THE LAW OF TORT

edited by

MICHAEL FURMSTON

Duckworth

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Policies and Trends in Liability for Damage to Property and Economic Loss

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Preface

Each year a Colston Symposium is held in the University of Bristol under the auspices of the Colston Research Society. The Society's financial contribution makes it possible to bring together eminent scholars from all over the world to promote their discussions and to publish the results as an annual Colston Paper. Its funds are contributed by the citizens of Bristol and one of its chief aims is to foster relations between the City and the University. The range of subjects covered in Colston Symposia is extremely wide. This volume is Colston Papers No. 36.

I would like to thank the Council and members of the Society for their support of the symposium in 1984 which produced this book, and in particular the President, Dr H.R. Bentley, who took a keen interest in the planning and running of the event. We also wish to thank the Economic and Social Research Council for a generous grant.

The symposium was jointly directed by Hugh Beale and myself. We are both very grateful to Christine Willmore for much unsung administrative work as Assistant Director. Last but not least I am grateful to Linda Mulcahy who not only compiled the Index and Table of Cases but helped greatly with the scrutiny of the proofs.

M.P.F.

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Introduction

Michael Furmston

During the 1970s the central concern of torts scholarship both in England and in the Commonwealth was in the field of personal injuries. It was widely accepted by writers that the existing tort system was fundamentally flawed because it left many of those who were injured uncompensated and devoted a disproportionate share of resources to the investigation of questions of fault.[1] Those who held these views generally favoured the replacement of the torts system in the field of personal injuries by a state-run social security system which would compensate all those who suffered injury whether or not the person who injured them was negligent. This school of thought was much encouraged by the adoption of such a system in New Zealand[2], and for a time it looked not impossible that there would be similar developments in Australia[3] and in England.[4] Similar views were supported by writers in the United States, although there was also an influential school of thought there which argued that the retention of fault-based liability had important deterrent effects, which would help to minimise the number of accidents.

By the end of the decade this intellectual ferment had largely run its course. Most academic tort lawyers were simultaneously convinced of the desirability of a fundamental change and of the improbability of its occurrence. The Pearson Commission had adopted a gradualist strategy only to find that it was reporting to a Government which was scarcely interested in moving at all. Torts lawyers had succeeded in persuading each other but had signally failed to persuade the politicians.

When we first formulated the plan for a Colston Symposium in 1981, it seemed to us that the time had come to turn to other aspects of the law of tort and in particular to consider how the law should develop in relation to damage to property and the causing of pure economic loss. Developments since, particularly in relation to economic loss, have only served to reinforce this view. All the signs are that we are in the middle of a sea-change in the Common Law's handling of pure economic loss – a change moreover which will be entirely judge-based, since there has not been even the hint of a suggestion of statutory reform in this area. This makes a striking contrast with personal injuries, where many people's preferred solution can only be brought about by legislation.

This Introduction is designed to highlight the main themes of the symposium. It should be explained that the full text of each paper was

circulated in advance and that the presentation of the papers was followed in each case by a full discussion. The discussions were recorded. Space has not permitted the provision of a complete note of the discussion, but account has been taken of some of its main features. In addition each author has rewritten his paper so as, among other things, to meet the main points raised.

1. A statement of the present law as to economic loss

Perhaps the one statement that can be made with complete confidence about the law relating to liability for negligently inflicted pure economic loss is that the law does not appear today to be the same as it appeared to be twenty five years ago. The law has gone through a period of rapid change and it seems likely that that change is not at an end. This much is certain. To describe precisely where the law is now, and where it is likely to go, is much more difficult. It is in a sense puzzling that English lawyers have persisted so long in the view that economic loss can *never* be recovered in tort, since this has not been true of statute law since 1846 and such an absolute denial of any liability is clearly inconsistent with the decisions of the House of Lords in *Morrison v Greystoke Castle*[5] and *Hedley Byrne v Heller*.[6] However, the decision of the House of Lords in *Junior Books Ltd v Veitchi Ltd*[7] appears finally to have removed that proposition from the lexicon of plausible views. The decision has not, however, carried matters forward to a stage where negligently inflicted pure economic loss is treated in exactly the same way as negligently inflicted personal injury.

Junior Books Ltd v Veitchi Ltd leaves many questions unanswered. Indeed it is obscure whether their Lordships have brought forth a mountain or a mouse. Although the theoretical underpinnings of the judgment appear radical, the decision makes only the most marginal change in liability, since on the skeleton facts presented to the court it appears that the defendant would have been liable in contract to his main contractor, who would in turn have been liable to the plaintiff in contract. On the face of it, therefore, the decision does not extend the defendant's liability so much as extend the range of potential defendants available for the plaintiff. It is a matter for speculation why the plaintiff sued the defendant instead of suing the main contractor. If this was because the main contractor was insolvent, the effect is to shift this risk from the plaintiff on to the shoulders of the contractor's other creditors (leaving, apparently, sub-contractors to bear this risk in the reverse case where they have done the work well but have not yet been paid). If it was because the main contractor, though solvent, could not be sued (for example because of an injudicious settlement or an architect's Final Certificate which could not in the circumstances be opened up) it serves, for reasons whose policy basis is not wholly clear, to allow the plaintiff an alternative avenue of attack. The majority speeches in the House of Lords suggest, without deciding, that the decision should not be treated as increasing the sub-contractor's liability so that the sub-contractor who had effectively excluded or limited his liability by contract with the main contractor should

be able to rely on this limitation or exclusion. It is not clear what technical rules can be relied on to produce this effect, which would not be produced if the sub-contractor's negligent performance of the contract had caused the building to fall down.

If we move outside the limited (though important in the construction context) field of nominated sub-contractors to the law of tort in general, we find a similar array of questions whose answers cannot be predicted with any confidence. For example:

1. Is *Spartan Steel* still law?
2. Can a consumer sue a manufacturer who negligently produces a shoddy but not unsafe product?
3. Can a plaintiff who is outside the scope of the Fatal Accidents Act recover for wrongfully inflicted death? In this context it is instructive to see Herbots' account of a French decision allowing a football club to recover for the negligently caused death of one of their players.
4. Similar questions could arise as to non-fatal injuries to employees and the like.

The papers of Stanton and Rabin address this problem from the standpoint of English and American law respectively, but the discussion revealed a striking degree of parallelism. Both speakers agreed that foreseeability did not provide a viable distinction between recoverable and non-recoverable loss in this area and that some further control device or devices were needed, though some scepticism was expressed as to the ability of the courts to develop such devices which would produce results both doctrinally coherent and practically acceptable. Of all the tests suggested by English judges, proximity seems that currently most favoured, and Stanton's discussion shows that a distinction must be drawn between risk proximity and party proximity and that the latter looks the most plausible control.

Rabin argued that proportionality might provide the key, and Herbots' paper revealed that this test had also been employed by French law. Rabin pointed out that economic loss was not the same as, but overlapped with, the problems of the multiple plaintiff. Many such cases – for example, those arising from airline disasters or the many victims of the same medication – simply involved application of established principles on a massive scale. Much more difficult to handle, because the extent of the loss was not only great but difficult to predict, were the cases of ripple effect when a single disaster spread outwards through a chain of victims.

The shadow of Cardozo's famous fear of 'liability in an indeterminate amount for an indeterminate time to an indeterminate class' still hangs over the law, and it is perhaps significant that in virtually all those cases where recovery has been allowed, it was clear that there was in fact no real risk of indefinite liability. This was true not only in *Junior Books* but also in the *Caltex* case;[8] in cases of negligent solicitors such as *Ross v Caunters*[9] and in the building cases[10] (if, as perhaps they should be, they are treated as cases of economic loss).

2. The relationship of contract and tort

Many of the leading economic loss cases occur along the boundary between contract and tort. In both *Junior Books v Veitchi Ltd* and the leading Californian case of *J'Aire*[11] the plaintiff had an apparently satisfactory contract remedy against one defendant but chose instead to pursue a more doubtful tort remedy against a different defendant. In *Junior Books* the reason for this is unclear; in *J'Aire* it was apparently because the plaintiff did not wish to disturb a good business relationship. This type of problem is a central feature of Schwartz's discussion, which considers in particular the inter-relation between a claim in tort on the products liability theory and in contract on an implied warranty theory. It is noteworthy that in English and American law the tendency has been to seek a remedy in tort to avoid a real or perceived difficulty in contract, whereas Herbots reports that in the continental systems the tendency has more commonly been to move into contract to avoid defects in tort.

The developments in tort have called into question a number of fundamental assumptions about the relationship between contract and tort. These are considered not only by Schwartz but also by Stanton and Bishop and in particular by Cane.

It seems clear that after an initial hesitation, represented by *Bagot v Stevens Scanlan*,[12] English law has adhered to its traditional freedom in allowing a plaintiff who can plausibly frame his action in contract or in tort to do so – even where the defendant is the same and the factual basis of the claims identical. The judgment to this effect of Oliver J in considering the liability of a solicitor in *Midland Bank v Hett Stubbs & Kemp*[13] appears to have been completely accepted both by writers and practitioners, and it is noteworthy that the contrary argument was not even raised before the House of Lords in *Pirelli v Oscar Faber*.[14] There has been little support for the notion adopted by French law (but not other continental systems) of non-cumul.

Some have argued that the drift of these developments is towards the coalescence of contract and tort into a single body of rules. On the other hand it can be argued that a legal system which allows a plaintiff a free choice between contract and tort actions and permits a different result on the same facts according to the avenue chosen by the plaintiff is emphasising the separateness of the two sets of rules. Cane's paper is an ambitious attempt to grapple with a general theory of liability for relationship cases. It is clear that there are a number of fundamental issues which remain to be resolved. Are we moving to a stage in which every 'negligent' breath of contract would be a tort? If so, what does 'negligent' mean in this context, especially where there is no danger of physical injury or property damage? How would the trial court in *Junior Books* have decided that the floor-laying was negligent? (By applying the contract standard or by applying some objective external standard such as a British standard?) What is the effect in this context of exclusion clauses, especially as between non-contracting parties?

Any attempt to develop a general theory of obligations will clearly have to face up to the fundamental question of where the line is to be drawn between

fault-based liability and strict liability. It is often said that liability in contract is strict, but this is clearly an oversimplification since the liability of professionals, whether in contract or in tort, is usually fault-based. The discussion that followed Cane's paper included a lively debate on this issue, and many speakers took the view that there were no substantial reasons why a professional should not in appropriate cases be strictly liable. No doubt only the clearest words would amount to a promise by an advocate that he would win a case, but why should a conveyancer not be treated as undertaking that the conveyance will be effective? These arguments have since been reflected in the instructive case of *Thake v Maurice*.[15]

3. What policies should control responsibility for economic loss?

Schwartz argued in his paper that it was a mistake to treat economic loss as a single problem. It should be treated rather as a series of problems calling for different approaches and solutions. There was considerable support for this position, as also for an apparent contradictory view expressed by other speakers that economic loss was not a special problem at all. It may be that this contradiction can be, at least in part, resolved by referring on to the discussion of the Hierarchy of Values. If it were possible to uncouple personal injuries on the one hand from property damage and economic loss on the other, it would be possible to argue that the policies behind liability for property damage are often not different from those behind at least some cases of economic loss. From this point of view it was perhaps wise for the courts in the 1970s to cast a mantle of obscurity over the classification of collapsing buildings as property damage or economic loss.

The papers by Bishop and by Harris and Veljanovski were directly addressed to the policy question via an economic analysis. Although both started from an economic efficiency standpoint, they did not end up in the same place, and the oral discussion revealed lively differences of view. Both papers concur, however, in the view that the problem is not a single problem. Bishop's paper contains a valuable summary of his earlier controversy with Rizzo and develops the notion of vicarious entitlement: that is, the plaintiff who, whatever the formalities, is in commercial reality part of the organisation employed by those to whom the defendant owed his duty.

Harris and Veljanovski developed an analysis, shown in diagrammatic form on p.58, which turns on two sets of distinctions: between voluntary and involuntary relationships and between two-party and three- or more party situations. In this analysis the concept of voluntary relationships is wider than that of contractual relationships. The paper discounts any significant importance to the distinction between pecuniary and technological externalities, but emphasises the consideration of the opportunities to avoid loss available to both parties and the costs of avoidance measures. An instructive example is given on p.50, where the marginal cost of taking extra safety precautions is measured against the probable costs of liability. This suggests that in many of the 'Cable Cases' there is no increase in deterrence

in making the cutter of the cable liable to all who suffer injury since an efficient level of deterrence can be achieved by more restrictive liability, and wider liability simply 'consumes resources in shifting the loss and processing claims'. Other factors which may justify a limited liability rule are the need to avoid 'crushing liability' and the asymmetric treatment of losses and gains.

The discussion by Burrows, though directed at the nuisance liability rule, provides an instructive contrast since, although approaching the problem from an economic standpoint, it challenges the weight given to efficiency arguments. Burrows argues that it is necessary to strike a balance between corrective justice and efficiency (see the example of the two plaintiffs driven from their gardens by fumes from two different defendants on p.203). He also argues that there are significant differences between different theorists in the definition of efficiency and that arguments based on efficiency often overlook the fact that because of information defects the court may not be able to identify the most efficient rule.

4. Insurance

Much of the discussion above has implicitly or explicitly rested on insurance considerations. At the lowest a liability system only operates effectively to the extent that potential defendants insure. At a more sophisticated level it is possible to argue for particular theories of liability on the basis of who can more conveniently (or cheaply) insure. It is often argued that, other things being equal, first-party (loss) insurance is likely to be cheaper than third-party (liability) insurance, since it is normally much easier to foresee the maximum amount of a loss than the maximum extent of liability. This assumes of course that potential loss-sufferers have adequate access to the insurance market and that the risk is one that can be readily insured.

Theoretical writing has so far been weak in empirical studies of what risks are insurable and how the insurance market really works. It has tended to make plausible but unproven assumptions. Hitcham's paper and the ensuing discussion were helpful in this respect. It appears that in England there is a significant overcapacity in the insurance market. One result is to undercut the deterrent effects which theory has often ascribed to liability insurance, since customers with substantial premiums and bad claims records are unlikely to have their premiums loaded to the extent theoretically justifiable, because of the fear that they will take their business elsewhere.

It is also interesting to note Hitcham's view that the loss insurer's right of subrogation where the loss sufferer has a tort claim against a loss inflictor is insignificant in relation to the fixing of premiums. If this is so, there may be a plausible case that subrogation is inefficient since the transaction costs will be significant. One could hardly abolish subrogation, however, and allow the loss sufferer to recover both against his loss insurer and the loss inflictor. This suggests that one needs to reduce the number of situations where loss insurance and liability insurance overlap. It does not follow that loss insurance should always be the preferred alternative, since there are certain

situations where the loss sufferer will be unable or very unlikely to have loss insurance: for example, the disappointed legatee cases such as *Ross v Caunters*.[16]

5. A hierarchy of values

Formally the rules governing the tort of negligence make no distinction between damage to persons and damage to property. On the other hand there are special rules which make it more difficult to recover for careless statements or for pure economic loss. It is fair to say that at the symposium there was little or no support for the values which underpin this system. Instead there was a widespread consensus that personal integrity was entitled to special respect and protection and considerable doubt as to whether property was now entitled to more protection than pure economic loss.

The most vigorous challenge to accepted values was by Abel, who argued that the law should not protect property interests against unintentional interference. Not surprisingly, this thesis produced the most lively discussion of the symposium. It attracted considerable though qualified support from those who would favour covering such losses by first-party insurance. Clearly a prudent man today needs to insure his own property against damage and to insure himself against liability for damage to others.

If society were composed entirely of prudent men this would mean that all losses would be doubly insured, which would be wasteful and inefficient (except possibly for insurance companies). It is perhaps significant that where the potential loss sufferer and the loss inflictor are in a contractual relationship, it is now considered perfectly sensible in many cases for them to agree that the loss should be borne by the loss sufferer, particularly where the loss sufferer will have in any case to insure against the loss being caused without anyone's fault, as in the case of fire insurance.[17]

Abel argues (p.155) that a liability-based system is redistributive from poor to rich. His example of a rich man driving an expensive car involved in an accident with a pensioner driving a cheap car for which both drivers were equally at fault is persuasive if the underlying assumption, that the liability premium of each driver is the same, is true. It appears that there are indeed jurisdictions where all drivers pay a uniform flat-rate liability premium.[18] The English practice of quoting composite premiums for liability and loss insurance makes the position less clear, but it appears probable that the assumption is not empirically valid for England. In any case, car insurance may be thought atypical because most civilised countries (though not the United States) operate a compulsory system of liability insurance. In respect of other losses it was widely felt that a complete shift to first-party insurance was not practicable since many potential loss sufferers (for example, young people living in rented accommodation) have inadequate access to the insurance market.

6. Possible objects of compensation

Underlying all the discussion above are questions about the objectives of the law in awarding compensation. This is the subject of the concluding paper by Ogus, which shows that the law has at various times adopted a number of goals of compensation and that none of the theories advanced can offer a wholly satisfactory explanation of the whole of the results which have been reached. An important feature of the discussion is the existence of systems of compensation in public law and the application to private law systems of the concept of 'demoralisation costs' developed in relation to public law by Michelman,[19] i.e. that the payment of compensation should 'mollify the sense of outrage which the non-payment of compensation might engender'.

1. The literature on this topic is now very extensive. See for instance Atiyah, *Accidents, Compensation and the Law*; Ison, *The Forensic Lottery*.
2. See Report of the Royal Commission of Inquiry into Compensation for Personal Injury in New Zealand 1967; Accident Compensation Act 1972 (NZ); Harris 37 MLR 361.
3. See Report of the National Committee of Inquiry into Compensation and Rehabilitation in Australia 1974, Luntz, *Compensation and Rehabilitation*.
4. Some optimists hoped for this result when the Pearson Royal Commission was set up. For that Commission's Report, see Cmnd 7054 – I, II, III. For a defence of the Commission's strategy, see Marsh 95 LQR 513; for a criticism Fleming 42 MLR 249.
5. [1947] AC 265.
6. [1964] AC 465.
7. [1983] AC 520.
8. [1976] 11 ALR 227.
9. [1980] Ch 297.
10. *Dutton v Bognor Regis UDC* [1972] I QB 373. *Anns v Merton London Borough Council* [1978] AC 728.
11. 24 Cal.3d 799 (1979).
12. [1966] 1 QB 197.
13. [1979] Ch 384.
14. [1983] 1 A11 ER 65.
15. [1984] 2 A11 ER 513.
16. [1980] Ch 297.
17. *Photo Production v Securicor Transport* [1980] AC 827.
18. I am told by Professor Harold Luntz that this is the case in some Australian States.
19. (1967) 80 Harv. LR 1165, 1217-18.

CHAPTER ONE

The recovery of pure economic loss in tort: the current issues of debate

K.M. Stanton

Since 1978 a number of English decisions have adopted a more liberal approach to the recovery of pure economic loss in the tort of negligence. I propose to evaluate the reasoning on which these developments have been based and to attempt to predict the course which this area of law is likely to take. I will put forward two main conclusions. First, that the ad hoc nature of the development of the common law has produced an uncontrolled extension of liability into the field of pure economic loss which the all-pervasive expansionary pressures created by the *Donoghue v Stevenson*[1] 'neighbour' principle are likely to seize upon. Secondly, that many of the difficulties which are thought to stand in the way of an expansion are based on erroneous views concerning forms of civil liability and are therefore likely to be surmounted.

I will approach these issues from a traditional legal standpoint. There are a number of reasons for this. It seems sensible to place the economic analysis of the subject which will follow in subsequent chapters in context, by looking at what the courts have actually claimed to have done and the reasons they have given for doing it. To date, there is no evidence that thinking derived from economic analysis has penetrated the English judicial appreciation of this subject. It is important to evaluate the courts' thinking on its own terms because we are in the grip of a theory which has its own internal and exceptionally powerful logic. Indeed, some recent judicial utterances have favoured the application of this logic to the exclusion of questions of policy.[2] If results derived from economic theory are to influence the law, the need exists to develop a linguistic formulation of these results, and such a formulation could scarcely fail to take account of the 'neighbour' test. From a different standpoint, a review of the judicial approach used to date is of value precisely because of the haphazard techniques which are revealed.

The recovery of pure economic loss under the tort of negligence is one of the last major battlegrounds for the neighbour principle. In essence, the law has to choose between the flexible, but inherently vague, foreseeability test, which may well have triumphed recently in the other, less significant, problem area of nervous shock,[3] or the alternative evolution of 'control'

factors which are always capable of producing arbitrary and anomalous results. The problem with the *Donoghue*-based approach is that it raises the spectre of an over-extensive area of liability which might hamper legitimate trade competition and infringe the traditional preserve of contract. The whole tenor of the development of the tort of negligence in the last fifty years points in this direction, whereas the persistence of the non-recovery of pure economic losses against the background of these developments suggests that there may be something in the nature of this subject which justifies its standing as an exception to the otherwise all-pervasive generalising trend. The current state of the law provides no easy guide. Although the courts have been more liberal in allowing recovery in recent years, no consensus has emerged as to the theoretical justification for this. English law has set out on a voyage of discovery in the absence of any but the most elementary instruments of navigation.

Several subsidiary points need to be borne in mind. First, substantial areas of accepted legal doctrine exist on the basis that pure economic loss is irrecoverable in tort. The Fatal Accidents Act and the insurance principles relating to subrogation are obvious examples. A doctrine this deeply embedded in the law should not be disturbed unless it is necessary to remove it.

Secondly, the capacity of 'control' factors to throw up anomalies tends to throw doubts on the factors themselves. The generalising effect of *Donoghue* is commonly assisted by arguments based on such anomalies. If there are underlying policies justifying the risk of such anomalies they need to be enunciated with clarity to survive.

Thirdly, the law on this issue does not exist in isolation. Pure economic losses are recoverable if they result from breach of contract or certain categories of tortious misstatement. English law has no deep seated antipathy to the recovery of pure economic losses.

Finally, we do have the history of the parallel, if not identical, area of liability for negligent misstatements available to assist us. This history suggests that there may be advantages in the slow evolution of principle, but also that nebulous, and potentially restrictive control factors such as the 'special relationship' are likely to be vulnerable to the neighbour principle.

Anomalies have always abounded in this subject. The commonly understood 'classical' theory allowed the recovery of economic losses consequential on physical damage to a person or his property, but did not permit the recovery of 'pure' economic losses; that is, those arising independently of any physical damage or those arising in consequence of damage to a third party's property. This made recovery of such losses a haphazard prospect. Generations of students have been forced to grapple with the fact that *Spartan Steel and Alloys Ltd v Martin & Co (Contractors) Ltd*[4] allowed recovery if a manufacturer's machines or property were damaged as a result of a tortfeasor damaging a public utility's property, but denied it if the manufacturer's machines were merely switched off. The real issue of whether or not to protect a manufacturer against lost production was sidestepped and the result made to depend on the irrelevant factor of the form of production at