RECOVERY OF ECONOMIC LOSS IN NEGLIGENCE: THE AUSTRALIAN HIGH COURT STRIKES A NEW TRAIL

DAVID F. PARTLETT*

The United States and Australia share the long tradition of the common law. This link is revealed best in the law of negligence.[1] Negligence jurisprudence in the United States has traditionally been the precursor of developments in the law of negligence elsewhere in the common law world. This leadership has been due in part to the more open fabric of judicial decisionmaking in the United States. When compared with British Commonwealth courts, United States courts are more often influenced by the social and political processes in the community than are the more tradition bound "British" courts, which tend to adhere more strictly to the doctrine of *stare decisis*.

Despite this leadership role in the development of the law of negligence, United States and British Commonwealth decisions on recovery of economic loss in negligence have occurred in relative isolation, though exhibiting a remarkable similarity of development.[2] Recently, however, the Australian High Court had occasion

* Lecturer in Law, Australian National University; LL.B., University of Sydney (1971); LL.M., University of Michigan (1974).

1. The commonality of the American and British Commonwealth experience in the law of torts is succinctly put by a dean of both, Professor J.G. Fleming, formerly Dean of the Australian National University School of Law and currently Professor of Law at the University of California, Berkeley, School of Law.

> There is little evidence to support the impression, not uncommonly encountered among American lawyers, that English law is beset with archaism characterized by inflexibility. Despite a more stringent observance of precedent in the Commonwealth, common law techniques offer sufficient elbowroom for constant adjustment and change. This is especially true of those areas of law, like torts, which by design are equipped with imprecise norms of reference so as to facilitate legal adjudication remaining readily responsive to the contemporary social environment. Any comparison between the British and American experience in a given legal field reveals a basic similarity, not only of the issues occupying judicial attention, but, equally, of the solutions being adopted . . . . [D]espite political boundaries, both countries are linked by fundamentally common attitudes to the problem of contemporary life no less than by the heritage of the common law itself.

Fleming, *Developments in the English Law of Medical Liability*, 12 VAND. L. REV. 633, 648 (1959).

2. Another academic leader in tort law, Professor Fleming James, has commented:

Published by CWSL Scholarly Commons, 1979

to reexamine the prevailing rule on recovery of economic loss. In *Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad,"*[3] the Australian High Court departed from the prevailing rule of law.[4]

Prior to the *Caltex* case, the accepted rule on the recovery of pure economic loss in negligence was as follows: a person suffering pure economic loss resulting from the negligent conduct of another, in the absence of any physical damage to his property or person, could not recover from that other person for that loss.[5] This will be referred to as the "exclusory rule."[6] With some exceptions, this is the predominant view in the United States.

The purpose of this article is to examine the views put forth by the High Court in *Caltex*. An in-depth exposition of these views can be useful as a guide to expose options and stimulate debate

---

> One [thing that should be noted] is the remarkable parallel between American decisions on this point [that is, pure economic loss] and those in the British Commonwealth. [citations omitted]. These developments were largely independent of each other; the courts in our country rarely have cited British authority, and the British courts rarely cite our decisions [citation omitted]. Nevertheless, the developments have been similar even to details in drawing the line of recovery . . . . Thus, British decisions, which have allowed recovery for economic consequences to one whose property was physically injured [citations omitted] but denied recovery for similar loss to one whose property suffered no physical impairment [citations omitted] has an almost exact American analogue.

James, *Limitations on Liability for Economic Loss Caused by Negligence — A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 45-46 (1972).

3. 51 A.L.J.R. 270 (Austl. 1976). The *Caltex* case was the culmination of years of judicial and academic comment on recovery in negligence for pure economic loss. *See, e.g.*, Weller & Co. v. Foot and Mouth Disease Research Institute, [1966] 1 Q.B. 569; S.C.M. (United Kingdom) Ltd. v. W.J. Whittal & Son Ltd., [1971] 1 Q.B. 337; Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27; Rivtow Marine Ltd. v. Washington Iron Works, 40 D.L.R.3d 530 (1973); Seaway Hotels Ltd. v. Cragg (Canada) Ltd., 21 D.L.R.2d 264 (Ont. Ct. App. 1959); French Knit Sales v. N. Gold & Sons, [1972] 2 N.S.W.L.R. 132. *Contra*, Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.). Examples of the academic comment are: Stevens, *Negligent Acts Causing Pure Financial Loss: Policy Factors at Work*, 23 U. TORONTO L.J. 431 (1973); James, *supra* note 2; Smith, *Clarification of Duty — Remoteness Problems Through a New Physiology of Negligence: Economic Loss: A Test Case*, 9 U. BRIT. COLUM. L. REV. 213 (1974); Atiyah, *Negligence and Economic Loss*, 83 L.Q. REV. 248 (1967); Harvey, *Economic Losses and Negligence: The Search for a Just Solution*, 50 CAN. B. REV. 580 (1972); Craig, *Negligent Misstatements, Negligent Acts and Economic Loss*, 92 L.Q. REV. 213 (1976); Brown, *The Recovery of Economic Loss in Tort*, 2 AUCKLAND U.L. REV. 50 (1972); Feldthusen, *Pure Economic Loss Consequent Upon Physical Damage to a Third Party*, 16 U.W. ONT. L. REV. 1 (1977).

4. In so doing, the High Court did not ignore American developments. Indeed, in referring to the Ninth Circuit Court of Appeals case, Union Oil Co. v. Oppen, 401 F.2d 558 (1974), Justice Stephen cited a comment on that case. *See* Comment, *Union Oil Co. v. Oppen: Recovery of a Purely Economic Loss in Negligence*, 60 IOWA L. REV. 315 (1974).

5. The rule was firmly established by the House of Lords in Cattle v. Stockton Waterworks Co., L.R. 10 Q.B. 453 [1875].

6. This is the term employed by Justice Stephen in *Caltex*. *See* Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 284 (Austl. 1976).

about the exclusory rule in the context of United States law. This, in turn, may lead United States courts to rethink the exclusory rule. It is also proposed to offer some criticism of the *Caltex* decision, for the High Court of Australia should not be seen as offering a universal panacea but as adopting an approach worthy of close scrutiny throughout the common law world. This examination may inspire bold judicial minds in the United States to augment United States jurisprudence just as many Commonwealth judicial minds have been inspired by advances in the law of torts in the United States.[7]

I. THE EXCLUSORY RULE

A. The Pre-Caltex Commonwealth Law

Prior to the *Caltex* case, a person suffering pure economic loss resulting from negligent conduct could not recover that loss in a negligence action from the person causing it. The crucial element in the rule is "pure economic loss." Pure economic loss is loss not suffered as a consequence of physical damage to the plaintiff's person or property.[8] This may occur in several distinguishable situations: (1) where there is no property damage at all; for example, where electrical power is disconnected by negligent conduct, causing the temporary shutdown of a factory and consequently loss of profits; (2) where there is damage to property in which the plaintiff has no proprietary interest; for example, a bridge connecting one side of town to another is negligently destroyed; a tavern owner whose trade is diminished may not recover;[9] (3) where damage occurs to the plaintiff's proprietary interest, but the economic loss suffered is not a consequence of that property damage. This will occur in cases involving the disconnection of utilities;[10] for example, the disconnection of electricity may cause the contents of a blast furnace to congeal. Costs incurred as a consequence of the congealing — that is, the physical damage — are recoverable. Profits lost as a result of the disconnection are not recoverable, since they arise independently of the congealing metal. This loss is

7. *See* notes 20 & 21 *infra*, and accompanying text.

8. *See* Cane, *Recovery in the High Court of Purely Economic Loss Caused by Negligent Acts*, 13 U.W. AUSTL. L. REV. 243 n.1 (1977).

9. Star Village Tavern v. Nield, 71 D.L.R.3d 439 (1976).

10. Economic loss resulting from lost production was not recoverable where electricity was cut off due to negligent conduct. *Accord*, Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27; British Celanese Ltd. v. A.H. Hunt (Capacitors) Ltd., [1969] W.L.R. 959 (Q.B.). *See* S.C.M. (United Kingdom) Ltd. v. W.J. Whittall & Son Ltd., [1971] 1 Q.B. 337.

not, in the words of Lord Denning, "truly consequential on material damage."[11]

The history of the exclusory rule has been well-treated elsewhere.[12] A classic statement of the rule is found in *Cattle v. Stockton Water Works Co.*;[13] it was most recently confirmed by the English Court of Appeal in *S.C.M. (United Kingdom) Ltd. v. W.J. Whittall & Son Ltd.*[14] and in *Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors)*.[15]

S.C.M. illustrates the corollary of the exclusory rule. That case held that economic loss consequent upon physical damage is recoverable. In *S.C.M.*, the defendant was a firm of building contractors. Its employees were digging a trench when an electric cable, which supplied current to many factories situated in the area, was severed. The severity of the damage caused a power failure, which affected the S.C.M. factory, causing molten metal in its machines to solidify. Certain machines were damaged beyond repair, while others could be saved by chipping away the metal. Moreover, profits from one full day's production were lost. The court denied recovery for lost profits, but allowed recovery for physical damage and economic loss flowing from the physical damage. The Court of Appeal affirmed, holding that to be recoverable, loss of profits must be consequent upon physical damage, and that loss not consequent upon the damage to the machines was pure economic loss and hence unrecoverable.[16]

The rationale for the rule enunciated in *S.C.M.* is found in one of two limiting factors employed by the courts — the *remoteness* issue and the *duty* issue.[17] In the latter, the courts have denied the existence of a duty to refrain from activities that will foreseeably cause pure economic loss.[18] In the former, the courts have held

11. S.C.M. (United Kingdom) Ltd. v. W.J. Whittall & Son Ltd., [1971] 1 Q.B. 337, 342. *See also* Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27.

12. Atiyah, *supra* note 3; Feldthusen, *supra* note 3.

13. Cattle v. The Stockton Waterworks Co., L.R. 10 Q.B. 453 (1875).

14. S.C.M. (United Kingdom) Ltd. v. W.J. Whittal & Son Ltd., [1971] 1 Q.B. 337.

15. Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27.

16. *See* S.C.M. (United Kingdom) Ltd. v. W.J. Whittal & Son Ltd., [1971] 1 Q.B. 337, 341-53. This was the approach adopted by the Supreme Court of California in Reynolds v. Bank of America, 53 Cal. 2d 49, 345 P.2d 926 (1959).

17. *See* Fleming, *Remoteness and Duty: The Control Devices in Liability for Negligence*, 31 CAN. B. REV. 471 (1953). One author holds that economic loss raises the issue of remoteness but *not* the issue of duty. *See* Smith, *supra* note 3, at 243. *See also* Harper, *Interference with Contractual Relations*, 47 NW. U.L. REV. 873, 893 (1953).

18. The rule is stated here as a duty of care. The exceptions were excluded from the rule for the purpose of clarity.

that, while a duty is owed, pure economic loss is by its very nature too remote to be recoverable.[19]

B. Rationale for the Exclusory Rule

In the face of wider recovery elsewhere in negligence, strict adherence to the exclusory rule has obliged the courts to justify application of the rule. This justification, which can be traced in United States and Commonwealth law, has been the fear first articulated by Chief Justice Cardozo in *Ultramares Corp. v. Touche*.[20] In that case, Justice Cardozo stated, in an often repeated phrase, that to allow recovery for pure economic loss would usher in "liability in an indeterminate amount, for an indeterminate time, to an indeterminate class."[21]

Two aspects of this fear can be discerned. First, from a slight negligent act may flow enormous economic harm.[22] Consider, for example, the Tasman Bridge disaster in Hobart, Tasmania, in which a freighter collided with a pylon of the Tasman Bridge over Hobart harbour, causing a substantial section of the bridge to collapse. Should the master and owner of the freighter be responsible for the pure economic loss suffered by commuters whose daily jour-

19. In the *S.C.M.* case, Lord Denning adopted the remoteness test. *See* S.C.M. (United Kingdom) Ltd. v. W.J. Whittal & Son Ltd., [1971] 1 Q.B. 337, 345. However, in *Spartan Steel* he refused the choice, stating: "I think the time has come to discard those tests which have proved so elusive . . . and to consider the particular relationship in hand, and see whether or not, as a matter of policy, economic loss should be recoverable." Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27.

Just as the exclusory rule rested on either of these formal bases, the court in *Caltex* was concerned on which of these bases a test to limit liability should be framed. Justice Mason, having observed that both courses had been taken in propounding the exclusory rule, found that "a more acceptable path to a solution of the problem is to be found through the duty of care." Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 293 (Austl. 1976). Justice Gibbs concluded that the proximity of the relationship between the plaintiff and defendant went to duty of care, *id.* at 280, although he 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." *Id.* at 275. *See also* Ins. Comm'r v. Joyce, 77 C.L.R. 29, 56 (1948); Nettleship v. Weston, [1971] 2 Q.B. 691. Justice Stephen spoke in terms of the need for "sufficient proximity between the tortious act and compensible detriment." Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 286 (Austl. 1976). This language would indicate that his Honor saw the question as one of remoteness, although he does not turn his mind to the choice of an appropriate formal limiting mechanism. *See also* Cane, *supra* note 8, at 260.

20. Ultramares Corp. v. Touche, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931).

21. *Id.* Justice Stephen quotes this description in *Caltex*, characterizing the application of the exclusory rule as "draconic." Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 284 (Austl. 1976).

22. James, *supra* note 2, at 50-51.

ney was greatly lengthened during the protracted period of reconstruction?[23] Secondly, an increase in claims would place unbearable demands on the court system in that a multiplicity of claims could flow from a single act of negligence.[24] In the Tasman Bridge disaster, all commuters to the city of Hobart who had previously used the bridge were potential plaintiffs.

In applying the exclusory rule, the courts have allowed the pure economic loss to rest where it falls. Hence, all commuters to Hobart had to bear the cost of extra gasoline and wear and tear on their vehicles. The reason for this was that pure economic loss was lower on the spectrum of interests than the courts were willing to protect.[25] The interests of society in allowing recovery of personal and property loss are clear; if a person by acting in a negligent fashion maims another, the former should bear the cost rather than the victim himself. Functionally, liability in this situation may have a deterrent effect on negligent behavior.[26]

Part of the reason for denying liability for pure economic loss was founded on the observation that the person suffering the loss may carry loss insurance. In *Caltex*, Justice Stephen emphasized this point by demonstrating the difficulties of basing recovery on an economic analysis of loss distribution.[27]

While the exclusory rule remained intact, these justifications served as a reasonable reference point. The rule was simple and was supported by rationalizations that seemed to make sense, although on a closer analysis this appeal flowed mainly from constant repetition over a long period of time. It will be shown below, however, that the test of liability enunciated in *Caltex* cannot rest on a mere recitation of the Cardozian incantation if uncertainty is to be avoided. The interests of the actors and society in drawing the limits of liability must be fully analyzed.

---

23. *See* Gypsum Carrier Inc. v. The Queen, 78 D.L.R.3d 175 (1977).

24. Atiyah, *supra* note 3, at 270-71; Stevens, *supra* note 3, at 450-53.

25. *Compare* James, *Scope of Duty in Negligence Cases*, 47 NW. U.L. REV. 778, 780-800 (1953) *with* Atiyah, *supra* note 3, at 269. An analogy may be drawn with recovery for negligently inflicted nervous shock; the courts were until recently reluctant to impose liability, partly because courts were not as willing to protect against nervous injury as they were to protect against physical injury.

26. P. ATIYAH, ACCIDENTS, COMPENSATION AND THE LAW 512-14, 547-57 (2d ed. 1975). *But see* G. CALABRESI, THE COSTS OF ACCIDENTS 244-65 (1970); Blum & Kalven, *The Empty Cabinet of Dr. Calabresi: Auto Accidents and General Deterrence*, 34 U. CHI. L. REV. 239 (1967).

27. S. WADDAMS, PRODUCTS LIABILITY 34 (1974).

C. *Recovery of Pure Economic Loss Outside the Exclusory Rule*

To this point, the exclusory rule was formulated with respect to negligent conduct to focus the discussion on the tort of negligence. However, if the negligent conduct also amounts to a public nuisance, such as in the well-known *Wagon Mound*[28] case, the courts do not hesitate to award damages for pure economic loss. This is so because the law of public nuisance contains a limiting aspect that saves it from the Cardozian nightmare of indeterminate liability: a plaintiff in an action in public nuisance must establish damage of a special or particular type which is peculiar to him, as opposed to the damage suffered by other members of the public.[29] The utility of this requirement in public nuisance cases has led one commentator to favor a rule in negligence which would allow recovery of pure economic loss if the plaintiff successfully establishes special or particular damages.[30]

Recovery for pure economic loss is also available in torts based on intentional acts.[31] *Sui generis* exceptions to the exclusory rule are also carved out by the doctrines of *actio per quod servitium amasit* and *actio per quod consortium amasit*.[32]

D. *Inroads into the Exclusory Rule*

The first inroads into the exclusory rule occurred in the area of negligent misstatement. Prior to the House of Lords' decision in

28. Overseas Tankship Ltd. v. Miller S.S. (Wagon Mound No. 2), [1967] A.C. 617; Overseas Tankship Ltd. v. Morts Dock and Eng'r (Wagon Mound), [1961] A.C. 388. The Judicial Committee of the Privy Council found that the remoteness test for foreseeable damage was common to both negligence and public nuisance actions. Overseas Tankship Ltd. v. Miller S.S. (Wagon Mound No. 2), [1967] 1 A.C. 617, 640, *rev'd sub nom*, Miller S.S. v. Overseas Tankship Ltd., [1963] N.S.W.R. 737. *See also* Green, *The Wagon Mound No. 2 — Foreseeability Revisted*, [1967] UTAH L. REV. 197; Dias, *Trouble on Oiled Waters: Problems of the Wagon Mound No. 2*, [1967] CAMBRIDGE L.J. 62; Goodhart, *The Brief Life Story of Direct Consequence Rule in English Tort Law*, 53 VA. L. REV. 857 (1967).

29. Walsh v. Ervin, [1952] V.L.R. 361, 368-69; W. PROSSER, THE LAW OF TORTS 586-88 (4th ed. 1971).

30. Comment, *Interference with Business or Occupation — Commercial Fishermen Can Recover Profits Lost as a Result of Negligently Caused Oil Spill*, 88 HARV. L. REV. 444, 451-52 (1974).

31. J. HEYDON, ECONOMIC TORTS 14-80 (2d ed. 1978); Jolowicz, *The Law of Tort and Non-Physical Loss*, 12 J. SOC'Y PUB. TCHRS. L. 91, 98-104 (1972); Comment, *Foreseeability of Third-Party Economic Injuries — A Problem in Analysis*, 20 U. CHI. L. REV. 283, 297-99 (1953).

32. Best v. Samuel Fox & Co., [1952] A.C. 716; Att'y-Gen. New S. Wales v. Perpetual Trustee, [1955] A.C. 457, 484. *See generally* H. LUNTZ, ASSESSMENT OF DAMAGES (1974); Stevens, *supra* note 3, at 439; Feldthusen, *supra* note 3, at 59-60, 62-66.

Hedley Byrne & Co. v. Heller & Partners Ltd.,[33] negligent misstatement as well as negligent conduct was covered by the exclusory rule. In *Hedley Byrne*, however, the rule gave way to the ascription of a duty of care in making statements where the plaintiff and defendant are in a "special relationship."[34]

It is somewhat of a paradox that negligent misstatement, and not negligent conduct, was the harbinger of liability for pure economic loss. The court in *Hedley Byrne* recognized that "words are more volatile than deeds, they travel fast and far afield, [and] they are used without being expended."[35] On a superficial analysis, this innate unruliness of words would lead to the conclusion that liability for pure economic loss caused by negligent conduct should have presaged recovery of pure economic loss caused by negligent misstatement. On a closer examination, however, the reason becomes apparent. Negligent misstatement enjoyed a separate growth and was uninfluenced by the pervasive foreseeability test which governed the duty of care issue where negligent conduct was involved.[36] Furthermore, a statement made in the context of a special relationship is more likely to be made consciously, with an appreciation of its ramifications.[37] A negligent act, on the other hand, can amount to a minor transgression of pure oversight, with no consciousness of its possible serious consequences.[38] This problem is fuelled by the very broad notions of foreseeability that have be-

33. Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.); *see also* PROSSER, *supra* note 29, at 705.

34. Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465, 486, 502 (Lord Reid), 503 (Lord Morris) (H.L.). *See* Lindgren, *Professional Negligence in Words and the Privy Council*, 46 AUSTL. L.J. 176 (1972); Stevens, *Two Steps Forward and Three Back*, 5 N.Z.U.L. REV. 39 (1972). *See also* Mutual Life & Citizens' Assurance Co. v. Evatt, [1971] A.C. 792. There is a line of cases expanding the ambit of liability to frame the duty test in terms of reasonable foreseeability. *See, e.g.*, Ministry Hous. & Local Gov't v. Sharp, [1970] 2 Q.B. 223. *See generally* Craig, *supra* note 3.

35. Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465, 534 (H.L.).

36. Nocton v. Ashburton, [1914] A.C. 932, 947. *Cf.* Craig, *supra* note 3, at 218 (impossible to avoid unbridled liability if law were wedded to the *Donoghue v. Stevenson* test). By contrast, respecting negligent misstatement, the courts were able to formulate a limiting test.

37. The Privy Council, on appeal from the High Court, prescribed that the statement be rendered by a person in the business of giving such advise. Mutual Life & Citizens' Assurance Co. v. Evatt, [1971] A.C. 792.

38. A combination of two slight acts of negligence, leaving inflammable film in the yard and then putting a match to it, led to great property damage. *See* Philco Radio v. Spurling Ltd., [1949] 2 All E.R. 882. Smith v. Leech Brain, [1962] 2 Q.B. 405, illustrates the operation of the "thin skull," extraordinary, unexpected physical damage resulting from a negligent act.

come endemic in the remoteness issue.[39]

Despite the separate growth of liability for negligent misstatement, *Hedley Byrne* has been construed to apply equally to both negligent misstatement and negligent conduct,[40] although this construction was generally refuted in pre-*Caltex* Commonwealth courts.[41] In *Caltex*, however, Justices Gibbs, Mason, and Stephen asserted the applicability of *Hedley Byrne* to negligent conduct. Justice Gibbs reasoned that to limit *Hedley Byrne* to negligent misstatement would be to ignore the finespun distinction between negligent misstatement and negligent conduct.[42]

In recent years, additional inroads into the exclusory rule have been made by Commonwealth courts. The courts have attempted to carve out exceptions to the rule to meet demands for recovery. The application of the "physical nexus test" — the corollary to the exclusory rule — has been used to grant recovery when economic loss is "truly consequential on physical damage."[43]

Some courts have gone beyond the physical nexus test to a "parasitic damage basis" for recovery of economic loss. The parasitic damage test allows recovery of economic loss as long as *some* damage to the plaintiff's person or property is present, regardless of whether the economic loss is proximately caused by the physical damage. In *Seaway Hotels Ltd. v. Gragg (Canada) Ltd.*,[44] a power line supplying the plaintiff's hotel was negligently severed by the defendant. The plaintiff had no proprietary interest in the line. The plaintiff recovered damages for spoiled foodstuffs — physical damage — and for loss of profits caused by closing the restaurant and bar for lack of refrigeration.[45] Here, loss of profits must be

39. *See* Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 292 (Austl. 1976).

40. "[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." Ministry Hous. & Local Gov't v. Sharp, [1970] 2 Q.B. 223, 278. *See also* Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd., [1964] A.C. 465, 516-17 (H.L.).

41. *See, e.g.*, Konstantinidis v. World Tankers (The World Harmony), [1965] 2 W.L.R. 1275 (P., P. Div'l Ct.); Weller & Co. v. Foot and Mouth Disease Research Institute, [1966] 1 Q.B. 569; British Celanese Ltd. v. A.H. Hunt (Capacitors) Ltd., [1969] 1 W.L.R. 959 (Q.B.). *See also* Stevens, *supra* note 3, at 434.

42. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 278 (Austl. 1976) (Gibbs, J.).

43. *See* S.C.M. (United Kingdom) Ltd. v. W.J. Whittal & Son Ltd., [1971] 1 Q.B. 337, 343. *See also* text accompanying note 16 *supra*; Reynolds v. Bank of America, 53 Cal. 2d 49, 345 P.2d 926 (1959).

44. 21 D.L.R.2d 264 (Ont. Ct. App. 1959).

45. Stevens, *supra* note 3, at 443; Harvey, *supra* note 3, at 594-95.

considered pure economic loss as no causal connection exists between the physical damage and the lost profits. This holding is now inconsistent with the decisions of the English Court of Appeal in *S.C.M.* and *Spartan Steel*.[46]

A further basis of recovery dependent on the physical damage test was suggested in *Weller & Co. v. Foot and Mouth Disease Research Institute*.[47] In *Weller*, Justice Widgery reasoned that the particular scope of duty of care owed by the defendant extended to persons whose property and person were foreseeably at risk. The plaintiff in *Weller* did not fall within the scope of the duty of care, although it was foreseeable that the plaintiff would suffer financial harm as a result of the defendant's negligence.[48]

The extension of the scope of duty to foreseeable damage was also employed in the House of Lords' decision in *Morrison Steamship Co. v. Greystoke Castle (Cargo Owners)*.[49] In *Greystoke Castle*, a ship was damaged in a collision at sea. The cargo owners became liable to general average contribution to the ship's owner. The cargo owners sued the defendant shipowners to recover their portion of the contribution. The damage was pure economic loss as the plaintiff's cargo had suffered no damage. A majority of the House of Lords held this loss recoverable.[50] Lord Roche stated in dicta:

> [I]f two lorries, A and B, are meeting one another on the road, I cannot bring myself to doubt that the driver of lorry A owes a duty to both the owner of lorry B and to the owner of goods then carried in lorry B. Those owners are engaged in a common adventure with or by means of lorry B and if lorry A is negligently

46. *But see* WINFELD & JOLOWICZ ON TORT 52 n.43a (10th ed. W.V.H. Rogers 1975); Rogers, *Economic Loss in the High Court of Australia*, 37 CAMB. L.J. 27, 29-30 (1978).

47. Weller & Co. v. Foot and Mouth Disease Research Institute, [1966] 1 Q.B. 569.

48. *Id.* at 587.

49. Morrison Steamship Co. v. Greystoke Castle (Cargo Owners), [1947] A.C. 265.

50. The crucial point in the view of Justice Stephen in *Caltex* was that the duty in *Greystoke Castle* was owed to both the owner of the goods and the ship or vehicle owner who are "engaged in a common adventure in the sense that their respective property is open to the same modes of injury, and one who encounters the ship or vehicle on the sea or on the highway owes to each party a like duty of care to avoid the infliction of injury or economic loss." Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 285 (Austl. 1976).

To anticipate later conclusions on the *Caltex* case, it is difficult to understand where this "common adventure" exception stands. Justice Jacobs considered that *Greystoke Castle* could not be restricted to "common adventure" situations. *Id.* at 297. Both Justices Gibbs and Stephen, *id.* at 276 & 288, respectively indicate it is good authority. Justice Gibbs draws on the case as providing a material factor — "common adventure" — to measure whether the parties are in a proximate relationship. *Id.* at 279.

> driven and damages lorry B so severely that whilst no damage is done to the goods in it the goods have to be unloaded for the repair of the lorry and then reloaded or carried forward in some other way and the consequent expense is by reason of his contract or otherwise the expense of the goods' owner, then in my judgment the goods' owner has a direct cause of action to recover such expense.[51]

The scope of duty approach was employed in the important Canadian Supreme Court decision, *Rivtow Marine Ltd. v. Washington Iron Works*.[52] In *Rivtow*, the claim arose out of losses incurred by the plaintiff in removing a barge from service because of the possibly dangerous condition of a crane attached to the barge used in the plaintiff's logging business. The crane had latent defects which made it dangerous to operate. The plaintiff also requested damages for the cost of repairs to the crane. The majority awarded damages incurred in removing the barge from service, but denied recovery of damages for the cost of repairs to the crane. In his dissent, Justice Laskin disagreed with the majority's finding that the cost of repairs was not recoverable. Justice Laskin reasoned that the defendant designer-manufacturer of the crane, Washington Iron Works, was liable in damages for the cost of repairs because the defect threatened property or personal damage.[53] Justice Laskin's dissent relied upon the scope of the duty of care extending to foreseeable physical damage, even though actual physical damage was absent.

Justice Laskin's dissent in *Rivtow* was apparently inspired by Lord Denning's opinion in *Dutton v. Bognor Regis Urban District Council*.[54] In *Dutton*, Denning stated: "If he makes it negligently, with a latent defect (so that it breaks to pieces and injures someone), he is undoubtedly liable. Suppose that the defect is discovered in time to prevent the injury. Surely he is liable for the cost of repair."[55]

In the House of Lords case, *Anns v. Merton London Borough Council*,[56] Lord Wilberforce was attracted by Mr. Justice Laskin's reasoning in *Rivtow*.[57] In *Anns*, the House of Lords was asked to

51. *Id.* at 289.
52. Rivtow Marine Ltd. v. Washington Iron Works, 40 D.L.R.3d 530 (1973).
53. *Id.* at 549-53.
54. Dutton v. Bognor Regis Urban Dist. Council, [1972] 1 Q.B. 373.
55. *Id.* at 396.
56. Anns v. Merton London Borough Council, [1977] 2 W.L.R. 1024.
57. *Id.* at 1039. In *Caltex*, Justice Stephen also cites this concept espoused by Justice Laskin in *Rivtow*. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R.

decide whether a local authority was under a duty of care towards the owners and occupiers of houses in relation to which the local authority had certain duties, powers, and discretions arising under the Public Health Act of 1936. The question arose in a factual context similar to that in *Dutton*;[58] the issue of whether a duty of care was owed by the Council towards the owner of a building when an inspector of the Council had negligently performed an inspection carried out under the Public Health Act of 1936.

Were the cost of repairs and restoration of damage to the structure itself physical or economic harm? In *Dutton*, Lord Denning found that the damage done "was not solely economic loss. It was physical damage to the house."[59] In *Anns*, the House of Lords confirmed this approach by finding that a duty of care arose under statute and covered damage to the dwelling house itself.[60] The court stated: "[I]f 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 and safety of persons occupying [it] . . . ."[61]

The New Zealand Court of Appeal in *Bowen v. Paramount Builders (Hamilton) Ltd.*[62] adopted similar reasoning. *Bowen* was decided almost contemporaneously with *Anns*. In *Bowen*, an action in negligence was brought against the defendant builder for damages incurred in repairs and restoration when the building subsided because of inadequate foundations. These costs were characterized as physical damage with consequent economic loss rather than as pure economic loss.[63] Once the loss was so labelled, the general notions of duty of care were employed.[64] An examination of the *Bowen* opinion reveals the court's confidence that the elements of causation and remoteness of damage in negligence would suffice to

270, 286 (Austl. 1976), *citing* Rivtow Marine Ltd. v. Washington Iron Works, 40 D.L.R.3d 530, 550 (1973).

58. Dutton v. Bognor Regis Urban Dist. Council, [1972] 1 Q.B. 373.

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

60. Anns v. Merton London Borough Council, [1977] 2 W.L.R. 1024, 1039.

61. *Id.*

62. Bowen v. Paramount Builders Ltd., [1977] 1 N.Z.L.R. 394.

63. *Id.* at 410, 411, 417. *See also* Smillie, *Liability of Builders, Manufacturers and Vendors for Negligence*, 8 N.Z.U.L. REV. 109 (1978).

64. Donoghue v. Stevenson, [1932] A.C. 562.

restrict recovery to proper grounds.[65] The difficulty with labelling damage in this way is that the law has not considered damage to the article itself as physical injury. For instance, in the *Rivtow* case, the Canadian Supreme Court did not consider the flaw in the crane as constituting physical damage.[66] Could a defect in a bicycle be described as "physical damage" in order to hold the manufacturer responsible to a purchaser in negligence for the cost of repairs? While this question may be left open under the reasoning of the above authorities, it would have startling implications for products liability law. Even bold United States judicial minds have been unwilling to take this step.[67]

To this point, Commonwealth authorities have relied on the presence, threat, or foreseeability of physical damage. They adhered to the exclusory rule to the extent that if no element of physical damage could be found, economic loss would not be recoverable.

Some authorities in the Commonwealth have gone beyond the physical damage nexus requirement. In *Rivtow*, Justice Ritchie, writing for the majority, found that the British Columbian distributor of the crane owed a duty to warn the plaintiff of its dangerous condition upon learning of the condition.[68] This duty was derived by analogy to cases dealing with chattels which are dangerous *per se*. This duty had been breached, thus "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,"[69] and economic loss was allowed "as compensation for the direct and demonstrably

---

65. Bowen v. Paramount Builders Ltd., [1977] 1 N.Z.L.R. 394, 413, 418.

> [T]he ambit of the duty can be effectively controlled only by a strict insistence of 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.

Id. at 413 (Richmond, J.).

66. *See* C. MILLER & P. LOVELL, PRODUCT LIABILITY 337 (1977).

67. T.W.A. v. Curtiss-Wright Corp., 6 N.Y. 749, 148 N.Y.S.2d 284 (1955), *aff'd* 153 N.Y.S.2d 546 (1956). Justice Elder states that if manufacturers were subjected to wide negligence liability:

> Manufacturers would be subject to indiscriminate lawsuits by persons having no contractual relations with them, persons who could thereby escape the limitations, if any, agreed upon in their contract of purchase. Damages for inferior quality, *per se*, should be better left to suits between vendors and purchasers since they depend on the terms of the bargain between them.

148 N.Y.S. at 290. *See also* Smillie, *supra* note 63, at 116.

68. Rivtow Marine Ltd. v. Washington Iron Works, 40 D.L.R.3d 530 (1973).

69. *Id.* at 537.

foreseeable result"[70] of the breach of duty to warn.

The majority in *Rivtow* is consistent with the opinion of Lord Justice Edmund-Davies in *Spartan Steel*.[71] *Spartan Steel* involved the question of the recoverability of loss to the plaintiff caused by a break in the electricity supply to the plaintiff's arc furnace resulting from the defendant's negligence. Some of the plaintiff's losses were clearly proximately caused by the physical damage; for example, the cost of removal of solidified metal to avoid damage to the lining of the furnace.[72] The damages in dispute were the loss of profits flowing from the plaintiff's inability to use the furnaces during the electrical shutdown.[73]

Lord Justice Edmund-Davies, showing clear impatience, stated that this case "highlighted a problem regarding which differing judicial and academic views have been expressed and which it is high time should be finally solved."[74] His Lordship's solution was that "an action lies in negligence for damages in respect of purely economic loss, provided that it was a reasonably foreseeable and direct consequence of failure in a duty of care."[75] Thus, his Lordship's solution relied upon both *directness* and *foreseeability*.

Lord Denning, on the other hand, despaired of tests "which have proved so elusive."[76] He stated that "[i]t seems . . . better to consider the particular relationship in hand, and see whether or not, as a matter of policy, economic loss should be recoverable."[77] Lord Denning then considered the question under five policy considerations: (1) the position of statutory undertakers — that is, the intention of Parliament in imposing a duty as supplier of electricity;[78] (2) "[t]he nature of the hazard — namely, the cutting off of the

70. *Id.* at 547.

71. [1973] 1 Q.B. 27, 39-46 (dissenting opinion).

72. Electric power to the furnace was needed to melt the metal. The injury to the furnace would have occurred once the metal began to solidify had the plaintiffs not taken alternate steps to melt the metal. The plaintiffs incurred damages when the metal was determined to be of lesser value due to the alternate melting method. *Id.* at 560.

73. The power failure prevented the plaintiffs from utilizing the furnace for 14 1/2 hours, and the plaintiffs, therefore, lost a profit of £1,767. *Id.*

74. *Id.* at 564.

75. *Id.* at 569.

76. *Id.* at 562.

77. *Id.*

78. But one thing is clear, the board has never been held liable for economic loss only. If such be the policy of the legislature in regard to electricity boards, it would seem right for the common law to adopt a similar policy in regard to contractors. If the electricity boards are not liable for economic loss due to negligence which results in the cutting off of the supply, nor should the contractor be liable.

Id. at 563.

supply of electricity;"[79] (3) whether there would be no end of claims;[80] (4) loss distribution;[81] and (5) law as the provider for deserving cases. Lord Denning saw recovery of actual physical damage in this light.[82] He still clung to the consequent damage test articulated in *S.C.M.* insofar as loss consequent upon physical damage would more easily fall within the policy guidelines for recovery.[83] This policy approach, however, has had no impact on judicial opinion. The Australian High Court in *Caltex* had occasion to review *Spartan Steel*, and the reasoning of neither Lord Denning nor Lord Justice Edmund-Davies found favor in the High Court.[84]

II. UNITED STATES AUTHORITY

The Commonwealth law discussed to this point has been complex and contradictory. In application, the apparent simplicity of the exclusory rule was not present. These obfuscations diminished the force of the rule's rationale that it provided a certain limitation on indeterminate liability.[85]

Little has been said of the prevailing doctrine in the United States. The parallels in United States and Commonwealth law in this area are not highlighted in clear mutual principles, but in common difficulties, wrongturnings, intricacies, and uncertain stages of development.

An in-depth exposition of United States law is not herein possible. Hence, the discussion below will be limited to some observations on possible directions of change in the prevailing rule in the United States.

Commentators in the United States have approached the question of recovery of pure economic loss mainly from the standpoint of interference with economic relations.[86] Contractual relations assume the overwhelming proportion of economic relations.[87] The

79. *Id.*
80. *Id.* at 564.
81. *Id.*
82. *Id.*
83. *Id.*
84. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 282-83 (Stephen, J.), 279 (Gibbs, J.), 291 (Mason, J.) (Austl. 1976).
85. *See* notes 20-25 *supra*, and accompanying text.
86. *See, e.g.*, Note, *Negligent Interference with Economic Expectancy: The Case for Recovery*, 16 STAN. L. REV. 664 (1964).
87. PROSSER, *supra* note 29, at 938 *et seq.*

leading case conforming United States law to pre-*Caltex* Commonwealth law is *Robin's Dry Dock & Repair Co. v. Flint*.[88]

In *Flint*, the United States Supreme Court denied recovery for a ship charter's loss of use when the defendant negligently damaged the ship. Justice Holmes considered the general rule to be so well established that no authority needed to be cited.[89] This rule held that "a tort to the person or property of one man does not make the tortfeasor liable to another merely because the injured person was under a contract with that other, unknown to the doer of the wrong."[90]

Although Dean Prosser has stated that "no very satisfactory reason has been given for this refusal of a remedy in negligence cases,"[91] and that the policy restricting recovery may be "expected to move in the future in the direction of recovery by those whose damages are foreseeable by the actor,"[92] he concluded that "[t]here is actually, however, very little looking even vaguely in this direction."[93] While this may still be true, there have been developments that indicate a trend towards liberalizing recovery of pure economic loss.

The first decision of note is that of the Ninth Circuit Court of Appeals in *Union Oil Co. v. Oppen*.[94] In this case, commercial fishermen brought an action for damages consisting of profits lost as a result of a loss in fishing potential caused by the Santa Barbara, California oil spill in 1969. Since the plaintiffs had no proprietary rights in the fishing grounds, the exclusory rule was immediately relevant. As Judge Sneed stated: "Defendants drew support by pointing to the widely recognized principle that no cause of action lies against a defendant whose negligence prevents the plaintiff from obtaining a prospective pecuniary advantage."[95]

The court in *Union Oil* reviewed past authority and, importantly for the relevance of this article, cited Commonwealth opinion.[96] The court found that the defendants owed a duty of care and hence allowed recovery of the economic losses. The main reason

88. 275 U.S. 303 (1927).
89. *Id.* at 309.
90. *Id.*
91. PROSSER, *supra* note 29, at 940.
92. *Id.*
93. *Id.*
94. 501 F.2d 558 (9th Cir. 1974).
95. *Id.* at 563.
96. *Id.* at 566.

for the court's decision to allow recovery was the foreseeability of damage.[97] Moreover, in looking to the factors isolated by the California Supreme Court in *Biakanja v. Irving*,[98] the Ninth Circuit confirmed the requisite duty:[99] "Thus, the fact that the injury flows directly from the action of escaping oil on the life in 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."[100] From an economic analysis perspective, the court reached the same conclusion.[101]

The court in *Union Oil* was fearful of the possibility of indeterminate liability. This fear was expressed in the court's insistence on strict proof of damages[102] and the limitation of the holding to none others except "commercial fishermen, whose economic or personal affairs were discommoded by the oil spill . . . ."[103] In its conclusion, *Union Oil* is equivocal in its regard of the exclusory rule. In this respect, the potential impact of the case goes far beyond its narrow holding. As one commentator noted, "Finally, although the Ninth Circuit neither expressly rejected the general rule nor expressly created another exception to it, this decision cannot help but further depreciate the precedential value of the rule and play an important part in opening a vast area of tort liability damages."[104]

The exclusory rule, however, has proved to be fairly resilient. In *Adams v. Southern Pacific Transportation Company*,[105] an intermediate California appellate court followed the California Supreme Court decision in *Fifield Manor v. Finston*[106] by finding

97. *Id.* at 568.

98. 49 Cal. 2d 647, 320 P.2d 16 (1958).

99. Union Oil Co. v. Oppen, 501 F.2d 558, 569 (9th Cir. 1974).

> While it is true that the earlier decision of the California Supreme Court in *Biakanja* does not accord 'foreseeability of the risk' the commanding position which it was afforded in *Dillon v. Legg*, we cannot escape the conclusion that under California law the presence of a duty on the part of the defendants in this case would turn substantially on foreseeability.

Id.

100. *Id.*

101. In the court's determination, the defendants were in a superior position to withstand liability. *Id.* at 569-70. For a discussion of the court's decision, including policy factors, *see* Comment, *supra* note 4, at 317-19 (1974).

102. Damages "must be established with certainty and must not be remote, speculative or conjectural." Union Oil Co. v. Oppen, 501 F.2d 558, 570 (9th Cir. 1974); *accord*, Dunlop Tire & Rubber Corp. v. FMC Corp., 385 N.Y.S.2d 971, 974-75 (1976). *See also* MacMillan Bloedel Ltd. v. The Foundation Co. of Canada, 74 D.L.R.3d 294, 299-300 (B.C. S. Ct. 1977).

103. Union Oil Co. v. Oppen, 501 F.2d 558, 570 (9th Cir. 1974).

104. Comment, *supra* note 4, at 327.

105. 50 Cal. App. 3d 37, 123 Cal. Rptr. 216 (1975).

106. 54 Cal. 2d 632, 354 P.2d 1073, 7 Cal. Rptr. 377 (1960). *Fifield Manor* refused to

that no cause of action was stated when the plaintiff employees lost their jobs because of the alleged negligence of the defendants in handling bombs which destroyed the plant in which they worked. In reaching his conclusion, Judge Friedman criticized *Fifield Manor*, but felt constrained to follow it. In a closely reasoned opinion,[107] his Honor attempted to demonstrate that the basis of the duty issue in *Fifield Manor* was weakened by a change in judicial technique dictated by *Dillon v. Legg*.[108] At the risk of oversimplification, the court reasoned that the court in *Dillon* had held that a duty of care is determined by proximity of the parties, and that any policy reasons must function so as to restrict that established duty of care.[109] Judge Friedman stated that it was reasonably foreseeable that the plaintiffs would suffer loss; thus, a duty of care initially arose. The court would then "balance the risk of loss factors to affirm or negate a duty of care running from the defendant to the plaintiff or the plaintiff's class."[110]

The dicta of Judge Friedman in the *Adams* case represents a further assault on the exclusory rule. While the reasoning of the court in *Union Oil* and the dicta of Judge Friedman in *Adams* are frontal attacks on the exclusory rule, other authorities have avoided the rule altogether by finding liability outside the law of negli-

---

allow a cause of action for economic loss based on alleged negligent conduct. The court reasoned that any other result would constitute an unwarranted extension of liability for negligence. *Id.* at 636-37, 354 P.2d at 1075, 7 Cal. Rptr. at 379.

107. Adams v. Southern Pac. Transp. Co., 50 Cal. App. 3d 37, 41-45, 123 Cal. Rptr. 216, 218-21 (1975).

108. 68 Cal. 2d 728, 441 P.2d 912, 69 Cal. Rptr. 72 (1968).

109. Adams v. Southern Pac. Transp. Co., 50 Cal. App. 3d 37, 41-45, 123 Cal. Rptr. 216, 218-21 (1975). *See* Rondel v. Worsley, [1969] A.C. 191 *and* Saif Ali v. Sydney Mitchell & Co., [1978] 3 All E.R. 1033, for an exposition of policy factors defining a barrister's duty of care to a client.

110. Adams v. Southern Pac. Transp. Co., 50 Cal. App. 3d 37, 45, 123 Cal. Rptr. 216, 221 (1975). *See* Scott Group Ltd. v. McFarlane, [1978] N.Z.L.R. 553 (N.Z. Ct. App.):

> The mere absence of precedent will not be enough to protect the defendant. In addition, if there is a prima facie relationship of the sort propounded by Lord Atkin (in *Donoghue v. Stevenson*), the plaintiff will no longer have to persuade the court by some sort of proleptic exercise that there can be no adequate reason for relieving such a defendant of the duty of care that otherwise the defendant must accept. Instead it will be for the defendant to accept that task and show affirmatively that there are good and valid considerations which require that the duty should be excluded in the situation under review.

Id. (Woodhouse, J.). *See also id.* at 583 (Cooke, J.). For a commentary regarding the individual judgments in *Scott Group, see* Note, *Negligent Misstatement — Auditor's Liability to Third Parties for Careless Report on Company's Annual Accounts*, 8 N.Z.U.L. REV. 175, 179-81 (1978).

gence.[111] Furthermore, some authorities have relied on the special status of the plaintiffs[112] or special relations analogous to "common adventure"[113] to avoid the rule. Academic comment in the United States preponderantly favors recoverability of damages for pure economic loss.[114]

When *Caltex* was decided, there existed a highly contradictory and complex body of Anglo-American case law and an active debate both within those authorities and among writers about the exclusory rule. To the credit of the High Court of Australia, the court took notice of this ferment in setting the law in Australia on a new path.

III. THE *CALTEX* CASE

In the *Caltex* case, a pipeline owned by Australian Oil Refining Pty. Ltd. (AOR) connected an oil refinery on the southern shore of Botany Bay, in Sydney, 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 this pipe. An action sounding in negligence was commenced in the Supreme Court of New South Wales. An action was also brought against Decca Survey Australia Ltd. (Decca) for negligently plotting the chart upon which the defendant dredge relied.

Damages claimed by Caltex included the expense incurred in obtaining alternative means to transport the oil, the cost of sending low sulphur oil to another terminal, the modifications to terminals, certain harbour dues, and other miscellanea. The quantum of damages was stipulated to be $95,000.00. The Supreme Court of New South Wales allowed no damages to the Caltex company for the claimed economic loss suffered as a result of the severing of the pipeline.[115]

On appeal, the High Court was asked to determine whether

111. For example, in Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958), the court found recovery based on a quasi third party beneficiary theory. *Id.* at 650, 320 P.2d at 18-19.

112. Carbone v. Ursich, 209 F.2d 178 (9th Cir. 1953) (crew members of a fishing vessel may bring an action for lost profits against another vessel which negligently damages fishing nets).

113. *See generally* Morrison Steamship v. Greystoke Castle (Cargo Owners) Ltd., [1947] A.C. 265; Aktieselskabet Cuzco v. The Sucarseco, 294 U.S. 394 (1934).

114. In addition to references previously cited, *see* Comment, *Foreseeability of Third-Party Economic Injuries — A Problem in Analysis*, 20 U. CHI. L. REV. 283 (1953); Carpenter, *Interference with Contractual Relations*, 41 HARV. L. REV. 728 (1928). For a particularly cogent argument favoring recovery, *see* Note, *supra* note 86.

115. Unreported.

the exclusory rule should be applied to deny Caltex recovery of the pure economic loss.[116] Because of the diversity of viewpoints among the judges, a brief survey of their views will be helpful.

A. The Individual Judgments

Justice Gibbs found that while the exclusory rule was generally applicable, it did not preclude the plaintiff from recovery in the present circumstances.[117] Justices Stephen, Mason, Jacobs, and Murphy found that the exclusory rule as traditionally posed was not the law in Australia.[118] Justice Mason proposed the following 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."[119] Justice Jacobs reasoned that 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.[120]

Justice Murphy simply reasoned that he did not accept the contention that "economic loss not connected with physical damage to the plaintiff's property is not recoverable."[121] His Honor did not attempt to formulate a test to limit the possible width of recovery and, as such, contrasted with the opinions of his colleagues who were at pains to find limiting formulations. Hence, the reasoning of

116. Subsidiary issues before the High Court on appeal were: (1) whether the captain of the dredge should have judgment entered against him; this was unanimously dismissed. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 273-74, 290, 294-95, 298 (Austl. 1976); and (2) whether Decca was immune from liability because of the intervening negligence of the navigators of the dredge. The High Court found that no *norus actus interveniens* was shown and that the negligence of both defendants was a concurrent cause of the damage. *Id.* at 274-75 (Gibbs, J.), 290 (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. *See* Home Office v. Dorset Yacht Co., [1970] A.C. 1004 (H.L.).

117. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 271 (Austl. 1976).

118. *Id.* at 284 (Stephen, J.), 292 (Mason, J.), 295 (Jacobs, J.), 299 (Murphy, J.).

119. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 293 (Austl. 1976).

120. *Id.* at 298.

121. *Id.* at 299.

Justice Murphy is outside the mainstream of opinion exhibited in the *Caltex* case.

Justice Stephen delivered possibly the most important opinion, which provided a very thorough review of the law, as well as the policy underlying it.[122] It is not, however, an easy opinion from which to distill a *ratio decidendi*. He found no rule of universal application that could be discovered and found that the law insisted "upon sufficient proximity between tortious act and compensable detriment."[123] Justice Stephen 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.[124]

On his case by case evaluation, Justice Stephen quoted Chief Justice Barwick of the High Court of Australia in *Mutual Life & Citizens' Assurance Co. v. Evatt*.[125] *Mutual Life* held 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."[126] These principles comport closely with the developing American doctrine as articulated by Justice Friedman in the *Adams* case.[127]

The facts that led to Justice Stephen's conclusion that sufficient proximity existed were: (1) 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;"[128] (2) the defendant's knowledge or means of

122. *Id.* at 280-87.

123. *Id.* at 287.

124. *Id.* at 287 (Stephen, J.), *citing* Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.) and Home Office v. Dorset Yacht Co., [1970] A.C. 1004, 1058 (H.L.). *See also* Glass, *Duty to Avoid Economic Loss*, 51 AUSTL. L.J. 372, 384-85 (1977); Adams v. Southern Pac. Transp. Co., 50 Cal. App. 3d 37, 41-45, 123 Cal. Rptr. 216, 218-21 (1975), *citing* Dillon v. Legg, 68 Cal. 2d 728, 741, 441 P.2d 912, 921, 69 Cal. Rptr. 72, 81 (*en banc* 1968) *and* Rodriguez v. Bethlehem Steel Corp., 12 Cal. 3d 382, 399, 525 P.2d 669, 679-80, 115 Cal. Rptr. 765, 775-76 (*en banc* 1974).

125. [1971] A.C. 792.

126. *Id.*

127. Adams v. Southern Pac. Transp. Co., 50 Cal. App. 3d 37, 41-45, 123 Cal. Rptr. 216, 218-21 (1975).

128. *See* note 44 *supra*.

knowledge of the pipeline and its use; (3) 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; (4) the nature of the detriment suffered by the plaintiff; and (5) 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 direct consequence of the detriment suffered.[129] Justice Stephen proposed an amalgam based upon policy factors added to a moral dimension. This will be discussed below.[130]

Justice Gibbs found that the Caltex company could recover on the basis that the facts established an exception to the exclusory rule.[131] This was a case, he said,

> in which the defendant had knowledge or means of knowledge that the plaintiff individually, 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.[132]

Justice Gibbs indicated that 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.[133] In his view, it was material "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."[134]

The effect of the *Caltex* case is to abolish the exclusory rule in Australia. The High Court's rationale was that the rule was arbitrary and unresponsive to underlying policy reasons, thus restricting recovery for pure economic loss within a narrow compass.[135] The court recognized that the exclusory rule was a creature of the Cardozian nightmare: "liability in an indeterminate amount, for an indeterminate time, to an indeterminate class."[136] Thus, the availability of recovery for economic loss where the loss could be

129. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 287 (Austl. 1976).

130. *See* text accompanying notes 143-153 *infra*.

131. *Id.* at 287.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.* at 284, 286, 293.

136. *Id.* at 284. The language was derived from Justice Cardozo's opinion in Ultramares Corp. v. Touche, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931). *See also* Seavey, *Mr. Justice Cardozo and the Law of Torts*, 52 HARV. L. REV. 372, 400 (1939).

tied to physical damage engaged the courts in a search to find that element of proprietary right in damaged goods.[137] It followed that a charterer by demise could recover for loss of use of the ship, while a time charterer could not.[138] Along similar lines, Justice Stephen pointed out that if the Caltex company had had a possessory right in the pipeline, which it may have had under contract, it could have recovered within the bounds of the exclusory rule. The ability to recover, then, turns on a factor which has no relationship to the underlying policy reasons of the rule. In other words, recovery turns on a completely arbitrary factor.

Justice Stephen commented that the maintenance of 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."[139] The rule was accordingly found to be inappropriate. The question then remained: what principles should be applied that would accommodate the demands of policy in generally restricting recovery, while allowing it in proper areas? The success of the High Court in formulating these principles is questionable.

B. The Applicable Formula

If policy was to be the determinative factor in the equation, there existed within the then existing armory of authority Lord Denning's direct policy approach in *Spartan Steel*.[140] In this case, Lord Denning reasoned that it was "better to consider the particular relationship in hand and see whether or not, as a matter of policy, economic loss should be recoverable . . . ."[141]

The High Court in *Caltex* rejected this policy approach. Justice Stephen recognized that "no doubt [policy considerations] play a very significant part in any judicial definition of liability and entitlement in a new area of law."[142] But he reasoned that the "process should . . . result in some definition of rights and duties, which can

137. This rule stems from Simpson v. Thompson, [1877] 3 App. Cas. 279, 289 (H.L. 1877). It was applied in Elliott Steam Tug Co. v. Shipping Controller, [1922] 1 K.B. 127 (C.A.).

138. *See generally* Feldthusen, *supra* note 3, at 41-42; Atiyah, *supra* note 3, at 266-67.

139. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 284 (Austl. 1976).

140. Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27, 37-39.

141. *Id.* at 37.

142. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 284 (Austl. 1976).

then be applied to the case in hand, and to subsequent cases, with relative certainty."[143] To adopt Lord Denning's thesis would be to "invite uncertainty and judicial diversity."[144] Justice Gibbs considered that while it was necessary to look at the particular relationship at 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."[145]

The dilemma is thus posed: policy will mold any test of recoverability of economic loss, but the use of policy on an *ad hoc* basis, while making the law responsive to policy, would invite the evil of uncertainty. A rule or test was necessary which, Justice Stephen states, "must depend upon policy considerations just as does the conclusion that for cases of economic loss such an additional control mechanism is necessary."[146] As noted above, Justices Mason and Gibbs articulated firm tests which certainly will aid in similar factual contexts,[147] while Justice Jacobs formulated an idiosyncratic test that depends on "physical affect," a departure from the views of his fellow justices.[148]

The opinion of Justice Stephen is the most significant in that it is prospective in nature. His opinion forms a jurisprudential roadmap for the future. In this sense, his opinion is similar to *Donoghue v. Stevenson*[149] or *Home Office v. Dorset Yacht*,[150] in that his views are cast with the future development of the law in mind.[151] As noted above, Justice Stephen enumerated factors which in this case were productive of the duty of care.[152]

On a more generalized plane, Justice Stephen considered the fundamental factor determining recovery to be whether recovery is

143. *Id.*
144. *Id.*
145. *Id.* at 279 (emphasis added).
146. *Id.* at 287.
147. *See* notes 119 & 132 *supra*, and accompanying text.
148. *See* note 120 *supra*, and accompanying text.
149. Donoghue v. Stevenson, [1932] A.C. 562.
150. Home Office v. Dorset Yacht Co., [1970] A.C. 1004 (H.L.).
151. *See* Stevens, *supra* note 3, at 448-66.
152. *See* note 129 *supra*, and accompanying text. The concept of moral blame was listed as a factor on which to base recovery in Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958). The California Supreme Court listed the following factors:

> [T]he 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.

Id. at 650, 320 P.2d at 19.

"fair and reasonable."[153] After quoting Lord Atkin in *Donoghue*,[154] that liability for negligence "is no doubt based upon a general sentiment of moral wrongdoing for which the offender must pay," he continues: "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."[155]

The question of whether the community would in justice expect liability to be placed on the defendant will overshadow policy reasons such as avoidance of unlimited liability, possibility of speculative claims,[156] potential administrative problems,[157] and economic allocation of resources.[158] In the final analysis, this must depend upon what the courts consider community expectations to be.[159] This may be conveniently called the justice or moral dimension.

The flaw in the High Court's decision appears at this point. Although Justice Stephen realized the need, when embarking on a new path, to alleviate the inevitable uncertainties, he left only partial and uncertain direction for future decisionmaking. Future decisions in this area will be based on two principle factors — the fear of indeterminate liability and the justice or moral dimension. However, this superficial analysis will undoubtedly inspire uncertainty, the very vice the court sought to avoid and for which Lord Denning was criticized.[160] Indeed, it is highly questionable whether the court's moral dimension is more certain than the appli-

153. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 287 (Austl. 1976), *quoting* Home Office v. Dorset Yacht Co., [1970] A.C. 1004, 1058 (H.L.) (Morris, L.).

154. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 287 (Austl. 1976), *quoting* Donoghue v. Stevenson, [1932] A.C. 562, 580.

155. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 287 (Austl. 1976).

156. Union Oil Co. v. Oppen, 501 F.2d 558, 563 (9th Cir. 1974).

157. Stevens, *supra* note 3, at 450-53.

158. Note, *supra* note 86, at 681-84; Comment, *supra* note 4, at 326-27. In the *Caltex* case, however, Justice Stephen expressed doubts as to the appropriateness of a court's consideration of loss distribution. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 289 (Austl. 1976).

159. *See* Biakanja v. Irving, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958); *see also* note 152 *supra*.

160. Justice Stephen was particularly concerned with the difficulty of this approach, citing "the wide range of matters thus thrown open to judicial consideration . . . ." Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 283 (Austl. 1976). This method would "lead to great uncertainty in the law. . . ." *Id.*

cation of Lord Denning's policy factors enunciated in *Spartan Steel*.

Clearly, Lord Denning's public policy approach in *Spartan Steel* is unsatisfactory, because he fails to formulate from these policy considerations a rule that is useful to the courts and legal advisors. Indeed, these policy factors are presented in a haphazard and undisciplined fashion.[161] They are drawn on an *ad hoc* basis from the facts of the particular case.[162]

Uncertainty is introduced not by express weighing of policy factors but by the manner in which these factors are weighed. In this context, certainty is the ability to predict how a court will make a decision. In any area of the law, the parameters of that law are made definite by a growing body of case law. In the absence of parameters drawn in this way, express articulation of *how* policy will be used would give insight into the decisionmaking process. The factors of morality and justice articulated in *Caltex* provide little guidance. On the other hand, to set forth policy factors in terms of an interest analysis would demonstrate how the courts will use these factors and lead to a greater degree of certainty.

Application of an interest analysis in *Caltex* would have involved a balancing of the relevant policy factors in terms of the competing interests of all of the parties involved.[163] The Caltex company's interest was to carry on its business free from negligent acts causing economic harm.[164] The defendants had a legitimate interest in conducting their business with a maximum degree of freedom without excessive burdens placed on them by way of liability in negligence.[165] Clearly, the community at large had an interest in an orderly relationship between the plaintiff and defendants.[166] Hence, four social policies can be identified in the

161. *See* notes 78-83 *supra*, and accompanying text.

162. For instance, he stressed the fact that there was a break in the supply of electricity and observed that "most people are content to take the risk on themselves . . . . [T]hey put up with it. They try to make up the economic loss by doing more work next day." Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors), [1973] 1 Q.B. 27, 38.

163. *See generally* Green, *Relational Interests*, 30 ILL. L. REV. 1, 4 (1935); SALMOND ON THE LAW OF TORTS 203 (17th ed. R.F.V. Heuston 1974). For an analysis using interests-to-be-protected as an aid to judicial decisionmaking in tort cases, *see* Treece, *Leon Green and the Judicial Process: Government of the People, by the People, and for the People*, 56 TEXAS L. REV. 447, 458 (1978). "The point of Green's organization is to aid analysis, and its elasticity guarantees its continued usefulness as a description of the tort process." *Id.*

164. *See* Note, *supra* note 86, at 675.

165. *Id.* at 676.

166. *Id. See also* Stevens, *supra* note 3, at 448-66.

Caltex case: (1) the stabilization of economic relations; (2) the preservation of freedom of action; (3) the distribution of economic losses; and (4) the discouragement of waste and negligent conduct.[167]

1. *The Stabilization of Economic Relations.* The maintenance of contractual relations is the most important factor in the stability of economic relations. Parties act, adjust their mutual relationship, and allocate resources to comport with contractual obligations. A decision or rule that undermines 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 by realizing as far as possible the original contractual expectations.

2. *The Preservation of Freedom of Action.* Society, as well as the particular actors, has an interest in ensuring that participants in that society be able to conduct their affairs without undue inhibitions. Initiative should not be frozen by fear of undue burdens in damage awards.[168]

3. *The Distribution of Economic Losses.* Society values an efficient allocation of resources. The law of negligence has been much influenced by the desire to distribute losses to those with the superior capacity to bear them.[169] In the majority of cases, the mode of distribution is through the insurance system. In some cases, an economic analysis is expressly employed which brings to bear questions of loss distribution. In Australia, the loss distribution interest is disfavored. In *Caltex*, for example, Justice Stephen doubted the desirability of its consideration. He stated that "[t]he task of the courts remains that of loss *fixing* rather than loss *spreading* and [that] if this is to be altered [it] is . . . a matter for direct

167. Note, *supra* note 86, at 676-79.

168. 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?*, 11 OSGOODE HALL L.J. 55, 62 (1973). *See also* Comment, *Alternatives to the Medical Malpractice Phenomenon: Damage Limitations, Malpractice Review Panels and Countersuits*, 34 WASH. & LEE L. REV. 1179 (1977); Note, *Medical Malpractice Arbitration: A Comparative Analysis*, 62 VA. L. REV. 1285 (1976); Project, *The Medical Malpractice Threat: A Study of Defensive Medicine*, 1971 DUKE L.J. 939.

169. Griffiths v. Kerkemeyer, 51 A.L.J.R. 792, 796 (Austl. 1976). *See also* Launchbury v. Morgans, [1971] 2 Q.B. 245 (Lord Denning, M.R.), *rev'd* [1973] A.C. 127.

legislative action rather than for the courts."[170]

4. *Discouragement of Waste and Negligent Conduct.* Although the effectiveness of negligence liability as a deterrent to negligent conduct is dubious,[171] courts continue to have faith in its force.[172] It is likely that a good deal of the moral dimension of Justice Stephen's policy analysis is subsumed by the interest in deterrence. Even if the deterrence factor is absent, the court may feel compelled to register its disapproval of the conduct in question. An outstanding example of this is found in the *Union Oil* case.[173] "[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."[174]

Parties' interests in any given case will be in conflict. This interplay can be gleaned from the *Caltex* case. To oppose the imposition of liability and hence to allow the loss to rest where it fell would serve the interests of preservation of freedom of action and distribution of economic losses. However, little weight could be ascribed to the former — preservation of freedom of action — since liability refers to a single act of negligence, and damages do not extend to remote consequences.[175] As to the latter — distribution of economic losses — the fact that Caltex was covered with loss insurance defeats the argument that a finding of liability would spread the losses, since loss insurance is more efficient in spreading losses in most circumstances.[176] On the other hand, while the stabilization of economic relations is of little importance in *Caltex*, discouragement of waste and negligent conduct are important. The action of the defendant was clearly negligent. The possible ramifications of negligence were known to the defendant. Moreover, the magnitude of the damage could be ascertained and the negligent conduct was of no countervailing social value.

170. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 287 (Austl. 1976).

171. Blum & Kalven, *supra* note 26, at 251-66.

172. G. WILLIAMS & B. HEPPLE, FOUNDATIONS OF THE LAW OF TORT 118 *et seq.* (1976).

173. Union Oil Co. v. Oppen, 501 F.2d 558 (9th Cir. 1974).

174. *Id.* at 569.

175. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 287 (Austl. 1976).

176. Alexander, *The Law of Tort and Non-Physical Loss: Insurance Aspects*, 12 J. SOC'Y PUB. TCHRS. L. 119, 120 (1972).

IV. IMPLICATIONS OF THE *CALTEX* CASE IN AUSTRALIA

A. Physical Nexus Cases

The effect of the *Caltex* case is to call into question those cases that relied expressly or impliedly on the exclusory rule. Thus, the rule enunciated by Lord Denning in *S.C.M.* — that economic loss truly consequential upon physical damage may be recovered — is no longer good law in Australia.[177] *Caltex* also requires a reexamination of those cases that turned on the characterization of damage as physical rather than pure economic loss. For instance, in *Dutton*,[178] *Anns*,[179] and *Bowen*,[180] the respective courts characterized the cost of repair and restoration of buildings caused by the defendants' negligence as economic loss flowing from the physical damage to the dwellings themselves rather than pure economic loss. In so doing, the duty of care was framed in accordance with the Atkinian test in *Donoghue v. Stevenson*,[181] which the *Caltex* court found to be inadequate to control the area of possible recovery where the loss suffered was economic loss.[182] Of course, the presence of physical damage will be highly material within the *Caltex* formulation.[183]

Justice Laskin in *Rivtow* also posed a test that relied upon threatened damage.[184] This decision must now be subject to the *Caltex* case in Australia. The presence of threatened physical danger will be relevant but not determinative in ascertaining whether the necessary degree of proximity exists.

B. Directness and Knowledge Cases

The approach suggested by Lord Justice Edmund-Davies in *Spartan Steel*[185] and by the majority opinion in *Rivtow*[186] was also rejected in the *Caltex* decision. That approach based recovery of

177. Walker, *Negligent Acts — Recovery for Economic Loss*, [1978] N.Z.L.J. 46, 47.
178. Dutton v. Bognor Regis Urban Dist. Council, [1972] 1 Q.B. 373.
179. Anns v. Merton London Borough Council, [1977] 2 W.L.R. 1024.
180. Bowen v. Paramount Builders (Hamilton) Ltd., [1977] 1 N.Z.L.R. 394 (N.Z. Ct. App.).
181. [1932] A.C. 562.
182. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 293 (Mason, J.) (Austl. 1976).
183. *Id.* at 279 (Gibbs, J.), 287 (Stephen, J.).
184. *See* note 53 *supra*, and accompanying text.
185. Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors) Ltd., [1973] 1 Q.B. 27, 39-46.
186. Rivtow Marine Ltd. v. Washington Iron Works, 40 D.L.R.3d 530 (1973).

economic loss on the basis of directness of damage and knowledge of the defendant.

In *Caltex*, Justice Gibbs said of Lord Justice Edmund-Davies' view, "I cannot find this approach altogether satisfactory."[187] Although Justice Mason concluded that his test was consistent with the majority in *Rivtow*, he strongly disapproved of the "directness" test, which he said harkened back to the pre-*Wagon-Mound* era.[188] Justice Stephen cited *Rivtow* and *Hedley Byrne* as examples of situations in which formulations to limit may be fashioned.[189] Earlier in his opinion, Justice Stephen referred to *Rivtow* as a case of rather "special circumstances involving products liability."[190] Both Justice Stephen and Justice Gibbs, however, cited *Rivtow* as establishing the importance of the knowledge of the defendant in determining the requisite proximity for recovery of the economic loss claimed in *Caltex*. In sum, directness of damage and knowledge of the defendant is not a sufficient basis for recovery of pure economic loss, although both factors will remain highly relevant under the *Caltex* principles.

C. Common Adventure

The exception to the exclusory rule enunciated in *Greystoke Castle*[191] is preserved by the *Caltex* case. The court accepted the dicta of Lord Roche as exemplifying a situation where the proximity between the cargo owner and the tortfeasor is close enough to allow recovery.[192] This springs from the common adventure element that the property of the owner of the goods — the plaintiff — and the vehicle owner were subject to the same risks.[193] The common adventure element itself provides a limiting test that checks the possibility of indeterminate liability.[194]

D. Negligent Misstatement

Hedley Byrne v. Heller[195] was cited in *Caltex* as authority for

187. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 279 (Austl. 1976).
188. *Id.* at 293.
189. *Id.* at 287.
190. *Id.* at 281.
191. *Id.* at 278-80, 288.
192. *Id.* at 279 (Gibbs, J.), 285 (Stephen, J.).
193. *Id. But see id.* at 297 (Jacobs, J.).
194. *See* note 50 *supra.*
195. Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.).

the proposition that the law of negligence had opened the door to recovery of pure economic loss. The High Court relied heavily on the utility of the "special relationship" requirement in *Hedley Byrne* as obviating the Cardozian nightmare of unbounded liability.[196] Hence, the *Caltex* court has confirmed the importance of the special relationship requirement. This should prevent any development in the law of negligent misstatement to base liability on mere notions of foreseeability.[197]

The law of negligent misstatement should now parallel liability for negligent conduct resulting in economic loss. That is, it should develop with close judicial attention to the fear of indeterminate liability and community expectations of justice and morality. Indeed, the Canadian Supreme Court needed no prodding from its Australian counterpart in deciding in *Haig v. Bamford*[198] the scope of an auditor's liability in negligence to parties other than his client. In *Haig*, Justice Dickson rejected, on the basis of possible indeterminate liability, the argument that the test should be one of mere foreseeability.[199] Moreover, the court considered the public role of auditors and their function in society as crucial.[200] This status[201] led to an increased responsibility that was reflected in their liability, which was determined according to what the public should expect of auditors in their public role. This approach closely parallels the moral dimension in Justice Stephen's opinion.[202]

The importance of this development in the law of negligent misstatement is that it introduces a dynamic element — that is, the

196. Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad," 51 A.L.J.R. 270, 277 (Gibbs, J.), 286 (Stephen, J.), 291 (Mason, J.) (Austl. 1976).

197. *See* note 34 *supra*, and accompanying text. One exception involves the liability of local authorities where a separate body of law is developing based upon general foreseeability notions of proximity. *Id., citing* Dutton v. Bognor Regis Urban Dist. Council, [1972] 1 Q.B. 373 and Ministry Hous. & Local Gov't v. Sharp, [1970] 2 Q.B. 223. *But see* Glass, *supra* note 124, at 380 and Phegan, Tort Liability of Local Authorities 6-7 (1978) (unpublished thesis available with the Comm. for Post-Graduate Studies, Law Department, University of Sydney). In the United States the general foreseeability test has been applied in cases concerning advice given by public officers. *See* Mulroy v. Wright, 240 N.W. 116 (Minn. 1931); Commonwealth for Use of Green v. Johnson, 96 S.W. 801 (Ky. Ct. App. 1906); Buszta v. Souther, 232 A.2d 396 (R.I. 1967); Vandewater & Lapp v. Sacks Builders, 186 N.Y.S. 2d 103 (App. Div. 1959) (information on public record).

198. 72 D.L.R.3d 68 (1977).

199. *Id.* at 74-75.

200. *Id.* at 74.

201. *See* Gilling, *Auditors and Their Role in Society — The Legal Concept of Status*, 4 A.B.L.R. 88 (1976).

202. *See* note 155 *supra*, and accompanying text.

scope of liability will depend on changing societal norms. Although the High Court can be criticized for introducing an element of uncertainty, it has firmly established for Australian courts that the law should be stimulated, on the one hand, by community expectations and restrained, on the other, by a desire to avoid the possibility of indeterminate liability. Thus, the law of negligent misstatement should develop in the direction indicated in *Haig v. Bamford*. An auditor's liability should not be limited to situations where that auditor knows both the particular recipient of the information and the particular transaction in which the information is to be used. Rather, it should be extended to situations where the auditor has knowledge of particular classes of recipients and transactions.[203]

E. Products Liability

The endorsement of Justice Laskin's dissent in *Rivtow* by Lord Wilberforce in *Anns* was seen as support for a more general recovery in tort of economic loss caused by negligently manufactured products.[204] It was reasoned that if, for instance, a motor vehicle was negligently manufactured so as to endanger the purchaser's person or property, economic loss for the cost of repairs should be recoverable from the manufacturer in an action in negligence. The manufacturer's duty of care was to all persons who may foreseeably be injured, which will include purchasers who are not in a contractual relationship with the manufacturer.

This reasoning as it relies on the exclusory rule is inconsistent with the *Caltex* case. The *Caltex* decision will direct Australian

---

203. *See* Brown, *Haig v. Bamford*, 15 OSGOODE HALL L.J. 474, 484 (1977). The New Zealand Court of Appeal in Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553, recently handed down an important decision relating to the liability for negligent misstatement of auditors to third parties. In this case, the law is clearly extended on policy reasons to the limits suggested in the text. *Id.* at 566 (Richmond, P.). *But see id.* at 574 (Woodhouse, J.):

> The issue has been made increasingly complex by the successive and varying formulas that have been used in an effort to confine the general area of responsibility, in particular for negligent words or in respect of purely economic losses. At this initial stage at least it should be possible to remove some degree of uncertainty . . . by a comprehensible and straightforward test of foreseeability.

Id. at 574. In strikingly similar fashion to Justice Stephen in *Caltex*, Justice Woodhouse was reluctant to prescribe any general limiting tests. His Honor listed the factors present in the case productive of the responsibility of the defendant to the plaintiff for the negligent misstatement. *Id.* at 575.

204. *See* Wallace, *Tort Demolishes Contract in New Construction*, 94 L.Q. REV. 60, 66-72 (1978); WADDAMS, *supra* note 27, at 26-37; for a resumé of American cases, *see* MILLER & LOVELL, *supra* note 66, at 338-42 (1977).

courts to view products liability more broadly, and hence note will be taken of the following obstacles to recovery of economic loss. First, the notion of the limits of tortious liability *vis-à-vis* contractual liability;[205] and second, increased legislative activity[206] granting remedies to aggrieved consumers — both of these will inhibit recovery in negligence for economic loss.

The application of an "interest" analysis may give more insight. The area of products liability lends itself to economic analysis.[207] Generally, the manufacturer and not the consumer is invariably the superior loss bearer. This would ordinarily favor liability in negligence.[208] The loss spreading argument, however, is less persuasive in the case of economic loss than it is in the case of personal or property damage caused by a defective product. It is generally assumed that safety of products is enhanced by placing liability for unsafe products on the manufacturer. When economic loss, and not safety, is involved, the deterrence basis of liability is absent.[209] Furthermore, the insurability of consequential economic loss is dubious. Risk distribution among a manufacturer's customers may inequitably increase the price of products to the vast bulk of customers. If liability is found and thus a spreading of the loss

205. *See* Rivtow Marine Ltd. v. Washington Iron Works, 40 D.L.R.3d 530, 536-40, 545-46 (1973). *See also* Fridman, *The Interaction of Tort and Contract*, 93 L.Q. REV. 422, 426 (1977); Wallace, *supra* note 204. Several cases have tested the pre-contractual negligent misstatement. *See, e.g.*, Esso Petroleum Co. v. Mardon, [1976] Q.B. 801 (C.A.); Dillingham Constructions Pty. v. Downs, [1972] 2 N.S.W.L.R. 49; Presser v. Caldwell Estates Pty., [1971] 2 N.S.W.L.R. 471; Capital Motors Ltd. v. Beecham, [1975] 1 N.Z.L.R. 576. For academic comments *see, e.g.*, Greig, *Misrepresentations and Sales of Goods*, 87 L.Q. REV. 179 (1971); McLauchlan, *Pre-Contract Negligent Misrepresentation*, 4 OTAGO L. REV. 23 (1977). For an American view, *see* Note, *Manufacturers' Liability to Remote Purchasers for "Economic Loss" Damages — Tort or Contract?*, 114 U. PA. L. REV. 539 (1966).

206. Law Reform (Manufacturers Warranties) Ordinance, 1977, No. 12 (Austl.). *See* the statement by 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." Bowen v. Paramount Builders Ltd., [1977] 1 N.Z.L.R. 394, 413-14. For similar American legislation, *see* Soug-Beverly Consumer Warranty Act, CAL. CIV. CODE § 1790 *et seq.*

207. For an economic analysis, *see* Symposium, *Products Liability: Economic Analysis and the Law*, 38 U. CHI. L. REV. 1 (1970). *See also* G. CALABRESI, *supra* note 26, at 13-14, 169; Anderson, *Current Problems in Products Liability Law and Products Liability Insurance*, 31 INS. COUNSEL J. 436 (1964).

208. Atiyah, *supra* note 3, at 276.

209. Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 951 (1966) [hereinafter cited as *Economic Loss*]. *Contra*, Note, *Manufacturer's Strict Tort Liability to Consumers for Economic Loss*, 41 ST. JOHN'S L. REV. 401, 415-16 (1967) (liability for economic loss would deter the marketing of defective products).

occurs, this would be to the detriment of stability of economic relations — the possible high increase in the price of products — and of the preservation of the freedom of action of the parties, especially the manufacturer who may incur very large costs in claims for economic loss.

For these reasons, liability of manufacturers for economic loss suffered by consumers of products will tend to be more narrowly circumscribed than where physical or personal damage is suffered or threatened. The widest scope of recovery under the principles of *Caltex*, insofar as they can be articulated, is that a manufacturer would be liable for pure economic loss suffered by a consumer where the manufacturer knew or had reason to know that the particular consumer or perhaps class of consumers would use the product, and that a defect of that kind would foreseeably cause the economic loss complained of. Thus, if a manufacturer of wool baling machines sold his products through distributors to farmers prior to the shearing season, *Caltex* may give a right to recovery to farmers who suffer economic loss caused directly by defects in the machines.

United States courts reflect this reluctance to impose liability in negligence for pure economic loss. The exclusory rule seems still firmly implanted in products liability.[210] Recovery of economic loss has been allowed, however, in strict liability[211] and breach of warranty.[212]

V. CONCLUSION: AN AUSTRALIAN TRANSPLANT?

In the United States, Australia, and other Commonwealth countries, the exclusory rule has been subject to heavy strains to reshape it in a more policy responsive form. The apparent virtue of the exclusory rule was its positive ease of application. However, application of the rule was complex and subject to doubt. The rule led to anomalies; for example, it allowed recovery on the completely arbitrary chance that physical damage to the plaintiff's property or person was manifested.

Caltex has freed Australian courts from this bondage. It

210. *See Economic Loss, supra* note 209, at 929-31; Bennett, *Products Liability: Tortious Recovery for Economic Loss*, 7 VICT. U. WELLINGTON L. REV. 330, 336-37 (1974); Comment, *Products Liability: Recovery of Economic Loss in California*, 13 CAL. W. L. REV. 297 (1977).

211. Santor v. A. & M. Karagheusian, Inc., 44 N.J. 52, 64, 207 A.2d 305, 309 (1965).

212. Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 417, 161 A.2d 69, 102 (1960). *See generally* Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145 (1965) for recovery of economic loss based on breach of warranty.

would be premature, however, to claim that in *Caltex* the Australian High Court has finally resolved all of the questions. In the process of formulating new law, some costs must be paid. Extra resources will be required to determine the limits of liability.[213] These costs are generated by increased litigation and uncertainties in the decisionmaking process. The courts were aware of the anomalies of the exclusory rule; they chose it with all its attendant problems on the grounds of public policy.[214] Consequently, the benefits of a new formulation of the law should have been weighed against the costs of invoking the new rule[215] and the costs of retaining the old. The uncertainty that *Caltex* engenders in its failure to create a framework for considering policy factors is significant in the weighing process. The failure of the *Caltex* court to provide this framework renders more difficult the task of the courts to consistently apply policy factors.

There is little doubt, however, that the *Caltex* decision will allow Australian courts to be more responsive and flexible. The courts will be able to build a consistent body of case law that will be free from the need to mold demands for recovery around the interstices of an inadequate rule.

Although the High Court's decision can be criticized, it has abolished the exclusory rule and put the law on a new path which will allow recovery when policy demands it. In short, the case has laid the foundations for a rationalization of the law. It is hoped that United States courts will see in *Caltex* persuasive authority to set their law on a similar track. It has been said of the exclusory rule in the United States: "Only when this rule against recovery has been eliminated will economic expectancies receive the protection which writers have urged, which courts are beginning to grant and which their social importance justifies."[216]

213. *See* Feldthusen, *supra* note 3, at 21.

214. S.C.M. (United Kingdom) Ltd. v. W.J. Whittal & Sons Ltd., [1971] 1 Q.B. 337, 339. *But see* Atiyah, *supra* note 3, at 274-75 (suggesting ways of retaining the rule while avoiding its capacious nature).

215. Feldthusen, *supra* note 3, at 15, 21.

216. Note, *supra* note 86, at 694.