

BBLs LEVEL 1 & 1BCL

Law of Tort:

Tutorial No. 4

Economic Loss

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*"Few areas in modern tort law are darker or more uncertain than pure economic loss"*¹

Introduction

Personal injury and property damage may both have economic consequences. A person who sustains an injury may lose not simply the use of their limbs, but also the earning capacity which goes with it. In such a case, the person will receive compensation for loss of future earnings as well as for the loss of the limb in question. The law of tort provides compensation for economic losses arising directly out of physical loss. This is not controversial. What has long been a pariah in the law of tort however, is the recovery for losses which are purely financial or economic in nature. Such losses are unconnected to personal or physical harm. They are pure economic loss. In most common law jurisdictions, liability is the exception and recovery is normally barred. Pure economic loss was one kind of injury which the courts at common law were loath to compensate. Why should recovery for economic loss be made to depend upon the fortuitous event that it is sustained through the medium of physical or property damage?

Few would argue with the statement that the law should provide greater protection to personal safety and health than to purely economic interests. A general duty of care to avoid causing foreseeable physical injury or disease is widely accepted. But why should interests in tangible property be better protected than mere financial interests? In *Canadian National Railway v. Norsk Pacific Steamship Co*, Stevenson J had this to say about the matter:

"Some argue that there is a fundamental distinction between physical damage and pure economic loss and that the latter is less worthy of protection ... but I am left unconvinced. Although I am prepared to recognise that a human being is more important than property and lost expectations of profit, I fail to see how property and economic losses can be distinguished."

This same kind of dated hierarchy of values has also been advanced in the topic of compensation for psychiatric injury, where some have argued against it on the grounds that *"it is widely felt that trauma to the mind is less serious than lesion to the body"*. Such views show how lawyers and judges fail to adapt to changing social conditions.

Historically, protection of property rights was one of tort law's principal functions, at least as much as the protection of life and limb. Indeed, 19th century common law conferred greater protection upon property than upon the person. Liability for interferences with land was, in many cases, strict, both in nuisance and under the principle of *Rylands v. Fletcher*, while negligent harm to the person frequently did not give rise to any liability due to the limited scope of the duty of care

¹ Harvey, 'Economic Losses and Negligence: The Search for a Just Solution', (1972) 50 Can BR 580

prior to *Donoghue v. Stevenson*. Even so, we still have no concrete explanation as to why there was such a sharp distinction between physical and economic losses.

Why have common law courts engaged on a crusade to slay the dragon of tortious economic loss?

A factor frequently mentioned by the courts as a reason for denying recovery for pure economic loss is the fear of floodgates liability, exposing defendants to an endless series of actions. It is a weak argument since extensive liabilities are just as likely to arise in cases of physical damage, such as pollution and products liability. Hundreds of thousands of claims have been made for asbestos related injuries, faulty contraceptive devices, silicone breast implants or defective heart valves. A duty of care was not denied in these circumstances simply because of the large volume of losses involved.

Another argument is that an open-ended duty of care in relation to economic losses creates a danger of indeterminate liability. Liability would be unpredictable in terms of both the size of claims and the number of potential claimants. This uncertainty, it is argued, would have a deterrent effect in relation to activities that are socially necessary or beneficial, which might not be carried on in the light of the risk of crushing liability for economic damage. An example frequently given concerns liability for the consequences of a road accident.

If a careless driver were potentially liable not simply to those immediately involved in a collision, but to all persons whose businesses or earnings were affected by the accident and the delay caused, then the costs of insurance and motoring would become prohibitive for all road users. Since liability has to stop somewhere, a rule excluding recovery for pure economic loss has the benefit of promoting a degree of legal and commercial certainty. La Forest J in *CNR* said:

“The solution to cases of this type is necessarily pragmatic and involves drawing a line that will exclude at least some people who have been undeniably injured owing to the defendant’s admitted failure to meet the requisite standard of care.”

THE CASES:

In this tutorial we were asked to read three cases outlining the attitudes of the courts to the recovery of pure economic loss in three common law jurisdictions.

Ireland

- *McShane Wholesale Fruit and Vegetable Ltd v. Johnston Haulage Co Ltd*, [1997] 1 ILRM 86 (HC)

Canada

- *Canadian National Railway v. Norsk Pacific Steamship Co.*, (1992) 91 DLR (4th) 289

Australia

- *Perre v. Apand*, (1999) 73 ALJR 1190

IRISH APPROACH

In Ireland, we originally took a very restrictive approach to claims for pure economic loss. Support for this is in the case of *Irish Paper Sacks Ltd v. John Sisk & Son (Dublin)*²

Irish Paper Sacks v. John Sisk

Facts

The defendant's employees, when excavating a trench on the highway, severed a cable that supplied electricity to the plaintiff's factory. This resulted in a power failure lasting two days, during which time the plaintiff had to cease production at the factory. The company suffered economic losses in relation to labour, overheads and loss of profits. It suffered no damage, however, since the severed cable was not on its property.

Held

The court denied recovery. After referring to the decisions of *Electrochrome Ltd v. Welsh Plastics Ltd*³ and *Elliot v. Sir Robert McAlpine & Sun Ltd*⁴, O'Keefe P stated:

"The principle to be derived from these cases is that the plaintiff suing for damages suffered as a result of an act or omission of the defendant cannot recover if the act or omission did not directly injure the plaintiff's person or property, but merely caused consequential loss. After a full consideration of the matter I think that I must apply the principle to these cases."

A more liberal stance was taken by Flood J in *McShane Wholesale Fruit and Vegetables Ltd v. Johnston Haulage Co Ltd*.⁵

McShane Wholesale Fruit v. Johnston

Facts

The plaintiff's factory had been brought to a halt by the loss of electrical power caused by a fire on the defendant's adjoining premises. The plaintiff sued for the economic loss that they sustained. Although the loss suffered by the plaintiff is never actually referred to as being purely economic, the tenor of Flood J's judgment is that he was addressing the issue of the duty to avoid causing purely economic loss rather than merely economic loss consequent on the physical injury sustained by the plaintiff. Flood J was called to try a preliminary issue as to whether economic loss consequent on a negligent act was recoverable in this jurisdiction.

² High Court, 18 May 1972 (O'Keefe P).

³ [1968] 2 All ER 205.

⁴ [1966] 2 Lloyd's LR 482.

⁵ [1997] 1 ILRM 86 (HC)

Held

In determining whether or not a duty of care is owed:

*“The quality of the damage does not arise. It can be damage to property, to the person, financial or economic. The question as to whether damage (of whatever type) is recoverable is dependent on proximity and foreseeability subject to the caveat of compelling exemption on public policy ... [an action] will fail not because the damage is of a particular type, but because the relationship between the wrongdoer and the person who suffers the damage does not have the essential relationship of proximity or neighbourhood. **It therefore follows that the fact that the damage is economic is not in itself a bar to recovery ...**”*

The judge seems to regard claims based on pure economic loss as essentially non-controversial and non-distinctive. However, as pointed out by McMahon and Binchy, Flood J was answering a preliminary issue couched in the broadest of terms: Was economic loss consequent on negligence recoverable in Ireland? His answer went no further than to say that it was not “*inevitably irrecoverable*”. The extent of recovery will be based on proximity, foreseeability and public policy.

Recently, in *Irish Equine Foundation Ltd*⁶ Geoghegan J, having observed the retrenchment of the duty of care in Britain over the past decade, said that:

“The law relating to the recovery of pure economic loss in a negligence action would appear to be different in Ireland having regard to Ward v. McMaster.”

A recent decision of the Supreme Court however suggests that Ireland could soon be following in the footsteps of the House of Lords in the retrenchment of the duty of care and the denial of recovery for pure economic loss with the exception of economic loss caused by negligent misstatements.

Glencar Exploration plc v. Mayo County Council⁷

Facts

There were two companies engaged in prospecting for mining ores and minerals, which had been granted prospecting licences by the Minister for Energy to explore for gold in an area south of Westport. After they had spent large sums of money, the respondent County Council adopted a mining ban in the County Mayo Development Plan. The applicants took judicial review proceedings, claiming a declaration that the mining ban was ultra vires the legislation, an order for certiorari and the award of damages for negligence and breach of statutory duty. The High Court had dismissed the claim for negligence, saying that although the respondents were negligent in the sense that they had done something which no reasonable authority would have done,

⁶ [1999] 2 ILRM 289 (HC)

⁷ [2002] 1 ILRM 481 (SC)

the applicants had no right to damages. The decision was appealed to the Supreme Court.

Held

The Supreme Court decision casts a huge shadow over the recoverability for pure economic loss in Ireland. The Chief Justice went out of his way to mention that he was reserving his position on this question:

“The reason why damages for economic loss – as distinct from compensation for injury to persons or damage to property – are normally not recoverable in tort is best illustrated by an example. If A sells B article which turns out to be defective, B can normally sue A for damages for breach of contract. However, if the article comes into the possession of C, with whom A has no contract, C cannot in general sue A for the defects in the chattel, unless he has suffered personal injury or damage to property within the Donoghue v. Stevenson principle. That would be so even where the defect was latent and did not come to light until the article came into C’s possession. To hold otherwise would be to expose the original seller to actions from an infinite range of persons with whom he never had any relationship in contract or its equivalent. That does not mean that economic loss is always irrecoverable in actions in tort. As already noted, economic loss is recoverable in actions for negligent misstatement ... [However] I would expressly reserve for another occasion the question as to whether economic loss is recoverable in actions for negligence other than for negligent misstatement and ... whether the decision of the House of Lords in Junior Books v. Veitchi should be followed in this jurisdiction.”

Given the enthusiasm with which the Supreme Court applied the restrictive British authorities relating to duty of care, it is very likely that we will see a retrenchment in the area of pure economic loss in Ireland.

RELATIONAL ECONOMIC LOSS

Relational economic loss refers to situations where the claimant suffers economic loss by virtue of damage caused by the defendant to the property of a third party with whom the claimant is in some kind of relationship, contractual or otherwise. The normal rule is that such loss is irrecoverable under English law, unless the claimant can show damage to his or her property. As stated by Lord Brandon in *The Aliakmon*⁸ it is not enough to have had only contractual rights in relation to the damaged property. A claimant must have legal ownership or a possessory title to the property in order to recover for relational economic loss.

It is thought that since most of the claims in this area occur in the commercial arena, the exclusionary attitude is justified because those with merely relational interests in property should have protected themselves by contract with the property

⁸ [1986] AC 785

owner. Although English courts have consistently rejected attempts to circumvent the exclusionary rule regarding relational economic loss, a more flexible approach has been adopted in other common law jurisdictions. We were referred to two of those jurisdictions in this tutorial, the first being Canada and the case of *Canadian National Railway v. Norsk Pacific Steamship Co.*⁹

History

In order to understand the law of relational economic loss as it now stands, it is important to understand where the impetus for the recent changes in the law has originated.

The exclusionary rule for economic losses of any kind can be traced back to the decision of the House of Lords in *Cattle v. Stockton Waterworks Co.*¹⁰ A contractor was retained by a land-owner to construct a tunnel through the latter's land. A third party then interfered with the land in a way which made the contractor's contract less profitable. The House of Lords, while appearing to want to grant the contractor's claim against the third party, stated:

*"If we did so, we should establish an authority for saying that, in such cases as that of Fletcher v. Rylands the defendant would be liable, not only to an action by the owner of the drowned mine, and by such workmen as had their tools or clothes destroyed, but also to an action by every workman and person employed in the mine, who in consequence of the stoppage, made less wages than he would otherwise have done ... It may be said that it is just that such persons should have compensation for the loss, and that if the law does not give them redress, it is imperfect. Perhaps it may be so. But as pointed out by Coleridge J in Lumley v Gye, courts of justice should not "allow themselves, in the pursuit of perfectly completely complete remedies for all wrongful acts to transgress the bounds, which our law ... has imposed on itself of redressing only the proximate and direct consequences of wrongful acts." In this we quite agree."*¹¹

The statements illustrate the driving force behind the exclusionary rule in economic loss: indeterminate liability. Any number of people can be affected by one's negligent interference with another's person or property. If recovery for economic loss was permitted, a tortfeasor could face claims for amounts which could far exceed the damage to the property.

The House of Lords revisited the *Cattle* exclusionary rule in 1947, when it decided *Greystoke Castle*.¹² The plaintiff was a cargo owner who was forced to pay general average damages to the owner of the ship on which it was shipping cargo, because of damage which the defendant had negligently caused by colliding with the ship. The ship's cargo had not been damaged in any way. The cargo owner brought a claim against the defendant for the money it had been required to pay. The House of Lords agreed that the defendant was liable. The House of Lords accepted that in this situation, the ship and cargo owners were so closely intertwined in their relationship

⁹ (1991) 91 DLR (4th) 289

¹⁰ (1875) L.R. 10 QB 453

¹¹ Ibid. at 457, Blackburn L.J.

¹² *Morrison Steamship Co. Ltd v. Greystoke Castle (Cargo Owners)* [1947] AC 265 (HL)

as against third parties that they constituted a ‘common adventure.’ As a result, the cargo owner could recover as if the ship had actually been its property.

Although the House of Lords in *Hedley Byrne v. Heller*¹³ gave the first indication of a crack in the exclusionary wall, the case was restricted to economic loss resulting from negligent misstatements, and did not gain common acceptance as a broad precedent for recovery for relational economic loss. For instance, in *Weller & Co v. Foot and Mouth Disease Research Institute*¹⁴ the court refused to award damages on the grounds of the exclusionary rule, invoking the need to avoid indeterminate liability in commercial situations. The plaintiff breeder had sued for losses suffered because cattle auctions had to be closed due to the defendant’s negligence.

In the *Aliakmon*¹⁵ the House of Lords held that it was preferable to maintain certainty in the law by uniformly enforcing the exclusionary rule. The court also explicitly stated that the *Greystoke Castle* was an anomalous decision which should be restricted to its facts.

Any possible doubt about the English position in relation to relational economic loss ended with *Murphy v. Brentwood District Council*¹⁶. Their conclusion was that outside the situation of negligent misrepresentation, no sufficient theory had developed under *Anns* or any other approach to prevent the possibility of indeterminate liability. While admitting that such cases as the *Greystoke Castle* were still law, they treated that particular case as being based on maritime law and not the common law. They overruled *Anns* and held that outside the negligent misrepresentation context, the *Cattle* exclusionary rule would once again apply in full against any claims for economic loss.

In recent cases both the Australian and Canadian high courts have produced decisions that imply a much greater willingness to award damages for relational economic loss.

CANADA

The *Cattle* exclusionary rule received the Supreme Court of Canada’s approval in *Warner Quinlan Asphalt v. The King*¹⁷. The case involved a claim by a time charterer for compensation under the War Measures Act 1914 for the loss of use of the chartered vessel because it had been expropriated for military service. The Supreme Court affirmed that *Cattle* was the law in Canada and that economic losses could not be recovered for damages to property which one did not possess or own.

In the case of *Gypsum Carriers Inc v. R*¹⁸, four railway companies sued for recovery of the expenses they incurred in rerouting their trains around a bridge negligently damaged by the defendant’s vessel. Collier held that:

“There need not be physical injury to the person or property of another in order to successfully recover for pure economic loss.”

¹³ [1964] AC 562 (HL)

¹⁴ [1966] 1 QB 569

¹⁵ *Leigh and Sullivan v. Aliakmon Ltd.* [1986] AC 785 (HL)

¹⁶ [1991] AC 398 (HL)

¹⁷ [1924] SCR 236

¹⁸ (1977) 78 DLR (3d) 175 (Federal Court Trial Division)

The court analysed the claims on negligence grounds to see whether the damages were a reasonably foreseeable result of the negligence. In the end the court held that the railway's damages were not proximate enough to the bridge's damage to be a reasonably foreseeable consequence of the collision. However, the approach did not last the year.

The same court in *Bethlehem Steel Corp v. St. Lawrence Seaway Authority*¹⁹ quickly retreated from the departure from the exclusionary rule. The court held that there was no exception for relational economic loss. The case involved plaintiffs who had suffered economic losses as a result of the negligent blocking of the St. Lawrence Seaway. The court denied all claims against the limited liability fund. The court said that although the application of the exclusionary rule may offend one's sense of justice, it was important in areas such as relational economic loss for the law to set up a clear system of rules which allow the parties involved to know where they stand and to govern themselves accordingly.

In *Ontario (AG) v. Fatehi*²⁰ Estey J, writing for the Supreme Court, described relational economic loss as "*unrecoverable economic loss*."

This was the situation in Canada before the leading relational economic loss case, *Canadian National Railway Co. v. Norsk Pacific Steamship* ("*Jervis Crown*").²¹

CNR v. Norsk Pacific Steamship

Facts

The New Westminster Railways Bridge, which spans the Fraser River and carries a single railway track, is owned by the Department of Public Works of Canada (PWC). A barge, towed by a tug owned by the defendants Norsk, and negligently navigated by its captain, damaged the bridge. As a result of the damage the bridge was closed for several weeks. CNR had to reroute traffic over another bridge incurring considerable additional expense. CNR, who accounted for 86% of the use of the bridge, had a licence contract with PWC, which obliged them to provide PWC with inspection, consulting maintenance and repair services as and when requested by PWC and at PWC's expense. In the past, there had been other collisions with the bridge leading to its closure due to the heavy marine traffic on the Fraser River. With this in mind, PWC had included an exclusion clause in the licence agreement with CNR, which provided that CNR could not claim damages from PWC in the event of the closure of the bridge in an emergency.

Held

Weir had this rather uncharitable view of the judgments in this case:

"It is fortunate that there are, or were, so many trees in that ex-dominion, for otherwise one might wonder at spending over one hundred pages on futile exercises in comparative law and juvenile law and economics ... what is quite clear is that no practitioner is aided in the slightest by the contrary disquisitions, more suitable to a law review – if one could get them published – than to the law reports."

¹⁹ (1977) 78 DLR (3d) 522 (Federal Court Trial Division)

²⁰ [1984] 2 SCR 536

²¹ [1992] 1 SCR 1021, 91 DLR (4th) 289

This case was actually a 4:3 majority decision; however the precedential value of the decision is weakened because Stevenson J, in allowing the claim, expressly rejected the methodology of the other majority judges.

It might be best to start with the areas where the majority and the minority were in agreement. Both agreed that the “*more flexible approach set out in Anns*” was preferable to the Murphy reasoning, which was expressly stated as not representing the law in Canada. In the words of La Forest J., who delivered the minority judgment: “*I fully support this courts rejection of the broad bar on recovery of pure economic loss.*” The dispute centred on the fact that the plaintiff suffered relational economic loss, i.e. economic loss suffered by a plaintiff as a result of property damage caused to another person.

Secondly, both camps agreed that the law of tort does not permit recovery for all types of economic loss. Thirdly, there was full agreement that cases such as this required a discussion of the wider economic and policy considerations. Finally, both the majority and the minority came within a whisker of bringing the case within the ambit of the rule in *Greystoke Castle*. Where they disagreed was in the “*test for determining the joint venture.*”

Majority: McLachlin, L’Heureux-Dubé and Cory JJ

McLachlin essentially adopted the Wilberforce two-pronged test enunciated in *Anns*. If there were negligence, foreseeable loss and sufficient proximity between the negligent act and the loss, then liability should follow unless “*pragmatic*” considerations dictated the opposite result.

“Proximity may consist of various forms of closeness – physical, circumstantial, causal or assumed – which serve to identify the category of cases in which liability lies ... The meaning of proximity is to be found ... in viewing the circumstances in which it has been found to exist and determining whether the case at issue is similar enough to justify a similar finding.”

She recognised that this would lead to an element of uncertainty in the law of negligence should a brand new category of case arise. However she thought that:

“Such uncertainty is inherent in the common law generally. It is the price the common law pays for flexibility.”

McLachlin then went on to consider her “*pragmatic considerations*”, the most notable of which were the insurance and loss spreading arguments from the law and economics discipline.

Insurance Argument: This stated that the plaintiff was in a better position to obtain cheaper insurance cover for his losses, because he was the only one capable of accurately assessing what his losses would be in the event of an accident. Only he knows the ins and outs of his business, therefore only he would be able to get insurance that would accurately cover his losses. **Response:** McLachlin thought that this argument was based on questionable assumptions. She believed that if the court were to adopt this view, then it would reduce the tortfeasor’s incentive to take care and thus would result in more accidents, which would increase insurance costs.

Loss-Spreading Argument: It was argued that it would be better for the economic well being of society if risk and loss were spread among many parties rather than being placed on the shoulders of a single tortfeasor. The idea behind it is that it is better that a large loss is manageable if you have a large number of people paying a small amount to make up the whole, rather than lumping it all on one person and possibly bankrupting them. **Response:** McLachlin J was just as hostile to this argument. She said that:

“Where losses are spread by relieving the tortfeasor of liability we can expect more accidents, and so more losses. Secondly, some of the victims must sustain large losses not small ones.”

Contractual Allocation of Risk Argument: It was argued that the law of negligence had no role to play in cases such as the present one where the parties could have made provision in their contract saying who should bear such losses. **Response:** The most convincing counter argument put forward by McLachlin was that such a policy presupposes that both parties have equal bargaining power. In this case you had an indispensable bridge which the defendant owned and which the plaintiff had to use or face huge financial burden. The defendant was in an incredibly strong bargaining position and therefore could insert terms like the exclusion clause refusing damages for the closure of the bridge.

Once McLachlin addressed the pragmatic considerations against recovery, she turned her attention as to whether there was sufficient proximity between the parties to justify recovery for the economic loss. Elements of physical and circumstantial closeness were CNR’s connection with the bridge, that CNR’s property could not be enjoyed without linkage to the bridge, which was an integral part of the railway system, and that CNR supplied materials, inspection and services for the bridge, was its predominant user and was recognised in previous negotiations surrounding the closing of the bridge. These factors in combination established a joint venture between the plaintiff and the owners of the bridge, recalling an earlier exception to the exclusionary rule in *Greystoke Castle*. Therefore, the plaintiff’s operations were so closely linked with the operations of the party suffering the physical damage, that for practical purposes, the plaintiff was in the same position as if he/she owned the property that was physically damaged and could thus recover for the economic loss suffered.

One of the major weaknesses of her judgment was that she did not distinguish between the different types of economic loss. She did not limit her judgment purely to relational economic loss. Instead she generalised, and applied her test to economic loss as a whole.

Majority: Stevenson J

This is the least effective of the three judgments, even though it was the swing judgment that won the case for the plaintiff. The core of his decision was that the plaintiff could recover because the defendant knew or ought to have known that “a specific individual ... as opposed to a general or unascertained class of the public” was likely in this instance to suffer foreseeable economic loss. His approach was based on the Australian case of *Caltex Oil v. The Dredge Willemsted*.²² The major

²² (1976) 136 CLR 529

weakness with this case was that the High Court of Australia did not speak with one voice and thus there is no clear ratio decidendi. Only three judges out of seven espoused the proximity test he relied upon, and the decision has met with universal criticism.

Not only has Stevenson J advanced a view that has failed to command wider support, he has also weakened the overall result of the case by expressly disapproving of McLachlin J's proximity test. The result is that we also have no clear ratio in CNR because of Stevenson J's judgment.

Minority: La Forest, Sopinka and Iacobucci JJ

La Forest J had serious doubts about the proximity test used by McLachlin J. He did not agree with lumping all types of economic loss together for analysis:

"Different types of factual situations may invite different approaches to economic loss and it seems to ... be at best unwise to lump them all together for the purposes of analysis."

Precedents from negligent misstatement cases and relational economic loss cases should not be used interchangeably, since they raise different policy issues. La Forest limited his analysis to relational economic loss. He believed relational economic loss was not recoverable because you can never have perfect compensation for such loss because of the unending ripple effects.

La Forest J rejected the joint venture argument. The *Greystoke Castle* exception involved the special relationship between ship and cargo in general average, by which cargo owners are bound to contribute to the ship owner's loss and seeks to recover against the tortfeasor. CNR's contribution to ship maintenance offered no parallel. There was no duty to share profits and losses. He saw no reason in policy why he should relax the exclusionary rule in this case.

La Forest J then went on to counter McLachlin's rejection of the economic arguments.

McLachlin's View: Non-liability would encourage risk takers, cause more accidents and ultimately raise insurance costs. **La Forest Counter:** Risk takers were already deterred from causing accidents because they already have liability to pay for the damaged property that causes the plaintiffs economic loss. In this case, the defendant's were already made liable for the damage they caused to the bridge. This was a sufficient deterrent for accidents and imposing liability for the relational economic loss caused would not make a difference to the deterrent effect that already existed.

Bow Valley Husky (Bermuda Ltd) v. Saint John Shipbuilding Ltd²³

At its broadest, McLachlin's judgment could have been interpreted as suggesting that Canada was willing to go farther than England in *Cattle* or *Murphy* and to award damages for relational economic loss where there was no apparent policy reason to negative liability. However, when the Supreme Court revisited the issue of relational economic loss in *Bow Valley*, it was made clear that Norsk was never meant to herald

²³ (1997), 153 DLR (4th) 385, [1997] 3 SCR 1210.

a general trend towards the imposition of liability for relational economic losses in Canada.

Facts

Husky Oil and Bow Valley hired Saint John Shipbuilding to build an oil drilling rig. Husky Oil and Bow Valley transferred the rig to a company they had established called Bow Valley Husky (Bermuda). As a result, Husky and Bow used the rig, but did not own it. Bow Valley Husky (Bermuda) contracted with Raychem to install a heat trace system in the rig to keep the pipes from freezing. Raychem failed to install a ground fault circuit breaker and the failure resulted in a fire. The rig was out of service for a number of months. Husky and Bow sued St. John Shipbuilding and Raychem in tort to recover their resultant economic losses.

Held

The court divided on a number of issues, but they were all unanimous in rejecting the claim for relational economic loss. In contrast with *Norsk*, McLachlin J did not allow recovery in *Bow Valley*. She did not expressly concede that she had changed her position in favour of the approach adopted by La Forest J. Instead she said:

“The difference in methodology is not ... as great as might be supposed ... La Forest J started from a general exclusionary rule and proceeded to articulate exceptions to that rule where recovery would be permitted. I [McLachlin J], stressed the two step test for when recovery would be available ... Despite this difference ... La Forest J and I agreed on several important propositions: (1) relational economic loss is recoverable only in special circumstances where appropriate conditions are met; (2) these circumstances can be defined by reference to categories which will make the law generally predictable; (3) the categories are not closed. La Forest J identified the categories of recovery of relational economic loss as defined to date as: (1) cases where the claimant has a possessory or proprietary interest in the damaged property; (2) general average cases; and (3) cases where the relationship between the claimant and the property owner constitutes a joint venture.”

She then went on to reiterate her view that the categories are not closed and that the court would need to adapt the two-step test outlined in *Anns* in order to determine if the particular facts of the case avoided the problem of indeterminacy. She seems intent on stressing that there was very little difference between her approach and that of La Forest J in *Norsk*. However, not all of the judges in the case were convinced of her explanation.

Iacobucci J said:

“I understand my colleague’s discussion of this matter to mean that she has adopted the general exclusionary rule and categorical exceptions approach set forth by La Forest J in Norsk.”

I would be more inclined to agree with Iacobucci J, that McLachlin J has resiled from her position in *Norsk. Bow Valley* thus indicates that *Norsk* did not herald a general trend towards the imposition of liability for relational economic loss in Canada.

AUSTRALIA

A form of mild chaos marks the history of economic loss in Australia. The orthodox approach consistently stated that there should never be any recovery for losses not consequential on damage to person or property. In opposition, there developed a body of law allowing exceptions to this rule or denying its validity entirely.

Caltex Oil (Australia) Pty. Ltd. V The Dredge “Willemstad”²⁴

Caltex was the leading case in Australia on the issue of relational economic loss prior to *Perre v Apand*.

Facts

A dredge negligently damaged a pipeline between an oil terminal and a refinery. The terminal owner sued for the economic losses incurred in transporting oil to the refinery using alternate methods. The pipeline was owned by the refinery. The High Court of Australia allowed the claim. However, while the decision was unanimous, it was arrived at on four separate grounds by five judges.

The Decision

Two judges held that there should be an exception to the exclusionary rule where the spectre of indeterminate liability does not arise on the facts of the case. These would be cases where the plaintiff was someone the defendant should have specially foreseen as likely to suffer economic loss as a result of the defendant's actions. This **known plaintiff** would be the only person entitled to recover.

Stephens J decided the case on the basis of proximity, and decided that the test required a strong proximate relationship between the injured and the plaintiff. The judge held that in this case there was sufficient proximity between the plaintiff and the property to grant compensation. This test differed from the **known plaintiff** test in that the defendant's knowledge of this relationship may not be a factor.

Jacobs J based his finding on the **physical propinquity test**. He stated that recovery should be granted where the damaged property in some way has physical effects short of actual injury upon the assets of the plaintiff. Examples would include an inability to move, operate or utilise one's property because of what the tortfeasor has done to another's property. In this case it was accepted that the plaintiff had the movement and use of its oil disrupted by the damage to the pipeline.

²⁴ (1976) 136 CLR 529

Finally, *Murphy J* applied the broadest exception. He turned to the **negligence principle of *Donoghue v Stevenson*** and held that it should include both physical and economic losses on the same grounds: duty of care and reasonably foreseeability.

Obviously, the High Court of Australia knew where it wanted to go in relation to recovery for economic losses; unfortunately it could not agree on how to get there. Equally unfortunate was that each of the principles utilised by the judges in coming to their decision have been extensively criticised as failing to provide the necessary framework and protection to permit us to abandon the exclusionary rule in *Cattle*.

Perre v Apand²⁵

Perre is the most recent decision of the High Court of Australia in the quest to provide a coherent set of principles by which to determine the circumstances in which a defendant owes a duty of care to prevent the suffering by others of purely economic loss. However, once again we are faced with an almost unanimous decision, but are no closer to the resolution of the problem. This is because the seven justices provided six different sets of reasons for their decision.

Facts

A group of companies owned and farmed land in South Australia on which potatoes were grown and on which potatoes grown by others were washed, graded and packed. The plaintiffs exported much of their crop to Western Australia because they received a considerably higher price than that available in South Australia. Apand conducted an experiment with a new brand of seed potato on the property of the Sparnons, which was situated close to the Perre's farms. This experimental seed turned out to be infected with bacterial wilt. This had very serious consequences for the Perres. By Regulations made under the Plant Diseases Act 1914 (Western Australia), the importation of potatoes into Western Australia was prohibited if they had been grown on property within 20 km of any outbreak of bacterial wilt within the previous five years. None of the potatoes grown by the Perres was infected with the wilt, but their ability to sell them profitably was seriously affected. Their claim was therefore for loss to their economic interests unconnected to any injury to their person or property.

Decision

While the High Court was unanimous in upholding the appeal, there was no unanimity in the reasons for that conclusion. Each of the judges recognised that, with respect to liability for purely economic loss, to establish a duty of care requires more than establishing reasonable foreseeability of harm. While reasonable foreseeability may be sufficient in cases of physical injury, the ripple effect which is an inherent aspect of purely economic loss demands some control factor that will limit the range of possible plaintiffs to manageable proportions. The court divided on the appropriate control mechanisms.

Gaudron J was of the view that in all categories of cases of purely economic loss other than that of negligent misrepresentation, a sufficient control mechanism was to

²⁵ (1999) 164 ALR 606

be found in determining whether the defendant had, by its conduct, infringed a legally protected right of the plaintiff. Such an infringement would result in liability if the defendant either knew, or ought to have known, of that effect of its conduct:

“Where a person knows or ought to know that his or her acts or omissions may cause the loss or impairment of legal rights possessed, enjoyed or exercised by another, whether as an individual or as a member of a class, and that that latter person is in no position to protect his or her own interests, there is a relationship such that the law should impose a duty of care on the former to take reasonable steps to avoid a foreseeable risk of economic loss resulting from the loss or impairment of those rights”

On the facts before her, Gaudron J considered that the Perre interests had had a right to sell potatoes in the West Australian market, and the right to use their land and equipment for the production of potatoes for that purpose, rights which were severely infringed by the conduct of Apand.

McHugh J considered that the notion of proximity was no longer a sufficient limitation on liability, and that various other tests, such as those propounded by the House of Lords in *Caparo Industries plc v Dickman* and *Anns v Merton London Borough Council*, were of no use in Australia in sufficiently defining a control mechanism. He went on to say that, in the light of the perceived need of practitioners and trial judges for a measure of certainty, the law:

"should be developed incrementally by reference to the reasons why the material facts in analogous cases did or did not found a duty and by reference to the few principles of general application that can be found in the duty cases".

McHugh J also considered specific matters that should be borne in mind in determining whether a duty exists to guard against or prevent purely economic loss. Those specific factors were: the degree to which liability, if imposed in one case, might lead to indeterminate liability in others; whether liability would constitute an undue burden on the defendant's legitimate trading activities; whether the plaintiff was in a position of relative inability to protect itself; and whether the defendant knew of, or was grossly careless as to, the extent of the risk of harm to the plaintiff. Applying each of these factors to the facts before him, McHugh J had no hesitation in finding that Apand owed a duty to some of the Perre interests.

While Gaudron and McHugh JJ each sought to enunciate a general principle by which to determine the existence of a duty of care, **Gummow J** (with whom **Gleeson CJ** agreed) considered that no general formula could properly be devised. Rather, Gummow J preferred the approach taken by Stephen J in *Caltex Oil*. He isolated a number of '**salient features**' which combined to constitute a sufficiently close relationship to give rise to a duty of care". The "salient features" to which Gummow J paid regard were at least three in number. First was the fact that Apand had actual knowledge of the risks associated with bacterial wilt, and especially that interstate exports would be prohibited from properties within a 20 km radius of an infected farm. Secondly, his Honour noted that Apand controlled the location of its trial with the seed which turned out to be infected, and thirdly he stressed that the Perre interests

had no way of knowing of the risk to which they were being exposed, and consequently no avenue by which to protect themselves against it.

The approach of **Kirby J** differed from each of those considered above. Following the approach that he had adopted in *Pyrenees Shire Council v Day*, Kirby J considered that the preferable methodology for determining whether a duty of care exists is to ask three questions:

First, whether the class of persons to which the plaintiff belongs was reasonably foreseeable by the defendant as likely to be injured by the latter's conduct;

Secondly, whether there existed a sufficient degree of "proximity" or "neighbourhood" between the parties and;

Thirdly, whether it would be fair, just and reasonable to impose a duty in the circumstances of the particular case.

This is, of course, the three-fold test adopted by the House of Lords in *Caparo Industries plc v Dickman*. In the application of this three-fold test to the facts before him, Kirby J found that Apand had in fact foreseen the possibility of economic harm to potato growers generally, and that the requisite degree of proximity was established by the fact that the export ban to Western Australia applied only within a radius of 20 km of a property on which there was an outbreak of disease. Issues of policy also favoured the Perre interests, in that Apand's liability was necessarily limited to those who grew, harvested, washed or graded potatoes, and could not extend to an indeterminate class, and such liability would not unreasonably interfere with the defendant's economic freedom.

The judgment of **Hayne J** has an air of apparent simplicity, which nevertheless goes to the heart of the whole concern over liability for purely economic loss. His Honour considered that the necessary control mechanism could be found in two factors -- the need to prevent indeterminate liability, and the concern not to interfere with ordinary business conduct. Liability would not be indeterminate, so long as it was known to the defendant that it was possible to identify all those who would be affected by its acts or omissions. But liability in negligence would interfere with the ordinary conduct of business if the same conduct, engaged in deliberately rather than negligently, would not have attracted any form of legal censure. On the facts before him, Hayne J concluded that the liability of Apand was clearly not indeterminate, as it was confined by the terms of the Western Australian legislation to being owed only to those growers and processors within a 20 km radius of an affected property. And, if Apand had deliberately sold infected seed to the Sparnons, it would have been in breach of South Australian legislation; hence to find it liable to the relevant Perre interests would not interfere with any of its legitimate business activities.

The approach of **Callinan J** was similar to that of McHugh and Gummow JJ, in that he based the liability of Apand on a variety of factors which, taken in combination, were sufficient to warrant that result. Those factors included: the dominance of the defendants in the whole potato industry, which led to its knowledge (or at least its "heightened awareness") of the dangers of bacterial wilt; the fact that the Western Australian legislation necessarily limited the class of those who might be affected; the observation that the imposition of liability on Apand would not affect its regular

trading activities; and the vulnerability of the plaintiffs arising from their inability to prevent, or even abate, the occurrence of the loss of which they complained.

Common Elements in the Judgments

The fact that even though each of the judges used a different test for liability yet came to the same conclusion suggests that their tests may actually be fundamentally similar. When we strip away the legalistic jargon, we do indeed find that there are many resonances across the disparate tests.

- First, despite the expressed disagreement between McHugh and Kirby JJ over the utility of the three-stage approach of considering foreseeability, proximity and the fairness, justice and reasonableness of the result, there is no great disparity in the substance of the reasoning employed by each judge. Thus, while McHugh J considered various factors in deciding whether this is a proper case for an incremental increase in the range of the duty of care, Kirby J considered matters which are not dissimilar, but in the context of assessing whether there is a sufficient relationship of proximity between the parties, and whether there are any reasons of policy to deny the prima facie duty of care. And one may ask whether either of these approaches is different in substance from the search by Gummow J (and, by his concurrence with that judge, by Gleeson CJ) for the "salient features" that will determine the issue, or the variety of factors considered by Callinan J in his quest for the same solution. One is tempted to say that, at least for every member of the bench other than Gaudron and Hayne JJ, a variety of factors in the relationship between these parties was the prime determinant of liability.
- A second common theme throughout the judgments is the nature of these factors. Each of their Honours points to the fact that Apand's liability is necessarily determinate, in that the Western Australian legislation which imposed the embargo on the potato trade was limited to those involved in the industry whose activities were within 20 km of a property where disease had been found. Thus, it would not apply to a potato grower whose property was more distant from one with disease, nor would the legislation affect people such as those in the trucking industry whose trade may well have been seriously harmed. The very fact of the legislative provision automatically prevented liability from extending with a ripple effect to an ever-widening group of people.
- A further factor to which all the members of the court paid regard was that a finding of liability on the part of Apand would not derogate from its pursuit of its own commercial advantage. The judges acknowledged that commercial activity by anyone in a competitive environment is likely to cause economic harm to others in the same field of commerce, and that to impose liability for negligent conduct may stifle that commercial activity. However, on the facts of this case, Apand's conduct in negligently distributing infected seed acted directly against its own commercial interests. Hence to impose liability for that conduct, and thereby possibly to deter it in the future, would promote rather than hinder competition.

- A final factor regarded as relevant by each of the judges was the vulnerability of the plaintiffs. It was accepted that there was nothing that any of the Perre interests could have done to protect themselves from this harm. Indeed, they had no way of even knowing that infected seed had been sold to the Sparnons for planting on their property.

The judges may have used different frameworks to come to their conclusions, but they were unanimous regarding the important aspects of the case i.e. knowledge, vulnerability and geographical closeness.

The decision means that the law in Australia allows for a greater range of recovery for purely economic loss than is available in any other major common law country.

Economic Loss in the Common Law World

Negligent Misstatements causing Economic Loss: The class of persons to whom the maker of a statement owes a duty of care is broadly similar in Australia²⁶, Canada²⁷ and England²⁸. In New Zealand, the ambit of the duty was put in somewhat more expansive terms in *Scott Group Ltd v McFarlane*, and that decision has lost none of its authority. And, in regard to services negligently provided to a client, leading to financial loss being suffered by a third party, the law in all four jurisdictions is, to all intents and purposes, the same.

Relational Economic Loss: Differences in the law emerge. The English courts have refused to countenance such a head of liability, and have insisted that a loss that is not consequent on damage to the plaintiff's property is not recoverable.²⁹ The Supreme Court of Canada has permitted an exception to that exclusionary rule, if the owner of the damaged goods and the plaintiff who has suffered economic loss are engaged in a common venture,³⁰ although the circumstances when two parties may be regarded as being partners in a common venture for these purposes is narrowly circumscribed.³¹ In this country, on the other hand, the *Caltex Oil* case was the first to break with that exclusionary rule, although a strict reading of the majority of the judgments in that case would suggest that the duty was owed only to a plaintiff who was individually in the contemplation of the defendant as likely to suffer that type of harm. And, until the handing down of the judgment under review, that decision had been followed only once in this country, in *McMullin v ICI Australia Operations Pty Ltd*,³² although it had been followed on two occasions in New Zealand, at first instance.³³ In the light of the decision in *Perre v Apand* it can now be suggested that, subject to the satisfaction

²⁶ See the discussion in *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords (Reg)* (1997) 188 CLR 241; 142 ALR 750, noted by C Phegan, "Reining in Foreseeability: Liability of Auditors to Third Parties for Negligent Misstatement" (1997) 5 TLJ 123.

²⁷ *Hercules Management Ltd v Ernst & Young* [1997] 2 SCR 165; (1997) 146 DLR (4th) 577

²⁸ *Caparo Industries plc v Dickman* [1990] 2 AC 605; [1990] 1 All ER 568.

²⁹ *Leigh & Sullivan Ltd v Aliakmon Shipping Co Ltd* [1986] AC 785; [1986] All ER 145.

³⁰ See the judgment of McLachlin J in *Canadian National Railway Co v Norsk Pacific Steamship Co Ltd* [1992] 1 SCR 1021; (1992) 91 DLR (4th) 289.

³¹ See *Bow Valley Husky (Bermuda) Ltd v Saint John Shipbuilding Ltd* [1997] 3 SCR 1210; (1997) 153 DLR (4th) 385.

³² (1997) 72 FCR 1. In *McMullin v ICI Australia Operations Pty Ltd* (No 7) (1999) 169 ALR 227, Wilcox J concluded that the decision of the High Court in *Perre v Apand Pty Ltd* did not compel him to alter any aspect of his earlier decision.

³³ *New Zealand Forest Products Ltd v Attorney-General* [1986] 1 NZLR 14; *Mainguard Packaging Ltd v Hilton Haulage Ltd* [1990] 1 NZLR 360.

of the other control mechanisms discussed by the court and referred to above, a plaintiff who is no more than a member of a determinate class may seek to recover for the purely economic loss suffered as the result of injury to, or a defect in, property belonging to another.