

RECOVERY OF ECONOMIC LOSS FOR NEGLIGENCE IN AUSTRALIA

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I. INTRODUCTION

The accepted doctrine in Australia until the High Court of Australia handed down its judgment in *Caltex Oil (Aust.) Limited v. The Dredge "Willemstad"*¹ was that a person suffering economic loss resulting from the negligent act of another, in the absence of any physical damage to his property or person, could not recover from the other for that loss.² This rule will be referred to as the "exclusory rule".³ The rule represents an exception to the general rule in the law of negligence that damages are recoverable for injuries or loss suffered by a person caused by the negligence of another where that injury or loss was foreseeable.⁴

The High Court in the *Caltex Case* put the law in Australia on a new path. With the exception of Gibbs, J.,⁵ their Honours decided that the exclusory rule should no longer be of general application. Gibbs, J. adhered to the exclusory rule but found that the facts warranted the carving out of a new exception. The major judgments are those of Stephen, Mason and Gibbs, JJ.⁶ Their Honours discussed the general policy factors bearing on recoverability of economic loss,⁷ analysed previous authority,⁸ and attempted to distil therefrom a test appropriate to the circumstances of the case.⁹ Jacobs, J. adopted an

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¹ (1977) 51 A.L.J.R. 270; (1976) 11 A.L.R. 227 (the *Caltex Case*).

² *Rivtow Marine Ltd. v. Washington Iron Works* [1974] S.C.R. 1189; Laskin, J. at 1216 put the question as "whether recovery may be had in a negligence action for economic loss which stands alone and is not consequent upon physical injury"; *Cattle v. Stockton Waterworks Co.* (1875) L.R. 10 Q.B. 453.

³ This is the term used by Stephen, J. in the *Caltex Case*, *supra* n. 1 at 284.

⁴ *Weller & Co. v. Foot and Mouth Disease Research Institute* [1966] 1 Q.B. 569; [1965] 3 W.L.R. 1082; [1965] 3 All E.R. 560. Foreseeability is not the determinative test; to adopt this test would open liability too widely — the *Caltex Case* *per* Mason, J. at 292-3; but *cf.* *Union Oil Co. v. Oppen* 501 F. 2d 558 (9th Cir. 1974) at 563. Comment (1964) 88 *Harv. L.R.* 444 at 445.

⁵ *Supra* n. 1 at 279. "[I]t is still right to say that as a general rule damages are not recoverable for economic loss which is not consequential upon injury to the plaintiff's person or property". This was the approach of the 9th Circuit Court of Appeal in *Union Oil Co. v. Oppen*, *supra* n. 4.

⁶ *Id.* Gibbs, J., although finding that the exclusory rule should generally apply, discussed the policy factors bearing on recoverability of economic loss.

⁷ *Supra* n. 1 at 278 *per* Gibbs, J.; at 283, 284, 286-9 *per* Stephen, J.; at 293 *per* Mason, J.; at 296 *per* Jacobs, J.; at 298-9 *per* Murphy, J.

⁸ *Id.* 275-9 *per* Gibbs, J.; at 282-8 *per* Stephen, J.; at 291-3 *per* Mason, J.; at 295-7 *per* Jacobs, J.

⁹ *Id.* 279 *per* Gibbs, J.; at 287-8 *per* Stephen, J.; at 293 *per* Mason, J.; at 298 *per* Jacobs, J.; at 299 *per* Murphy, J.

approach different from his brethren¹⁰ but reached the same conclusion. Murphy, J. used little analysis but found that for policy reasons pure economic loss should be treated identically to physical damage, and should be recoverable on the same principles.¹¹

The *Caltex Case* came as something of a culmination of judicial¹² and academic comment.¹³ As the first decision to make a complete break from the exclusory rule the decision will have a significant impact in the common law world. Tort doctrines and developments are remarkably transferable between common law jurisdictions.¹⁴

Before analysing the High Court's judgment it is proposed to discuss what is meant by pure economic loss and the reasons for the past adherence to the exclusory rule. Well established exceptions to the rule will be reviewed.

It will be argued that the inability of the exclusory rule to accommodate proper policy considerations led to its abandonment by the High Court. These policy considerations had opened fissures in the exclusory rule, that could not be remedied except by the invocation of a new approach to the recovery of economic loss.

It is finally proposed to criticize the case and to appraise how it may affect the development of the law generally and in particular in the areas of negligent misstatement and product liability.

¹⁰ *Id.* 296 putting forward the view that the exclusory rule was not the law but that it was necessary in every case to examine how the "so-called economic loss arises. If it arises in a way which can only be characterized as the loss of the benefit of a contract with a third party it will not be recoverable. However, if it arises out of a physical effect on the person or property of the plaintiff, it will not be irrecoverable simply because it is economic loss".

¹¹ *Id.* 298-9.

¹² The tempo of judicial comment had accelerated in recent years; cf. *Weller & Co. v. Foot and Mouth Disease Research Institute*, *supra* n. 4; *S.C.M. (United Kingdom) Ltd. v. W. J. Whittall & Son* [1971] 1 Q.B. 337; [1970] 3 W.L.R. 694; [1970] 3 All E.R. 245; *Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors) Ltd.* [1973] 1 Q.B. 27; [1972] 3 W.L.R. 502; [1972] 3 All E.R. 557. In Canada, *Rivtow Marine Ltd.*, *supra* n. 2; *Seaway Hotels Ltd. v. Gragg (Canada) Ltd.* (1960) 21 D.L.R. (2d) 264; Supreme Court of New South Wales in *French Knit Sales v. N. Gold & Sons* [1972] 2 N.S.W.L.R. 132. This puts aside authority stemming from *Hedley-Byrne v. Heller* [1964] A.C. 465; [1963] 3 W.L.R. 101; [1963] 2 All E.R. 575. American authority is collected in *Union Oil v. Oppen*, *supra* n. 4.

¹³ Commensurate with the increase in judicial comment, has been academic comment. A sample of the legion: Fleming James, "Limitations on Liability for Economic Loss Caused by Negligence — A Pragmatic Appraisal" (1972) 12 *J. Society Pub. Teachers of Law* 105; L. L. Stevens, "Negligent Acts Causing Pure Financial Loss: Policy Factors At Work" (1973) 23 *U. Toronto L.J.* 431; J. C. Smith, "Economic Loss, A Test Case" (1974) 9 *U.B.C.L.R.* 213; P. S. Atiyah, "Negligence and Economic Loss" (1967) 83 *L.Q.R.* 248; C. Harvey, "Economic Losses and Negligence: The Search for a Just Solution" (1972) 50 *Can. B.R.* 580; P. P. Craig, "Negligent Misstatements, Negligent Acts and Economic Loss" (1976) 92 *L.Q.R.* 213; A. H. Brown, "The Recovery of Economic Loss in Tort" (1972) 2 *Auckland U.L.R.* 50; Feldthusen, "Pure Economic Loss Consequent Upon Physical Damage to a Third Party" (1977) 16 *U.W.O.L.R.* 1

¹⁴ *Id.* Fleming James at 107 draws attention to the "remarkable parallel between American decisions . . . and those in the British Commonwealth".

Pure Economic Loss

It is necessary at the outset to understand what the courts have meant by the term "pure economic loss".

In the first place pure economic loss should be contrasted with physical damage. The law of negligence has been primarily concerned with this latter type of damage.¹⁵ The seminal case of *Donoghue v. Stevenson*¹⁶ concerned an allegation of physical harm — gastroenteritis, and shock.¹⁷ There was no claim for the cost of the bottle of ginger beer, even though that was a clear loss.

Pure economic loss is financial damage not suffered as a consequence of physical damage to either the plaintiff's person or his property.¹⁸ It is useful to distinguish the sets of situations in which it may occur.¹⁹ These exist:

- (i) where there is no property damage at all;
- (ii) where there is property damage but the plaintiff has no proprietary interest in the property;
- (iii) where there is damage to the plaintiff's proprietary interest but the economic loss suffered by the plaintiff is not as a consequence of that property damage.

These sets of situations can be exemplified:

(i) *No Property Damage:*

A failure of electricity supply may cause no property damage but may force a shut down of a factory resulting in lost profits. Even though the failure was caused by the negligence of another, the exclusory rule precluded recovery. Another example is the negligent failure of a bank to honour cheques drawn on the plaintiff's account, so that a policy of insurance lapses.²⁰ Immediately, it will be recognized that there is a field of liability very close to this where the courts now allow recovery of pure economic loss. This is liability in negligence for negligent misstatement.²¹ This form of liability was formulated by the House of Lords in *Hedley-Byrne v. Heller*.²² The exclu-

¹⁵ Fleming, *The Law of Torts* (5th ed. 1977) 169.

¹⁶ [1932] A.C. 562.

¹⁷ For a fascinating insight into this case see R. F. V. Heuston, "*Donoghue v. Stevenson* in Retrospect" (1957) 20 *Mod. L.R.* 1. For observations on extension of *Donoghue v. Stevenson* to pecuniary loss, *id.* 18-19.

¹⁸ Cf. P. F. Cane, "Recovery in the High Court of Purely Economic Loss Caused by Negligent Acts" (1977) 13 *U.W.A.L.R.* 243 at n. 1.

¹⁹ Cf. Comment, "Negligent Interference with Economic Expectancy: The Case for Recovery" (1964) 16 *Stan. L.R.* 664 at 666 distinguishes four basic classes of cases.

²⁰ *Ibid.* A further example is that occurring in *Biakanja v. Irving* (1958) 49 Cal. 2d 467; 302 P. 2d 16 — economic loss suffered from the negligent drawing of a will. Cf. R. Jackman, "Solicitors' Liability for Negligence in the Drafting and Execution of a Will" (1971) 5 *Ottawa L.R.* 242.

²¹ *Hedley-Byrne v. Heller* [1964] A.C. 465; *Mutual Life & Citizens' Assurance Co. v. Evatt* [1971] A.C. 793; (1969-70) 122 C.L.R. 628; High Court (1969-70) 122 C.L.R. 556.

²² *Id.*

sory rule has been expressed above so as to exclude negligent misstatement from its ambit. However, it will later be submitted that the *Caltex Case* has an impact on liability for negligent misstatement.

(ii) *No Property Interest:*

The *Caltex Case* is an example of this. Caltex had no proprietary interest in the pipeline which was severed by the negligent conduct of the defendant dredge.²³

(iii) *Loss not a Consequence of Material Damage:*

Cases involving disconnection of utilities are illustrative of this category.²⁴ Although damage may be caused to the plaintiff's property by the cutting off of electricity, for example the solidifying of contents of a furnace, the *pre-Caltex* law held that loss of profits not "truly consequential on the material damage"²⁵ may not be recovered. The deceptive simplicity of that language hides the difficulty of classifying economic damage as being "truly consequential".²⁶

The Formal Basis for the Exclusionary Rule

The courts have supplied the law of negligence with several control mechanisms by which the field of liability can be regulated.²⁷ The two adopted in respect of pure economic loss have been the duty issue and the remoteness issue. Under the former, the courts have denied that a person owes a duty of care to refrain from activities that will foreseeably cause pure economic harm.²⁸ Under the latter the courts have stated that while a duty is owed, pure economic loss is of its nature too remote to be recoverable.²⁹

In the *Caltex Case* both approaches were recognized and commented upon, for the purpose of finding under which, the new test should be framed.

²³ *Per* Stephen, J. at 281: "Although the pipelines were apparently used exclusively for the delivery of products to the Caltex terminal, Caltex had no proprietary or possessory right in respect of the . . ."

²⁴ *S.C.M. (U.K.) Case*, *supra* n. 12 — electricity cut off due to negligent conduct, economic loss caused by lost production not recoverable; *Spartan Steel Case*, *supra* n. 12 — electricity supply interrupted by defendant's negligent conduct; similar circumstances in *British Celanese Ltd. v. A.H. Hunt (Capacitors) Ltd.* [1969] 1 W.L.R. 959; [1969] 2 All E.R. 1252.

²⁵ *S.C.M.*, *id.* 342. *Cf.* *Spartan Steel* [1972] 3 All E.R. 557 at 560.

²⁶ *But cf.* Lord Denning, M.R. in *S.C.M.*, *id.* 346: "Where is the line to be drawn? Lawyers are continually asking that question. But the judges are never defeated by it. We may not be able to draw the line with precision, but we can always say on which side of it any particular case falls."

²⁷ J. G. Fleming, "Remoteness and Duty: The Control Devices in Liability for Negligence" (1953) 31 *Can. B. R.* 471. Smith, *supra* n. 13 at 243 puts forward the view that economic loss raises issues of remoteness and not of duty.

²⁸ The exceptions to the exclusionary rule are put aside, for the purpose of clarity in stating the rule in a duty of care context.

²⁹ In *The S.C.M. Case*, *supra* n. 12 at 345, Lord Denning, M.R. adopts a remoteness test. But in the *Spartan Steel Case*, *supra* n. 25 at 562, his Lordship depairs of choosing: "I think the time has come to discard those tests which have proved so elusive . . . better to consider the particular relationship in hand, and see whether or not, as a matter of policy, economic loss should be recoverable". This "policy approach" is discussed *infra* at p. 126.

Mason, J., having observed that both courses had been taken in propounding the exclusory rule, found that "a more acceptable path to the solution of the problem is to be found through the duty of care."³⁰ Gibbs, J. concluded that the proximity of the relationship between the plaintiff and defendant went to the duty of care,³¹ although his Honour confessed that "in this, as well as in other branches of the law of negligence questions of duty of care and remoteness of damage are difficult to disentangle".³² Stephen, J. talked in terms of the need for sufficient "proximity between tortious act and resultant detriment."³³ This language would indicate that his Honour saw the question as one of remoteness, although he does not turn his mind to the choice of an appropriate formal limiting mechanism.³⁴

Rationale for the Exclusory Rule

The policy reasons for the exclusory rule are dealt with in the three main judgments in the *Caltex Case*.³⁵ The rule was a reflection of the fear that to allow recovery would usher in "liability in an indeterminate amount, for an indeterminate time, to an indeterminate class".³⁶ This judicial fear can be traced in the United States as well as in Commonwealth case law.³⁷

Two aspects of this fear may be discerned. In the first place, from a slight negligent act may flow enormous economic harm.³⁸ Secondly, an increase in claims would place unbearable demands on the court system, in that a multiplicity of claims may flow from one act of negligence.³⁹ Underlying this fear is the issue of limited community resources to be devoted to alleviating economic loss. For this reason economic harm has not figured high in the hierarchy of interests that courts have been willing to protect.⁴⁰ To raise a rule shifting

³⁰ *Supra* n. 1 at 293.

³¹ *Id.* 280.

³² *Id.* 275. Cf. observations of Dixon, J. (as he then was) in *Insurance Commissioner v. Joyce* (1948) 77 C.L.R. 39 at 56; *Nettleship v. Weston* [1971] 2 Q.B. 691; [1971] 3 W.L.R. 370; [1971] 3 All E.R. 581 (*per* Lord Denning).

³³ *Supra* n. 1 at 286.

³⁴ *But cf.* Cane, *supra* n. 18 at 260.

³⁵ *Supra* n. 1 at 278-9 *per* Gibbs, J.; at 284 *per* Stephen, J.; at 293 *per* Mason, J.

³⁶ *Per* Cardozo, C.J. in *Ultramares Corporation v. Touche* 255 N.Y. 170; 174 N.E. 441 (1931). Cf. *supra* n. 1 at 284 *per* Stephen, J. where his Honour criticizes the exclusory rule as "Draconic" and "unexplained either by logic or by common experience", as a response to this fear.

³⁷ For comment on American case law: Fleming James, *supra* n. 13; Comment, "Foreseeability of Third Party Economic Injuries — A Problem in Analysis" (1953) 20 *U. of Chic. L.R.* 283 at 286; Comment, *supra* n. 19; Note, "*Union Oil Co. v. Oppen*: Recovery of a Purely Economic Loss in Negligence" (1974) 60 *Iowa L.R.* 315. The reflection of this fear is treated in Craig, *supra* n. 13 at 214 and 229-33.

³⁸ Fleming James, *supra* n. 13 at 111.

³⁹ Atiyah, *supra* n. 13 at 270-1; Stevens, *supra* n. 13 at 450-3.

⁴⁰ Fleming, *op. cit.* *supra* n. 15 at 166; Atiyah, *supra* n. 13 at 269. An analogy may be drawn with recovery for negligently inflicted nervous shock; the courts were until recently reluctant to ascribe liability, it is submitted, partly because in the spectrum of interests courts were willing to protect, nervous injury was not placed as highly as physical injury.

losses brings with it costs of enforcement. The interests of society in shifting personal and property losses are clear. They have not been apparent to the courts where economic losses are concerned. There has been a great deal of judicial⁴¹ and academic⁴² comment on these policy grounds underpinning the exclusory rule. It is unnecessary now that a new course has been taken by *Caltex* to reiterate those comments. However, at this juncture the ensuing discussion should be placed in context.

Uncertainty of the *Caltex* Policy Approach

It will be suggested below, that the High Court in the *Caltex Case* while supplying what is purported to be a test responsive to policy, for recovery of economic loss, can be criticised in not giving sufficient guidance on what those policy factors should be.⁴³ It will be contended that this leads to unnecessary uncertainty. This was the very charge levelled by various members of the High Court at Lord Denning's general policy approach in the *Spartan Steel Case*, which he expressed in these terms:

It seems to me better to consider the particular relationship in hand, and see whether or not, as a matter of policy, economic loss should be recoverable.⁴⁴

The writer's argument is this: Lord Denning's approach is unsatisfactory because there was no attempt to bring his factors of policy into the form of a rule that could be used by future courts and legal advisers. Further, Lord Denning presented his policy factors in a most undisciplined fashion. His Lordship looked to the particular facts in *Spartan Steel*, drawing out of them *ad hoc* policy perspectives. There was no attempt to abstract a test of liability beyond the factors in that case. For instance, he stresses the fact that there was a break in the supply of electricity and observes that "most people are content to take the risk on themselves . . . they put up with it. They try to make up the economic loss by doing more work next day."⁴⁵ Such observations are not helpful to future decision-makers.

However, the germ of wisdom in this is that, in the end, a court makes its decision on policy grounds. The High Court recognizes this.⁴⁶ The dilemma is how to admit policy reasons and yet inculcate that necessary certainty in the judicial process. The answer to this is to ensure that policy reasons are taken account of within a logical framework.

⁴¹ Generally *supra* n. 12.

⁴² Fleming James, *supra* n. 13; Stevens, *supra* n. 13.

⁴³ *Infra* text at nn. 213, 214.

⁴⁴ *Supra* n. 25 at 563-4. Cf. Solomon and Feldthusen, "Recovery for Pure Economic Loss: The Exclusionary Rule", in Klar (ed.), *Studies in Canadian Tort Law* (1977) 167 at 184-5.

⁴⁵ *Supra* n. 25 at 564.

⁴⁶ *Supra* n. 1 at 286-7 *per* Stephen, J.; at 278 *per* Gibbs, J.

The task is to provide that logical framework which will, on the one hand, supply the policy factors to guide future decisions and, on the other, introduce discipline to make those policy factors consistently applicable. It is suggested that policy factors should be weighed in terms of an interest analysis; that is, there should be a comparison of the competing interests of the actors, and of other persons or institutions involved.⁴⁷ A plaintiff has an interest in conducting his affairs so as to be free from negligent acts causing economic harm.⁴⁸ A defendant has a legitimate interest in a maximum amount of freedom to order his affairs without excessive burdens being placed upon him by way of liability in negligence.⁴⁹

Clearly, society has an interest in the ordering of the relationship between a plaintiff and defendant.⁵⁰ Four social policies have been isolated.⁵¹ These are:

- (i) stabilizing economic relations;
- (ii) preserving freedom of action;
- (iii) distributing economic losses; and
- (iv) discouraging waste and negligent conduct.⁵²

(i) *The Stability of Economic Relations:*

The most important aspect is the upholding of contractual relations. Parties act, adjust their mutual relationship and allocate resources to accord with contractual obligations. A decision, or rule that does not sustain these obligations will have a destabilizing effect. Thus, if an act of negligence forces a breach of contract, a right to recover against the negligent actor will tend to promote economic stability in realizing as far as possible, the original contractual expectations.

(ii) *The Preservation of Freedom of Action:*

Society, as well as the particular actors, has an interest in ensuring that participants in that society are able to conduct their affairs without undue inhibitions. Initiative should not be frozen by fear of undue burdens imposed by the award of damages.⁵³

⁴⁷ Cf. C. E. Carpenter, "Interference with Contractual Relations" (1927-28) 41 *Harv. L.R.* 728 at 732.

⁴⁸ Cf. Comment, *supra* n. 19 at 675.

⁴⁹ *Id.* 676.

⁵⁰ Cf. classic article on interest analysis: Green, "Relational Interests" (1936) 30 *Ill. L.R.* 1 at 4. *Salmond on the Law of Torts* (17th ed. by R. F. V. Heuston, 1977) at 203.

⁵¹ Comment, *supra* n. 19 at 676. For similar exposition of interests in a policy framework: Stevens, *supra* n. 13 at 448-66.

⁵² Comment, *id.* 676-9.

⁵³ The so-called crisis in medical malpractice may be seen in part as a restriction of freedom of the doctor flowing from fear of litigation. This leads to the evils of defensive medicine, unnecessary diagnostic tests and increased costs caused by high insurance premiums. Kretzmer, "The Malpractice Suit. Is It Needed?" (1973) 11 *Osgoode Hall L.J.* 55 at 62. See also Comment, "Alternatives to the Medical Malpractice Phenomenon: Damage Limitations, Malpractice Review Panels and Countersuits" (1977) 34 *Wash. & Lee L.R.*

(iii) *The Distribution of Economic Losses:*

Society looks to an efficient allocation of resources. The law of negligence has been much influenced by the desire of the courts to distribute losses to those with the capacity to bear them.⁵⁴ In the majority of cases the mode of distribution is through the insurance system. The U.S. Ninth Circuit Court of Appeals in *Union Oil* employed an economic analysis bringing to bear questions of loss distribution. However, a cloud hovers above the force of this interest in Australia as Stephen, J. in *Caltex* doubted the desirability of its consideration:

The task of the courts remains that of loss fixing rather than loss spreading and if this is to be altered it is, in my view, a matter for direct legislative action rather than for the courts.⁵⁵

(iv) *Discouragement of Waste and Negligent Conduct:*

Although the effectiveness of negligence liability in acting as a deterrent to wasteful negligent conduct can be doubted,⁵⁶ courts still maintain considerable faith in its force.⁵⁷ It is probable that a good part of the moral or justice policy factor of Stephen, J., as articulated in *Caltex*, is subsumed under this interest perspective. Even if deterrence is not present, the Court may feel that the negligent conduct was of such a kind that it should register its disapproval. An outstanding example of this is the *Union Oil Case*:

[T]he fact that the injury flows directly from the action of escaping oil on the life of the sea . . . , the public's deep disapproval of injuries to the environment and the strong policy of preventing such injuries, all point to the existence of a required duty.⁵⁸

The various interest perspectives in any given case will generally compete. In the *Caltex Case* the interplay may be observed. Opposing the imposition of liability and allowing the loss to rest where it fell, we would find those interest perspectives of preservation of freedom

Footnote 53 (Continued).

1179; Note, "Medical Malpractice Arbitration: A Comparative Analysis" (1976) 62 *Va.L.R.* 1285; Project, "The Medical Malpractice Threat: A Study of Defensive Medicine" [1971] *Duke, L.J.* 939.

⁵⁴ *Griffiths v. Kerkemeyer* (1977) 15 A.L.R. 387 at 399 (High Court of Australia per Stephen, J.); *Launchbury v. Morgans* [1971] 2 Q.B. 245 per Lord Denning, M.R. But cf. House of Lords reversed [1973] A.C. 127.

⁵⁵ *Supra* n. 1 at 289.

⁵⁶ P. S. Atiyah, *Accidents, Compensation and the Law* (2nd ed., 1975) 512-14, 547-57; but cf. G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis* (1970) Ch. 5 and 6; G. Calabresi, "Optional Deterrence and Accidents" (1975) 84 *Yale L.J.* 656. For rejoinder see W. J. Blum and H. Kalven, "The Empty Cabinet of Dr. Calabresi: Auto Accidents and General Deterrence" (1967) 34 *U. Chic. L.R.* 239.

⁵⁷ G. Williams and B. Hepple, *Foundations of the Law of Tort* (1976) at 118 ff.

⁵⁸ *Supra* n. 4 at 569.

of action and distribution of economic losses. However, little weight could be ascribed to the former, as liability is referable to a single act of negligence and damages do not extend to remote consequences.⁵⁹ The fact that the Caltex company was covered with loss insurance withdraws any argument that the finding of liability would spread the losses; loss insurance is more efficient than liability insurance in spreading losses in most circumstances.⁶⁰ On the other hand, while the stabilization of economic relations carries no great weight in *Caltex*, the discouragement of waste and negligent conduct seems to. The action of the defendant was clearly negligent. The possible ramifications of negligence were known to the defendant. The magnitude of the damage could be gauged and the conduct carried no countervailing social value.

However, the High Court employs no analytical approach in dealing with policy perspectives. The root of the matter is that the High Court treats policy as though it were the forbidden apple. It likes the look of it, would like to taste it, but is afraid of its results. Stephen, J., for instance, noted that the Court of Appeals in *Union Oil* isolated three policy factors but then observed that a further six were suggested in an academic comment:

This is illustrative of the diversity of possible policy factors which may be thought to be relevant for consideration if recovery is to depend upon a court's assessment of what is desirable policy in the particular facts of any case.⁶¹

It is as though a court will be lost in a welter of policy reasons composed by bright lawyers. It is suggested that the simple way of digesting the apple is by systematizing the use of policy. There may well be a dozen or more policy factors but this should not lead to confusion so long as the court has a method of programming them. No claim is made that the application of the interest analysis suggested, will solve problems and give certain conclusions. Nor is this the only way of attempting to reach more certain and rational decisions.

However, it is submitted that a full articulation of the interests at stake in the *Caltex Case* would have provided courts coming after with the fundamental reasons for the finding of recoverability of the economic loss. As it is, the High Court has supplied us with very faint guide posts for the future. The evanescent quality of the guide posts and the utility of an interest analysis will become clear in the ensuing discussion.

⁵⁹ *Supra* n. 1 at 287 per Stephen, J.

⁶⁰ Cf. A. V. Alexander, "The Law of Tort and Non-Physical Loss: Insurance Aspects" (1972) 12 *J. Society Pub. Teachers of Law* 119 at 120-4.

⁶¹ *Supra* n. 1 at 283.

Recoverability Outside the Exclusionary Rule

(i) *Specific Areas*

While economic loss caused by negligence has been treated warily, this circumspection has not been apparent elsewhere in the law of torts. A field of liability with much in common with negligence is nuisance. As the famous *Wagon-Mound*⁶² litigation demonstrates, the one set of facts may give rise to actions in both negligence and public nuisance.⁶³ And yet, pure economic loss has always been regarded as recoverable in an action in public nuisance.⁶⁴

The reason for this is apparent; public nuisance provides a limiting mechanism that saves it from the Cardozian nightmare of indeterminate liability. A plaintiff must be able to show that he has suffered damage of a special or particular kind, differing in kind from that suffered by other members of the public.⁶⁵ This had led at least one commentator to favour a rule allowing recovery of pure economic loss in negligence limited by the requirement that the plaintiff show special damage.⁶⁶

Torts based on intentional acts stand on a different ground from negligence, and pure economic loss may be recovered.⁶⁷

The exclusionary rule applied to prevent recovery where economic loss was caused by physical damage to the person or property not of the plaintiff but of another.⁶⁸ For instance, in an American case the plaintiff employees failed to recover in negligence where they had lost their jobs and suffered economic loss because of the alleged negligence of the defendants in handling bombs that destroyed the plant in which they worked.⁶⁹ However, *sui generis* exceptions were carved out of this aspect of the rule by the *actio per quod servitium amisit* and the *actio per quod consortium amisit* doctrines.⁷⁰ The compensation to

⁶² *Overseas Tankship (U.K.) Ltd. v. Miller Steamship Co. Pty. Ltd.* [1967] A.C. 617; *Overseas Tankship (U.K.) Ltd. v. Morts Dock and Engineering Co.* [1961] A.C. 388.

⁶³ This overlap led the Judicial Committee of the Privy Council to find that the test for remoteness of foreseeability of damage was common to both actions sounding in negligence and public nuisance. *Wagon Mound (No. 2)*, *id.* 640 reversing Walsh, J., N.S.W. Supreme Court *sub nom. Miller Steamship Co. Pty. Limited v. Overseas Tankship (U.K.) Limited* [1963] N.S.W.R. 737.

⁶⁴ *Walsh v. Ervin* [1952] V.L.R. 361 (Victorian Supreme Court).

⁶⁵ *Id.* 368, 369.

⁶⁶ Note, "Interference with Business or Occupation: *Union Oil Co. v. Oppen*" (1974) 88 *Harv. L.R.* 444 at 451-3. *Cf.* 9th Circuit of Appeals in the noted case, *supra* n. 4 at 570.

⁶⁷ J. D. Heydon, *Economic Torts* (1973); A. J. Jolowicz, "The Law of Tort and Non-Physical Loss" (1972) 12 *J. Society of Pub. Teachers of Law* 91 at 98-104; Comment (1953) *supra* n. 37 at 297-9.

⁶⁸ *Best v. Samuel Fox & Co. Ltd.* [1952] A.C. 716; *Attorney-General for New South Wales v. Perpetual Trustee Co. Ltd.* [1955] A.C. 457 *per* Lord Simonds at 484.

⁶⁹ *Adams v. Southern Pacific Transportation Company* 123 Cal R. 216 (1975) (Court of Appeals, 3rd District).

⁷⁰ For summary of this law see H. Luntz, *Assessment of Damages* (1974) Chap. 10; Stevens, *supra* n. 13 at 439; Feldthusen, *supra* n. 13 at 59-60, 62-6.

relatives legislation represents a similar legislative exception to the exclusory rule.⁷¹

A specific inroad reviewed by the High Court in the *Caltex Case* was that relating to maritime claims exemplified in the House of Lords decision of *Morrison Steamship Co. Ltd. v. Greystoke Castle (Cargo Owners)*.⁷² In this case, a ship was damaged in a collision at sea and cargo owners became liable for general average contribution to the ship's owners. The cargo owners sued the defendant ship owners to recover their portion of the contribution. The damage was pure economic loss. No physical damage was suffered by the plaintiff as the cargo had not been damaged. The claim was upheld by a majority of the House of Lords. Reliance was placed by the plaintiff in *Caltex* on the wide *dicta* of Lord Roche in the *Greystoke Castle*.⁷³ Gibbs, J. drew from this case that it was a material factor that the parties were engaged in a common adventure.⁷⁴ Stephen, J. considered that the case could not be restricted to the technical doctrine of general average contribution but stood for the principle that "one who encounters the ship or vehicle on the sea or on the highway owes to each party a duty of care to avoid the infliction of injury or economic loss". This duty is owed to "the goods owner" and "the ship or vehicle owner" who is "engaged in a common adventure in the sense that their respective property is open to the same risks of injury".⁷⁵

The United States courts have maintained the exclusory rule,⁷⁶ to which further exceptions have been found.⁷⁷ An exception of a different order is contained in the Court of Appeals case of *Union Oil Co. v. Oppen*.⁷⁸ The Court there found that fishermen suffering economic loss as a result of the Santa Barbara oil spillage were entitled to recover.⁷⁹ The Court was faced with a classic example of pure economic loss. The fishermen had no proprietary rights in the fishing ground. The Court felt obliged to award damages for economic loss, even though the case could not be brought into an exception to the exclusory rule. On a consideration of the policy factors in this case it was decided that this was a proper case to award damages. The

⁷¹ Luntz *id.* 260-74.

⁷² [1947] A.C. 265; [1946] 2 All E.R. 696.

⁷³ *Id.* 280. Comments in *Caltex Case per Gibbs, J., supra* n. 1 at 276; *per Stephen, J.* at 288.

⁷⁴ *Id.* 279.

⁷⁵ *Id.* 285. But *cf.* Jacobs, J. at 297 who did not consider that the *Greystoke Castle, supra* n. 72 could be limited to "common adventure".

⁷⁶ *Robins' Dry Dock and Repair Co. v. Flint* (1927) 275 U.S. 303; 48 S. Ct. 134 (U.S. Supreme Court). W. L. Prosser, *The Law of Torts* (4th ed. 1971) at 940.

⁷⁷ Generally by finding in an action other than negligence, e.g., *Biakanja v. Irving* (1958) 49 Cal. 2d 647; 320 P. 2d 16: the Court found recovery erased on a quasi third party beneficiary theory.

⁷⁸ *Supra* n. 4.

⁷⁹ This case was expressly referred to in *Caltex — per Gibbs, J.* at 278; *per Stephen, J.* at 283. For discussion see Note, *Union Oil Co. v. Oppen, supra* n. 37.

Court was careful however, to avoid opening liability too widely. The Court of Appeals restricted its holding to recovery of damages by the fishermen, expressly stating that the decision did not extend to all those who had suffered economic loss as a consequence of the oil spill.⁸⁰ It is noteworthy that the Court of Appeals, and Gibbs, J. in *Caltex*, took similar approaches in that it was admitted that the exclusory rule was of general applicability but that an exception was created under the respective facts.⁸¹

The *Union Oil Case* is an important precedent in the United States; it may be viewed as a decision weakening considerably the almost universal and blind application of the exclusory rule.

(ii) *Negligent Misstatement*

Before the House of Lords decided *Hedley-Byrne v. Heller*,⁸² the exclusory rule could have been expressed to cover both negligent acts and negligent misstatements. In one jump in that case the law was taken from a denial of the existence of a duty of care to the point of allowing a duty of care to arise for negligent misstatement causing pure economic loss. To establish such a duty of care a special relationship had to be established between the maker of the statement and the recipient of it.⁸³ It is this requirement of the "special relationship" that provided the control mechanism by confining the duty of care within careful limits.⁸⁴ The breadth of the duty of care since *Hedley-Byrne v. Heller* has been subjected to many constricting and expanding forces. This tale cannot be told here.⁸⁵

It is perhaps paradoxical that negligent misstatement rather than negligent conduct should have first heralded in liability for pure economic loss. It was recognized in *Hedley-Byrne* that "words are more volatile than deeds, they travel fast and far afield, they are used without being expended".⁸⁶ Logically, those added dangers should have meant that liability for negligent conduct causing pure economic loss should have presaged negligent misstatement causing pure economic loss. The reason for this reversal lies in the difficulties of

⁸⁰ *Supra* n. 4 at 570.

⁸¹ *Id.* 563, 566, 568.

⁸² *Supra* n. 12. The House of Lords approved the dissenting opinion of Lord Denning in *Candler v. Crane Christmas* [1951] 1 All E.R. 426 at 428 ff.

⁸³ *Supra* n. 12 at 486 *per* Lord Reid; at 502, 503 *per* Lord Morris.

⁸⁴ Fleming, *op. cit.* *supra* n. 15 at 166.

⁸⁵ *Cf. Mutual Life & Citizens Assurance Co. v. Evatt* [1971] A.C. 793. The disparate views of the majority in the Privy Council and the minority of the High Court of Australia with the minority in the Privy Council and the majority in the High Court (*per* Barwick, C.J. (1968) 122 C.L.R. 556 at 569). See K. E. Lindgren, "Professional Negligence in Words and the Privy Council" (1972) 46 *A.L.J.* 176; L. L. Stevens, "Two Steps Forward and Three Back" (1972) 5 *N.Z.U.L.R.* 39. There is a line of cases expanding the ambit of liability to frame the duty test in terms of reasonable foreseeability. *Ministry of Housing and Local Government v. Sharp* [1970] 2 Q.B. 223; [1970] 2 W.L.R. 803; [1970] 1 All E.R. 1009. Further discussion see Craig, *supra* n. 13.

⁸⁶ *Supra* n. 12 at 534.

formulating limiting tests with respect to negligent conduct, and the historically separate growth of negligent misstatement.⁸⁷ A statement to which the law is likely to ascribe a duty is made consciously with an awareness of its possible ramifications. A negligent act, on the other hand, can be a minor transgression of pure oversight with no consciousness as to its serious economic consequences.⁸⁸ Superadded to this is the wide area of damage for which a defendant may be liable under prevailing notions of foreseeability. Mason, J. recognized this in concluding that a test of foreseeability would not sufficiently control liability within acceptable limits.⁸⁹ For a minor transgression should a person be responsible for the almost unbounded economic harm which can result?

If the suggested interest analysis is applied the reasons for finding liability in the context of certain relationships appear. The finding of liability clearly promotes the interests of stabilizing economic relations (as contractual expectations tend to be sustained), distributing economic losses (where the provider is insured or the superior loss bearer, as he generally is where a "special relationship" may be implied), and discouraging waste and negligent conduct in that advice is carefully and thoughtfully provided. The special relationship based upon reliance by the recipient and the assumption of responsibility of the provider, reduces the force of the counter policy of preservation of freedom of action. Advice is provided usually in a free bargaining type of situation. However, in the absence of the special relationship requirement, and its substitution with a broad *Donoghue v. Stevenson* foreseeability test, there may be a much greater check on freedom of action. The other interests may be promoted, less confidently loss distribution, but at a great cost in inhibiting freedom of action. It followed, that so long as liability for negligent conduct was tied to the Atkinian foreseeability test, the finding of a duty of care for pure economic loss would be bought at this cost.

Hedley-Byrne has been used as a basis for denying the vitality of the exclusory rule. The argument ran that *Hedley-Byrne* was not confined to negligent misstatement, but applied equally to negligent con-

⁸⁷ *Nocton v. Ashburton* [1914] A.C. 932 at 947. *Cf.* Craig, *supra* n. 13 at 218 explains the difficulties by the impossibility of avoiding unbridled liability if a *Donoghue v. Stevenson* test were applied, while at the same time the law was wedded to this test in respect of negligent conduct. This was not the case in respect of negligent misstatement where the courts were able to formulate a limiting test.

⁸⁸ *Cf.* *Philco Radio v. Spurling Ltd.* [1949] 2 All E.R. 882 in which a combination of slight acts of negligence, leaving of inflammable film in yard and the flicking of a cigarette into it, led to great property damage. *Smith v. Leech Brain* [1962] 2 Q.B. 405, illustrates the operation of the "thin skull" in respect of physical damage caused, by a negligent act leading to unthought of dire consequences.

⁸⁹ *Supra* n. 1 at 292.

duct.⁹⁰ This point was referred to by Gibbs, J. in *Caltex*. His Honour found that to accept that *Hedley-Byrne* was limited to negligent misstatement would be surprising as it was quite often difficult to distinguish negligent conduct from negligent misstatement.⁹¹

Stephen, J. regarded negligent misstatement as exemplifying a particular situation out of which may be fashioned a formulation "limiting the extent of liability."⁹² Mason, J. also considered that *Hedley-Byrne* could not be compartmented from the issue before the court.⁹³ Their Honours reasoned that *Hedley-Byrne* was a material authority but it did not conflict with the exclusory rule. In other words, it gave guidance in demonstrating that pure economic loss was recoverable by the application of relevant limiting tests. The courts, as Mason, J. acknowledged, firmly denied that *Hedley-Byrne* would usher in a general duty of care to avoid economic loss.⁹⁴

The search for limits in respect of negligent misstatement still goes on. Putting aside the special case relating to public authorities,⁹⁵ the debate is whether the duty of care should be extended, from particular recipients of advice in particular transactions of which the defendant knew, to classes of recipients and transactions of which he knew,⁹⁶ and indeed whether these limiting tests should be dispensed with in favour of a general foreseeability test. The *Caltex Case* is instructive in the line of development that may be taken in the law

⁹⁰ *Ministry of Housing and Local Government v. Sharp*, *supra* n. 85 *per* Salmond, L.J. at 278: "[T]he existence of a duty of care to take reasonable care no longer depends upon whether it is physical injury or financial loss which can reasonably be foreseen". See also *Hedley-Byrne v. Heller*, *supra* n. 12 at 516-17 *per* Lord Devlin.

⁹¹ *Supra* n. 1 at 278.

⁹² *Id.* 287.

⁹³ *Id.* 292-3.

⁹⁴ *Id.* 291. Amongst the authorities are: *The World Harmony* [1967] P. 341; [1965] 2 W.L.R. 1275; *Weller & Co. v. Foot and Mouth Disease Research Institute*, *supra* n. 4; *Electrochrome Ltd. v. Welsh Plastics Ltd.* [1968] 2 All E.R. 205; *British Celanese Ltd.*, *supra* n. 24. See also Stevens, *supra* n. 13 at 434.

⁹⁵ *Supra* n. 1 at 292 *per* Mason, J. *Cf.* Glass, J., "Duty to Avoid Economic Loss" (1977) 51 *A.L.J.* 372 at 380. C. Phegan, "Tort Liability of Local Authorities", paper presented in Series: *Recent Developments in Equity and the Law of Torts and Contract*, Committee for Post-Graduate Studies in the Department of Law, University of Sydney, October 19, 1978, at 6, 7. In the United States there has grown a separate body of case law on advice given by public officers, the general foreseeability test has been applied: *Mulroy v. Wright* (1931) 240 N.W. 116; *Commonwealth for Use of Green v. Johnson* (1906) 96 S.W. 801; *Buszta v. Souther* (1967) 232 A. 2d 396. *Cf.* where information on public record *Vandewater & Lapp v. Sacks Builders* (1959) 186 N.Y.S. 2d 103.

⁹⁶ *M.L.C. v. Evatt*, *supra* n. 21 at 570, *per* Barwick, C.J. observed in describing the requisite "special relationship" between provider and recipient of information:

The information or advice will be sought or accepted by a person on his own behalf or on behalf of another identified or identifiable person or on behalf of an identified or identifiable class of persons.

Cf. Comment, *supra* n. 19 at 690-2. The Supreme Court of Canada developed the law relating to an auditor's liability for negligent misstatement along these lines in *Haig v. Bamford* [1976] 3 W.W.R. 331 at 338. See discussion *infra* text at nn. 233-40.

relating to negligent misstatement.⁹⁷ The implications of *Caltex* in respect of negligent misstatement are taken up below.⁹⁸

The Limits of the Exclusionary Rule

It is commonly observable that when rules of law do not meet legitimate expectations in the community, the courts attempt to meet those expectations by preserving the rule but interpreting it so as to find exceptions to accommodate those expectations.⁹⁹ The application of the exclusionary rule by the courts exemplifies this process. The courts were able to accommodate deserving cases by, first discovering an element of physical damage to which the economic loss could be described as consequent; second, by characterizing the loss not as economic but as physical loss.

Recovery of financial loss suffered as a consequence of physical damage in the measure of damages, provided the courts with a convenient method of allowing recovery for economic loss, where the elements of consequential damage were made out. In measuring damages, a person injured by the negligent conduct of another may recover damages not only for medical expenses but also for loss of earning capacity. This is an economic loss consequent upon the physical injury sustained by that person. The availability of recovery for economic loss where that loss could be tied to physical damage engaged the courts in a search to find that the plaintiff had a property right in damaged goods from which had flowed the economic loss suffered by him.¹⁰⁰ If some element of property damage could be shown this may have been a sufficient peg on which to hang recovery for economic loss. The application of the rule allowing recovery in the presence of material damage was highly capricious. A charterer by demise may recover for loss of use of a ship if it were immobilized by the negligent act of the defendant, but a time charterer could not.¹⁰¹ Recovery thus turned on a completely arbitrary factor.¹⁰² Similarly, if the Caltex company had obtained a proprietary right in the pipe

⁹⁷ See *infra* text at nn. 200-4, 228-43.

⁹⁸ *Ibid.*

⁹⁹ For example, in occupiers' liability, the rule that an occupier owed no duty of care to a trespasser on his premises was established by the House of Lords in *Robert Addie & Sons (Collieries) Ltd. v. Dumbreck* [1929] A.C. 358. The courts, in the ensuing years, struggled to find exceptions to the rule that would permit recovery by plaintiff trespassers in proper circumstances. Cf. W. L. Morison, R. L. Sharwood and C. S. Phegan, *Cases on Torts* (4th ed., 1973) at 605-14; Fleming, *op. cit. supra* n. 15 at 458-66. This accommodation of exceptions eventually led to the formulation of a new rule by the House of Lords in *British Railways Board v. Herrington* [1972] A.C. 877, and by the Judicial Committee of the Privy Council on appeal from the High Court of Australia in *Southern Portland Cement v. Cooper* [1974] A.C. 623.

¹⁰⁰ The rule stems from the House of Lords case *Simpson v. Thomson* (1877) 3 App. Cas. 279 at 289. The rule was applied in *El.ott Steam Tug Co. Ltd. v. Shipping Controller* [1922] 1 K.B. 127 (Court of App.al). Cf. *French Knit Sales Pty. Limited, supra* n. 12.

¹⁰¹ Cf. Feldthusen, *supra* n. 13 at 41-2; Atiyah, *supra* n. 13 at 266-7.

¹⁰² *Supra* n. 1 at 284 *per* Stephen, J.

line severed by the defendant dredge's negligence, it could have recovered. It is clear that functionally the chance of possessing a proprietary interest should be of no moment. Stephen, J. was led to comment that, in light of this arbitrariness, the exclusory rule was a "high price to pay for protection against the fear of possibly excessive extension of the right to recover compensation for a proved loss".¹⁰³

The zenith of the artificiality of the requirement for nexus between physical harm and economic loss may be observed in *Seaway Hotels Ltd. v. Gragg (Canada) Ltd.*¹⁰⁴ In this case electricity was cut off by the defendant, severing a power line supplying the plaintiffs. The plaintiffs were not only able to recover for spoiled foodstuffs, but also for loss of profit arising from closing down of the dining room and bar because of lack of refrigeration.¹⁰⁵ It is difficult to see how the loss of profit flowed from the physical damage of the spoiled foodstuffs. That loss of profit more naturally resulted from the damaged power line in which the plaintiffs had no property interest.¹⁰⁶

Lord Denning, M.R. in *S.C.M.(U.K.) Ltd. v. W. J. Whittall* and in *Spartan Steel* attempted to develop the law along the consequential economic loss line. His Lordship rejected as an "opprobrious epithet" the use of "parasitic damages".¹⁰⁷ He emphasized that the economic loss must be "truly consequential on the physical damages".¹⁰⁸ In light of *S.C.M.* and *Spartan Steel*, the *Seaway Hotels Case* was subject to doubt in so far as recovery for loss of profits was allowed.¹⁰⁹ Any notion of "parasitic damages" must accordingly be limited to economic loss consequent on physical injury; the mere presence of some physical injury would not be sufficient.¹¹⁰ In the *Caltex Case*, the plaintiff did in fact suffer some material damage. Some of its oil had escaped from the broken pipe, but the economic loss claimed did not flow from the lost oil. It resulted from the severed pipe and the consequent dislocation of supplies.¹¹¹ The facts in *Spartan Steel* are also instructive. The plaintiff manufactured stainless steel. The electricity cable to its factory was cut through the negligent conduct of the defendants. This put an arc furnace out of commission. The plaintiff took steps to remove the

¹⁰³ *Ibid.*

¹⁰⁴ *Supra* n. 12.

¹⁰⁵ *Cf. Stevens, supra* n. 13 at 443; Harvey, *supra* n. 13 at 594, 595.

¹⁰⁶ *Cf. S.C.M., supra* n. 12 at 343 *per* Lord Denning, M.R.

¹⁰⁷ *Spartan Steel, supra* n. 25 at 561.

¹⁰⁸ *Id.* 560.

¹⁰⁹ *S.C.M., supra* n. 12 at 343 *per* Lord Denning, M.R.

¹¹⁰ *Cf. Winfield and Jolowicz on Tort* (10th ed. by W. H. V. Rogers, 1975) at 52, n. 43a considers that the *Seaway Hotels Case, supra* n. 12, is good law except for actions "arising out of the negligent interruption of supplies or services". The learned editor confirms this view in case note, "Economic Loss in the High Court of Australia" (1978) 34 *Camb. L.J.* 27 at 29-30, where he indicates that "the same answer would have been reached in *Caltex* by the application of the . . . now well interned principle of 'parasitic' damages exemplified in *Seaway Hotels v. Gragg*". It is difficult to agree with this proposition in light of *S.C.M.* and *Spartan Steel*.

¹¹¹ *Supra* n. 1 at 282 *per* Stephen, J.

molten metal from the furnace before it could damage its lining. The metal was consequently of much less value. If the interrupted melt had been completed a profit would have been made. In addition, the plant was shut down for some time, preventing further melts and causing loss of profits. This last head of damage, Lord Denning found, was not truly consequential. It was, therefore, not recoverable. In *Spartan Steel* it was apparent that the latter head of lost profits was not caused by the physical damage to the metal but by the cutting off of electricity.

In conclusion, it may be said that the test depending on whether economic loss was "truly consequential" creates as many problems as it solves. Its major fault in application is that it leads to capricious results depending upon the random chance that the plaintiff's property or person has been damaged.¹¹² In addition, it introduces notions of causation that are notoriously difficult to resolve.

A further approach still dependent on the element of physical damage to the plaintiff's property or person was suggested in *Weller & Co. v. Foot and Mouth Disease Research Institute*.¹¹³ Widgery, J. opined that the particular scope of the duty of care owed by the defendant was to persons whose property and person were foreseeably at risk. The plaintiff in this case did not fall within the scope of the duty of care. Its property was not foreseeably at risk, although it was foreseeable that it would suffer financial harm as a result of the defendant's negligence.¹¹⁴

The courts have accommodated the exclusory rule to a wider demand for recovery, by the articulation of a principle in a line of cases, that damage may be labelled "physical" rather than "economic". Lord Denning, M.R. proved to be the catalyst in *Dutton v. Bognor Regis Urban District Council*.¹¹⁵ In this case the subject structure was damaged due to subsidence of the foundations. The owner claimed the amount required to repair the building and its diminution in value. A proper inspection by the Council pursuant to its powers under the Public Health Act, 1936 (U.K.) would have revealed the inadequacy of the foundations. His Lordship found that the claim for negligence against the Council could not be limited "to those who suffered bodily

¹¹² For limits as formulated by American Courts see Comment, *supra* n. 19 at 668-9.

¹¹³ *Supra* n. 4 per Widgery, J. at 587 explains previous authority finding liability: "The duty of care arose only because a lack of care might cause direct injury to the person or property of someone and the duty was owed only to those whose person or property were foreseeably at risk".

¹¹⁴ *Ibid.* Cf. Mason, J., *supra* n. 1 at 293. The development of this rule is analogous to the development of the law regarding recoverability for negligently inflicted nervous shock. *Bourhill v. Young* [1943] A.C. 92. Cf. Atiyah, *supra* n. 13 at 256, 274.

¹¹⁵ [1972] 1 Q.B. 373; [1972] 2 W.L.R. 299; [1972] 1 All E.R. 466.

harm"; the damage done "was not solely economic loss. It was physical damage to the house."¹¹⁶

In *Anns v. Merton London Borough Council*¹¹⁷ the House of Lords confirmed this aspect of the *Dutton Case*. Lord Wilberforce found that a duty of care arising from the statute was reposed on the Council. The duty of care covered damage to the dwelling house itself:

If classification is required, the relevant damage is in my opinion material, physical damage, and what is recoverable is the amount of expenditure necessary to restore the dwelling to a condition in which it is no longer a danger to the health or safety of persons occupying [it].¹¹⁸

Lord Wilberforce drew support from the dissenting (in part) judgment of Laskin, J. (as he then was) in the Canadian Supreme Court case of *Rivtow Marine Ltd.*¹¹⁹ and the New Zealand Court of Appeal case of *Bowen v. Paramount Builders (Hamilton) Ltd.*¹²⁰ Both of these cases are significant because they take the law from the context of duties of statutory bodies and apply it, to manufacturers in the *Rivtow Case*, and to builders in the *Bowen Case*.¹²¹ In *Bowen*, the negligence of the defendant builder caused damage or threatened damage to the building itself. The costs of repairs, and restoration were characterized respectively, as physical damage and economic loss resulting from it, rather than "pure" economic loss.¹²²

In the *Rivtow Case* no physical damage had manifested itself. The claim in this case arose out of losses incurred by the plaintiff in withdrawing a crane from service on discovery that an identical crane was subject to latent defects making it susceptible to collapse. The majority of the Canadian Supreme Court allowed damages for loss of profits for the period in which the crane was idle,¹²³ but denied recovery for cost of repairs to render the crane serviceable.¹²⁴ Laskin, J. considered that the damages should include "economic loss resulting directly from avoidance of threatened physical harm to property, or to

¹¹⁶ *Id.* 396; but *cf.* at 404 Sacks, L.J. considered that the distinction was "fallacious" in relation to "the exercise of duties and powers by a public authority"; and Sacks, L.J. at 408 doubted that a claim lay for "any reduction in the market value of the premises over and above the cost of the relevant work".

¹¹⁷ [1977] 2 W.L.R. 1024.

¹¹⁸ *Id.* 1039. *Cf.* Phegan, "Tort Liability of Local Authorities", *supra* n. 95 at 2.

¹¹⁹ *Supra* n. 2.

¹²⁰ [1977] 1 N.Z.L.R. 394.

¹²¹ *Cf. Batty v. Metropolitan Realizations Ltd.* [1978] 2 W.L.R. 500.

¹²² *Supra* n. 120 at 410, 411 *per* Richmond, P.; at 417 *per* Woodhouse, J.

¹²³ *Supra* n. 2 at 1213 *per* Ritchie, J.

¹²⁴ *Id.* 1207 *per* Ritchie, J., citing *T.W.A. v. Curtiss-Wright Corporation* (1955) 148 N.Y.S. 2d 284, that liability for "the cost of repairing damage to the defective article itself and for economic loss flowing directly from the negligence, is akin to liability under the terms of an express or implied warranty of fitness and as it is contractual in origin cannot be enforced against the manufacturer by a stranger to the contract".

a person."¹²⁵ It was this aspect of the opinion of Mr Justice Laskin from which Lord Wilberforce stated in the *Anns Case* that he had received much assistance.¹²⁶

It may be concluded from these cases that the exclusory rule would not operate to deny recovery where economic loss is suffered:

1. as a result of damage which posed a danger to the structure or chattel itself.
2. as a result of avoiding threatened physical or personal damage, either to the fabric of the structure or chattel itself or to property or persons outside them.

It will be argued below that the *Caltex Case* has important ramifications for this line of cases and the conclusions drawn from them; especially as they relate to liability for economic loss resulting from defective products.¹²⁷

II. THE CALTEX CASE

1. Introduction

To this point the parameters and rationale of, and strains upon, the exclusory rule have been shown. It is now proposed to analyse the various judgments in the *Caltex Case* and appraise its significance.

The facts should be briefly related. A pipeline owned by Australian Oil Refining Pty. Ltd. (AOR) connected an oil refinery on the southern shore of Botany Bay to an oil terminal belonging to the Caltex company on the northern shore. Caltex had no proprietary interest in the pipeline. The defendant dredge "Willemstad" fractured the pipe and an action was brought in respect of this admittedly negligent conduct. An action was also brought against Decca Survey Australia Ltd. (Decca) for negligently plotting a chart upon which the dredge relied.

Sheppard, J., in the Supreme Court of New South Wales, allowed no damages to the Caltex company for the economic loss suffered as a result of the severing of the pipeline. The items claimed by Caltex were: the expense incurred in obtaining alternative means to transport the oil, the necessity of sending low sulphur oil to another terminal, the modifications to terminals, certain harbour dues and the like. The *quantum* of the damage was agreed at \$95,000. The prime question for the High Court was whether Caltex was entitled to recover this loss. The subsidiary issues were first, whether the captain of the dredge should have had judgment entered against him. This was unanimously dismissed.¹²⁸ Second, whether Decca was immunized from liability

¹²⁵ *Id.* 1216, 1217. This has considerable importance in widening the scope of product liability.

¹²⁶ *Supra* n. 117 at 1039. *Cf. Caltex, supra* n. 1 at 286 *per* Stephen, J. citing the opinion of Laskin, J. in the *Rivtow Case*.

¹²⁷ *Infra* text at pp. 155-157.

¹²⁸ *Supra* n. 1 at 273-4 *per* Gibbs, J.; at 290 *per* Stephen, J.; at 294 *per* Mason, J.; at 295 *per* Jacobs, J.; at 298 *per* Murphy, J., agreeing with Stephen, J.

because of the negligence of the navigators of the dredge. The High Court held that no *novus actus interveniens* was constituted and that the negligence of both defendants was a concurrent cause of the damage.¹²⁹ The direct question before the High Court was whether the exclusory rule should be applied to deny Caltex recovery of the economic loss.

2. The Opinions

The High Court unanimously found that the claimed economic loss was recoverable.

Gibbs, J. found that the exclusory rule while generally applicable did not preclude the Caltex company from recovery in these circumstances. Stephen, Mason, Jacobs and Murphy, JJ. found that the exclusory rule as traditionally posed was not the law in Australia.

Mason, J. proposed a test:

A defendant will then be liable for economic damage due to his negligent conduct when he can reasonably foresee that a specific individual, as distinct from a general class of persons, will suffer financial loss as a consequence of his conduct.¹³⁰

Jacobs, J. formulated the duty of care thus:

The duty of care was that owed to a person whose property was in such physical propinquity to the place where the acts or omissions of the dredge and Decca had their physical effect that a physical effect on the property of that person was foreseeable as the result of such acts or omissions.¹³¹

Murphy, J. simply stated that he did not accept the contention that "economic loss not connected with physical damage to the plaintiff's property is not recoverable".¹³² His Honour made no attempt to provide any limiting formulation. This must be contrasted with his fellow judges who were at pains to find limiting formulations. This places the reasoning of Murphy, J. outside the mainstream of opinion.

Stephen, J. provided a most thorough review of the law in this area. However, for those interested in distilling a *ratio decidendi* his judgment offers little comfort. His Honour reviewed the law and the general policy underlying it.¹³³ His proposition was that no rule of universal application could be discovered. He found the need for the

¹²⁹ *Id.* 274-5 *per* Gibbs, J.; 290 *per* Stephen, J. This finding is consistent with a line of authority showing a judicial disinclination to find that actions of third parties may constitute a *novus actus interveniens* so as to immunize a tortfeasor from liability in negligence. *Chapman v. Hearse* (1961) 106 C.L.R. 112 — intervening negligent acts; *Home Office v. Dorset Yacht Co.* [1970] A.C. 1004 (House of Lords) with respect to intervening intentional acts.

¹³⁰ *Supra* n. 1 at 293.

¹³¹ *Id.* 298. But *cf.* *Cane, supra* n. 18 at 254-7.

¹³² *Id.* 299.

insistence by the law "upon sufficient proximity between tortious act and compensable detriment". He continued:

The articulation, through the cases, of circumstances which denote sufficient proximity will provide a body of precedent productive of the necessary certainty; the gradual accumulation of decided cases and the impact of evolving policy considerations will reflect "the courts assessment of the demands of society for protection from carelessness of others" — per Lord Pearce in *Hedley-Byrne* reiterated by Lord Diplock in *Dorset Yacht Co. v. Home Office* [1970] A.C. 1004 at 1058.¹³⁴

On the same theme, Stephen, J. quoted Barwick, C.J. in *M.L.C. Assurance Co. Ltd. v. Evatt*¹³⁵ that the elements of the relationship out of which a duty of care would be imposed by law "will be elucidated in the course of time as particular facts are submitted for consideration in cases coming forward for decision". The features of this case leading to the conclusion that sufficient proximity existed were:

- (i) the defendant's knowledge that the property damaged . . . was a kind inherently likely, when damaged, to be productive of consequential economic loss to those who rely directly upon its use; there was here something akin to a "common adventure".¹³⁶
- (ii) the defendant's knowledge or means of knowledge of the pipeline and its use.
- (iii) the infliction of damage by the defendant to the property of a third party in breach of duty of care owed to that third party.
- (iv) the nature of the detriment suffered by the plaintiff.
- (v) the nature of the damages claimed reflecting loss of use, representing not some loss of profits arising because collateral commercial arrangements are adversely affected but the quite direct consequence of the detriment suffered.¹³⁷

Stephen, J. proposed an amalgam based upon policy factors added to a moral dimension. This will be analysed below.¹³⁸

Gibbs, J. found that the Caltex company could recover on the basis that the facts established an exception to the exclusory rule. This was a case, he said:

[I]n which the defendant has knowledge or means of knowledge that the plaintiff individually, and not merely as a member

¹³³ *Id.* 280-7.

¹³⁴ *Id.* 287. *Cf.* Glass, J., *supra* n. 95 at 384, 385.

¹³⁵ *Supra* n. 21 at 569.

¹³⁶ *Infra* text at n. 153.

¹³⁷ This is a paraphrase of Mr. Justice Stephen's factors, *supra* n. 1 at 287.

¹³⁸ See *infra* text at nn. 213-19.

of an unascertained class, will be likely to suffer economic loss as a consequence of his negligence, and owes the plaintiff a duty to take care not to cause him such damage by his negligent act.¹³⁹

His Honour indicated that the exceptions may eventually overtake the exclusory rule, but that any formulation of a novel rule must await judicial exposition on a case by case basis.¹⁴⁰ It was material here "that some property of the plaintiff was in physical proximity to the damaged property" and that "the plaintiff, and the person whose property was injured, were engaged in a common adventure".¹⁴¹

3. Previous Authority on Recovery of Economic Loss

The High Court dealt with previous authority in this area. This raises a direct question as to how much of this previous authority is now good law in Australia.

The law before *Caltex* was complex and contradictory.¹⁴² For instance, Lord Denning in *Spartan Steel* eschewed a rule based approach for the direct application of policy factors.¹⁴³ Edmund-Davies, L.J. in the same case supplied a different test depending on whether the economic harm was foreseeable and direct.¹⁴⁴ Similarly, in the *Rivtow Case* the majority of the Canadian Supreme Court repudiated Lord Denning's reasoning in favour of a rule relying on demonstrable foreseeability and directness.¹⁴⁵ But against the majority's rather narrow reasoning must be weighed the more telling and influential opinion of Laskin, J.

How far has *Caltex* provided a fresh beginning for recovery of pure economic loss so as to obviate the need to reconcile these authorities? It is clear that the High Court considered the exclusory rule arbitrary and unresponsive to underlying policy reasons for limiting recovery.¹⁴⁶ Furthermore, the exceptions to the rule as variously formulated¹⁴⁷ were subject to the same criticism. Thus, it is apparent

¹³⁹ *Supra* n. 1 at 279.

¹⁴⁰ *Ibid.*; quoting Lord Diplock in *M.L.C. Assurance Co. Ltd. v. Evatt*, *supra* n. 85 at 809.

¹⁴¹ *Supra* n. 1 at 279.

¹⁴² *Cf.* Atiyah, *supra* n. 13 *passim*.

¹⁴³ *Supra* n. 25 at 562-4.

¹⁴⁴ *Id.* 565.

¹⁴⁵ *Supra* n. 2 at 1215: "damages . . . were recoverable as compensation for the direct and demonstrably foreseeable result of the breach (of the duty to warn)", *per* Ritchie, J.

¹⁴⁶ *Supra* n. 1 at 284, 286 *per* Stephen, J.; at 293 *per* Mason, J. This observation is reminiscent of that in an excellent law review comment, *supra* n. 19 at 675; in referring to Dean Prosser's statement that no satisfactory reason had been given for the exclusory rule, it was said: "The validity of this criticism depends upon whether the desirable result, ascertained by a determination of the interests involved in the cases and by a balancing of those interests, is one of rigid non-liability or of liability in appropriate cases". See *supra* text at nn. 47-53.

¹⁴⁷ *Cf.* three approaches exhibited in *Spartan Steel*, *supra* n. 25 of Lord Denning at 560-4; Edmund-Davies, L.J. at 564 ff.; Lawton, L.J. at 571 ff.

that the *S.C.M. Case*¹⁴⁸ and the *Spartan Steel Case*¹⁴⁹ are not good law in Australia.¹⁵⁰ The state of the law as Stephen, J. said encouraged "the search for some principle of law which will operate as a sufficient restraint upon excessively wide liability without calling in aid as a control mechanism the quite random incidence of damage resulting from a particular act of carelessness".¹⁵¹

Has the High Court left any of the previous authority intact?

The Greystoke Castle

The *dicta* of Lord Roche in the *Greystoke Castle Case* is accepted by the court as exemplifying a situation where the proximity between the cargo owner and the tortfeasor is close enough to allow recovery.¹⁵² This is because of the common adventure element; the property of the owner of the goods and the vehicle owner were subject to the same risks.¹⁵³ Thus, in cases of common adventure where a plaintiff suffers economic loss caused by the infliction of physical damage to the carrier or his goods by the negligent act of the defendant, the plaintiff may recover the economic loss from the defendant. The authority of *Greystoke Castle* remains intact because the limiting formula inherent in common adventure itself acts as a check on indeterminate liability.

The *Caltex Case* will have a profound affect on the general development of the law of negligence relating to economic loss. This will be especially marked in two areas where the law is developing rapidly. These areas are tort liability for defective structures and chattels causing economic loss, and negligent misstatement. The implications of *Caltex* on those areas will be considered.

Liability of Public Authorities, Builders and Others for Defective Structures

*Dutton v. Bognor Regis U.B.C.*¹⁵⁴ has proved to be a seminal case in the liability of public authorities and builders for defective structures. In two *post-Dutton* cases Australian courts have addressed the liability of public authorities. In both of these cases — *Hull v. Canterbury Municipal Council*¹⁵⁵ and *G. J. Knight Holdings Pty. Ltd. v. Warringah Shire Council*¹⁵⁶ — single judges of the New South Wales

¹⁵⁰ Cf. G. R. Walker, "Negligent Acts — Recovery for Economic Loss" [1978] *N.Z.L.J.* 46 at 47-8.

¹⁵¹ *Supra* n. 1 at 286.

¹⁴⁸ *Supra* n. 12.

¹⁴⁹ *Ibid.*

¹⁵² *Id.* 285 per Stephen, J.; at 279 per Gibbs, J.

¹⁵³ *Ibid.* But cf. Jacobs, J. at 297.

¹⁵⁴ *Supra* n. 115.

¹⁵⁵ [1974] 1 N.S.W.L.R. 300.

¹⁵⁶ [1975] 2 N.S.W.L.R. 797. See also *Commonwealth v. Turnbull* (1976) 13 A.C.T.R. 14 per Franki, J. (Sup. Ct. of A.C.T.). *Dutton* and *Anns* were distinguished in *Dunlop v. The Council of the Municipality of Woollahra* (Unreported, Supreme Court of N.S.W., No. 4347 of 1976) per Yeldham, J. For discussion of case law see C. S. Phegan, "Tort Liability of Local Authorities" *supra* n. 95 at 3 ff.

Supreme Court based their decisions on an application of the Atkinian foreseeability test of potential plaintiffs, and not upon the limiting "special relationship" test formulated in *Hedley-Byrne v. Heller* as interpreted by the Privy Council in *M.L.C. v. Evatt*.¹⁵⁷ Liability was based upon negligent misstatement causing economic loss. Although here, as in other situations, the labelling of the Councils' action as advice rather than conduct does not proceed from any firm differentiation of the two.¹⁵⁸

In *Dutton*, Lord Denning adopted the foreseeability test of liability. This followed, once the damage to the premises was characterized as physical.

It is submitted that the *Caltex Case* has freed the category of cases under discussion from the necessity of characterizing the loss as physical. The loss is economic and recovery will depend upon an application of the principles arising out of the *Caltex Case*. But would an Australian court be constrained from applying an Atkinian test of foreseeability? In respect of liability of public authorities this test seems to be entrenched. Mason, J. considered that the application of the "foreseeability principle" could be "supported by reference to the special character and duty of the authority".¹⁵⁹ This indicates that cases involving actions and advice of local authorities and the like ought to be considered specially.¹⁶⁰ The nature of their statutory duties¹⁶¹ and their knowledge of the ramifications of the exercise of those duties provide limiting factors. The foreseeability test can apply without danger of excessive liability.¹⁶² However, Lord Wilberforce in *Ann's Case* saw that objection may be taken to "an endless, indeterminate class of potential plaintiffs that may be called into existence".¹⁶³ To avoid this the duty of care was confined to be owed only to "an owner or occupier, who is such when the damage occurs".¹⁶⁴ In contrast, no limitation was required either in Lord Salmon's judgment in *Anns* or, outside the public authority situation, in the opinion of the New Zealand Court of Appeal in the *Bowen Case*.¹⁶⁵

¹⁵⁷ *Supra* n. 85. See also *Rutherford v. A.-G.* [1976] 1 N.Z.L.R. 403.

¹⁵⁸ *Supra* n. 1 at 278 per Gibbs, J.: "It is often not easy to decide whether a particular act of negligence can rightly be described as a negligent misstatement or as negligent conduct". Illustrative of this was whether the negligent plotting of the chart by Decca was an act or a statement.

¹⁵⁹ *Id.* 292.

¹⁶⁰ *Cf.* Phegan, *supra* n. 95; Glass, J., *supra* n. 95.

¹⁶¹ *Anns v. Merton London Borough Council*, *supra* n. 117.

¹⁶² *Cf.* Glass, J., *supra* n. 95.

¹⁶³ *Supra* n. 117 at 1038.

¹⁶⁴ *Ibid.*

¹⁶⁵ *Supra* n. 120 at 413 per Richmond, P.: "[T]he ambit of the duty can be effectively controlled only by a strict insistence on the proximity principle . . . In other words . . . the duty of the builder is *not* owed to anyone who purchases a building with actual knowledge of the defect or in circumstances where he ought to have used his opportunity of inspection in a way which would have given him warning of the defect."

Where the liability of public or local authorities is not called in question, the principles of the *Caltex Case* will apply. The liability in negligence for economic loss of architects, builders and the like will be circumscribed under these principles, rather than measured in terms of mere foreseeability. As the purpose for characterizing, in the *Bowen Case*, the loss as flowing from physical damage, was to avoid the exclusory rule,¹⁶⁶ it follows, that the case must now be reappraised. It will remain highly material that the economic loss flowed from physical damage.¹⁶⁷ It is submitted that, the *Bowen Case*, if decided under the *Caltex* principles would yield the same result. The tests propounded by Gibbs, J.,¹⁶⁸ Mason, J.¹⁶⁹ and indeed Jacobs, J.¹⁷⁰ are satisfied. The factors making up the necessary degree of proximity supplied by Stephen, J. are present.¹⁷¹ In *Bowen* the defendant builder had knowledge or means of knowledge that a particular plaintiff (a subsequent owner of the structure) would be likely to suffer economic loss as a consequence of his conduct.

The characterization of the damage as physical, rather than its true economic nature, has led the law of defective structures into a miasma of difficulties in respect of the running of the limitation period. Lord Denning, M.R. in *Dutton* expressed the view that the limitation period began to run when the "foundations were badly constructed".¹⁷² This served to limit the number of potential plaintiffs. The Court of Appeal reconsidered this opinion in *Sparham-Souter v. Town and Country Developments (Essex) Ltd.*,¹⁷³ deciding that the cause of action did not accrue before a person capable of suing discovered or ought to have discovered the damage. This recantation was approved by Lord Wilberforce in *Ann's Case*, but the formula supplied was that the cause of action — the starting point of the limitation period — may "only arise when the state of the building is such that there is present or imminent danger to the health or safety of persons occupying it".¹⁷⁴ But this produces anomalies. For instance, the threat may be latent and undiscoverable, and yet be a danger to health or safety. For instance, the inadequate beams under the stage in *Voli v. Inglewood Shire Council*,¹⁷⁵ may have fallen within this category. On the

¹⁶⁶ *Dutton v. Bognor Regis*, *supra* n. 115 per Lord Denning, M.R.; *Bowen v. Paramount Builders*, *supra* n. 120 at 417 per Woodhouse, J. But cf. Cook, J., *id.* 423. Cf. J. A. Smillie, "Liability of Builders, Manufacturers and Vendors for Negligence" (1978) 8 *N.Z.U.L.R.* 109 at 112-24.

¹⁶⁷ *Supra* n. 1 at 279 per Gibbs, J.; at 287 per Stephen, J.

¹⁶⁸ *Id.* 279.

¹⁶⁹ *Id.* 293.

¹⁷⁰ *Id.* 298.

¹⁷¹ *Id.* 287-8.

¹⁷² *Supra* n. 115 at 396.

¹⁷³ [1976] Q.B. 858.

¹⁷⁴ *Supra* n. 117 at 1039. Cf. Lord Salmon who found that the action did not arise until the occupier bought his interest in the property — at 1049.

¹⁷⁵ (1963) 110 C.L.R. 74 (High Court of Australia).

other hand, damage such as cracks may have manifested itself, but may not be a present danger to health or safety.

The anomaly is compounded by the manner in which Lord Wilberforce restricted the field of potential plaintiffs. The duty, he said, is only owed to "an owner or occupier, who is such when the damage occurs".¹⁷⁶ It is not clear what the meaning of "damage" is. It may mean, on the one hand, imminent danger to health and safety. In which case the doubts about the limitation period still persist. If this interpretation were adopted it would militate against the restrictive purpose of the requirement. Imminent danger to health and safety is a continuing harm. If it occurs to one owner, and is not rectified, it will surely recur during the ownership of subsequent owners. This raises the spectre of an "indeterminate class of potential plaintiffs",¹⁷⁷ the very result Lord Wilberforce did not want.

On the other hand, it may mean the physical damage to which the imminent danger to health and safety is referable. If this meaning is taken physical damage may manifest itself during the ownership of one person, but not become a danger to health and safety until the period of ownership of a succeeding owner. Does this mean that the succeeding owner may not recover as the damage did not occur during his ownership? It may be argued that the damage does not occur until it flowers into damage causing imminent danger to health and safety. The identification of this change may not be an easy task.

It is possible to argue that, as Lord Wilberforce saw the duty arising out of the statute, and that as this was directed to health and safety, it was this kind of damage, or the threat of it, that formed the cause of action. It follows that where the cause of action is not dependent on statute, the *Sparham-Souter* test of reasonable discovery would apply. The cause of action would arise when the occupier of premises discovered, or reasonably should have discovered, a defect of such a kind that it presented a danger either of physical or personal damage outside them or of physical damage to them.¹⁷⁸

However, doubt may be cast upon this statement by the Court of Appeal decision in *Batty v. Metropolitan Property Realizations Ltd.*¹⁷⁹ In that case, the Court considered the liability of a builder and developer for negligence in the construction of a house. The house had been built on sloping land that was subject to slippage. It was found that the house would probably within ten years succumb to a land slide — it was "doomed". The facts involved neither public authority, nor person acting under colour of statutory authority, and

¹⁷⁶ *Supra* n. 117 at 1038.

¹⁷⁷ *Ibid.*

¹⁷⁸ For discussion of requirement of dangerousness of defect: Smillie, *supra* n. 166 at 114-15.

¹⁷⁹ [1978] 2 W.L.R. 500.

yet the Court rested its finding of liability on the negligence of the defendants causing "imminent danger to the health or safety of persons occupying this house".¹⁸⁰

No certain test can be distilled from the authorities and it is submitted that it is now futile to make the attempt. The anomalies stem from the false characterization of the damage as physical rather than economic. As *Caltex* now recognizes the recoverability of pure economic loss, and disapproves the exclusory rule, the real picture may be focussed. It is submitted that as the loss is economic, the cause of action will arise when that loss is suffered. Whether danger or damage is latent and undiscoverable will be of no moment; the question will be the point of time that *financial loss* was suffered. For example, if a house is built with inadequate foundations, and the occupier is put to the expense to shore up the foundations, the cause of action arises when the expense is incurred, not at any previous time. Any failure on the part of the plaintiff to reasonably discover the defect may amount to either, a *novus actus interveniens* insulating the defendant from liability,¹⁸¹ or contributory negligence on the plaintiff's part, reducing the damages. This overcomes the previous anomalies noted with the running of the limitation period.

As noted, the Courts in *Dutton*, *Anns* and *Bowen* have insisted that the defect be of a kind which presents a danger to the fabric of the premises or to persons or property outside them. Defects of a kind which merely affect the quality of the premises do not fall within the category of damages for which the courts are prepared to allow recovery.¹⁸² The application of this distinction leads to startling anomalies. An example in an article by J. A. Smillie puts the point well:

¹⁸⁰ *Id.* 513. This does not exhaust the complications on the limitation period. See *id.* and *Midland Bank Trust Co. Ltd. v. Hett, Stubbs and Kemp* [1978] 3 W.L.R. 167 *per* Oliver, J. Both cases maintain that the limitation period begins to run only from the time of damage; but previous authority had held that the limitation period began to run from the time of breach of contract where the duty of care arose out of contract as it did in the *Midland Bank Trust Case* (solicitor's negligence), see *Boorman v. Brown* (1842) 3 Q.B. 511; *Ward v. Lewis* (1896) 22 V.L.R. 410; *Schwebel v. Telekes* [1967] I.O.R. 541. This authority relied on the common ancestry of contract and tort in assumption, and thus where the action arose out of a contractual situation of a person exercising a calling, no proof of special damage was necessary: *Godefroy v. Jay* (1831) 7 Bing. 413; 131 E.R. 159. But *cf. Ellul and Ellul v. Oakes* (1970) 3 S.A.S.R. 377. The law is unsettled, *cf.* equivocal stance of High Court in *Max Garrett Distributors v. Tobias* (1976) 50 A.L.J.R. 402. *Semble* authority canvassed in body of this paper would favour the "modern" tort approach of Oliver, J. in the *Midland Bank Trust Case*. See also *Arenson v. Arenson* [1975] 3 W.L.R. 815 and *Saif Ali v. Sydney Mitchell and Co.* [1978] 3 All E.R. 1033 (widening categories of duty of care) and *Esso Petroleum v. Mardon* [1976] Q.B. 801 (co-existence of liability in tort and contract).

¹⁸¹ *Supra* n. 120 at 413-14 *per* Richmond, P. But *cf. Cooke, J.* at 423.

¹⁸² *Bowen v. Paramount Builders, supra* n. 120 at 413 *per* Richmond, P.; at 418 *per* Woodhouse, J.

[A] taxi proprietor whose taxi is put out of action while a dangerous defect in the braking system is repaired could recover from the negligent manufacturer or assembler not only (sic) the cost of the repairs but also (as economic loss resulting directly from physical damage) the loss of business profit he suffers during the time the cab is off the road. But a taxi proprietor whose cab is off the road for repair of an engine defect which completely immobilizes the taxi would not recover even the cost of the repairs from the negligent manufacturer because the defect neither causes nor threatens physical damage to either external property or the car itself, and the loss suffered would be purely economic.¹⁸³

The proper characterization of the damage as economic loss avoids this anomaly. It leaves unanswered the extent of liability for economic loss caused by defective products and premises. A question which must now be answered under the principles in the *Caltex Case*. The application of the *Caltex* principles will result in a less artificial and strained body of case law in respect of liability for defective structures and products.

The Rivotow Case

An authority that had received close attention before the *Caltex Case* was the Canadian Supreme Court case of *Rivotow Marine Ltd. v. Washington Iron Works and Walkem Machinery and Equipment Ltd.*¹⁸⁴ This case was a milestone on the road of liability for pure economic loss as the Canadian Supreme Court was unanimous in finding that the exclusory rule did not negative liability.¹⁸⁵ The case is of importance because of its application to negligence liability for defective products. In *Rivotow* there were two heads of economic loss. The first was constituted by loss of profits caused by the inability of the plaintiff to use the defective crane. The second was the cost of repair to the crane. The former head was allowed by the Court. Ritchie, J. for the majority, relying on an analogy to cases of chattels dangerous *per se*, found that the defendant, Walkem Machinery and Equipment Ltd., the British Columbian distributor of the crane, owed a duty to warn the plaintiff of the danger when the defendant became seized with the knowledge.¹⁸⁶ It had breached this duty "exposing the (plaintiff) to the direct consequence of losing the services of the barge for at least a month during one of its busiest seasons".¹⁸⁷ This economic loss was recoverable "as compensation for the direct and demonstrably foreseeable result"¹⁸⁸ of the breach of the duty to warn.

¹⁸³ Smillie, *supra* n. 166 at 116.

¹⁸⁴ *Supra* n. 2. Cf. C. Harvey, "Economic Losses and Products Liability" (1974) 37 *Mod. L.R.* 320.

¹⁸⁵ *Id.* 1215 *per* Ritchie, J.; at 1216, 1217 *per* Laskin, J.

¹⁸⁶ *Id.* 1207, 1209.

¹⁸⁷ *Id.* 1200.

¹⁸⁸ *Id.* 1215.

At other points of his judgment Ritchie, J. uses language requiring the economic loss to be the "immediate consequence" of the negligent conduct. In adopting this view the Court is in close accord with Edmund-Davies, L.J. in *Spartan Steel*.¹⁸⁹

In contrast, Laskin, J. (as he then was) found that the defendant Washington Iron Works, the designer manufacturer of the crane, was liable not only on the former head but also on the latter head. That is, that the cost of repairs should have been recoverable. The basis of this was that the costs of rectifying a fault produced through negligence should be recoverable where that fault threatened property or personal damage.¹⁹⁰

The approach of the majority in *Rivtow* is clearly contrary to the *Caltex Case*. For instance, Gibbs, J. commented on the view of Edmund-Davies, L.J. in the *Spartan Steel Case* and of the Court in *Rivtow Case* — "I cannot find this approach altogether satisfactory".¹⁹¹ Stephen, J. cited *Rivtow* along with *Hedley-Byrne* as a particular fact situation out of which formulations limiting liability may be fashioned.¹⁹² But earlier in his judgment he referred to *Rivtow* as being a case of rather "special circumstances involving products liability".¹⁹³ While Mason, J. specifically stated his test accorded with the decision in *Rivtow* he referred with strong disapproval to the "directness" test which he considered harkened back to the *pre-Wagon-Mound* era.¹⁹⁴

On the credit side, the knowledge component proposed by Ritchie, J. in the *Rivtow Case* was seized upon by Stephen and Gibbs, JJ. as founding the importance of knowledge in formulating the requisite proximity in the *Caltex Case*.

The judgment of Laskin, J. is significant in any possible extensions to the common law in respect of defective goods causing pure economic loss.¹⁹⁵ The reasoning adopted by Laskin, J. is analogous to that of Lord Denning in the *Dutton Case*. In essence it is an *ad absurdum* argument: it would be illogical for the law to allow damages for resultant loss to be recovered once property or personal damage had occurred, but to deny damages to a person who had taken prudent precautionary steps and incurred costs to prevent manifestation of harm.¹⁹⁶ As mentioned, the observations of Laskin, J. were approved

¹⁸⁹ *Supra* n. 25 at 570.

¹⁹⁰ *Supra* n. 2 at 1217-22.

¹⁹¹ *Supra* n. 1 at 279.

¹⁹² *Id.* 287.

¹⁹³ *Id.* 281.

¹⁹⁴ *Id.* 293.

¹⁹⁵ Cf. I. N. D. Wallace, "Tort Demolishes Contract in New Construction", *infra* n. 246 at 68-72; S. M. Waddams, *Products Liability* (1974) at 26-37; for resumé of American cases: C. J. Miller and P. A. Lovell, *Product Liability* (1977) at 338-42.

¹⁹⁶ *Supra* n. 2 at 1219-20 *per* Laskin, J.

by Lord Wilberforce in the *Anns Case*.¹⁹⁷ They were based on an extension of the *S.C.M. Case* and *British Celanese Ltd. v. A. H. Hunt Ltd.*¹⁹⁸ from economic harm based on actual, to threatened physical damage. To this extent, as contended above in respect of the *Bowen Case*, the analysis is in accord with *pre-Caltex* case law. Clearly threatened physical harm may be a highly material factor in deciding whether the necessary degree of proximity exists. However, the basing of the test on mere foreseeability of threatened harm and whether the plaintiff is in a class of persons who are foreseeably so threatened, goes beyond the ambit of liability that the High Court would allow.

In as much as the opinion of Laskin, J. had implications for product liability, the *Caltex Case* if it affects the standing of the reasoning of Laskin, J. must also. It is suggested, that the concentration of the High Court in limiting the potential field of liability of defendants for economic loss would prevent extension of a manufacturer's liability, to a foreseeable class of consumers. The requirement of liability would be that the manufacturer of goods knew or had means of knowing that identity of the plaintiff and the nature of the economic loss that he would suffer because of negligent manufacture or design.¹⁹⁹ This is not to say that the *Caltex Case* precludes development of the law towards a wider field of plaintiffs. All that it is intended to conclude is that the emphasis on carefully controlling the field of liability makes the test of Laskin, J. incompatible with the *Caltex Case*.

Negligent Misstatement

As noted, *Hedley-Byrne v. Heller*²⁰⁰ was cited as authority for the proposition that the law of negligence had opened the category of recovery of pure economic loss. The Court placed heavy reliance on the special relationship requirement as obviating the potential Cardozian nightmare of unbounded liability.²⁰¹ Any drift towards the formulation of the duty issue under the rubric of the Atkinian foreseeability test has probably been arrested by the *Caltex Case*.²⁰² The Atkinian test does not provide sufficient control over liability in either negligent misstatement or negligent conduct. Those cases involving local

¹⁹⁷ *Anns v. Merton London Borough Council*, *supra* n. 117 at 1039.

¹⁹⁸ Respectively, *S.C.M. (U.K.)*, *supra* n. 12 and *British Celanese Ltd.*, *supra* n. 24.

¹⁹⁹ *Supra* n. 1 at 279 *per* Gibbs, J. requires that "the defendant has knowledge or means of knowledge that the plaintiff individually, and not merely as a member of an unascertained class . . ."; at 293 *per* Mason, J.: ". . . he can reasonably foresee that a specific individual, as distinct from a general class of persons. . ."

²⁰⁰ *Supra* n. 12.

²⁰¹ *Supra* n. 1 at 286 *per* Stephen, J.; at 277 *per* Gibbs, J.; at 291 *per* Mason, J.

²⁰² *Cf. Ministry of Housing and Local Government v. Sharp*, *supra* n. 85. *Cf. Walker*, *supra* n. 150 at 48.

authorities charged with statutory duties may be placed to one side as special exceptions.²⁰³

Taking into account the admitted difficulty of distinguishing statement from conduct in many situations there will be a coalescing of the law in these two areas.²⁰⁴ The *Caltex Case* accordingly will have a direct impact on the way in which the courts are willing to extend liability for negligent misstatement. The opinion of Stephen, J. is most significant in this respect in explaining the basis for the courts opening up this category of liability. This basis which is rooted both in policy and morality or fairness will have an influence on the way in which Australian courts go about widening liability for negligent misstatement. This is discussed below. The short point is that the significance of the *Caltex Case* goes beyond negligent conduct causing economic loss to the limitations of liability for negligent misstatements.

In order to gauge the form of future developments in the law, it is necessary to probe more deeply into the judgments in the *Caltex Case*.

4. Rationale of the *Caltex Case*

The High Court in *Caltex* eschews the use of policy on an *ad hoc* basis in the way Lord Denning employed it in the *Spartan Steel Case*. His Lordship in that case thought it "better to consider the particular relationship in hand and see whether or not, as a matter of policy, economic loss should be recoverable, or not".²⁰⁵

Stephen, J. stated that "no doubt (policy considerations) play a very significant part in any judicial definition of liability and entitlement in a new area of law". But he opined that the "process should however result in some definition of rights and duties, which can then be applied to the case in hand, and to subsequent cases, with relative certainty".²⁰⁶ To adopt Lord Denning's approach would be to "invite uncertainty and judicial diversity".²⁰⁷ Similarly, Gibbs, J. considered that while it was necessary to look at the particular relationship in hand, he did not think that "the law leaves it entirely to the court to decide as a matter of policy whether the economic loss should be recoverable".²⁰⁸

All their Honours apprehended that the demands of policy would shape the law in providing courts with a test, or basis on which to decide the recoverability of economic loss. They considered that the exclusory rule was based on a policy of the law to guard against the possibility of unbounded liability. On a policy basis the exclusory rule

²⁰³ *Supra* n. 160.

²⁰⁴ *Supra* n. 1 at 287 *per* Stephen, J. *Cf.* Walker, *supra* n. 156 at 48.

²⁰⁵ *Supra* n. 25 at 562.

²⁰⁶ *Supra* n. 1 at 284.

²⁰⁷ *Ibid.*

²⁰⁸ *Id.* 279.

was unresponsive. Therefore, a new rule had to be established. Stephen, J. recognizes that any test "must depend upon policy considerations just as does the conclusion that for cases of economic loss such an additional control mechanism is necessary".²⁰⁹

At this point lies the core of weakness of the *Caltex Case*. As the test is purported to be policy responsive, it is necessary to examine those articulated policy reasons to determine how the law regarding economic loss may develop. The judgment of Stephen, J. is most important as representing a type of jurisprudential road-map for future decisions. But it is a rather incomplete and uncertain road-map.

The *Caltex Case* may be viewed as a similar decision to *Donoghue v. Stevenson*²¹⁰ or *Home Office v. Dorset Yacht*,²¹¹ in that the decision is framed prospectively with the development of the law in mind. In the end, all these decisions depended upon the demands of policy²¹² and it is policy which played the pivotal role in the predictability of the law arising from these cases.

Stephen, J. considered that the fundamental factor determining whether recovery should be afforded was whether it was "fair and reasonable"²¹³ in the circumstances. This introduces what may be termed a moral element. Stephen, J. stated after quoting Lord Atkin in *Donoghue v. Stevenson*²¹⁴ that liability for negligence "is no doubt based upon a general sentiment of moral wrongdoing for which the offender must pay".

Such a sentiment will only be present when there exists a degree of proximity between the tortious act and the injury such that the community will recognize the tortfeasor as being in justice obliged to make good his moral wrongdoing by compensating the victims of his negligence.²¹⁵

The inclusion of this moral or justice dimension serves notice that a mere totalling of policy reasons, such as avoidance of unlimited liability, possibility of speculative claims,²¹⁶ potential administrative problems,²¹⁷ and economic allocation of resources²¹⁸ will not be dispositive. The overriding question, it seems, on Mr Justice Stephen's view is whether the community would in justice expect liability to be

²⁰⁹ *Id.* 287.

²¹⁰ *Supra* n. 16.

²¹¹ *Supra* n. 129.

²¹² *Cf.* Stevens, *supra* n. 13 at 448-66 and C. R. Symmons, "The Duty of Care in Negligence: Recently Expressed Policy Elements" (1971) 34 *Mod. L.R.* 394 at 528.

²¹³ *Supra* n. 1 at 287.

²¹⁴ *Supra* n. 16 at 580.

²¹⁵ *Supra* n. 1 at 287.

²¹⁶ *Union Oil Co. v. Oppen*, *supra* n. 4 at 563.

²¹⁷ Stevens, *supra* n. 13 at 450-53.

²¹⁸ Comment, *supra* n. 19 at 681-4; Note, *Union Oil Co. v. Oppen*: *supra* n. 37 at 326, 327. But *cf.* the *Caltex Case*, *supra* n. 1 at 289.

placed on the defendant. This must, in the final analysis, depend on what the courts consider community expectations to be.²¹⁹

Stephen, J. set out a list of factors which filled this requirement and also restricted indeterminate liability. These were outlined above.²²⁰

Unfortunately, Stephen, J. did not provide limiting policy factors beyond indeterminate liability and the moral dimension. Thus, while Stephen, J. and his brethren admitted the role of policy, they made little attempt to define the details of particular policy grounds. What are the community expectations? What is the evil of indeterminate liability? The policy grounds are too vague to be useful. If, as is suggested, policy plays a pivotal role in predicting the law from case to case,²²¹ the High Court has failed to give future courts a clear notion of the substance of that policy. This leaves the *Caltex Case* decidedly open-ended and exposes it to criticisms that it has generated uncertainty. The use of an interest analysis would have been beneficial in exposing policy reasons.²²²

As foreshadowed above²²³ Stephen, J. did, however, raise one policy perspective that fitted within the interest analysis proposed. This is the question of loss distribution.²²⁴ He raised this only to dismiss its relevance. He said:

The task of the courts remains that of loss fixing rather than loss spreading and if this is to be altered it is, in my view, a matter for direct legislative action rather than for the courts.²²⁵

Stephen, J. points out that insurance may be something of a two-edged sword; as loss insurance is "more efficient"²²⁶ than liability insurance this may dictate that loss should lie where it falls.²²⁷ This is a perceptive observation but it is difficult to see that from it follows the proposition that loss distribution should therefore be ignored. The court may be in the business of loss shifting but this does not mean that in shifting losses it may not have an eye to loss spreading. The

²¹⁹ The concept of moral blame was listed as a factor on which to base recovery in *Biakanja v. Irving*, 49 Cal. 2d 647 at 650; 320 P. 2d 16 at 19 (1958). The Court listed these factors: "the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm" (320 P. 2d at 19).

²²⁰ *Supra* text at n. 137.

²²¹ *Supra* text at n. 213.

²²² *Supra* n. 59.

²²³ *Supra* text at nn. 47-53.

²²⁴ *Cf.* Cane, *supra* n. 18 at 254; Craig, *supra* n. 13 at 235-9

²²⁵ *Supra* n 1 at 289.

²²⁶ *Ibid.*; *cf.* A. V. Alexander, "The Law of Tort and Non-Physical Loss: Insurance Aspects" (1972) 12 *J. Society Pub. Teachers of Law* 119 at 120-4.

²²⁷ *Id.*; but *cf.* the use of this policy perspective by Stephen, J. in *Griffiths v. Kerkemeyer* (1977) 15 A.L.R. 387 at 395, 399: "The wrongdoer, likely to carry liability insurance, will prove a much better loss distributor".

better conclusion from Mr Justice Stephen's observation that insurance may be something of a two-edged sword, is that therefore, courts must be wary of shifting losses where economic loss is suffered by a business organization which would likely carry loss insurance. This demands a microscopic examination of any situation in light of the policy of risk distribution rather than a wholesale discounting of a valuable policy perspective.

III. FUTURE DIRECTIONS

1. Negligent Misstatement

It was indicated above that the *Caltex Case* will have an impact on the law of negligent misstatement and the development of the law of negligence in respect of product liability. The real significance of *Caltex* for both of these areas of negligent liability lies in the observations of Gibbs, Stephen, and Mason, JJ. that the formulation for recovery of economic loss must be policy responsive. Although, as observed, the Court has left few definite criteria on the particular policy factors and most fundamentally has failed to provide a framework in which policy factors can be taken into consideration, Stephen, J. provides the indeterminate liability ground and the moral dimension ground. Therefore, the limits of negligent misstatement and product liability can be examined by application of Mr Justice Stephen's reasoning.

The application of these guides will produce a gradual case by case extension from liability depending on particular knowledge of the subject individuals and transactions to liability depending upon knowledge of a class of individuals and transactions.²²⁸ In Lord Denning's famous dissent in *Candler v. Crane Christmas*,²²⁹ liability of the accountants depended upon their knowledge of the particular recipient of information and of the particular transaction for which the information was to be used. His Lordship reserved opinion on the extension of liability to where the accountants knew of the class of recipient and class of transaction.²³⁰ Barwick, C.J. suggested such an extension in *Evatt v. M.L.C.* Recent Canadian²³¹ and New Zealand²³² authority dealing with an auditor's liability have wrestled with the question of

²²⁸ *Infra* text at nn. 240-3.

²²⁹ *Supra* n. 82 at 428 ff.

²³⁰ *Id.* 435.

²³¹ *Haig v. Bamford* [1976] 3 W.W.R. 331.

²³² *Dimond Manufacturing Co. Ltd. v. Hamilton* [1969] N.Z.L.R. 609 (Court of Appeal); *Scott Group Ltd. v. McFarlane* [1975] 1 N.Z.L.R. 582. On appeal to the Court of Appeal the judgment of Quilliam, J. was upheld but for varying reasons [1978] N.Z.L.R. 553. For comment: R. Baxt, "Liability for Auditors for Potential Investors in Companies — A New Statement from the New Zealand Court of Appeal"; Vol. 49 *The Chartered Accountant in Australia*, September, 1978, at 45 and Case Note, "Negligent Misstatement — Auditors' Liability to Third Parties for Careless Report on Company's Annual Accounts" (1978) 8 *N.Z.U.L.R.* 175.

opening the categories from the particular to the general class. The Canadian Supreme Court in *Haig v. Bamford*²³³ extended liability to the situation where the auditors knew that the audited accounts were to be utilized by a foreseeable class of recipient in a foreseeable class of transactions.²³⁴ Dickson, J., for the Canadian Supreme Court, rejected the argument that the test should be one of mere foreseeability.²³⁵ The New Zealand Court of Appeal in *Scott Group Ltd. v. McFarlane*²³⁶ dealt with the liability of auditors to third parties. Richmond, P. adopted a test in line with that of Dickson, J.²³⁷ but Woodhouse, J. considered "reasonable foresight" and "evidence in terms of causation", "would prevent any risk of an open-ended type of duty".²³⁸ This contrasts with the careful opening of liability exhibited in most Anglo-American common law jurisdictions.²³⁹

The reasoning of the Canadian Supreme Court would, it seems, commend itself to the High Court, in that the Canadian Supreme Court viewed as crucial the public role of auditors and their function in society.²⁴⁰ This status²⁴¹ led to an increased social responsibility which was reflected in their legal liability. This accords closely with Mr Justice Stephen's moral principle, that the proximity test ought to be drawn at a point where the community considers it just and fair that liability should rest on the defendant's shoulders.²⁴²

The courts under the influence of the *Caltex Case* may open the categories of liability in negligent misstatement along the lines suggested. This development will be stimulated as stated on the one hand by community expectations, and restrained on the other, by a desire to avoid indeterminate liability. Thus, one would expect the shift will be from the particular to the class rather than a leap to only a foreseeability test.²⁴³

2. Product Liability

Negligence liability for physical damage caused by defective products is of long standing.²⁴⁴ However, the recovery of damages in

²³³ *Supra* n. 231.

²³⁴ *Id.* 338-9, 345.

²³⁵ *Id.* 338, 339.

²³⁶ *Supra* n. 232.

²³⁷ *Id.* 566.

²³⁸ *Id.* 576.

²³⁹ Mess, "Accountants and the Common Law Liability to Third Parties" (1976-77) 52 *Notre Dame Lawyer* 838.

²⁴⁰ *Supra* n. 231 at 338.

²⁴¹ The ascription of a duty of care as a reflection of status was stressed by the majority of the Privy Council in *Mutual Life & Citizens Assurance Co. Ltd. v. Evatt*, *supra* n. 85 at 803. For comment see D. M. Gilling, "Auditors and Their Role in Society—the Legal Concept of Status" (1976) 4 *A.B.L.R.* 88, and Lindgren, *supra* n. 85 at 184-5.

²⁴² *Supra* text at nn. 213-25.

²⁴³ *Cf.* Craig, *supra* n. 13 at 239-41. But *cf.* *Scott Group Ltd. v. McFarlane*, *supra* n. 232 *per* Woodhouse, J. at 576.

²⁴⁴ *Donoghue v. Stevenson*, *supra* n. 16; *Grant v. Australian Knitting Mills* [1936] A.C. 85. Generally, Miller and Lovell, *Product Liability* (1977).

negligence for economic loss caused by defective products is in England and Australia almost unexplored.²⁴⁵ In addition to the constraints of finding liability for pure economic loss already canvassed, there are further reasons to expect judicial wariness with respect to product liability. To find negligence liability for such economic loss may trespass into the contractual law preserve.²⁴⁶ Second, with increased legislative activity²⁴⁷ it may be considered that this is not a proper area for judicial innovation. These factors will make courts loath to find liability based in general Atkinian foreseeability terms.

The *Caltex Case* will be taken to require a limiting test that the manufacturer knew or had means of knowledge that the particular plaintiff would use the product and that a defect of that kind in the products would foreseeably cause the economic loss complained of. One can envisage that any extension beyond this point would be from knowledge of the particular plaintiff to a particularly identified class of consumers. For instance, if a manufacturer assembled aeroplanes specifically for crop dusting in the outback which were bought by graziers for this purpose, and were useless because they overheated, it seems that the graziers may have a good cause of action against the manufacturer for direct economic loss.

Product liability has lent itself to the application of economic analysis.²⁴⁸ Without an extensive discussion it may be apparent that the manufacturer and not the consumer is almost invariably the superior loss bearer. Ordinarily, this factor would militate in favour of

²⁴⁵ The first tentative steps were taken in the *Rivtow Case*, *supra* n. 2. Cf. Atiyah, "Negligence and Economic Loss", *supra* n. 13 at 276. See generally: Miller and Lovell, *Product Liability* (1977); Waddams, *Products Liability* (1974).

²⁴⁶ Cf. *Rivtow Marine*, *supra* n. 124 *per* Ritchie, J. with Laskin, J., *supra* n. 125. Cf. G. H. L. Fridman, "The Interaction of Tort and Contract" (1977) 93 *L.Q.R.* 422 esp. at 426; I. N. D. Wallace, "Tort Demolishes Contract in New Construction" (1978) 94 *L.Q.R.* 60. The borders of this debate have been tested with respect to pre-contractual negligent misstatement: *Esso Petroleum Co. v. Mardon* [1976] Q.B. 801 (Court of Appeal); *Dillingham Constructions Pty. Ltd. v. Downs* [1972] 2 N.S.W.L.R. 49 (Supreme Court of N.S.W.); *Presser v. Caldwell Estates Pty. Ltd.* [1971] 2 N.S.W.L.R. 471; *Capital Motors Ltd. v. Beecham* [1975] 1 N.Z.L.R. 576 (N.Z. Supreme Court). Amongst the host of academic comment see D. W. Greig, "Misrepresentations and Sales of Goods" (1971) 87 *L.Q.R.* 179; P. S. Atiyah, "Misrepresentation, Warranty and Estoppel" (1971) 9 *Alberta L.R.* 347; D. W. McLauchlan, "Pre-Contract Negligent Misrepresentation" (1977) 4 *Otago L.R.* 23. For American view see Note, "Manufacturers' Liability to Remote Purchasers for Economic Loss Damages — Tort or Contract?" (1966) 114 *U.Pa. L.R.* 539.

²⁴⁷ Law Reform (Manufacturers Warranties) Ordinance, 1977 (A.C.T.). The Trade Practices Amendment Act 1978 (Cth.). Cf. *Bowen v. Paramount Builders*, *supra* n. 120 at 413-14 *per* Richmond, P. "I do not think that the courts would be justified in imposing a duty of care on builders tantamount to the full warranties normally implied in a building contract. Any such extension to the present law seems to me to be more properly a matter for legislation".

²⁴⁸ Symposium, "Products Liability: Economic Analysis and the Law" (1970-71) *U. of Chic. L.R.* 1. Cf. Calabresi, *op. cit. supra* n. 57 (1970) at 13, 14, 169. For insurance perspectives: Anderson, "Current Problems in Product Liability Law and Products Liability Insurance" (1964) 31 *Ins. Counsel J.* 436.

liability in negligence.²⁴⁹ However, Mr Justice Stephen's disavowal of this particular policy factor may cast some doubt on the cogency of this argument. Further, the argument in respect of loss spreading is not as clear with respect to economic loss as in the physical injury situation. There is some doubt that consequential economic loss is insurable and risk distribution amongst a manufacturer's customers may be inequitable in increasing the price of products. In addition, if recovery is divorced completely from physical or threatened physical harm the element of deterrence in manufacturing dangerous products is absent. Thus the policy factors promoting the holding of manufacturers liable in negligence for economic loss caused by their products are weakened.²⁵⁰ Approached in an interest analysis framework the social policies of stabilizing economic relations and distributing economic losses are not greatly enhanced, while the preservation of freedom of action is sacrificed to no great gain.

This is an example of how an interest analysis may introduce clarity. It would force courts to fully articulate precise policy grounds, instead of disguising decisions under more generalized and less useful policy perspectives. The consequent channelling of argument in accordance with this framework would inculcate certainty and consistency in judicial decision making. It is submitted that if the High Court had adopted an interest analysis, the future direction of the law with respect to product liability would be more certain. As it is, a decision-maker must weigh these policy factors, without the assurance that a court will apply the same considerations.

In sum, because of these rather equivocal factors, the *Caltex Case* will encourage courts to keep a tight rein on liability for economic loss caused by defective products.²⁵¹

3. General Perspectives

Moving away from the fields of negligent misstatement and product liability, what general guidance can one derive from the *Caltex Case*?

In the first place, the nomenclature of "pure economic loss" should now pass from the vocabulary of negligence law. All economic loss now falls under the same rubric, whether economic loss is caused

²⁴⁹ Atiyah, *supra* n. 13 at 276.

²⁵⁰ *Cf.* Note, "Economic Loss in Products Liability Jurisprudence" (1966) 66 *Col. L.R.* 917 at 950-8. But *cf.* Note, "Manufacturer's Strict Tort Liability to Consumers for Economic Loss" (1967) 41 *St. J.L.R.* 401 at 416-20 arguing that the fault basis of negligence liability should favour ascribing of negligence liability on manufacturer for defective product causing economic losses.

²⁵¹ *Cf.* Miller and Lovell, *op. cit. supra* n. 195 at 343-4 for espousal of restrictive approach. But *cf.* Wallace, *supra* n. 246 at 68-71 the general thesis propounded is that the *Anns*, *supra* n. 117, and *Rivtow*, *supra* n. 2, cases will lead to an "expanding body of case law", *id.* 69, on liability for defective chattels. But the *Caltex Case* cuts the ground from beneath the reasoning of *Anns* and *Rivtow* in that recovery no longer depends on the element of physical injury.

by, or arises completely in the absence of foreseeability of, physical harm, its recoverability will depend on the *Caltex Case*. This will not vary the law relating to measure of damages. Hence those financial loss items in assessment of personal damages such as loss of future earning capacity are not governed by *Caltex*, which goes to the issues of duty or remoteness, anterior questions to that of measure of damages.²⁵² The following hypotheticals may expose some of the implications of the *Caltex Case*.

(A) If A's negligent conduct causes B's machine to break down, will B be able to recover damages for lost profits from contracts that he would have entered but for that breakdown?

(B) If a bank negligently dishonours A's cheque, and in consequence an insurance contract is not completed covering A for professional negligence, and A is subsequently liable for professional negligence, would A have an action against the bank for that loss?²⁵³

One must first harken to Mr Justice Stephen's words that these answers may only be finally revealed to us in time. For the impatient, I would hazard that the recovery of economic loss will depend on:

1. The degree of the defendant's knowledge of the particular plaintiff and the particular transaction.
2. The nature and context of the negligent act; is negligence likely to cause economic loss?²⁵⁴
3. The presence of physical damage caused by the defendant's negligent act.
4. The damages claimed being of a direct kind and not depending on "collateral commercial arrangements".²⁵⁵

The answer to (A), the former hypothetical, depends in part on the nature of the machinery. It would be necessary that the machinery was of a type that a person would usually employ in a business to generate income, and that the profits lost were directly resultant on the defendant's negligence.²⁵⁶ Moreover, the court would insist on A knowing to a fair degree of particularity B's presence and business and the way in which loss may occur through his negligence.

In the second example, (B), although there is no physical damage, the bank would know A's identity, and at least have constructive knowledge of the particular transaction. This is, moreover, a commercial transaction in which, because of its inherent nature, negligent conduct is likely to cause economic loss.

²⁵² *Salmond, supra* n. 50 at 537 citing at 64 *Wieland v. Cyril Lord Carpets Ltd.* [1969] 3 All E.R. 1006.

²⁵³ *Cf. Comment, supra* n. 19 at 674.

²⁵⁴ *Supra* n. 1 at 287 *per* Stephen, J.

²⁵⁵ *Ibid.*

²⁵⁶ *Ibid.*

The overriding policy injunctions of avoidance of indeterminate liability and promotion of community expectations of what is just and fair would not seem to be breached by finding liability in either of these circumstances. The writer would predict that on the basis of the *Caltex Case* both defendants would be liable. A caveat should be added that without further insight on how these very general considerations will be weighed in judicial decision making, such a conclusion must be essentially impressionistic.

Some of the difficulties in applying *Caltex* are highlighted by *George Hudson Pty. Ltd. v. Bank of New South Wales*,²⁵⁷ the only judicial comment to date on the *Caltex Case*. In this case, Master Allen in the New South Wales Supreme Court struck out a cross claim by one Harrod against the Bank of New South Wales. Harrod was a large shareholder in a company, George Hudson Pty. Ltd. The cross claim alleged that the defendant bank had credited cheques payable to that company to another account. As a consequence Harrod had suffered loss through the negligence of the bank.

Master Allen found that the Bank owed no duty of care to Harrod. The Master put aside an argument based on *Caltex* that the Bank had a duty because of its knowledge that Harrod was a large shareholder. The requirement of knowledge, he found, was "directed rather to knowledge that the plaintiff is peculiarly exposed to damage".²⁵⁸ With respect, it is suggested that, Master Allen failed to recognize that the function of the knowledge of identity requirement is to limit the field of potential plaintiffs. Specific knowledge both of identity and susceptibility to economic loss are required under the *Caltex* formulations. The Bank's knowledge of Harrod's identity was a necessary but not sufficient element in determining whether a duty of care arises.

Master Allen provides in his judgment no convincing reason for denying a duty of care. It is suggested that a more cogent reason for denying a duty of care would have been the nature of the damages claimed by Harrod — diminution in value of shares.²⁵⁹ These are not the damages of a direct mitigating kind contemplated in the *Caltex Case*.²⁶⁰ In as much as the High Court would not have allowed a duty to arise for "loss of profits arising because collateral commercial arrangements are adversely affected",²⁶¹ Harrod could not have founded a duty of care for damage equally as consequential. The nature of the damages claimed also goes to the issue of remoteness, so that a court may be willing to find that a duty of care existed, but deny recovery on the basis that the damage was too remote. The choice

²⁵⁷ (1978) 3 A.C.L.R. 366.

²⁵⁸ *Id.* 369.

²⁵⁹ *Id.* 367.

²⁶⁰ *Supra* n. 1 at 287 *per* Stephen, J.

²⁶¹ *Ibid.*

between either the duty issue or remoteness issue as a control device on liability is immaterial.²⁶²

Examples can be constructed in relation to which the *Caltex Case* can be applied with certainty in deciding whether the economic loss is recoverable. Inevitably, a large grey area exists which will provide much fodder for litigants and law review writers.

A Correct Departure?

After the consistent application of the exclusory rule should the High Court have departed from it?

It has been shown that the exclusory rule as it stood was subject to heavy strains to reshape it in a policy responsive form.²⁶³ These accommodations caused the application of the rule to be complicated and subject to doubt. What is more, it led to anomalies allowing recovery on the completely arbitrary chance that physical damage to the plaintiff's property or person was manifested.²⁶⁴

The question is whether the High Court has adequately responded to the problems that the law presented.

In the train of any new formulation of the law there are certain costs. Resources will be required to determine the limits of liability.²⁶⁵ These costs will be exacerbated by the inherent uncertainties of the *Caltex Case*. The High Court failed to spell out a framework for considering policy perspectives while laying down a policy responsive test. It is fairly predictable that a stream of litigation will ensue testing the limits of liability.

The High Court did not advert to this question. It made no attempt to perform any cost benefit analysis. It was assumed that a policy responsive test was superior to the exclusory rule. Unfairness resulting from the rule is at the base of this conclusion. However, previous authority had acknowledged these anomalies but favoured the retention of the rule on grounds of public policy.²⁶⁶ Some recognition that the invocation of a new rule would involve costs²⁶⁷ and an attempt to weigh those costs against the benefits of the new formulation and

²⁶² Fleming, *supra* n. 27; *King v. Phillips* [1953] 1 Q.B. 429 at 439 *per* Lord Denning. *Cf. supra* text at nn. 30-2.

²⁶³ *Supra* text at nn. 99-127.

²⁶⁴ *Supra* n. 1 at 284 *per* Stephen, J.: "[the exclusory rule] operates to confer upon . . . physical injury a special status unexplained either by logic or by common experience".

²⁶⁵ *Cf. Saif Ali v. Sydney Mitchell and Co.* [1978] 3 All E.R. 1033 at 1056 *per* Lord Keith of Kinkel (dissenting). For academic comment Epstein, "Nuisance Law: Corrective Justice and Its Utilitarian Constraints" (1979) 8 *J. of Leg. Studies* 49 at 76: "When errors of individualized decision making become too great the system may be better off (i.e., make fewer errors) if gross and imperfect rules of easy application are substituted for perfect rules of difficult application".

²⁶⁶ Lord Denning in *S.C.M.*, *supra* n. 12 at 344. *Cf. Atiyah, supra* n. 13 at 274-5 suggests ways of avoiding the capacious nature of the rule, while retaining it.

²⁶⁷ Feldthusen, *supra* n. 13 at 21.

costs of the exclusory rule would have made the Court's reasoning more convincing.

If the High Court had jettisoned a workable and clear rule of law there may have been more room for criticism.²⁶⁸ The fact is, however, that the exclusory rule was difficult to apply and probably would have increased in complexity with the pressures for it to accommodate to claims.²⁶⁹ On the other hand, the *Caltex* decision allows the courts to be responsive and flexible. This will lead to greater individual fairness as opposed to the previous arbitrariness. The courts will be able to build up a consistent body of case law free from the need to mould it around the interstices of an inadequate rule. Ultimately there will likely emerge a body of law more certain and enduring having the salutary effect of permitting persons to make positive decisions on the basis of it.

The *Caltex Case* is in the ilk of *Donoghue v. Stevenson*,²⁷⁰ *Home Office v. Dorset Yacht Co.*,²⁷¹ and *Hedley-Byrne v. Heller*.²⁷² Its seminal character requires that its implications can only be ascertained over time in light of a developing body of case law. This will, it is hoped, supply a framework for weighing policy factors argued for in this article. The High Court can be criticized for not providing that framework to take account of policy factors,²⁷³ but there is no doubting that the case has laid the basis for a rationalization of the law of negligence relating to recovery for economic loss.

²⁶⁸ Cf. Comment, *supra* n. 19 at 693-4.

²⁶⁹ For instance, Professor Atiyah's suggestions at *supra* n. 266 would lead to significant uncertainties.

²⁷⁰ *Supra* n. 16.

²⁷¹ *Supra* n. 129.

²⁷² *Supra* n. 12.

²⁷³ *Supra* text at nn. 41-53.