ECONOMIC LOSS – PRINCIPLES IN BRIEF

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The Principles

1. Until ***Hedley Byrne & Co Ltd v Heller & Partners Ltd*** (1964) AC 465, a plaintiff could not maintain an action for pure economic loss (being economic loss not consequential upon injury to person or damage to property). The High Court in ***Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad"*** (1976) 136 CLR 529 confirmed that such cause of action exists in Australia. However, notwithstanding that a plaintiff may now bring an action in negligence for pure economic loss, the law in Australia is uncertain, primarily as a result of the seven separate judgments delivered by the High Court in ***Perre v Apand Pty Ltd*** (1999) 198 CLR 180. What does seem ascertainable is that there are recognized categories of the action, such as negligent misstatement, and that more than foreseeability is required to establish the action. It has not been authoritatively determined what the additional element/s is or are.

Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad" (1976) 136 CLR 529

2. The defendant's dredge fractured a pipeline connecting an oil refinery and an oil terminal. The refinery and terminal were owned by Australian Oil Refining Pty Ltd. The terminal was owned by Caltex. Caltex supplied crude oil to the refinery, and the refined product was carried via the pipeline from the refinery to Caltex's terminal. The product in the pipeline belonged to Caltex. Caltex brought an action in negligence against the party responsible for fracturing the pipeline, seeking damages for economic loss.

3. Gibbs J refers (at p549, [27]) to ***Hedley Byrne & Co v Heller*** & ***Partners Ltd,*** noting that:

> *.....It is important to notice that their Lordships did not simply place liability for negligent words on the same footing as liability for negligent acts. It was not enough that the maker of the misleading statement could foresee that financial loss would result from it. The duty arose from the special relationship between the parties.....*

And further noting (at p552, [29]) that there are sound reasons of policy why economic loss should not be treated in exactly the same way as material loss.

After noting (at p555, [35]) that..... *it is necessary to consider the particular relationship in hand, but cannot think that the law leaves it entirely to the court to decide as a matter of policy whether the economic loss should be recoverable,* he concludes (at p555, [36]):

> *In my opinion it 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 plaintiffs person or property. ·The fact that the loss was foreseeable ·is not enough to make it recoverable. However, there are exceptional cases in which the defendant has knowledge or means of knowledge that the plaintiff individually, and not merely as a member 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. It is not necessary, and would not be wise, to attempt to formulate a principle that would cover all cases in which such a duty is owed; to borrow the words of Lord Diplock in Mutual Life & Citizens' Assurance Co. Ltd. v. Evatt (1970) 122 CLR 628, at p 642; (1971) AC 793, at p 809: "Those will fall to be ascertained step by step as the*

facts of particular cases which come before the courts make it necessary to determine them." All the facts of the particular case will have to be considered. It will be material, but not in my opinion sufficient, that some property of the plaintiff was in physical proximity to the damaged property, or that the plaintiff, and the person whose property was injured, were engaged in a common adventure.

4. Stephen J, at p572, [40], notes that reasonable foreseeability on its own, while no doubt providing adequate limitation of liability in the general run of duty situations in negligence, has been recognized as inadequate in certain specific duty situations, going on to say then at pp573-575, [42]-[43]:

> *But if economic loss is to be compensated its inherent capacity to manifest itself at several removes from the direct detriment inflicted by the defendant's carelessness makes reasonable foreseeability an inadequate control mechanism.....*
>
> *The need is for some control mechanism based upon notions of proximity between tortious act and resultant detriment to take the place of the nexus provided by the suggested exclusory rule which **I** have rejected. Its precise nature and the extent to which it should restrict recovery for purely economic loss must depend upon policy considerations just as does the conclusion that for cases of economic loss such an additional control mechanism is necessary. Both in actions for negligent misstatement and in products liability actions based upon negligence, the particular fact situations encountered are likely themselves to provide material out of which formulations limiting the extent of liability may be fashioned; Hedley Byrne (1964) AC 465 and Rivtow Marine (1973) 40 DLR (3d) 530 respectively provide examples of this process in these two areas. But in the general realm of negligent conduct it may be that no more specific proposition can be formulated than a need for insistence upon sufficient proximity between tortious act and compensable detriment. 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 the carelessness of others" - per Lord Pearce in Hedley Byrne (1964) AC, at p 536 reiterated by Lord Diplock in Dorset Yacht Co. v. Home Office (1970) AC 1004, at p 1058. It was Lord Pearce in Hedley Byrne who explained the divergence between the law of negligence in word and that of negligence in act in terms of the quite special characteristics of words as the instrument of negligence (1964) AC, at p 534. Economic loss possesses many of the characteristics which Lord Pearce attributed to negligence by word and the need which his Lordship recognized for proximity as a precondition of liability for negligence by word applies equally to all cases of recover for purely economic loss.*

5. Mason J suggested that the test should be foreseeability limited by the factor of indeterminate liability so that ".....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. This approach eliminates or diminishes the prospect that there will come into existence liability to an indeterminate class of persons; it ensures that liability is confined to those individuals whose financial loss falls within the area of foreseeability". (at p p593, [23])

6. Jacobs J takes a broader approach (at pp597-598, [11]-[13]):

> *The relevant duty of care in the present case is the duty of care owed to those whose persons or property are in such physical propinquity to the place where an act or omission of the defendant has its physical effect that a physical effect on the person or property of the plaintiff is foreseeable as the result of the plaintiffs act or omission. The damages for the breach of such a duty of care are those which result from the physical effect on the plaintiffs person or property of the defendant's act or omission*.
>
> *..... it is an error to concentrate attention on the question whether a particular loss is pecuniary or economic. Rather it is necessary to examine the circumstances of the loss. If the loss arises from the physical effect of an act or omission on the person or property of a plaintiff and that physical effect is one which was foreseeable and that foreseeability gives rise to a duty in the defendant to take reasonable care to avoid that physical effect, it is no answer to the plaintiffs claim for damages that his loss was pecuniary or economic.....*

Noting, however (at p598, [14]):

> *The risk of causing a loss to another which arises solely from a relationship of that other with a third party does not generally give rise to a duty of care to avoid the risk to the other.....*

He formulates the principle at pp602-603, [24]:

> *.....I would however avoid characterizing recoverable damage as direct or proximate in favour of relating the damage to the nature of the duty of care in any given .circumstances. In result there may not .be a substantial difference though I would avoid as far as possible the test of causation which is perhaps implicit in tests of directness or proximateness.*

Applying it to the present case (at p604, [31]) to say that:

> *..... The duty of care was that owed to a person whose property was in such physical propinquity to the place where the ads 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 ads or omissions.....*

7. Murphy J does not accept the contention that economic loss not connected with physical damage to the plaintiff's property is not recoverable (p606, [7]).

Perre v Apand Pty Ltd (1999) 198 CLR 180

8. Farmers in South Australia grew potatoes, some for export to Western Australia. Apand introduced a disease onto the land of one farmer. The Western Australian regulations prohibited importation of potatoes grown on land known to be affected by the disease and also potatoes grown on land within a certain distance of such land. Perre and others grew potatoes on such land and claimed to suffer financial loss (by reason of being unable to export their potatoes to Western Australia). The issue was whether Apand owed to such farmers a duty of care.

9. Gleeson CJ

Referring to Caltex ***Oil (Australia) Pty Ltd v The Dredge "Willemstad,*** Gleeson CJ noted (at p192, [4]) that:

> *..... all the members of the Court, except Murphy J, accepted that there is no general rule that one person owes to another a duty to take care not to cause reasonably foreseeable financial harm. The consequences of such a rule would be intolerable. However, as the decision in that case showed, and as had previously been shown in* ***Hedley Byrne & Co Ltd v Heller & Partners Ltd,*** *there are circumstances in which the law recognises a duty of care such as will permit recovery of pure economic loss.*

Stating then (at pp192-193, [5]) that:

> *There are at least three considerations which have been, and will remain, influential in restraining acceptance of such a duty of care in particular cases, or categories of case. First, bearing in mind the expansive application which has been given to the concept of reasonable foreseeability in relation to physical injury to person or property, a duty to avoid any reasonably foreseeable financial harm needs to be constrained by "some intelligible limits to keep the*

law of negligence within the bounds of common sense and practicality''Ifil. Secondly, to permit recovery of foreseeable economic loss, which may or may not occur in a commercial setting, for any negligent conduct, may interfere with freedoms, controls and limitations established both by common law and statute in many legal contexts. Thirdly, 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......

He notes at p193, [7] that there is no convincing reason why conveying advice or information should be treated as the solitary exception to an otherwise absolute exclusionary rule (which otherwise absolutely prevented recognition of a duty of care in economic loss cases). However, in deciding then what rule to apply, he rejects (at p194, [9]) the three-stage test formulated by Lord Bridge of Harwich in *Caparo Industries Pie v Dickman* [1990] 2 AC 605 (but which is approved by Kirby J at p275, [259]).

He discusses then the significance of vulnerability, noting that "knowledge (actual, or that which a reasonable person would have) of an individual, or an ascertainable class of persons, who is or are reliant, and therefore vulnerable, is a significant factor in establishing a duty of care" (p194, [10] and "Vulnerability can arise from circumstances other than reliance. In ***Caltex,*** the obvious vulnerability of a specific plaintiff was influential in a number of the judgments"

He agrees with the reasons given by Gummow J for concluding that a duty of care was owed (p194, [12]).

10. Gaudron J

Gaudron J notes that the law as to liability for economic loss is a "comparatively new and developing area of the law of negligence". It has not yet developed to a stage where there has been enunciated a governing principle applicable in all cases."(p197, [25]).

She then notes various of the approaches including the ***Caparo*** 3 stage approach advocated by Kirby J in ***Pyrenees Shire Council v Day*** (1998) 192 CLR 330 (p197, [26]), stating at (p198, [27]) that:

> *It is clear that foreseeability does not, of itself, suffice to render a defendant liable for negligently inflicted economic loss. This notwithstanding, the notion of proximity, which has generally been adopted by this Court to describe the special feature or features that attract a duty of care in economic loss cases [267, has been criticised as being incapable of constituting a universal criterion of liability [277 and, also, as having only limited utility in determining whether there exists a duty of care in a particular case [287. It may well be that, at this stage; the notion of proximity can serve no purpose beyond signifying that it is necessary to identify a factor or factors of special significance in addition to the foreseeability of harm before the law will impose liability for the negligent infliction of economic loss [297.*

She then notes (at pp198-201, [28]-[38]) several categories of economic loss cases, namely:

(i) Negligent misstatement;

(ii) Policy considerations, the first being "the law's concern to avoid the imposition of liability 'in an indeterminate amount for an indeterminate time to an indeterminate class'." (the absence of which is not, however, not necessarily fatal), and the second being that 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." (because of which the law requires some special factor or factors before it will impose a duty of care in protection of commercial interests, opportunities or, even, advantages); and

(iii) Protection of legal rights

Her Honour then states as the principle (at p202, [42]):

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

11. McHughJ

McHugh J notes at p204, [50] that:

> ..... *in my opinion the decision in Caltex was correct. Although the facts of the present case are very different from those present in Caltex, the reasons (with some modification) that led this Court in that case to hold that the defendant owed a duty to the plaintiff to protect it from economic loss, apply here. The losses suffered by the Perres were a reasonably foreseeable consequence of Apand's conduct in supplying the diseased seed; the Perres were members of a class whose members, whether numerous or not, were ascertainable by Apand; the Perres' business was vulnerably exposed to Apand's conduct because the Perres were not in a position to protect themselves against the effects of Apand's negligence apart from insurance (which is not a relevant factor); imposing the duty on Apand does not expose it to indeterminate liability although its liability may be large; imposing the duty does not unreasonably interfere with Apand's commercial freedom because it was already under a duty to the Sparnons to take reasonable care; and Apand knew of the risk to potato growers and the consequences of that risk occurring.*

With regard to the relevance of foreseeability to breach (as opposed to whether there is a duty of care) McHugh J notes (at p207, [66]) that:

> *A defendant does not breach its duty simply because it foresees a risk of harm. Foreseeability of harm is an element of breach. A defendant only breaches a duty of care when it both knows or ought to know of a risk of harm from doing or failing to do an act and does or fails to do that act and has reasonable means available to it of avoiding that harm.*

At p208, [70]:

> *Where a defendant knows or ought reasonably to know that its conduct is likely to cause harm to the person or tangible property of the plaintiff unless it takes reasonable care to avoid that harm, the law will prima facie impose a duty on the defendant to take reasonable care to avoid the harm. Where the person or tangible property of the plaintiff is likely to be harmed by the conduct of the defendant, the common law has usually treated knowledge or reasonable foresight of harm as enough to impose a duty of care on the defendant. 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.*

At p209, [72]:

> .....*even with the demise of the exclusionary rule, courts in most jurisdictions still require a plaintiff in a pure economic loss case to show some special reason why liability should be imposed on the defendant.*

At pp209-210, [74]-[75]:

> *this Court no longer sees proximity as the unifying criterion of duties of care [597. The reason that proximity cannot be the touchstone of a duty of care is that it "is a category of indeterminate reference par excellence.'[607*

However,

> ..... *neither this Court nor the English courts - which have also rejected proximity as the duty of care determinant - have entirely abandoned the use of proximity as a factor in determining duty. Nor do courts generally now appear to accept the categories approach although individual judges have favoured it.*

In any event,

> .... *neither proximity nor the categories approach or any synthesis of them has gained the support of a majority of Justices of this Court. Indeed, since the fall of proximity, the Court has not made any authoritative statement as to what is to be the correct approach for determining the duty of care question* (p210, [76]).

His Honour rejects the Caparo test, discussing its defects (at pp211-212, [78]-[80]) and noting at p211, [78] that:

> *Dawson J was correct when he said in* **Hill v Van Erp** *that proximity is neither a necessary nor a sufficient criterion for the existence of a duty of care [677. Furthermore, proximity in the sense of nearness or closeness is. hardly a useful concept in most cases of pure economic loss.*

His Honour also rejects the test in *Anns v Merton London Borough Council* [1978] AC 728 at pp212-213, [83], that test being that the court will find that a duty existed if the defendant knew or ought to have known that its conduct might cause harm to the plaintiff and there is no policy reason for negating the existence of such a duty.

His Honour also rejects (at p213, [84]) the precise legal rights test, ie that a defendant should owe a duty of care merely because its conduct may defeat or impair "a precise legal right" of the plaintiff in circumstances where the defendant is in a relationship with the plaintiff and in a position to control the enjoyment of that right (noting that the strongest judicial support for imposing a duty in this situation is found in the judgment of Gaudron J in ***Hill v Van Erp.)***

He also rejects the exclusionary rule (at pp214-215, [87], noting that whatever else *Caltex* may have decided, it determined that Australia no longer adheres to the strict exclusionary rule with or without defined exceptions[89].

After noting at p216, [91] that "Ideally, arguments about duty should take little time with need to refer to one or two cases only instead of the elaborate arguments now often heard, where many cases are cited and the argument takes days", he supports the incremental approach (at p217, [94]):

> *In my view, given the needs of practitioners and trial judges, the most helpful approach to the duty problem is first to ascertain whether the case comes within an established category. If the answer is in the negative, the next question is, was the harm which the plaintiff suffered a reasonably foreseeable result of the defendant's acts or. omissions? A negative answer will result in a finding of no duty. But a positive answer invites further inquiry and an examination of analogous cases where the courts have held that a duty does or does not exist [937. The law should be developed incrementally by reference to the reasons why the material facts in analogous cases did or did not found a duty and by reference to the few principles of general application that can be found in the duty cases.*

He refers to the categorisation of cases of pure economic loss proposed by Professor Feldthusen and adopted by the Canadian Supreme (in *Winnipeg Condominium Corporation No 36 v Bird Construction Co* [1995] 1 SCR 85 at 96-97) [94] (at pp217-218, [96]):

(i) *The Independent Liability of Statutory Public Authorities;*

(ii) *Negligent Misrepresentation;*

(iii) *Negligent Performance of a Service;*

(iv) *Negligent Supply of Shoddy Goods or Structures;*

(iv) *Relational Economic Loss.*

Where a case does not fall into one of the categories, "the issue of duty must be decided by reference to the few general principles that appear to govern all cases of pure economic loss" (p218, [99]).

> *In determining whether the defendant owed a duty of care to the plaintiff, the ultimate issue is always whether the defendant in pursuing a course of*

conduct that caused injury to the plaintiff, or failing to pursue a course of conduct which would have prevented injury to the plaintiff, should have had the interest or interests of the plaintiff in contemplation before he or she pursued or failed to pursue that course of conduct **(Donoghue v Stevenson** [1932] AC 562 at 580 per Lord Atkin). *That issue applies whether the damage suffered is injury to person or tangible property or pure economic loss [997. If the defendant should have had those interests in mind, the law will impose a duty of care. If not, the law will not impose a* duty..... (p218, [100])

In assessing the effect of indeterminacy he states (at pp219-220, [102]):

> .....*indeterminacy and conduct legitimately protecting or pursuing a person's social or business interests are merely factors which negative the existence of a duty. That is an important limitation on their utility as a principle for determining whether a duty exists. Recognition of that limitation also answers the criticism that indeterminacy of liability and conduct legitimately protecting or pursuing a person's social or business interests are not useful criteria in determining duty because they are not relevant to all cases of pure economic loss. On the contrary, they are useful because, when they apply, they provide valid reasons for rejecting a duty. It hardly needs to be said that, when they are absent, no duty, or even a prima facie duty, automatically arises.*

Continuing at p220, [103]-[105], noting that vulnerability is the likely decisive factor:

> *Nevertheless, when a court is satisfied that the economic loss suffered by the plaintiff was reasonably foreseeable by the defendant, that no question of indeterminacy of liability arises and that the defendant was not legitimately protecting or pursuing his or her social or business interests, it will often accord with community standards and the goals of negligence law, as an instrument of corrective justice, to hold that the defendant should have had the plaintiffs interests in mind when engaging or refusing to engage in a particular course of conduct. However, the common law in its desire to give effect to the autonomy of each individual does not generally require a person to ad as if he or she were "my brother's keeper". That is particularly so when the defendant would have to take affirmative action to save a person from suffering harm.*
>
> *What is likely to be decisive, and always of relevance, in determining whether a duty of care is owed is the answer to the question, "How vulnerable was the plaintiff to incurring loss by reason of the defendant's conduct?" So also is the actual knowledge of the defendant concerning that risk and its magnitude. If no question of indeterminate liability is present and the defendant, having no legitimate interest to pursue, is aware that his or her conduct will cause economic loss to persons who are not easily able to protect themselves against that loss, it seems to accord with current community standards in most, if not all, cases to require the defendant to have the interests of those persons in mind before he or she embarks on that conduct.*

> *The principles concerned with reasonable foreseeability of loss, indeterminacy of liability, autonomy of the individual, vulnerability to risk and the defendant's knowledge of the risk and its magnitude are, I think, relevant in determining whether a duty exists in all cases of liability for pure economic loss. In particular cases, other policies and principles may guide and even determine the outcome. But I do not think that a duty can be held to exist in any case of pure economic loss without considering the effect of the application of these general principles.*

His honour then discusses indeterminacy at pp220ff, [106ff] (however, such does not arise as a limiting factor in *Sage/ease's* case), noting in the course thereof that "the common thread that may be drawn from the judgments of Gibbs, Stephen and Mason JJ in *Caltex* is that more than reasonable foreseeability of harm to a person is required before the defendant comes under a duty of care. Knowledge of harm to the plaintiff is a minimum requirement" (at p222, [111]), noting also, however, that "the only criticism that I have of the reasoning in *Caltex* is that it imposed too narrow a test for determining to whom a duty was owed" (p223, [113]).

McHugh J also notes the concern with unreasonable burdens on the autonomy of the individual, quoting (at p224, [114]) from his judgment in *Hill v Van Earp,* that:

> *"Anglo-Australian law has never accepted the proposition that a person owes a duty of care to another person merely because the first person knows that his or her careless act may cause economic loss to the latter person (Dorset Yacht Co v Home Office [1970] AC 1004 at 1027 per Lord Reid). Social and commercial life would be very different if it did. Indeed, leaving aside the intentional tort cases of wrongful interference with another person's legal rights (inducing breach of contract, intimidation and conspiracy, for example) a person will generally owe no duty to prevent economic loss to another person even though the first person intends to cause economic loss to another person. In our free enterprise society, no one questions the right of the trader to increase its advertising or cut its prices even though that action is done with the intention of taking the market share of its rivals."*

His Honour then refers to the notion of vulnerability, stating (at pp225-226, [118-119]):

> *Cases where a plaintiff will fail to establish a duty of care in cases of pure economic loss are not limited to cases where imposing a duty of care would expose the defendant to indeterminate liability or interfere with its legitimate acts of trade. 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.

In ***Esanda Finance Corporation Ltd v Peat Marwick Hungerfords*** *[1227, an important factor in denying a duty of care was that the plaintiffs were sophisticated investors well able in the circumstances to protect themselves. On the other hand, this Court found a duty in* ***Hill v Van Earp*** *[1237 and* ***in Pyrenees Shire Council v Day*** *[124] partly because of the defendant's control (and knowledge) and relative inability of the plaintiffs to protect themselves.*

Noting further at p 2 2 6 , [120] t h a t "……Business p e o p l e frequently take, or are easily able to take, steps to minimise their business or economic losses……." and continuing at pp228-230, [124]-[129]:

Vulnerability will often include, but not be synonymous with, concepts of reliance and assumption of responsibility. The widely used concepts of "reasonable reliance" and "assumption of responsibility" have come under criticism [1337. This Court has recognised that neither concept represents a necessary or a sufficient criterion for determination of a duty of care [1347, saying that commonly, but not necessarily, a duty will arise in cases which "involve an identified element of known reliance (or dependence) or the assumption of responsibility or a combination of the two". This statement provides an insight into why both reliance and assumption of responsibility have been rejected as a unifying criterion in cases of pure economic loss. Like proximity, reliance and assumption of responsibility are neither necessary nor sufficient to found a duty of care.

In my view, 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. The most explicit recognition of vulnerability as a possible common theme in cases of pure economic loss is found in the judgment of Toohey and Gaudron JJ in ***Esanda Finance Corporation Ltd v Peat Marwick Hungerfords [135].***

Reliance may therefore be seen - for the purposes of duty of care - as an indicator of vulnerability: the plaintiff is specially vulnerable to the words and/or

conduct of the defendant because he or she reasonably relied on the defendant. Reliance may also, of course, be relevant to causation. In terms of a duty of care, however, it is not reliance that is relevant, but its consequence, vulnerability. That is so, even though in certain situations "reasonable reliance" will be the appropriate test for determining whether the plaintiff was vulnerably exposed to harm from the defendant's acts or omissions.

The case law indicates that vulnerability as a test of duty is not restricted to the category of negligent misstatements. Nor are reliance and assumption of responsibility its only indicators. Thus, in Hill v Van Erp [1367, a case of negligent performance of a service, which is closely analogous to negligent misstatement [1377, neither reliance nor assumption of responsibility to the plaintiff was present [138]. Justice Gaudron dismissed these criteria as indicators of duty and relied on the concept of control to found a duty [1397. But that is simply another way of saying that the plaintiff is vulnerable to the defendant's conduct because the defendant controls the situation. In dissent in Hill v Van Erp, I said that the plaintiff's inability to protect her own interest (ie vulnerability) was the single strongest factor pointing to the existence of a duty [1407. Brennan CJ, Dawson J and Toohey J based their judgments, at least in part, on a variant of the assumption of responsibility criterion [141 l which is a powerful indicator of the plaintiff's vulnerability to harm from the defendant's acts or omissions. Moreover, Dawson J and Toohey J also relied on the doctrine of "general reliance' which even more than "specific reliance" may be reduced to vulnerability [1427.

In Pyrenees Shire Council v Day [1437, Brennan CJ rejected general reliance as a useful concept in that case. Gummow J and Kirby J also rejected general reliance on the ground that it was a legal fiction and dependent on a principle - reliance - which already held too much sway in negligencel1447. These criticisms of general reliance, however, do not apply to the concept of vulnerability. Vulnerability is not a legal fiction, nor is it dependent on reliance.

The degree and the nature of vulnerability sufficient to found a duty of care will no doubt vary from category to category and from case to case. Although each category will have to formulate a particular standard, the ultimate question will be one of fact. The defendant's control of the plaintiff's right, interest or expectation will be an important test for vulnerability. That test was applied by Gummow J in Pyrenees where his Honour noted that like the situation in Hill v Van Erp, there was no evidence of actual reliance [1457.

His Honour then discusses the requirement of knowledge and reasonable foreseeability, stating at p230, [131]:

The cases have recognised that knowledge, actual or constructive; of the defendant that its act will harm the plaintiff is virtually a prerequisite of a duty of care in cases of pure economic loss. Negligence at common law is still a fault based system [149]. It would offend current community standards to impose

liability on a defendant for acts or omissions which he or she could not apprehend would damage the interests of another.

However,

> *..... where the defendant is not legitimately protecting or pursuing its own interests, current community standards would also seem to require that the knowledge of a defendant that its actions are likely to harm the interests of an ascertainable class of persons is a factor weighing in favour of imposing a duty. .....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. Furthermore, because fault remains the basis of negligence liability, **I** see no reason why recklessness or gross carelessness should not be a relevant factor in determining whether a duty of care was owed. In Caltex [1537, Stephen J seems to have thought that "the grossness of the wrongdoer's want of care" was a relevant matter in determining whether a duty of care should be imposed.* (pp230-231, [132])

In determining then whether a duty of care is owed, he formulates the questions to be asked, applying them to Apand (at p231, [133]):

1. *Was the loss suffered by the Perres or members of the group reasonably foreseeable?*
2. *If yes to question 1, would the imposition of a duty of care impose indeterminate liability on Apand?*
3. *If no to question 2, would the imposition of a duty of care impose an unreasonable burden on the autonomy of Apand?*
4. *If no to question 3, were the Perres or some of them vulnerable to loss from the conduct of Apand?*
5. *Did Apand know that its conduct could cause harm to individuals such as the Perres?*

12. Gummow J

Gummow J notes (at p243, [172]) that:

> *The decision of this Court in Caltex Oil[1837 is authority at least for the proposition that, in a case such as the present, one does not begin with an absolute rule that damages in negligence are irrecoverable in respect of economic loss which is not consequential upon injury to person or property. The same may be said of more recent decisions of this Court[1847 and the House of Lords[1857, as well as of the Supreme Court of Canada[1867 and the New Zealand Court of Appeal[1877.* (p.... [172])

In determining whether there is a duty of care, His Honour referred to the need for 'salient features' (at pp254-255, [201] [202]):

> ***I*** *prefer the approach taken by Stephen J in Caltex Oil. His Honour isolated a number of "salient features" which combined to constitute a sufficiently close relationship to give rise to a duty of care owed to Caltex for breach of which it might recover its purely economic loss [2447. In Hill v Van Erp [2457 and Pyrenees Shire Council v Day [2467,* ***I*** *favoured a similar approach, with allowance for. the operation of appropriate "control mechanisms". In those two cases, the result was to sustain the existence of a duty of care.*
>
> *In Esanda Finance Corporation Ltd v Peat Marwick Hungerfords[2477. there had been no trial and thus no facts found. The pleading was bad because it did not allege facts adequate to carry the auditors into a sufficiently close relationship with the creditors or financiers of the company so as to found the element necessary to constitute a duty of care to the appellant. There, the potential for foreseeable but indeterminate and possibly ruinous loss by a large class of plaintiffs and other circumstances pertaining to the relationships between auditors, company and investors or creditors[2487 made it appropriate to take into account various "control mechanisms". For example, Toohey and Gaudron JJ pointed out that [2497:*
>
> > *"there is nothing to suggest Esanda was not itself able to have accountants undertake the same task on its behalf as a condition of its entertaining the possibility of entering into financial transactions with Excel. And, which is much the same thing in the circumstances of this case, there is nothing to suggest that it was reasonable for Esanda to act on the audited reports without further inquiry."*

In the circumstances of the present case, Gummow J noted (at pp259-260, [216]-[217]) that:

> *Perres had no way of appreciating the existence of the risk to which they were exposed by the conduct of the Apand experiment and no avenue to protect them against that risk. They thus stood in quite a different position from that of the financier in Esanda Finance Corporation Ltd v Peat Marwick Hungerfords which had the power to deal from a position of strength in ordering its commercial relationship with the party to whom it provided financial accommodation [2527. Here, the relevant risk to the commercial interests of the appellants was in the exclusive control of Apand. Its measure of control was at least as great as that of the Shire in Pyrenees Shire Council v Day [2537.*
>
> *The characteristics of the present case to which* ***I*** *have referred combined, subject to what follows, to bring the Perres and Apand into such close and direct relations as to give rise to a duty of care owed by Apand for breach of which purely economic loss may be recovered.....*

Concluding (at p261, [222]) that "the standard of care exacted is that which is reasonable in the circumstances. The degree of care under that standard necessarily

varies with the risk involved, including both the magnitude of the risk coming to pass and the seriousness of the potential damage that would follow [254J."

13. *Kirby J*

His Honour discusses the options which have emerged, concluding (at p275, [259]) that the proper approach is foreseeability, proximity and policy (being the *Caparo* test):

> ***It*** *was expressed in my reasons in Pyrenees Shire Council v Day [3337. As an approach or methodology for deciding whether a legal duty of care in negligence exists,* ***I*** *suggested that the decision-maker must ask three questions:*
>
> 1. *Was it reasonably foreseeable to the alleged wrongdoer that particular conduct or an omission on its part would be likely to cause harm to persons who have suffered damage or a person in the same position?*
> 2. *Does there exist between the alleged wrongdoer and such person a relationship characterised by the law as one of ''proximity" or "neighbourhood"?*
> 3. *If so, is it fair, just and reasonable that the law should impose a duty of a given scope upon the alleged wrongdoer for the benefit of such a person?*

Noting (at p276, [261]) that this "is where I part company from McHugh J in this appeal. The rules which he has expressed are not universal. They are no more than criteria, applicable in the facts of this case, for giving content to the universal requirement of undertaking the policy analysis required by the third stage of the *Caparo* approach".

Kirby J discusses past decisions of the High Court at pp281-284, [274]-[281], including *Caltex, Bryan v Malony, Hill v Van Erp,* noting (at p284, [282]) "the successive rejections of "reasonable foreseeability", "reliance" and "proximity" as universal determinants of the existence or absence of a legal duty of care" which reinforce him in the opinion that "a three-fold approach or methodology of reasoning is required. Even if foreseeability and proximity are first established, there is no escaping the evaluation of the competing arguments of policy for and against the attachment of

legal liability in the particular case", commenting further at p285, [286] that "considerations of indeterminacy of liability, vulnerability to risk, the autonomy of the individual and market competitiveness are not issues relevant to all negligence actions. It is therefore quite inappropriate to elevate them so that they are legal preconditions to the existence of a duty of care in negligence or "principles" to be applied in deciding whether the duty exists in the particular case. They are not even essential or relevant to every case framed in negligence where the damage claimed is purely of an economic character, without physical injury to the plaintiff's property or person. What is therefore needed is a more general or conceptual methodology or approach which provides the heading to which these considerations may be assigned when, in the particular case, they are considered relevant. Conceptually, they all belong to the evaluation of considerations of policy. Each of them is a powerful negative policy reason for inhibiting the extension of legal liability in negligence for pure economic loss."

With respect to the third stage of the test, being "policy", he refers (at p p 2 8 9 -290, [298]) firstly to the concern to avoid imposing legal liability upon an indeterminate class for indeterminate amounts [417J and the need for a line to be drawn to limit indeterminate liability, and secondly (at p290, [300]) to the unreasonable interference with economic freedom. autonomy and the competitive operation of the marketplace [418], noting that as a matter of policy, the law will generally uphold the right of a party lawfully to gain profit although doing so will occasion economic loss to others.....

14. ***Hayne J***

Hayne J notes (at pp299-300, [329]): that

> *Two threads, then, can be seen as important in the development of the principles governing liability for negligently caused pure economic toss. First is the desire to avoid "liability in an indeterminate amount for an indeterminate time to an indeterminate c/ass"[4307. Second is the concern not to establish a rule that will render "ordinary" business conduct tortious. Deciding whether one person owed a duty of care not to cause pure economic loss to another requires consideration of both these matters. Foreseeability of injury is essential but not enough. But that test (as it has developed) often extends widely. The decisions in the area of pure economic loss reflect the search for*

some further mechanism of controlling liability (further, in the sense of additional to foreseeability of injury) [431]....

Hayne J then discusses the utility of "proximity" as a controlling mechanism (at pp300-303, [330]-[335]) without seemingly concluding its status or definition, noting (at pp300-301, [330]) that save and except to say that:

> *.....although the "relationship of proximity" may be a useful description of the result of the decision whether, in particular circumstances, the defendant owed a duty to the plaintiff not to cause pure economic loss, it is only in that sense that the relationship of proximity "remains the general conceptual determinant and the unifying theme of the categories of case in which the common law of negligence recognizes the existence of a duty to take reasonable care to avoid a reasonably foreseeable risk of injury to another"[438].*

Concluding that:

> *.....To search, in these circumstances, for a single unifying principle lying behind what is described as a relationship of proximity is, then, to search for something that is not to be found.*

However, he also notes (at p301, [331]):

> *it is for like reasons that the problem of identifying when a duty of care to prevent economic Joss should be found to exist cannot be solved by discarding references to proximity and substituting a test that is (or includes) whether the imposition of a duty would be "fair, just and reasonable"[443]...*

From which he states (at p303, [335]) that:

> *..... the search for a control mechanism in addition to foreseeability is driven by at least two considerations - the desire to avoid indeterminate /liability and the concern not to establish a rule that will render "ordinary" business conduct tortious. **If** those are the concerns, then the criterion or criteria devised by the courts should address them directly rather than obscure their significance behind expressions such as "fair, just and reasonable". **It** may be that there are additional considerations that may have to be taken into account as this area of law develops but for present purposes the two that **I** have mentioned are critical: whether the liability is indeterminate, and whether the liability is consistent with basic assumptions about the economy in which the conduct takes place.*

He then discusses these two criteria at (pp303-307, [336]-[349]).

15. *Callinan J*

Callinan J discusses previous decisions of the Court including:

(a) ***Caltex*** (at pp316-321, [387]-[392]), noting at pp316-317, [387] that the:

> .....*Court held that, although as a general rule damages are not recoverable for foreseeable economic loss which is not consequential on injury to person or property, damages may be, and were there recoverable in a case in which the defendant had knowledge, or the means of knowledge that a particular plaintiff would be likely to suffer economic loss as a consequence of the defendant's negligence. Although the principle emerging from Caltex may be stated in those broad terms, its application in any particular case requires a careful marshalling of all the relevant facts and circumstances, and has on occasions been frankly acknowledged [4797 as involving the weighing of relevant policy considerations.*
>
> And (at p318, [389]) that "Stephen J accepted that policy considerations dictated the need to look beyond mere foreseeability of loss or damage as a test for liability for economic loss".

(b) ***Bryan v Maloney*** (at p321, [393]), noting that Mason CJ, Deane and Gaudron JJ adopted the same sort of approach as commended itself to Stephen J in ***Caltex.***

(c) ***Hill v Van Erp*** (at p322, [394]).

(d) ***Esanda Finance Corporation Ltd v Peat Marwick Hungerfords*** (at pp323-324, [396]-[400]).

Concluding at p324, [402] and p325, [403] that:

> *The cases subsequent to Caltex in this country show that all judges are united in their opinions that. for policy reasons, there is a need for a control mechanism to limit the availability of relief for pure economic loss so that commerce, providers of services, courts and society generally will not have to bear the burden and uncertainty of incalculable claims by a mass of people whose identity or very existence may be unknown to the defendant.....*.
>
> *The different path which this Court has followed in Caltex and the ensuing cases to which **I** have referred makes it unnecessary to consider Caparo Industries Pfc v Dickman [5217*

And at p325, [404] that:

> *It should be made clear however that the determination of a claim for pure economic loss is not a merely discretionary matter: it requires the application of*

the principles stated in Caltex and the subsequent cases in this Court to the various factual situations as they arise in the courts.

Noting (at p325, [405]) that it is "an area of the law in which the courts should move incrementally and verve cautiously indeed. It is not yet possible to identify a bright line of demarcation between those cases of pure economic loss in which damages are recoverable and those in which they are not. The law is still developing in the somewhat piecemeal fashion that Stephen J predicted in Caltex [526]..."

In determining the case at hand he effectively covers all the criteria, turning (at p326, [406]) "to a consideration of the factors which in combination Ithink relevant in this case and which establish a sufficient degree of proximity, foreseeability, a special relationship, determinacy of a relatively small class, a large measure of control on the part of the respondent, and special circumstances justifying the compensation of the appellants for their losses."

Referring then to: the geographical propinquity (p327, [410]); the commercial propinquity (p327, [411]) (both of which factors bespeak proximity); the fact that the appellants were rendered powerless to abate, or to prevent the occurrence of the loss to which they were subjected (p328, [416]); the fact that what happened to the appellants here was not the result of merely legitimate, competitive, commercial activity in the relevant industry (p328, [419]) [5321; the fact that the imposition of liability upon the respondent would not impose an impediment in the way of ordinary commercial activity in the industry (p328, [421])[5331; and that what the respondent did went considerably beyond careless inadvertence and resulted from conscious decisions carrying with them obvious risks (pp328-329, [422]), noting that this was not a case of a common adventure in which the appellants can be shown to have relied upon any statement, or act, or abstention from doing an act by the respondent[539l (p330, [429]).

16. It is to be noted that the three-stage approach of Lord Bridge in ***Caparo Industries v Dickman*** (as adopted by Kirby J above) **does not represent the law in Australia – *Sullivan v Moody; Thompson v Connon*** [2001] HCA 59 (11 October 2001) per Gleeson CJ, Gaudron, McHugh, Hayne and Callinan JJ at [49]

(2001) 75 ALJR 1570, at 1578.

Johnson Tiles Pty Ltd *&* Ors v Esso Australia Pty and Esso Australia Resources Pty Ltd (No 2) [2001] VSC 292 (17 August 2001*)*

17. Gillard J discusses the state of the law at present, noting (at [45]) that in Australia, the Courts have, in the past, applied a two-step test, referring to statements from the cases of ***Cook v Cook*** (1986) 162 CLR 376 (at [46]) and ***Bryan v Maloney*** (1995) 182 CLR 609, before referring to ***Perre v Apand Pty Ltd*** (at [51]ff), commenting (at [63]) that:

> *Each of the seven justices of the High Court, in that case, delivered separate reasons for judgment, and a consideration of each of the judgments supports the observation that the legal principles to apply in a case involving pure economic loss are now more uncertain than before. This makes the task of legal practitioners and Judges of advising and deciding, difficult. McHugh J recognised the importance of certainty of the law in practice - see pp.211 and 215. It is unfortunate that the members of the Court did not bear that maxim in mind when delivering their reasons. All one can say is that the law concerning duty of care to avoid pure economic loss is in a state of change, and is uncertain.*

before summarising the judgments as follows (from [65]-[83]):

> *.....the Chief Justice agreed with the reasons of Gummow J. His Honour did, however, make a number of general observations. He did not agree with the three stage English test. He emphasised that knowledge by the tortfeasor actual or constructive, of the vulnerability of the victim is the significant factor* [65].
>
> *Gaudron J, after noting there was no governing principle and discussing the various approaches of the past, observed that, although the notion of proximity had been accepted by the High Court in the past, its usefulness was questionable. See pp.197-8* [66].
>
> *Her Honour referred to the law concerning negligent misrepresentations, and observed that there was another category that could be articulated [67].*
>
> *She summarised this category at p.201, when she said -*
>
> > *"Where a person is in a position to control the exercise or enjoyment of another of a legal right, that position of control and, by corollary, the other's dependence on the person with control are, in my view, special factors or, which is the same thing, give rise to a special relationship of 'proximity' or 'neighbourhood' such that the*

law will impose liability upon the person with control if his or her negligent act or omission results in the loss or impairment of that right and is, thereby, productive of economic loss." [68]

McHugh J was of the opinion that proximity was no longer a test, and he opined the view that the High Court had held that it no longer applied. I would respectfully query whether this is correct [69].

He opined the view that there was a need for a new framework for determining the existence of a duty of care. His Honour disagreed with Gaudron J's approach, based upon the control of the exercise or enjoyment of another of a legal right [70].

His Honour was of the view that the most satisfactory approach was the incremental approach. If the case did not fall within an established category, then it was necessary to examine analogous cases to determine whether a duty of care does or does not exist [71].

At p.218, His Honour said -

"In determining whether the defendant owed a duty of care to the plaintiff, the ultimate issue is always whether the defendant in pursuing a course of conduct that caused injury to the plaintiff, or failing to pursue a course of conduct which would have prevented injury to the plaintiff, should have had the interest or interests of the plaintiff in contemplation before he or she pursued or failed to pursue that course of conduct. That issue applies whether the damage suffered is injury to person or tangible property or pure economic loss. If the defendant should have had those interests in mind, the law will impose a duty of care." [72]

If I may say so, with the greatest of respect, His Honour appears to me to have substituted one test, with its uncertainties, with another test, with a similar degree of uncertainty [73].

At p.231, His Honour stated that there were five questions to be considered in determining whether there was a duty of care [74].

Gummow J, with whom the Chief Justice agreed, after discussing the principles concerning recovery of pure economic loss in the field of negligence through the cases in many jurisdictions, concluded, at p.254, by saying -

"I prefer the approach taken by Stephen J in Caltex Oil. His Honour isolated a number of 'salient features' which combine to constitute a sufficiently close relationship to give rise to a duty of care owed to Caltex for breach of which it might recover its purely economic loss. In Hill v Van Earp and Pyrenees Shire Council v Day, I favoured a similar approach, with allowance for the operation of appropriate 'control mechanisms'. In

those two cases, the result was to sustain the existence of a duty of care." [75]

What the control mechanisms are, in any particular case, will depend upon the circumstances. The cases have established a number of relevant matters [76].

It appears that Gummow J was applying the traditional two-step approach, which was exemplified by Stephen J in Caltex Oil [77].

*Kirby J prefers the English approach, which involves a three-step exercise, namely, foreseeability, proximity and policy [*78].

.....It is clear that members of the High Court were aware of the English approach, and yet no High Court Judge in the past has embraced the English approach. Kirby J now does [81].

Hayne J adopted the traditional approach of applying the two-test exercise, but emphasised the importance of control mechanisms, which he identified in the case, at p.303, as being indeterminent liability and a concern not to establish a rule that will render "ordinary" business conduct tortious [82].

Callinan J also adopted the two-step approach, which was applied in the Caltex case, and emphasised the importance of particular factors to the question of duty of care [83].

Concluding (at [84]) that:

In my opinion, the majority of the High Court still favour the two-step exercise, but what is relevant to the proximity aspect will depend upon the circumstances of each case. Clearly, questions of policy can arise and apply.

David H Denton, S.C.
Chancery Chambers