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Pure Economic Loss 1: Policy Concerns and Approach in Novel Cases

'Where a person suffers pure economic loss, however, the law has not been so willing to impose a duty of care on the defendant. By pure economic loss, I mean loss which is not the result of injury to person or tangible property.' (*Perre v Apand*, McHugh J at [70])

Example:

Spartal Steel and Alloys v Martin

Defendant accidentally damaged an electricity cable (publicly owned, not belonging to plaintiffs) while working outside a metal factory; as a result of losing power, the factory stopped operations and metal had to be discarded/could not be sold. **3 distinct economic losses found:**

economic losses found:

- 1) Damage to metal (depreciation in value)
- 2) Loss of profit on metal
- 3) Loss of production i.e. further \$\$ loss

The English Court of Appeal held by a majority of 2:1 that losses 1 and 2 were recoverable, but not loss 3. Loss 1 was foreseeable property damage. Loss 2 was economic loss consequential on that property damage.

Loss 3 not recoverable because it flowed from the **disruption of power supply, not from any damage to property owned by the plaintiff.**

- a. *'Such a hazard is regarded by most people as a thing they must put up with — without seeking compensation from anyone. Some are some who install a stand-by system. Others seek refuge by taking out an insurance policy against breakdown in the supply. But most people are content to take the risk on themselves. When the supply is cut off, they do not go running round to their solicitor... They do not try to find out whether it was anyone's fault. They just put up with it. They try to make up the economic loss by doing more work next day. This is a healthy attitude which the law should encourage.'* - Lord Denning MR
- b. Concern for floodgates "there would be no end of claims"
- c. Risk of economic loss would be suffered 'by the whole community who suffer the losses', pinning liability on 'one pair of shoulders...the contractor on whom the total of them, all added together, might be very heavy'.
- d. Law provides for 'deserving cases' (i.e. negligence causing actual physical damage) and any 'economic loss truly consequential on the material damage'.

2 Main types of Pure Economic Loss

1. "Relational" Economic Loss
 - Interruption of public utilities;
 - Damage to transport systems;
 - Damage to power lines.
2. Negligent Misstatements
 - Careless credit references;
 - Careless financial or legal advice;
 - Careless audit reports and/or accountant negligence.

Reynolds v Katoomba

Held: (1) Where a member of a club is a problem gambler, but is able to look after his own interests and is not open to the club's control, the club owes no duty of care to protect that person against financial loss from gambling. (53 [49]; 82

Per Spigelman CJ: "The law should not recognise a duty of care to protect persons from economic loss, where the loss only occurs following a deliberate and voluntary act on the part of the person to be protected. There may be, however, an extraordinary case where a duty should be recognised".

Policy Concerns

a) Economic interests less important than physical welfare or property interests?

There is something of our 'selves' vested in property which gives it greater value than mere money.

[The distinction between the redress given for damage to property interests and pure economic interests] is explicable on the basis that, whereas an individual's personality is partly constituted by the property that he or she owns, so that property can be seen as essential to the ways in which individuals constitute and define themselves, no such claim can be made with respect to mere abstract holdings of wealth. Although wealth permits the acquisition of property and participation in activities and experiences which might help to ... define the self in the future, the very fact that wealth has not been transposed into these things precludes it from being considered as important as actual holdings of property. The protection of property interests ought, therefore, to precede the protection of mere economic interests.

(C Witting, 'Distinguishing between Property Damage and Pure Economic Loss in Negligence' (2001) LS 481.)

b) Economic losses are not really harmful - do not result in any overall social loss.

(Not commonly used by judges except for the rare example found in *Perre*:

McHugh J

One important reason why courts have felt the necessity to distinguish between liability for harm resulting in pure economic and...for harm to person or tangible property is that pure economic losses frequently result in mere transfers of wealth. The plaintiff's loss is the defendant's or a third party's gain. Harm to person or property, on the other hand, ordinarily involves a net loss to social wealth.

c) Duty to protect P's PE interests would unduly restrict D's commercial autonomy?

Is the liberty to harm others economically an important aspect of a defendant's 'commercial freedom'? Would it unreasonably restrict a defendant's freedom to compete commercially if he or she were expected to protect the economic interests of others?

[33] ... in a competitive commercial environment, 'a duty to take reasonable care to avoid causing mere economic loss to another... may be inconsistent with community standards in relation to what is ordinarily legitimate in the pursuit of personal advantage'. It is because of this that the law requires some special factor or factors before it will impose a duty of care in protection of commercial interests, opportunities or ... advantages ...

[115] As long as a person is legitimately protecting or pursuing his or her social or business interests, the common law will not require that person to be concerned with the effect of his or her conduct on the economic interests of other persons. And that is so even when that person knows that his or her actions will cause loss to a specific individual.

d) Indeterminate liability?

Floodgates argument; where a single careless act leads to potentially an entire large or uncertain class of plaintiffs. (see *Perre*)

At least 6 different objections to imposing liability in such circumstances have been suggested::

- a) Liability would go on for too long in time (the temporal argument).
- b) It would lead to too much litigation for courts to handle (the administrative argument, sometimes also called the 'floodgates' argument). This argument is not often used, but it does crop up occasionally, for example in cases involving financial fraud, which can be complex evidentially and time-consuming
- c) D's liability would be unfairly large (the 'disproportionate liability' argument). This argument is sometimes used and other times rejected outright.
- d) Large liabilities would have harmful social effects by driving defendants out of business or, by raising prices, making their services unaffordable.
- e) It would be impossible to know where to stop (the slippery slope argument). This argument is rare.

Current approach:

- f) liability would be too uncertain for defendants to predict or insure against (the 'uncertainty' argument) (*Perre* [107]–[108] (McHugh J); [336] (Hayne J)).

McHugh J in Perre

Because economic losses tend to ripple outward so as to affect parties in ways that physical damage does not, they can be very unpredictable/uncertain and it may therefore be difficult for a defendant to calculate in advance what his or her liability might be and insure against it. Note that this argument is not about the size of potential liability (argument (c) above), but about its uncertainty. *'It is not the size or number of claims that is decisive in determining whether potential liability is so indeterminate that no duty of care is owed. Liability is indeterminate only when it cannot be realistically calculated.'*

e) Duty to protect P's PE interest may conflict with contractual risk-allocation or statutory regulations.

A person's financial interests are often already protected via contract, or by statute. Where this is the case, courts are reluctant to impose additional duties of care that might conflict with the way in which the parties themselves, or Parliaments, have chosen to protect those interests.

(*Perre* at [5]) Glesson CJ:

'...In those cases where the loss occurs in a commercial setting, a third party, C, may suffer financial harm as a result of conduct which is regulated by a contract between A and B. It may be that the consequences of such conduct, as between A

and B, are governed and limited by the contract. This is a problem which commonly occurs in relation to maritime claims, and may help to explain the strictness with which an exclusionary rule has been applied in shipping cases.'

[115] McHugh J in *Perre*:

'As long as a person is legitimately protecting or pursuing his or her social or business interests, the common law will not require that person to be concerned with the effect of his or her conduct on the economic interests of other persons ...even when that person knows that his or her actions will cause loss to a specific individual...consumer owes no duty to a trader not to cause loss to that person by withdrawing custom. However.... the cloak of immunity cannot extend to conduct which cannot be fairly described as a legitimate pursuit or protection of a person's interests.'

What counts as 'legitimate pursuit' or 'protection' of a person's interests?

[116] McHugh J: 'Ordinary competitive conduct imposes no duty to protect others from economic loss. At the other end of the spectrum, conduct involving deceit, duress or intentional acts prohibited by law could seldom, if ever, be regarded as done in the legitimate protection or pursuit of one's interests. However, it does not follow that, other indicia of duty being present, a person will always lose the immunity given to protect the autonomy of the individual merely because his or her conduct has been done in breach of law....[117] Because protection of the individual's autonomy is the reason for the immunity conferred by the legitimate protection or pursuit of interest doctrine, that doctrine can have little, if any, application in a case where the defendant already owes a duty of care to do or not to do something'

f) **P has an alternative means of protection? (contractual warranties?)**

The argument here is that D should owe P no duty of care where P can reasonably protect himself or herself against a financial loss. See the first paragraph of the excerpt from Lord Denning's judgment in *Spartan Steel*, above.

Perre [118]-[121]. McHugh J:

[118] 'In many cases, **there will be no sound reason for imposing a duty on the defendant to protect the plaintiff from economic loss where it was reasonably open to the plaintiff to take steps to protect itself.** The vulnerability of the plaintiff to harm from the defendant's conduct is therefore ordinarily a prerequisite to imposing a duty. If the plaintiff has taken, or could have taken steps to protect itself from the defendant's conduct and was not induced by the defendant's conduct from taking such steps, there is no reason why the law should step in and impose a duty on the defendant to protect the plaintiff from the risk of pure economic loss.'

[120] '...an important consideration will be **whether the plaintiff could easily have protected itself against the risk of loss by protective action...by obtaining contractual warranties.** Business people frequently take, or are easily able to take, steps to minimise their business or economic losses. Taking these steps will often be a more efficient way of dealing with the risk of these losses than requiring defendants to have regard to the risk that others may suffer economic loss.

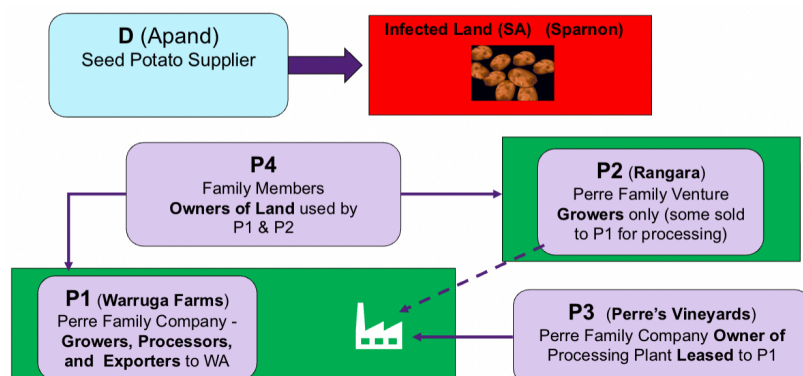
[121]: In the twentieth century, many areas of economic activity are extensively regulated by legislation and regulations....potential for **interference with such a body of law is vitally important in determining whether a common law duty of care should be imposed on a defendant.**...it is the relationship of negligence with contract that must ordinarily be considered'.

'We have a body of law designed for such disputes. It is called **contract law.**'

Modern Approach to Duty in PEL cases

Perre v Apand

Apand supplied infected seeds to Warruga (Perre Family Company) Sparnon could not export potatoes to WA from the infection and neither could anybody else who had grown within a 20 Km radius of the outbreak (WA regulations banning import of potatoes affected by bacterial growth). **Ps all neighbours of Sparnon and all suffered PEL as a result. Ps have no contractual/direct relationship with either Apand or Sparnon.**



Decision: Gleeson CJ, Gaudron, Gummow, Callinan, Kirby JJ: Duty Owed to Ps 1-4

McHugh J: Duty owed to P1, P2, P4 but no duty to P3

Thought there was indeterminate liability in regard to P3

Hayne J: Duty owed to P1 and P2 only. No duty to P3 or P4

McHugh J's 'Multifactorial' approach (from Perre)

1. **Was the loss reasonably foreseeable?:** McHugh J *rejected* reasonable foreseeability alone as sufficient. [110] Gibbs J in *Caltex* 'would not confine the duty to persons whom the defendant knew would be affected by its conduct; would also extend the duty to at least a person who could be identified using constructive knowledge.'
2. **If yes, would a duty of care impose indeterminate liability on D? [106]-[113]**
 - I. Not 'size or number of claims that is decisive'; if the 'likely number of claims and nature of them can be reasonably calculated...cannot be...indeterminate' liability. [107]
 - Here the losses were reasonably foreseeable and Apand knew of the risk to nearby potato growers and exporters; allowed actual knowledge (sometimes constructive) of harm to an ascertainable class (not indeterminate persons) to ground a duty
 - II. However, 'size and number of claims' is still relevant
 - per Gibbs J in *Caltex*, it is a 'policy of proportionality not indeterminacy that prevents court from imposing liability. 'to require the wrongdoer to compensate all those who had suffered pecuniary loss would impose upon him a burden out of all proportion to his wrong...' But even if this statement represents the current law — and it should be noted that courts do not hesitate to find a duty of care where an accident has caused extensive property damage or injury to many people — it is a policy of proportionality, not indeterminacy that prevents a court from imposing liability.' [108]
 - Quoting Mason J in *Caltex*: 'a duty would be owed only where the defendant 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.' [109]
 - 'The indeterminacy issue does not require that the defendant's knowledge be limited to individual persons who are known to be in danger of suffering harm from the defendant's conduct. Its liability can be determinate even when the duty is owed to those members of a specific class whose identity could have been ascertained by the defendant.'
 - III. Indeterminacy protects D against indeterminate liability not numerous plaintiffs
3. **If no to (2), would a duty of care impose an unreasonable burden on D's autonomy ? [114]-[117]** [115] 'consumer owes no duty to a trader not to cause loss'... 'however where other indicia of duty are present, immunity cannot extend to conduct which cannot be fairly described as a legitimate pursuit of a person's interests', which is '**deceit, duress or intentional acts prohibited by law**' or where a party **already has a duty of care to do (or not do) something**': → **pursuit of interest doctrine does not apply there.**
4. **If no to (3), was P vulnerable to loss ? [118]-[130]**
 - There will be no reason for imposing duty on D to protect P from EL where it was reasonably open to P to take steps to protect itself SO **vulnerability of P to harm from D's conduct is a prerequisite to imposing a duty** (e.g. *Esanda Finance* were 'sophisticated investors' so expected to protect themselves)
 - However, duty may be found (like in *Pyrenees Shire*) **if the D's control and knowledge and relative inability of P's protect themselves.** 'Reasonable reliance' is the test for determining whether P was vulnerable i.e. they were vulnerable because they reasonably relied on the defendant.
 - Important to look to **whether P could have easily protected themselves through contractual warranties**, because 'pecuniary losses' are 'ordinary risks' of business and thus 'life'
 - McHugh J at [125]: 'reliance and assumption of responsibility are merely indicators of the plaintiff's vulnerability to harm from the defendant's conduct, and it is the concept of vulnerability rather than these evidentiary indicators which is the relevant criterion for determining whether a duty of care exists.'

- NOTE: insurance will not be relevant in most cases

5. If yes, did D know that its conduct could cause harm to P either individually or as a member of an 'ascertainable class'?

[132]: 'where the defendant has actual knowledge of the risk and its consequences for an ascertainable class and is **not legitimately pursuing or protecting its interests**, I see no reason why that actual knowledge should not be an important factor in deciding the duty issue.'

[143]: 'That class should be defined as the owners of, and the growers of potatoes on, land within 20 km of the Spannons where potatoes grown on that land were exported to Western Australia. Whether or not Apand knew who were the members of the class is beside the point. They were easily identifiable, particularly by Apand. Indeed, it would be surprising if Apand did not know every member of the class.'

Mallonland Pty Ltd v Advanta Seeds

Advanta (D) supplied infected seeds to wholesale distributors, who had then sold them to growers (P): no direct contractual relationship between Advanta and growers. Mallonland was the first. Advanta had labelled their bags excluding liability for pure economic loss and that there was a small risk of contamination.

OUTCOME: No duty owed because:

1. No assumption of responsibility by Advanta
2. Applying salient features approach, P's arguments did not afford a 'principled basis upon which to recognise alleged duty of care' [49]

Majority Reasoning

- I. Reiterated exclusory rule for PEL: 'Ordinarily, a person does not owe a duty to take reasonable care to avoid causing reasonably foreseeable pure economic loss to another'. Flood gates, policy concerns, commercial viability cited as deterrents.
 - A. Actual knowledge of the risk to a person or class of persons and of the magnitude of the economic loss will strengthen the case for a finding of a duty of care (citing *Perre*).
- II. Reasonable foreseeability was found but is only a necessary and not sufficient basis for finding of duty.
- III. Critical factor that the producer did not in fact know the seeds it had placed into the market were contaminated. Producer knew that failure to take reasonable care in production process led to risk that an ascertainable class who would plant and purchase contaminated seed would suffer economic loss however that was not knowledge of the risk of economic loss to the plaintiff growers specifically.
- IV. Producer's capacity to control risks of seed contamination was not absolute (clear from the packaging disclaimer)
- V. P's were not found to be sufficiently vulnerable as they were warned by the packaging and could refrain from planting the seeds (they had an 'informed choice'). Though they could not have obtained a warranty, they did have the choice to return the seed if they did not want to accept the risk.