened to mention a limited class of persons who would rely on the reports.²⁵⁷ However, an accident itself is fortuitous.²⁵⁸ For example, if a driver negligently runs over a child, did the accident not happen by chance? A loss is fortuitous if it is not intended; thus, chance alone cannot be a reason to exclude liability.²⁵⁹ Instead, the imposition and the scope of tort liability are determined by policy.²⁶⁰ Since the *Restatement* rule allows the recovery for pure economic loss and, at the same time, limits the professional's liability to intended third parties, it both offers better protection for innocent victims and prevents exposing

²⁵² See *supra* note 190 at 784.

²⁵³ *Id.*

²⁵⁴ For reasons why referring to Criminal Code of the Republic of China for definition of intentional act and of negligent act, see *supra* 46-47.

²⁵⁵ Lin Yuhsiung, Hsin Hsing Fa Tsung Tze (General Criminal Law) 181 Taipei: Angle Publishing Co., Ltd., 2006.

²⁵⁶ See *supra* note 63.

²⁵⁷ See *supra* note 190 at 784.

²⁵⁸ Inherent in the plain meaning of “accident” is the doctrine of fortuity. See *Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, 306 S.W.3d 69, 74 (Ky. 2010).

²⁵⁹ *Id.*

²⁶⁰ See *supra* 39-43.

professionals to indeterminate liability.²⁶¹ Thus, this Thesis argues that the *Restatement* rule best conforms to the policy and spirit of the Civil Code of Taiwan.

4) The Proposed Rules Regarding Recovery for Pure Economic Loss in Unintentional Tort

The next task is to propose a specific rule for Taiwanese legal system. This Thesis argues that the best rule is the one derived from both the *Restatement (Second) of Torts* and the Tentative Rule proposed by the American Law Institute for the *Restatement (Third) of Torts: Economic Harm*.²⁶²

a. Overview

Economic interest is a recognized right under the former part of first paragraph of Article 184 and pure economic loss, therefore, is a legally cognized harm.²⁶³ In this way, pure economic loss is recoverable in both intentional and unintentional tort according the former part of first paragraph of Article 184. Second, whether recovery for pure economic loss should be limited under certain circumstances is an issue about the coverage of recovery.²⁶⁴ Here, the general rule in both Articles 213 and 216 is prefaced with “unless otherwise provided by the act or by the contract” and refers to Chapter in the Civil Code on tort law.²⁶⁵ However, none of the statutes in the chapter explicitly mention recovery for pure economic loss in tort actions. As a result, it is necessary to have new

²⁶¹ See *supra* note 190 at 785.

²⁶² See *supra* note 136.

²⁶³ See also *Biakanja v. Irving*, 49 Cal. 2d 647 (1958).

²⁶⁴ See *supra* 48.

²⁶⁵ Taiwanese tort law covers from Article 184 to Article 198 in Civil Code of Taiwan.

legislation.²⁶⁶ To follow the structure of Civil Code of Taiwan, this Thesis argues that the proposed rule should be placed in the chapter on tort law in Civil Code of Taiwan.²⁶⁷

b. The Context of the Proposed Rules

The proposed Article 196-1 in Civil Code provides a standard for recovery for pure economic loss in unintentional tort by as follows:

[Recovery When Parties in Privity of Contract] When parties are *in privity of contract*, pure economic loss caused by negligence in the performance or negotiation of a contract between the parties is *not* recoverable.

[Recovery When Parties Not in Privity of Contract] When parties are *not in privity of contract*, recovery for pure economic loss is subjected to the following rules:

(a) General Principle: Unless otherwise provided by law, pure economic loss is not recoverable in products liability, public nuisance, or other negligence cases if unaccompanied by physical harm to the victim's person or property.

(b) Recovery in Negligent Misrepresentation:

[Liability Rule] (i) A professional, when negligently supplying false information for the guidance of others, is subject to liability for pure economic loss caused to them by their reliance upon the information.

[Limitation on Liability] (ii) Except as stated in subsection (iii), the liability stated in subsection (i) is limited to loss suffered (1) by the person or one of a limited group of persons for whose guidance the actor intends to supply the information, or for whose guidance he knows the recipient intends to supply it; and (2) through reliance upon the information in a transaction that the actor intends to influence, or that he knows the recipient intends to influence, or in a substantially similar transaction.

[Exception to Limitation on Liability] (iii) The liability of one who is under a public duty to supply the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

(c) Recovery in Negligent Performance of Service:

[Liability Rule] (i) A professional, when negligently performing a service for the benefit of others, is subject to liability for pure economic loss caused to them by their reliance upon the service.

²⁶⁶ See *supra* 19.

²⁶⁷ See *supra* note 265.

[Limitation on Liability] (ii) The liability stated in first subsection is limited to loss suffered (1) by the person or one of a limited group of persons for whose benefit the actor performs the service; and (2) through reliance upon it in a transaction that the actor intends to influence.

c. Comments

i. Applying the First Paragraph of Proposed Article 196-1 — Privity of Contract

Under proposed Article 196-1, recovery for pure economic loss depends on whether parties are in privity of contract.²⁶⁸ The first paragraph of the rule incorporates both Sections 3 and 4 of the new *Restatement* rule.²⁶⁹ In the new *Restatement* Section 3, a contract between two parties is the sole source of liability for any financial losses caused by negligence in performing it.²⁷⁰ Section 4, however, is an exception to Section 3, and supports recovery for pure economic loss in other cases.²⁷¹ The rule is established upon two premises. First, the promises by professionals tend to be limited to careful efforts rather than results.²⁷² Second, most clients do not know enough to protect themselves by inspecting the professional's works or by other independent means.²⁷³ Recognizing a tort action therefore assigns the risk of the professionals' negligence to the professionals.²⁷⁴

Contrary to the new *Restatement* rules, the proposed Article 196-1 does not recognize liability for negligence in negotiating or performing a contract even if one of the parties is a professional. This is because Taiwanese contract law gives the plaintiff creditor a special protection by shifting the burden of proving the defendant's negligence

²⁶⁸ See *supra* 54.

²⁶⁹ See *supra* 33.

²⁷⁰ See *comment a.* to Section 4 in RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM (Tentative Draft No.1, 2012).

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ *Id.*

²⁷⁴ *Id.*

in breach of contract to the defendant.²⁷⁵ The defendant must prove he was not negligent in breach of contract to avoid liability and, thus, the client need not specify the professional's obligation.²⁷⁶

Also, even if it's difficult for most clients to protect themselves by inspecting the professional's works, equalizing the bargaining power between contractual parties should be a matter for contract law.²⁷⁷ Finally, exempting the defendant from liability for pure economic loss when parties are in privity does not contradict with the opinion of *Zuigao Fayuan, 77 Nian 19 Tze Minschi Di Er Chuehyi*. This Thesis does not argue that breach of contract can't be a tort; instead, it argues that protecting the contractual parties is a question for contract law.²⁷⁸

ii. Applying the Second Paragraph of Proposed Article 196-1 — Not in Privity of Contract

The second paragraph of the proposed Article 196-1 incorporates common law standards for recovery for pure economic loss from Sections 5 and 6 of the new *Restatement*. This rule establishes the standards for recovery for pure economic loss on a category-by-category basis. Section (a) in the second paragraph of the proposed rule starts with the recovery for pure economic loss in products liability, public nuisance, and

²⁷⁵ Take, the first paragraph of Article 225 in Civil Code of Taiwan, for instance: The debtor will be released from his obligation to perform if the performance becomes impossible by reason of a circumstance to which he is not imputed.

²⁷⁶ Chen Tsungfu, *Yi Liao Su Sung Chih Chu Cheng Tse Jen - Zuigao Fayuan 98 Tai Shang Zi No. 276 Pan Chueh Ping Shih* (Burden of Proof in Medical Malpractice Cases – Analysis on Tai Shang Zi No. 276 by Supreme Court of Taiwan in 2009), *Lawmonthly* Vol.61 No.4 28-55 (2010) However, minority view of scholars in Taiwan thinks that, incomplete performance of contractual obligation that led to other damages such as personal harm or property damages, as is specified by second paragraph of Article 227 of the Civil Code of Taiwan, equals to tort acts and the burden of proving the defendant's negligence should rest on the plaintiff's part.

²⁷⁷ For example, it is a question for contract law to determine whether a specific condition in a standard form contract is fair and binding to contractual parties. See also *supra* note 67 at 17-35.

²⁷⁸ See *supra* note 18.

other negligence cases. Here, pure economic loss is not recoverable in products liability because contract law and warranty law governs harm to product itself.²⁷⁹ Similarly, pure economic loss is also generally not recoverable in public nuisance cases for fear that the defendant may be subject to indeterminate liability.²⁸⁰ Finally, this rule generally does not recognize such liability in unintentional torts and adds “other negligence cases” to prevent any omission.

Section (b) and section (c) in the second paragraph of the proposed Article 196-1 incorporates both Sections 5 and 6 of the new *Restatement* and limits liability for pure economic loss in negligent misrepresentation or performance of service to intended third parties so the defendant is not subject to indeterminate liability.²⁸¹ However, as was done in Section 6 in the new *Restatement*, subsection (iii) in section (b) of the second paragraph of the rule is not carried over here because common law has not called for it.²⁸² As for application of comparative negligence, Article 217 of the Civil Code generally applies, and the proposed rule does not need to incorporate it from Sections 5 and 6 in the new *Restatement*. Article 217 provides that:

If the injured person has negligently contributed in causing or aggravating the injury, the court may reduce or release the amount of the compensation.

If the reason of a grave injury was unknown to the debtor and the injured person has omitted to call the attention of the debtor beforehand, or to avert, or mitigate the injury, the injured person will be deemed to be negligently contributed in the injury.

The provisions of the preceding two paragraphs shall apply mutatis mutandis to the situation when the agent of the injured person or the person performing the obligation for the injured person has negligently contributed to the injury.

²⁷⁹ See *supra* 27-28.

²⁸⁰ See *supra* 29.

²⁸¹ See *supra* 53, the Restatement rule best conforms to the policy concerns and the spirit of Civil Code of Taiwan.

²⁸² See *Reporter's Note (a)* to Section 6 in RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM (Tentative Draft No.1, 2012).

The proposed rule also omits the definition of “professional” because it could be supplemented by customs and jurisprudence according to Article 1 in Civil Code of Taiwan.²⁸³

The next part of this Thesis will apply the proposed rule to the illustrations of economic loss mentioned in Chapter One.

B. Applying the Rules to Illustrations in Chapter One

1) Recovery for Pure Economic Loss in Products Liability²⁸⁴

Assume a buyer brings a tort action claiming recovery for loss of use and personal injuries caused by the defendant’s design defect of a vehicle. Assuming the plaintiff bought the vehicle from a dealer, not directly from the manufacturer, there is no consumer relationship with the defendant manufacturer and, therefore, the Consumer Protection Law does not apply.²⁸⁵ The defendant manufacturer is subject to the general liability for manufacturers according to Article 191-1 in Civil Code.²⁸⁶ To bring suit in tort, the plaintiff therefore has to claim his recovery on the bases of both Article 184 and Article 191-1.²⁸⁷ Coverage of recovery in the tort action is subject to the rules from Articles 192 to 196 and to proposed Article 196-1. Hence, the plaintiff victim may claim

²⁸³ A professional is one who is in the course of his business, profession, or employment, or in any other transaction in which he has a pecuniary interest. See also Section 5 in RESTATEMENT OF THE LAW THIRD TORTS: LIABILITY FOR ECONOMIC HARM (Tentative Draft No.1, 2012).

²⁸⁴ See *supra* 12.

²⁸⁵ Consumer Protection Law is a special rule governing liability for manufacturers; however, it applies to situations only where a legal relationship, the consumer relationship, arises between the consumer and the manufacturer. See *supra* note 67 at 103.

²⁸⁶ The third paragraph of Article 191-1 in Civil Code of Taiwan provides that “the manufacturer mentioned in the preceding (the first) paragraph is the person who produces, manufactures, or processes the merchandise...”

²⁸⁷ The first paragraph of Article 191-1 in Civil Code of Taiwan provides that “the manufacturer is liable for the injury to another arising from the common use or consumption of his merchandise, unless there is no defectiveness in the production, manufacture, process, or design of the merchandise, or the injury is not caused by the defectiveness, or the manufacturer has exercised reasonable care to prevent the injury.”

recovery for personal injuries.²⁸⁸ However, he may not claim loss of use because it is harm to property itself.²⁸⁹

2) Recovery for Pure Economic Loss in Public Nuisance²⁹⁰

In the first example, a construction site collapsed because of the constructor's negligence. As a result, nearby shops had to shut down for several weeks. The plaintiff shop owner has to bring suit in tort claiming lost income during the shut down according to the former part of first paragraph of Article 184. In the second case, Mr. X was trapped at the scene of a car accident and missed out on his contractual opportunities. He also needs to bring suit in tort according to the former part of first paragraph of Article 184. As for coverage of recovery of these two actions, since both the shop owner and Mr. X suffered pure economic loss, it is subject to the proposed Article 196-1.²⁹¹ Thus, the shop owner cannot recover for lost income; neither can Mr. X recover for lost contractual opportunities.²⁹²

3) Recovery of Pure Economic Loss for Negligent Misrepresentation²⁹³

Mr. B negligently issued financial reports of the Company A, and failed to disclose Company A's insolvency. Relying on the reports, a third party suffers pure economic loss in his investment in Company A, and brings a Torts action under the former part of first paragraph of Article 184. Before doing this, the accountant knew the

²⁸⁸ See *supra* 18-20.

²⁸⁹ See *Supra* 54 for section (a) of the second paragraph of the proposed Article 196-1 in CIVIL CODE of Taiwan.

²⁹⁰ See *Supra* 12.

²⁹¹ See *supra* note 289.

²⁹² *Id.*

²⁹³ See *supra* 13.

report would be used by potential buyers of the company to assess financial status, but did not know who the specific third persons would be. Under the proposed Article 196-1, Mr. *B* cannot recover for his lost profits because he is only part of the potential buyers within the general public.²⁹⁴

4) Recovery of Pure Economic Loss for Negligent Performance of Service²⁹⁵

An attorney negligently drafts an invalid will and causes a beneficiary to lose a gift of \$50,000. The beneficiary suffered pure economic loss and he a tort action under the former part of first paragraph of Article 184. Since the lawyer's liability is determinate to the specific victim, the beneficiary can recover damages under section (c) of the second paragraph of the proposed Article 196-1.

²⁹⁴ See *supra* 54 for subsection (ii) of section (b) of the second paragraph of the proposed Article 196-1 in CIVIL CODE of Taiwan.

²⁹⁵ See *supra* 13.

Chapter Five

Conclusion and Development of Pure Economic Loss in the Future

5.1 Suggestions for Recovery for Pure Economic Loss Prior to Adoption of Proposed Legislation: Apply the Foreseeability Rule to Determine the Recovery

Before the proposed legislation is enacted, this Thesis argues that courts should consult case law to protect individual rights.²⁹⁶ In this way, pure economic loss is recognized as harm under the former part of first paragraph of Article 184 in Civil Code of Taiwan.²⁹⁷ Here, the defendant should be liable for pure economic loss where that harm is foreseeable to the defendant, the same approach used under the foreseeability rule in the American common law.²⁹⁸

Similarly, while Taiwanese scholars argue that pure economic loss is not allowed under the former part of first paragraph of Article 184,²⁹⁹ this Thesis argues that such an interpretation is misleading. Instead, it is better to treat the issue as a question of coverage of recovery.³⁰⁰ In this way, pure economic loss can be recovered under limited category-by category basis rather than being denied for every unintentional tort case.³⁰¹

5.2 Recovery for Pure Economic Loss After the Proposed Legislation: Applying the Standard for Recovery for Intended Third Party Rule Under the American Common Law

This Thesis argues that pure economic loss is a recognizable harm under the former part of first paragraph of Article 184 in Civil Code of Taiwan as presently held by

²⁹⁶ See *supra* note 223

²⁹⁷ See *supra* note 87-89.

²⁹⁸ See *supra* 31.

²⁹⁹ See *supra* 6-7.

³⁰⁰ See *supra* 8.

³⁰¹ *Id.*

a majority of Taiwanese court opinions.³⁰² Moreover, this Thesis argues that this best is done by enacting a new legislative standard — the proposed Article 196-1 of the Civil Code of Taiwan. The proposed legislation both properly limits recovery and accommodates the policy concerns of the Civil Code.³⁰³ Once such legislation is enacted, this Thesis argues, Taiwanese courts can solve the issue of recovery for pure economic loss in unintentional tort and that the concerns of either conflict between contract law and tort law or the fear of indeterminate liability of a defendant will be accommodated.

³⁰² See *supra* note 87-89.

³⁰³ See *supra* 53-58.

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