A Production Theory of Pure Economic Loss

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Although the pure economic loss rule has been remarkably durable in the common law, it suffers from a theoretical deficit. The rule has not been properly framed within the broader context of Anglo-American political economy. Any theory must recognize that the rule fundamentally deals with business risk and economic organization. Two conceptions of risk are important: risk to economic assets essential to the production function (loss of a factor of production), and risk to outcomes (loss of production). This Article proposes a production theory of the pure economic loss rule, which is rooted in the neoclassical economic understanding of the relationship between uncertainty and profit. The theory is simply stated: tort law protects one’s factors of production, but not outcomes. The emphasis on the loss of an economic asset departs from the requirement of loss of one’s property, the traditional basis for recovery of consequential economic loss. Ownership is not and should not be the touchstone of recovery. Rather, society has a normative preference for economic production, and tort law protects an asset essential to the production function, irrespective of ownership. The pure economic loss rule is a market abstention doctrine. It reflects a bright line judicial policy against corrective legal action when economic loss represents not a market failure in precaution but instead is a necessary condition of the engagement of enterprise under Knightian uncertainty. Thus, the production theory resolves a classic, longstanding riddle of the common law—that is, why consequential economic loss is recoverable upon a loss of an asset, but pure economic loss is not upon a poor economic outcome.