



The Right Honourable Lord Mustill

Negligence in the World of Finance



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(b. 10 May 1931)

Lord Mustill studied at St John's College, Cambridge. He was called to the Bar in 1955, and was made a Bencher of Gray's Inn in 1976. He became a Queen's Counsel in 1968.

From 1978–1985, Lord Mustill was a Judge of the Queen's Bench Division of the High Court. In 1985, he was appointed Lord Justice of Appeal. Lord Mustill became a Lord of Appeal in Ordinary in the House of Lords in January 1992.

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Lord Mustill was the Chairman of the Judicial Studies Board (1985–1989); a Trustee of the Mental Health Foundation (1980–1990); Member of the House of Lords Select Committee on Medical Ethics (1993–1994); President, Vice-President and Member



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Lord Mustill is one of the most distinguished scholars on commercial law. He has written some of the more significant judgments in the area of commercial law in recent years. He is the co-author of *The Law and Practice of Commercial Arbitration* (with Stewert C Boyd, now 2nd edition, 2001); was the joint-editor of *Scrutton on Charterparties and Bills of Lading*; and joint-editor of the classical work on marine insurance, *Arnould on Marine Insurance* (now with JCB Gilman QC and in its 17th edition, 1997, published in 3 volumes). He is one of the contributors to *Modern Law of Marine Insurance Volume 2*, (edited by Professor D Rhidian Thomas, 2002).

As a Queen's Counsel, Lord Mustill, gained ad hoc admission to the Malaysian Bar in 1971 (see *Re Michael John Mustill* [1971] 1 MLJ 175, High Court, Kuala Lumpur, before Yong J). Interestingly, he appeared before His Royal Highness Sultan Azlan Shah (then Raja Azlan Shah J) in the High Court in the case of *Boon & Cheah Steel Pipes Sdn Bhd v Asia Insurance Co Ltd & Ors* [1973] 1 MLJ 101; [1975] 1 Lloyd's Rep 452, HC, the only reported case in the Commonwealth on marine insurance dealing with the total loss of the insured cargo and the application of the de minimis rule in calculating whether there is total loss of cargo (referred to in most leading textbooks on marine insurance and also referred to in *25 Halsbury's Laws of England*, 4th edition, 2003 Reissue, paragraphs 462 and 468).

6 Negligence in the World of Finance

Lord Mustill

Lord of Appeal in Ordinary, House of Lords

Your Majesty, it is a great privilege to have been chosen to deliver the Sixth Sultan Azlan Shah Law Lecture.¹

Not only because of the honour which this accords, but also because it will enable me to claim a qualification which few Englishmen have possessed during the past 800 years: namely to have addressed the same personage successively as judge and as Monarch: as judge, during January 1972 in the case of *Boon & Cheah Steel Pipes v Asia Insurance Co*;² as Monarch, at this gathering here tonight, almost 20 years later.

I have mentioned the interval of 800 years, for that is the time which separates us from King Henry Plantaganet, the ruler who founded the English judicial system, the test-bed of the common law, that great engine of justice under whose authority countless millions throughout the world still live their lives.

Thus, when called upon to perform the most difficult task which faces a person invited to give a lecture—namely to select a topic—I resolved at once that it should spring from the common law; that it should raise doctrinal problems faced by every legal system; and that it should be of practical importance to my host country, poised as it is on the verge of a great expansion into the world of international commerce. These requirements combined to suggest a discussion of liability for negligence by professional men and women, leading to pure economic loss.

This paper is an expanded version of the Sixth Sultan Azlan Shah Law Lecture, delivered on 10 December 1991 in the presence of His Majesty Sultan Azlan Shah.

¹ The writer is greatly indebted to Dr Lorraine Newbold, Barrister, for references to some valuable sources.

In the United Kingdom a great body of literature on the topic has accumulated and it would be pointless to list them all.

Amongst the more recent articles in English journals at the time this lecture was delivered may be mentioned — BS Markesinis, (1989) 105 LQR 104; P Cane (1989) 52 MLR 2000; IN Duncan Wallace (1991) 107 LQR 228; J Stapleton (1991) 107 LQR 249; K Nicholson (1991) 40 ICLQ 551.

² [1975] 1 Lloyd's Rep 452.

Categorising the cases

This catchphrase, familiar though it is, calls for explanation. Most, although not all, claims in negligence seek compensation for financial loss. This may happen in a number of ways, calling for very different legal analysis. Six of these are illustrated in Appendix I.³ The first is the most familiar. The plaintiff is injured in an accident. Whilst recovering he is off work and loses wages. The second situation also stems from a negligent act or omission having physical consequences, but here those consequences are not suffered by the plaintiff himself. For example, the defendant's barge carelessly rams a bridge, and whilst it is shut a lorry containing goods urgently required by the plaintiff is kept waiting.

The second pair of situations is concerned with claims arising from words carelessly uttered. In one instance, perhaps rather uncommon, the words lead to an event the physical consequences of which cause the plaintiff to suffer financial loss—as where, for instance, the defendant unwisely tells the plaintiff that the road is clear for him to back his car into heavy traffic. Of greater interest to us today is the fourth situation, where carelessly uttered words lead directly to financial loss—the classical case of the auditor whose inaccurate report misleads an investor.

The third pair of situations identifies more complex types of complaint. Here there is an earlier act or omission (usually the latter) associated with a physical object, which had later adverse repercussions on the plaintiffs relationship with the object. In one, the negligent act by the defendant (typically a surveyor) causes an adverse condition to pass unnoticed, which when later revealed puts the plaintiffs to the expense of repair. (For example, the subsequent purchaser of a house finds that he has to spend money strengthening foundations the inadequacy of which ought to have been discovered by the defendant when the house was built.) The other situation differs, in that the house plans which were carelessly approved suffers cracking when the foundations subside.

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See page 178, below.

These and similar classifications serve one useful purpose, in that they impose some semblance of order on an otherwise chaotic “wilderness of single instance”.⁴ Working as it does *a posteriori* the common law bogs down if the material from which general principles are to be derived is simply a blur of static. But all those working in the field do, I believe, come in the end to realise that the categories do not form a basis from which a strictly logical, as distinct from a practically serviceable, delictual law of negligence can be derived. Neither by distinguishing the consequences of words from those deeds, nor by distinguishing those adverse effects on the plaintiff’s pocket which stem from damage to his person or property from those which occur without the interpolation of damage, is it possible to build up an intellectually sound defensible law of tort.

Furthermore, not only do the categories have a false air of precision, but they also tend to disguise other, equally plausible, ways of dividing up the cases. One such instance is germane. It is often convenient to speak of liability for “negligent misstatement” as if all such sources of liability were the same. But this is not so. In some instances, the defendant’s carelessness takes the shape of the act of making the statement: for instance, where he intends to write one thing but writes another. A different, and much more common source of an asserted liability exists where the statement itself is accurate, in the sense of reflecting correctly the outcome of a previous process of reasoning, but where that process contains an error. Such is the case where an auditor certifies an inaccurate set of accounts. Here, it is almost always unsound to describe the act of signing as negligent, since it will be no more than a formality; the auditor has written what he meant to write. Rather, if he is held liable, it is for the lack of care of those who have at an earlier stage collected the information on which the accounts are based, and have formed and expressed in the draft accounts an opinion upon them.

This example points to another and different basis of categorising negligent conduct: namely into acts and omissions.

⁴ Alfred, Lord Tennyson, “Aylmer’s Field”.

Very often this dichotomy is of no practical importance, and may indeed seem purely linguistic. Where the friend has caused damage by carelessly telling the driver that he can safely reverse into a busy road, to draw a distinction between the wrongful act of speaking without having first looked, and the wrongful omission of having failed to look before he spoke, will serve only to make the practical man impatient. Yet for any sound analysis of the roots of delictual liability for negligence this distinction is potentially of great importance, since if the second way of putting the case is right the defendant is being held liable for failing to do something which he has never promised the defendant to do. This objection is not too hard to overcome when only two parties are involved, but it becomes much more difficult when the situation is complex, as we shall later have to observe.

I mention these distinctions, not because it is practicable to explore them here tonight, but to sound a note of warning. A single lecture could not begin to address the practical and intellectual problems arising from delictual responsibility for negligent conduct in all its multifarious shapes. The focus must be narrowed. Even liability for “economic loss” is too large a topic. A very important aspect of this, represented by situations 5 and 6 in Appendix I,⁵ has very recently been the subject of published analysis, both by His Majesty⁶ and by two recent Sultan Azlan Shah Lecturers;⁷ I shall abstain from covering the same ground again, and will instead concentrate on liability for that form of “economic loss” which stems from “negligent misrepresentation”. I feel justified in this course, because my concern tonight is principally with juristic method rather than with an exploration of what the law is, or what it should be. Nevertheless, I must repeat that to assume that these categories are exhaustive or even soundly based may soon lead to error.

Donoghue v Stevenson

Against this background I will briefly trace the history of the chosen topic by reference to a few only of the salient English cases. Whatever else the law student forgets, *Donoghue v Stevenson*⁸ will remain, with *Carlill v Carbolic Smoke Ball Co.*⁹ forever embedded in his recollection. He will

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I am very grateful to Harriet Edgerly for preparing the diagrams which form the Appendices.

6

His Majesty Sultan Azlan Shah, “Engineers and the Law: Recent Developments” (1989) SCJ 89.

Now see *Constitutional Democracy, Rule of Law and Good Governance*, 2003, Professional Law Books and Sweet & Maxwell, Kuala Lumpur.

7

Sir Robin Cooke, *Administrative Law Trends in the Commonwealth*, chapter 5, above, and Lord Oliver of Aylmerton, *Judicial Legislation: Retreat from Anns*, chapter 3, above.

8

[1932] AC 562.

9

[1893] 1 QB 256.

recall that in the company of a friend Mrs Donoghue went into Mr Minchella's cafe. The friend bought, amongst other items, a drink of ginger beer and poured some of it out for Mrs Donoghue. According to the latter's pleaded case there floated out the decomposed remains of a snail, the sight of which made her ill. Her claim for damages against the manufacturers failed in the court of session, but on appeal to the House of Lords she won a memorable victory, by three votes to two.

What is odd is that although everyone remembers the victory, very few actually read the case. It is an instructive task, on which I comment in a moment, but first let me identify the crucial elements in the decision:

1. The claim was brought against the background of a chain of two or more contracts—one by which the friend purchased the beverage from Mr Minchella, and the other by which the latter purchased it from the defendant manufacturers.
2. Mrs Donoghue did not sue upon either of these contracts, for she was not a party to them. This fact would have made it futile in 1930 even to contemplate an action in contract, and would probably be so regarded by the great majority of practitioners today. I shall return to this later.
3. Mrs Donoghue sued the manufacturers, not Mr Minchella. She could not have sued him in contract, for she did not herself buy the drink, and an action in tort would have failed, since he could not have known about the snail.
4. Mrs Donoghue did not assert that the manufacturers knew about the snail, merely that they had failed to take care in providing a system of work which would ensure that foreign bodies did not contaminate the drink and remain undetected.

Although these facts are a long distance from our topic tonight, they have two features which we must immediately notice.

The first is that the case was of a type illustrated in diagram 1 of Appendix I.¹⁰ *Donoghue* represents the simplest and most common case of negligence, in which a careless act causes direct physical damage, which in turn leads to economic loss.

The second feature, which I have already mentioned, is that the claim arose against the background of one species of what may be called a “contractual network”. These networks, and the problems which they raise, are not easy to describe in words without confusing both the listener and oneself, and I have therefore illustrated some varieties of them in Appendix II.¹¹ In each of them the plaintiff is at the top of the diagram. The continuous lines represent contracts, and the broken lines are the duties in tort asserted by the plaintiff.

These diagrams are mainly self-explanatory, but a few words of comment may be useful. In Group A (Appendix II), diagrams 1, 2 and 3 illustrate situations where only two parties are concerned. The first is the simplest: the traffic accident. The second exists where the physical damage is caused to one person, but the economic loss is suffered by another; for example where a workman operating a mechanical digger severs an electricity cable in the road and thereby shuts down the plaintiff’s factory. In the third, the parties are already linked by a contract which imposes duties on the defendant, but for some reason it suits the plaintiff to lay his claim for breach of those duties in tort.

Diagrams 4 and 5 in Group B are I believe self-explanatory, differing only that in the latter the plaintiff is not connected to the defendant by an uninterrupted chain of contracts, albeit contracts create the framework of the relationships.

The situations depicted in Groups C, D and E are essentially triangular in nature, but differ as to the extent to which each party is linked by contract to one or more of the others.

¹⁰
See page 178, below.

¹¹
See pages 179–181, below.

The diagrams in Group F serve to illustrate relationships very often encountered in commerce. These can take many different forms, but share the characteristic that the parties, often numerous, are linked only by their common participation in a network of relationships.

The diagrams in Group G are of a different kind, and I will discuss them at a later stage.

Let us now return to *Donoghue*.¹² When we come to read the report, the impression is surprising, for the appeal was argued quite briefly on a very narrow front, as a case on dangerous chattels. The question posed was whether the law confined, or at least whether it should any longer confine, the right of recovery to cases where either the article fell into the category of objects dangerous in themselves, or it was an article which the manufacturer knew to be dangerous. The two dissenting speeches concerned themselves exclusively with this question, and proposed a narrow answer on grounds which, regarded as an exercise in precedent, still carry much conviction. The majority by contrast were prepared to extend the responsibility as far as a duty on a manufacturer of goods intended for human consumption to use reasonable diligence to ensure freedom from possible non-apparent defects which would be likely to make the product noxious or dangerous in use.

Now it was at once realised that this was a landmark decision. To a modern lawyer that is not surprising, but what is surprising is the reason for this assessment. We can see this in a brief article by Sir Frederick Pollock, published some six months later:¹³

As to the importance of the decision there is no doubt. The House of Lords itself has proclaimed it. A notable step has been made in enlarging and clarifying our conception of a citizen's duty before the law (to put it in the shortest and plainest words) not to turn dangerous or noxious

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The remarkable history of this case, the outlines of which are known to so many, and the details to so few, is set out in *The Paisley Papers*, a compilation as enjoyable as it is instructive, published (ISBN 0-86504-551-8) by The Continuing Legal Education Society of British Columbia. I am indebted to the Hon Mr Justice Martin R Taylor of the Court of Appeal of British Columbia, for making available copies of this volume.

13
49 LQR 22.

things loose on the world. We have to thank the Scots Lords of Appeal for overriding the scruples of English colleagues ...

And so on. The case was treated as lying in the field of what we would now call “product liability”. As such, it is of no interest at all today (except perhaps in one respect to which I shall later return). It now seems incomprehensible that the liability of the manufacturer should ever have been in doubt. And it may be that within a few years the whole of the British law on the topic may be made obsolete by European Community directives invoking no-fault liability.

Immateriality of contractual rights

It was not however all that *Donoghue* decided. Two other matters were canvassed, both of them central to our topic. The first concerned the difficulties created by the co-existence of contractual rights and liabilities as far down the chain as the pursuer’s friend. Nowadays, as we shall see, it might be suggested that this could form the basis of a cause of action. At the time, however, precisely the opposite was asserted. *Donoghue* was an instance of what I have called a “broken chain” of the type shown in Appendix II, diagram B5. The defendant manufacturers had for a stipulated price assumed towards their wholesalers (or Mr Minchella, if they sold direct to him) responsibilities which were defined by the terms of their contract of sale, read against the background of the general law of contract. How could it be fair, not only to add a further liability towards someone who had made no contract with the manufacturers or anyone else and had paid no price to them or anyone else, but also to do so in a manner which imposed on them, not the contractual duties which they had chosen to accept, but different duties, imposed by the law of tort? This was a formidable objection at the time, and remains so today, although the part which it played in *Donoghue* is now largely forgotten. Whatever one makes of the problems of “non-cumul”—ie, of the question whether in the simple bilateral situation shown in diagram B3 the plaintiff should have any right of action in tort—it is at least clearly established that the plaintiff is not allowed to assert any

more onerous duty than the defendant assumed under his contract. Why should the position be more favourable to the plaintiff in a situation such as *Donoghue*, simply because the parties are separated by a chain, and a broken chain at that?

This problem was tackled head-on by Lord Macmillan, in the following passage:

Where, as in cases like the present, so much depends upon the avenue of approach to the question, it is very easy to take the wrong turning. If you begin with the sale by the manufacturer to the retail dealer, then the consumer who purchases from the retailer is at once seen to be a stranger to the contract between the retailer and the manufacturer and so disentitled to sue upon it. There is no contractual relation between the manufacturer and the consumer; and thus the plaintiff, if he is to

succeed, is driven to try to bring himself within one or other of the exceptional cases where the strictness of the rule that none but a party to a contract can found on a breach of that contract has been mitigated in the public interest, as it has been in the case of a person

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who issues a chattel which is inherently dangerous or which he knows to be in a dangerous condition. If, on the other hand, you disregard the fact that the circumstances of the case at one stage include the existence of a contract of sale between the manufacturer and the retailer, and approach the question by asking whether there is evidence of carelessness on the part of the manufacturer, and whether he owed a duty to be careful in a question with a party who has been injured in consequence of his want of care, the circumstance that the injured party was not a party to the incidental contract of sale becomes irrelevant, and his title to sue the manufacturer is unaffected by that circumstance. The appellant in the present instance asks that her case be approached as a case of delict, not as a case of breach of contract. She does not require to invoke the exceptional cases in which a person not a party to a contract has been

held to be entitled to complain of some defect in the subject matter of the contract which has caused him harm.

It is not my place to consider whether this is a convincing answer. Nevertheless, it does seem to me plainly to show a resolve to treat the contractual background as immaterial to the existence of a cause of action in tort, and if it is still good law (and I know of no authority for asserting that it is not), it places a formidable obstacle in the way of a contractual approach to the problems of recovery for pure economic loss, of the kind to which I shall come in due course.

A general duty of care

The second and far more celebrated feature of *Donoghue* was the enunciation of a general duty of care, not confined to product liability. For many years, the following words from the speech of Lord Atkin echoed through every law faculty lecture hall in the common law world:

The rule that you are to love your neighbour becomes in law, you must not injure your neighbour; and the lawyer's question, "Who is my neighbour?" receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be—persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as so affected when I am directing my mind to the acts or omissions which are called in question.

This novel concept of a general duty of care, centred on the foreseeability of harm, opened up exciting new vistas. The landscape of delictual responsibility, hitherto sparsely furnished with isolated clumps of nominate causes of action, entitled trespass to goods, chattels dangerous per se, and so on, would suddenly become densely planted with fresh varieties of potential liability, multifarious in foliage yet all having the same rootstock in a general duty of care.

Events never previously imagined as a source of responsibility would suddenly become actionable; duties would be owed by categories of people and to categories of people who would never previously have been parties to an action for what could now simply be called “negligence”.

Twenty years after the good neighbour principle was articulated, law students such as myself were taught to regard it as an exemplar of the common law method working at its best. Induction followed by deduction. The assembly of a set of instances; the derivation from them of a unifying principle; the application of that principle to a new set of facts. The fresh yet magisterial tone of Lord Atkin’s language; the boldness of its theme in the face of timid and reactionary opposition; its success in giving Mrs McAllister a remedy where a remedy was obviously just. All these combined to make *Donoghue v Stevenson* seem a dramatic *coup de main*, inspirational and seminal in a way perhaps unequalled since the unknown medieval clerk invented the writ in *consimili casu*.

So it seemed to us. It is plain enough however, if you look at the cases, that it is not how it was viewed in the courts, then or for some time afterwards, and it is instructive to see why.

Before this, however, I must pause for a word of explanation. My object this evening is not to give a chronological epitome of the English law of negligence. Even to a legal historian in England

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it would be of only marginal interest, and surely none at all to those here tonight. My purpose is to use the tangle in which the English cases have entwined themselves to illustrate the serious conceptual, social and economic problems raised by claims against professionals, and to see what a more satisfactory way forward might be.

Low impact of *Donoghue*

Returning to *Donoghue*, there are, I believe four reasons why the statements of Lord Atkin and Lord MacMillan did not detonate an explosive increase in successful claims for negligence outside the established area of direct physical injury happening between persons in direct contact. Of these, two were broadly social in character, and two intellectual.

In the first place, there were few successful claims, simply because few people at the time would have thought of claiming, and those who did would rarely have been able to afford it. The expectation that through some outside agency all misfortunes must be remedied had not yet been born. Hardship was so prevalent, and so little mitigated by social services in the modern pattern, that it was viewed as something to be borne, no doubt resentfully, but without the assumption that a right must have been infringed. Resignation not litigation was the response.

There was another reason. Delictual rights had traditionally grown by accretion, like coral. A remedy established in one situation was the growth point for the establishment of another, in a slightly different situation, just as claimants were reticent to demand, so courts were frugal to recognise, entirely new types of recourse. The judicial approach was cautious, and the climate was not ripe for broad generalisations of delictual rights.

A serious intellectual objection to the good neighbour principle also told against it: namely that it is circular, or at least risks being so, for it proposes a dialogue on the following lines. Question: “When does the author of another’s misfortune incur a liability in tort?” Answer: “When he owes him a duty of care.” Question: “How do we tell whether he owes the other person a duty of care?” Answer: “When he stands in a sufficient proximity to him.” Question: “When does he stand in such a proximity?” Answer: “When he owes him a duty of care.” Not for the first or last time in the history of the common law a

principle is stated in terms which conceal the fact that the process of deciding on liability begins with an answer which is largely intuitive, and reasons backwards from it.

Another, kindred, reason why Lord Atkin's generalisation has been a failure, and indeed one must say, the source of decades of fruitless effort, is that in practice it tells us nothing. Of course the

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generalisation is consistent with cases such as liability for motor accidents, for medical negligence, and for reliance on misleading financial forecasts. But liability in these cases can be, and in fact has been, developed on a piecemeal basis without recourse to the good neighbour principle. Consistency of the generalisation with existing authorities is not enough to validate it; to be of any use it must predict the outcome of new disputes. In theory it does do this, but

the use of foreseeability of loss as the only criterion would lead to so many successful claims as to become socially and economically unsupportable, and the application of the principle has had to be so heavily qualified that it is no longer an active principle at all.

These were amongst the reasons why a general liability in respect of the foreseeable consequences of loss made little headway during the two decades after *Donoghue*. Rather, we can see traces in the judgments and the academic writings of the view that Lord Atkin's generalisation was untimely; that it was *obiter*; that it marked an important step forward, but only in the field of product liability; that it was valid, but only in relation to claims for physical damage resulting from physical acts of negligence; and so on. In this intellectual climate it is not surprising to find that even after *Donoghue* the rule which had been laid down years before in *Le Lievre v Gould*¹⁴ precluding a recovery in tort for losses resulting from a negligent misstatement remained undisturbed. Thus, the

¹⁴ [1893] 1 QB 491.

negative outcome of *Candler v Crane Christmas*¹⁵ in 1951 was entirely predictable.

There, the plaintiff was contemplating an investment in a Cornish tin mine. Prudently he wanted to see some up-to-date figures, and the chairman of the company arranged for a clerk with the company's accountants to show him the draft annual accounts, on the basis of which the plaintiff ventured and duly lost his money. It was held by a majority in the Court of Appeal that he had no cause of action against the accountants notwithstanding that the accounts had been negligently drawn, and also notwithstanding that the parties were in direct personal contact in circumstances which made it clearly foreseeable that carelessness would cause the investor to suffer loss.

I cannot stay to analyse the decision, but history demands that I mention the dictum in Lord Justice Denning's dissenting judgment that in the earlier cases, including *Donoghue*, the courts had been divided in opinion—"On the one side there were the timorous souls who were fearful of allowing a new cause of action. On the other side were the bold spirits who were ready to allow it if justice so required." Nor must one overlook the riposte of Asquith LJ, who held in company with Cohen LJ that *Donoghue* did not apply outside the field of damage to person or property, and added pointedly—"If this relegates me to the company of 'timorous souls' I must face that consequence with such fortitude as I can command". This comment was the cause of much restrained mirth in 1951, but as we shall see it is not always the person who laughs loudest who laughs last.

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For the time being, therefore, it seemed that even if the snail of a general law of negligence had escaped from the bottle of confining doctrine, it had travelled neither fast nor far. Nor had it made any greater progress in the United States, where on the very high authority of Chief Justice Cardozo it had been held in a similar case¹⁶ to *Candler*,

¹⁵ [1951] 2 KB 264.

¹⁶ *Ultramares v Touche* 174 NE 441 (1931).

that in the absence of fraud the unlucky investor had no cause of action.

I pause for a moment to invite attention again to Appendix I. The third situation (*viz* negligent words leading directly to physical damage) is rarely a source of claims, and tends to be overlooked. Situations 5 and 6 had not yet achieved prominence, so that in the 1950's those concerned with claims in tort tended to divide them into the orthodox claims for physical damage resulting from physical acts or omissions, and all the others. These others mainly comprised situations 2 and 4, and it was easily assumed that because they were unorthodox they were the same, the more so since most instances of pure economic loss arise from negligent misstatements, and most negligent misstatements have purely economic consequences. It now seems plain that the two categories are in reality quite different, but it was not so obvious at the time.

Thus in the 1950's the law student was taught, and the practitioner assumed, that there was no liability in tort for careless misstatement. The broader question of recovery for pure economic loss however caused was not greatly canvassed, because it arose principally in the context of negligent misstatement and was mistakenly assumed to be a reflection of the same point.

Explosion in law of negligence

This continued to be the orthodox doctrine for more than a decade. Only a brave young lawyer would have stood up to assert a claim in negligence for pure economic loss, and only one brave to the point of foolhardiness would have argued for a liability founded on a careless misstatement. And yet within less than 20 years the position was completely turned around. The law of negligence exploded and the impact penetrated into areas of commercial life which would have astonished Lord Atkin himself, let alone judges such as Scrutton and Asquith LJ. Whereas for centuries it had seemed impossible to win a claim for negligence based on pure economic loss or careless

misstatement, it seemed for a while impossible to lose one, if the facts were right. Suddenly the snail of a general duty of care was accelerating towards the horizon.

A torrent of litigation was unleashed, on a scale without precedent in English law: and this was not just an English experience but was reproduced everywhere, to a greater or lesser extent, throughout the free-market world.

What were the reasons for this phenomenon? One would need the qualifications of a sociologist as well as a lawyer, and the space of half a dozen lectures, to attempt a full answer. But let me touch upon a few factors, legal and psychological.

The legal facts are the more obvious. In England the decisive impetus came from two decisions of high authority which gave an incalculable psychological as well as doctrinal boost to aspiring claimants in hitherto unexplored fields. These two cases were *Hedley Byrne v Heller*¹⁷ in 1963, and *Anns v Merton London Borough Council*,¹⁸ 14 years later, which seemed for a while to have struck off the chains of the old doctrines. Both will be familiar to the lawyers in this audience, but I must describe them briefly for the benefit of others.

Hedley Byrne v Heller

Like *Candler v Crane Christmas*, *Hedley Byrne* was an instance where negligent words had caused pure economic loss. On this occasion the words took the shape of a banker's reference, supplied by the defendants to a vendor who was being asked to extend credit to one of the banker's customers. The reference was favourable, but in truth the customers were not in good shape and soon went into liquidation leaving the suppliers with a large unpaid debt. The vendors sued the bankers claiming that they had been misled by the reference. Once again the claim failed, but for a new reason: namely that the reference expressly stated that it was given without responsibility. In the House of Lords, it was held that this factor was sufficient to negative any

¹⁷
[1964] AC 465.

¹⁸
[1978] AC 728.

assumption of a duty of care on the part of the bank. So far, nothing surprising, although the effectiveness of such a disclaimer, at least in a case where the service is not gratuitous, is increasingly open to question, in face of the rising tide of consumerism.

However that may be, the real importance of the case resides in the unanimous opinions of the House that the suppliers would have had a good cause of action but for the disclaimer. I well remember the astonishment which the case caused at the time.

In the first place, Lord Justice Asquith's mild joke had lost its point, and the dissenting judgment of Lord Justice Denning in *Candler v Crane Christmas* had been vindicated. How had this come about? I believe that if most lawyers had been told the conclusion and invited to speculate as to the way the House had reached it they would have expected heavy reliance on *Donoghue v Stevenson*, either by a direct application of Lord Atkin's good neighbour principle or by treating a misleading reference as analogous to a dangerous chattel: and this was indeed how the matter was argued for the plaintiffs. One might therefore have had either an elaboration of the existing general duty of care, applied in a new field; or the expansion of a "pocket" of particular law, on this occasion in the field of consumer protection. Rather surprisingly, the House adopted neither of these lines. With the exception of Lord Hodson, the Lords did not legitimise their opinions by reference to the existing authority of *Donoghue*—very possibly because they suspected, not without reason, that it would not bear the weight. Instead, the House struck out in an entirely new direction by developing the concept of a "voluntary assumption of responsibility". According to this, the bank could, if it thought fit, have declined to supply a reference, but having chosen to so do it must (in the absence of a disclaimer) be taken to have accepted some responsibility for seeing that the answer was given carefully. No longer was a duty imposed on a defendant by operation of law simply by virtue of the foreseeability that his acts would cause harm. Instead, he was understood to have brought the duty on himself by electing to establish a relationship with the plaintiff. This was a much narrower

concept, not perhaps far removed from that of a contractual promise, unsupported by consideration.

If we pause to analyse the nature of the plaintiffs' complaint, which neither judges nor lawyers have taken much time to do, we can see that these are not cases where the negligence resides in the making of the statement. Rather, the complaint has two components: first, that the defendant has done a poor job of work; and second, that he has gone on to communicate the results of his work to the plaintiff, implicitly representing that it has been well done. In a real sense, therefore, the defendant is being sued for having caused economic loss by a misperformance of a job performed under a contract made with someone other than the plaintiff.

The plaintiffs' complaint has two components: first, that the defendant has done a poor job of work; and second, that he has gone on to communicate the results of his work to the plaintiff, implicitly representing that it has been well done.

Although it has tended to pass from view in later years, the distinction between such a claim and one founded on a "pure" negligent misrepresentation was clearly recognised in *Hedley Byrne*. The discussion in the House was dominated by consideration of the actionability of negligent misstatements, and very little is said about pure economic loss. This is perfectly understandable, since the problem was how to dispose of a line of authority of which *Candler* was only the latest example which had established that negligent misstatements were not actionable. If the plaintiffs failed in this, the question of economic loss was academic. Unfortunately the endorsement by the House of a solution to this problem seems to have led to a much later assumption that the problem of economic loss had also been successfully brushed aside.

I say "much later" because I recall well that in the profession this problem was seen at the time as very much alive. For example, I was involved as counsel in a dispute where the negligent navigation

of an oil carrier had resulted in extensive pollution to holiday beaches. The physical damage, represented by the cost of cleaning up, was large enough; but far larger was the economic loss suffered by those who were not directly concerned with the physical damage. In the front line were the hoteliers, whose customers did not want to spend their holidays paddling in oily mud. At one remove were the owners of cafes and gift shops. Further away were the wholesale food merchants who supplied the hotels and cafes. Still further were the importers who brought into the country the food and the souvenirs. All those concerned with the case were aware of these receding vistas of potential liability and knew very well that the courts would have to draw a line somewhere. What nobody knew was whether the court would decide that the line was so impossible to draw on any rational basis that it would maintain a rule which entirely denied a recovery for pure economic loss except in cases of negligent misstatement (since *Hedley Byrne* had established a right of recovery which could hardly be undone so soon afterwards), or whether a way would be found to say that hoteliers could recover and wholesalers would not; an exercise which would have in some way to skirt the plain man's objection that whatever foreseeability in the abstract might involve, in reality, the last thing that the ship's master was contemplating when he set the wrong course on the chart was anything at all about the people ashore. The case was settled at quite an early stage, which was a pity because the dispute would undoubtedly have reached the House of Lords, before the freewheeling approach of later years had obscured the fact that *Hedley Byrne* was not a case about economic loss—and moreover in a context where the highest court would have been forced to recognise the fact that the formulation of duties of care involved a broad exercise in social engineering.¹⁹

Anns v Merton Borough Council

However none of this happened, and we must now press forward to the next decade, where we encounter the problem of *Anns v Merton Borough Council*. The plaintiffs were lessees, most of them taking by assignments from prior parties, who had purchased the leases from

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On 30 April 1992, the Supreme Court of Canada delivered important judgments in a case where the ramming of a bridge by a tug led to delays in the use of the bridge by railway companies who had contracts with the owners of the bridge. The Court was deeply divided but the judgments contain much valuable material. In particular the dissent of La Forest J displays a cosmopolitan and wide-ranging appreciation of the social and economic issues to where this area of the law gives rise.

Editor's note: See *Canadian National Railway Co v Norsk Pacific Steamship Co* [1992] 1 SCR 1021, SC.

builders. The local authority passed plans which showed foundations of a particular design and dimensions, but the flats were actually built with foundations to a different depth. It was alleged that in consequence the flats underwent subsidence, and in proceedings against the local authority it was contended that the latter were negligent in failing through their inspectors to ensure that the building corresponded with the plans. This was on the face of it a different type of claim from those we have so far considered. It was of the type illustrated in diagram 6 of Appendix I, which is analogous to, but not always the same as the one shown in diagram 5.

Any complete discussion of the problems raised by cases of this kind will have to address the question whether situations 5 and 6 are governed by the same principles, and whether either or both of them are governed by the same principles as those which apply to situation 1, where the defective object or negligent act injures someone or something other than itself. This was a well-recognised problem in the field of commercial and maritime law, where it was not uncommon to encounter claims based on defects in machinery or structures which were discovered before they had the opportunity to cause damage, but which led to the condemnation of the article and consequent costly delay. These cases, which arose in the field of insurance as well as negligence, very rarely came to trial, and attracted little academic attention; and it was not until *Anns* and its immediate predecessors that the question became a matter of more general debate.

For the reasons already stated I shall not this evening address the very difficult question whether on the alleged facts it was rightly held in *Anns* that the plaintiffs had a good cause of action against the local authority. For the time being, at least this particular problem has been laid to rest in the United Kingdom—although by no means everywhere else—by a series of very recent decisions in the House of Lords²⁰ which have in effect decided that it was not rightly so held. There are however two important aspects on which I must remark.

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Of which *Smith v Eric S Bush* [1989] 2 All ER 514 and *Caparo Industries v Dickman* [1990] 2 WLR 359 are perhaps the most conspicuous examples.

In the first place I think it clear, looking back on this line of cases, that the answer at which the court will arrive, if left free to do so, is determined by the social and economic premises from which it starts. Of course, it is constrained by prior binding decisions, which it will endeavour to synthesise and apply. But there is a very perceptible undercurrent of policy impelling the court towards deciding in a particular way; and this current may change direction with the passage of time.

The second, and more particular, aspect of *Anns* is that it laid down a principle which was new, albeit acknowledging parentage in the good neighbour principle. This involved a two-stage process. At the first, the court considered whether the relationship between the parties was such that in the reasonable contemplation of the defendant, carelessness on his part might be likely to cause damage to the plaintiff. If the answer was “Yes”, then a cause of action would be held to exist unless there were any considerations which ought to negative or reduce or limit the scope of the duty or the class of persons to whom it was owed or the damages to which a breach of it might give rise.

This enquiry was plainly more favourable to plaintiffs than a formulation under which they had to persuade the court that something more than mere proximity existed, and much more favourable than a regime which required plaintiffs to fit their claims into pigeon-holes representing situations which were already recognised as generating causes of action. The decision was also much more radical than *Donoghue*. The two cases had this much in common, that neither plaintiff had any connection at all with the defendant at the time of the allegedly tortious act. But the noxious drink and the lady’s injured person were different, whereas with *Anns* the subject matter of the negligence and the subject matter of the loss were the same. Whether this ought to make a difference in law is for debate on another occasion, but *Anns* plainly added a conspicuous new category of potential claims; and did so by a new route.

In the result, *Hedley Byrne* and *Anns* legitimised the assertion in principle of claims for pure economic loss—and in particular for the kind of loss which results from the combination of doing a poor job, and representing to someone who had not actually employed you to do the job, that you have done it well.

I say “legitimised” because there had developed by this time a social and economic climate ripe for an entirely new approach to negligence in the field of commerce, and was awaiting only the development of the legal tools to make its presence felt.

Coupled with this was what one may call the encouragement factor. Advisors who in the past, rightly believing a cause of action to be unarguable on the law as it stood would have refrained from wasting their clients’ money in trying to argue it, were now faced with two radical and unexpected benefits. If the law could change so fast in one direction, why not try to change it in another? Timorous souls were now at a discount.

Other factors were in play as well. Most obviously, there was the sheer size of potential claims. Even allowing for the fall in the value of money, potential liabilities are vastly greater than they were at the time of *Candler*. The stakes are now very high, and the incentive to turn irritation into litigation is correspondingly great. It may also be said that the increased complexity of modern life gives more opportunity for mistakes although I am myself skeptical about this.

Equally if not more important however was a general shift in the relationship between the individual and society—at least in the northern world, and those parts of the globe imbued with the values

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of the northern world. In particular I believe that the notions of misfortune and bad luck had come to feature much less in people's thinking than in the past. Whereas previously if someone suffered loss he would try to rise above it, to treat it as a reflection of the risks involved in being a human being, now the response was to look round for compensation—in the first place from society at large, and if not from society then from the individual conceived to be the author of the misfortune. Instead of relying on himself the individual relies on someone else, and if necessary blames someone else. Coupled with the contemporary pre-occupation with rights, this has led to an astonishing growth in litigation, very evident in our chosen field today. Previously, if your accountant let you down, you changed your accountant; now you sue him. Moreover you also sue somebody else's accountant, if you think he has cost you money, notwithstanding that it is not you who have paid his fee.

For these and no doubt other reasons there began a period during which the policy underlying the decisions of appellate courts encouraged freewheeling claims for pure economic loss arising from negligent misstatement. Bankers were much in evidence as both plaintiffs and defendants in these claims, which came in all shapes and sizes. For our purposes they may be arranged in two, and possibly three, broad categories:

1. Those where the plaintiff and the defendant are linked to one another by a contract: the bipolar situation, shown in Appendix II, Illustration 3.
2. Those where either the plaintiff, or the defendant or both are parties to a contract or contracts connected with the subject matter, but where there is no direct contract between them: the network situation, Appendix II, Illustrations 12, 13, and 14.
3. (Possibly) Those where the plaintiff's economic loss occurs without the intervention of any relevant contract.

I mention the third category only for completeness, since in practice the plaintiff's economic loss will almost always arise because the defendant's negligence induces him to make a contract, or do something under a contract, or because it in some other way affects his rights under a contract. One can imagine idiosyncratic cases—for example where a motorist stops to ask the way, and his informant sends him on a circuitous route involving a great waste of fuel. But in the world of finance these cases are so rare as not to merit discussion, and I leave them aside, theoretically interesting though they are.

I will also pass rapidly over the bipolar situation where the defendant already owes to the plaintiff a duty in contract, but the latter puts forward the same complaint as the basis for a parallel claim in tort. Such cases are usually brought because the plaintiff gains a procedural advantage by formulating his claim in negligence—because he is better off as regards jurisdiction, or measure of damage, or barring by lapse of time, or in some other way. The problems are difficult. They are solved in French law by the doctrine of *non-cumul*, which forbids the existence of a parallel duty in tort. English law seems to be moving in that direction: witness the Privy Council case of *Tai Hing Cotton Mill v Lin Chong Hing Bank*²¹ in 1986, and a very recent decision of the House of Lords in *Scally v Southern Health and Social Services Board*.²² However, the even more recent decision at first instance in *Nitrigin Eireann Teoranta v Inco Alloys Ltd*²³ shows that it has by no means arrived there as yet.

²¹
[1986] AC 80.

²²
[1991] 4 All ER 257.
There are other cases, too numerous to be cited here, but a glimpse of the problem may be obtained from *Midland Bank Trust Co v Hett Stubbs & Kemp* [1979] Ch 384, [1978] 3 All ER 571, Ch D and *Youell v Bland Welch & Co* [1990] 2 Lloyd's Rep 431.

²³
[1992] 1 All ER 854, QBD.

Although the bi-polar situations are interesting and difficult they are of quite limited importance in practice, and pressure of time requires me to leave them aside, pausing only to note a paradox. In *Donoghue*, one problem which faced the majority in the House of Lords in 1931 was how to find a duty of tort when there was no contract between the parties. Sixty years later the problem was seen by the House in *Scally* as finding a duty in tort where there was a contract between the parties. Can both objections be soundly based? Surely not.

The retreat

The remaining cases concern what I call the network situation, where although the parties are not directly linked contractually, one or more contacts are an essential feature of the commercial context. For a time plaintiffs in network situations had a good deal of success throughout the common law world. Too much success, perhaps, and serious alarm quite soon began to develop.

In the first place, it came to be recognised that the readiness of the courts to give effect to these claims had overlooked some facts of economic life. In the carefree days of the 1960's and 1970's, it had appeared that state and corporate defendants had such ample resources that they could sustain almost indefinitely the claims of anyone who had suffered financial hardship as the result of culpable though honest mistakes. This was not so; the money had to come from somewhere. In the case of the state, the funds for satisfying claims had to be found either by reducing the provision of state services, or by increasing taxes: in either event the result was to compensate the injured plaintiff at the expense of his fellow citizens. In the case of commercial or professional defendants the ultimate liability was borne by insurers, who would raise the premiums paid by their assured, who in turn would pass them on to their clients in the shape of increased professional fees. At best, this meant that the courts were engaged in running a kind of slow, costly and erratic mutual insurance scheme, in which all the citizens and commercial bodies insured one another against the economic consequences of negligence. At worst, the cost of the claims would compel insurers to cease writing liability business, and would drive many professional people, either out of their professions altogether, or into less exposed positions within it. The serious social problems presented by the uncontrolled growth of medical malpractice suits are well known. Perhaps less well known, for the moment, is the serious disquiet now being expressed about the health of the accounting profession—a profession whose soundness is essential to the world of finance—in view of the enormous claims faced at the suit of third parties who

have relied on work done by the accountants, work for which they have not themselves paid.

The next cause for concern was the open-ended nature of the liability thrust on the professional by these third-party claims. Visiting us from the past comes the warning given by Chief Justice Cardozo²⁴ against the creation of liability “in an indeterminate amount for an indeterminate time to an indeterminate class”. Visiting us from the past has come the oft-cited hypothetical example of the careless cartographer who omits from a chart a submerged reef, on to which many years later a ship is driven, owned by someone of whom the cartographer has never heard and who indeed may not even have existed at the time when the mistake was made. For two decades and more warnings of this kind were brushed aside as reactionary. Now they have the ring of truth.

Again, the need to remedy the loss suffered by the plaintiff has so filled the screen that the defendant’s interests have been almost completely hidden. The accountant takes on a job. His terms may contain exclusions or limitations on his liability. He prices the job at rates which directly or indirectly reflect his exposure to claims by his employer. But this bears no relation to his exposure to the third party, whose loss from buying a company at an overvalue in reliance on a careless audit is likely to be much greater than the loss suffered by the company itself. Moreover, since the common law does not in general recognise a concept of vicarious immunity in tort, the exclusions and limits for which he contracted will not prevail against the plaintiff. This is unfair to the defendant. Yet if we alter the law so as to make the contractual terms bind the plaintiff, he is treated as a quasi-party to the contract of which he may know nothing.

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Finally, it has come to be realised that although in theory a generalised principle of negligence has the great benefit of being

²⁴ *Ultramares v Touche* 174 NE 441 (1931).

directly applicable to all new problems, in practice those put forward in *Donoghue*, *Hedley Byrne* and *Anns* have needed so much restraint by qualifications of policy rather than logic that their intellectual validity has been fatally compromised.

Another juristic revolution

By the beginning of the present decade the time was ripe for another juristic revolution. The nettle was there to be grasped and in 1990, the House of Lords grasped it in *Caparo Industries v Dickman*²⁵ with a vigour which has disconcerted many commentators. The facts were

simple. The defendants were the auditors of a company, and produced various reports and accounts regarding the company's financial position. In reliance on these, the plaintiffs bought the company's shares in the market. Later, so they alleged, they discovered that the figures were over-optimistic, and they sued the auditors in negligence. On a preliminary issue as to whether the defendants owed a duty of care, the plaintiffs failed in the House of Lords.

In a graphic phrase, Lord Oliver propounded that "to search for any single formula which will serve as a general test of liability is to pursue a will-o'-the-wisp". Since Lord Atkin's good neighbour principle may be regarded as just such a general test, it seems that the beacon which for decades has illuminated even the dimmest of law students has now been extinguished.

I say nothing about the decision itself. The significance of *Caparo* for present purposes is that it marked a crucial new step in the reappraisal of the general principle of liability in negligence. It had two aspects. First, the notion of "voluntary assumption of risk", which had been at the root of the reasoning in *Hedley Byrne*, and which had subsequently enjoyed a considerable vogue, was bluntly

repudiated. Furthermore, to such extent as it had survived earlier judicial assaults, the two-tier process established by *Anns v Merton* of a general presumption of duty flowing from proximity, constrained only on grounds of policy, was firmly extirpated. So indeed was the use of words such as "proximity" to provide any reliable practical

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[1990] 2 WLR 359.

guidance on when a person owes a duty of care. Most strikingly of all was the flight from broad generalisations which were now to be regarded as a source of difficulty

and uncertainty. In a graphic phrase, Lord Oliver propounded that “to search for any single formula which will serve as a general test of liability is to pursue a will-o’-the-wisp”.

Since Lord Atkin’s good neighbour principle may be regarded as just such a general test, it seems that the beacon which for decades has illuminated even the dimmest of law students has now been extinguished.

It seems that the wheel has come full circle. The general theory of the law of negligence has returned to what it was in 1930.

Secondly, there has been substituted an approach already formulated in the High Court of Australia by Mr Justice Brennan²⁶ in words which it is instructive to recall:

It is preferable, in my view, that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a *prima facie* duty of care restrained only by indefinable “considerations” which ought to negative, or to reduce or limit the scope of the duty or the class of persons to whom it is owed.

This minimalist approach, developing the law on a case by case basis, with each move forward anchored in an established category would have been wholly acceptable to the dissenting Lords in *Donoghue*. It seems that the wheel has come full circle. The general theory of the law of negligence has returned to what it was in 1930—subject of course to the very important practical qualification that some, albeit perhaps not many, instances of negligent misstatement are recognised as at least potentially actionable.

We can thus see that in the space of 60 years the courts have successively embraced six mutually inconsistent doctrines in a field of

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Council of the Shire of Sutherland v Heyman (1985) 157 CLR 424.

great theoretical and practical importance, which the outsider would surely assume to be open to a simple and permanent solution.

1. Before 1930—no general duty of care.
2. In *Donoghue v Stevenson*—a general duty defined by the good neighbour principle.
3. After *Donoghue*—a practice which was much narrower than the good neighbour principle.
4. After *Hedley Byrne*—a general duty, narrower than the *Donoghue* duty, and expressed in terms of the voluntary assumption of risk.
5. After *Anns*—a presumption of duty arising from foreseeability, rebutted on occasion by considerations of policy.
6. At the present day—a repudiation of any general duty, and an enlargement of the duty only on a case by case basis.

Now it involves no disloyalty on my part to the legal system in which I have spent my working life, or to past, present and future colleagues, to say that the picture thus painted is not one of unqualified success.

One cannot help being reminded of the troops of Lars Porsenna in Macaulay's poem²⁷ of whom it was said that "... those behind cried 'Forward' and those before cried 'Back'."

This is a thoroughly undesirable situation for several reasons. Most obviously it is embarrassing. In some areas of life, the courts are reproached for making bad law. Here the reproach of the financial community might fairly be that there is no settled law at all. And the courts cannot escape by blaming the legislature, or the European

27
Thomas Babbington
Macaulay, *Lays of Ancient
Rome*, "Horatius".

Community, or anyone else. They have had the field to themselves since liability in negligence emerged from the mists of mediaeval history, yet they have still not been able to stabilise the law.

Furthermore the uncertainty of the law is now posing serious practical problems both to the legal system and those who are drawn into it. Too much precious court time is being spent on massive negligence actions, and on the legal problems which they raise. Too many clients find it hard to settle claims without the means of knowing the extent of their liabilities. The insurers of professional men cannot rate their indemnity policies with any accuracy when the future is so unpredictable.

It is also possible that on a broader economic view even the more restricted scope of liability for third-party claims is too wide. In the United Kingdom the Cadbury Commission on Corporate Governance has recently been receiving submissions from the Institute of Chartered Accountants, emphasising the pressures on auditors, and the risk that they are being ground between the millstones of excessive public expectations and an inability to reduce risks by improving performance.

Now these problems are not peculiar to English law, and I have illustrated them by the English experience only because that is what I know most about. They are I believe endemic in the world of business, and may indeed be inherent in the nature of business itself. How are we to tackle them?

Tackling the future

In posing this question, I must not be understood to stand here this evening with a kit of instructions on how my hosts should organise their law of negligence. That would be discourteous and impertinent. My purpose is not to urge the judicial, legal and business communities of this country to cling to the British decisions, and to distil from them the elixir of a successful law of pure economic loss. Quite the reverse. I

believe that the British authorities are useful for two reasons, and for two alone.

First, because whatever else their deficiencies they do give a tolerably full account of the ways in which third-party claims for pure economic loss might be accommodated within the common law of tort. They furnish a repertory upon which an overseas court might fruitfully draw, without necessarily committing itself to a solution, or to the grounds for arriving at it, which had at some moment of time seemed convincing to the English court.

Secondly, because the history of this topic in the English appellate courts reveals a failure of what I am bound to call methodology, for want of a less ugly word. An overseas legal system can and, I suggest should, profit by the mistakes which have been

The root of the problem is I believe a reluctance on the part of the judges to accept inwardly, and afterwards to acknowledge outwardly, that decisions in this field are essentially concerned with social engineering.

made elsewhere even if, as I suspect, we cannot in England now escape from our self-made impasse without the help of legislation. If some of the finest minds in the history of the common law have run the doctrine into the sand, may the explanation perhaps be that the whole enterprise is misconceived?

The root of the problem is I believe a reluctance on the part of the judges to accept inwardly, and afterwards to acknowledge outwardly, that decisions in this field are essentially concerned with social engineering. Conjoined is a failure to articulate the policies to which the judges have given effect so that later courts can recognise that they are dealing, not with the inexorable logical development of a set of legal premises, such as one finds for example in the law of bills of exchange, but with a refraction through the judge's eyes of a set of contemporary economic and political value-judgments. If this could be made more clear, the judge would liberate his successors from the duty to follow in the new world of finance economic norms forged in the old.

So the first step which should be taken by any system which does not want simply to mimic the failures of the British experience is to recognise that we are here concerned with policy; that is to say with an approach to the moulding of the law which begins with a proposition about what remedies the law ought or ought not to give in a situation of which the case before it is an example. Coupled with this should be a willingness to ask some questions which are simply not there to be asked where the legal system has gone as far down the road as in England. Take as an example *Hedley Byrne*, where the banker giving the reference to the intending lender was held potentially liable to him in negligence. In *Smith v Bush* and *Caparo* that decision was endorsed, yet the rationalisation of a voluntary assumption of liability was repudiated. Are we therefore to consider, as some commentators have suggested, that we must now accept *Hedley Byrne* as rightly decided for the wrong reasons? The common law doctrine of precedent will just about accommodate this proposition, and the House of Lords in recent years has gone far in this field to fix the older cases with a sceptical stare. But it would be a much bolder step to say that the result itself in *Hedley Byrne* was wrong, and that Lord Justice Asquith was right after all to number himself with the timorous souls. Yet this is just the kind of proposition which ought to be examined, even if on examination it proves to be unsound.

So I believe that somebody—and we will consider who, in a moment—ought to be asking some questions, as a start to creating a systematic treatment of economic loss. Here are one or two examples:

1. How should accidental loss be distributed between the doer of the act which caused the loss; the state (which means the taxpayer); insurers (which means payers of premiums); and the victim himself?
2. Does the answer to this question depend on whether the doer was at fault; and if so, why?

3. Should the question whether the victim has an adequate remedy elsewhere—for example by liability insurance, or under a contract—affect his right to recover in tort?
4. Is it (a) in the interests of the community (b) fair that there should be a distinction between damage to property, parasitic economic loss, and pure economic loss, and if so why?
5. If in this field there is a conflict between fairness to the individual, and the general economic and other interests of the community, which should prevail, and how should the line be drawn?
6. In some countries there is no-fault liability for certain types of physical injury. Nobody has ever suggested that similar provision should be made in the case of economic loss. Why is this?
7. Should there be distinctions between types of economic loss: for example between the loss suffered by the ultimate purchaser of an article which later proves defective, and the person who loses through reliance on a defective audit?
8. Should the law on negligent misstatements be broadly aligned with the law on consumer protection, so that the adverse consequences of a careless banker's reference are compensated according to the same principles as the loss flowing from the consumption of a defective foodstuff?
9. Since it is difficult if not impossible to draw any rational line to mark off those consequences of negligent misstatements which are recoverable and those which are not, might it be better to forbid any recovery for negligent misstatement—unless perhaps it causes physical loss?

There are many more questions like this, and although it would be absurd to expect that convincing answers can be found to them all, the simple fact of asking them could be a great benefit: and particularly asking them in advance. The trouble is that they are neither asked nor answered in advance, but only when a conspicuous dispute has already arisen. For tonight, it is enough to say that they are not currently being examined outside the context of individual disputes, and that when they do come to be examined the enquiry is not methodical.

This is partly because the adversarial system is not a good way of examining broad issues of policy, excellent as it is in some other respects. The task of the advocate is to win the client's case; and if this means inducing the court to make some law, the advocate is concerned to make it favourable to his client, irrespective of its social or economic merits. Nor indeed will the advocate or the client necessarily even possess any views on relevant social or economic issues, or any ideas which coincide. Furthermore, even if the advocate wishes to deploy arguments on a more general front, he or she will lack the training to do so, and will not be equipped with the economic data enabling the court to envisage the social consequences of preferring one solution to another. The most one is likely to get from the advocate is a routine reference to "opening the floodgates".

Much the same can be said of the judges. It would be unfair to blame them for giving effect to their own views on policy in situations where the way has not been clearly pointed by prior decisions. After all, in a field which seems to defy logical analysis it is the only method available, and it is the judges who have to use it. Nonetheless, a lifetime spent in the practical application of the law is unlikely to furnish the judge with any but the most imprecise perception of the socioeconomic context in which the problems are being posed. This is not to belittle the willingness of the judges to take the broader implications into account when they can be perceived. Nor is it easy to imagine any panel of one or three or five persons differently selected

who would be more qualified to perform the task. Nevertheless, it is, I believe undeniable that the perspective is too narrow.

One solution, at least in theory, would be to devise a system which would enable the wider issues to be explored in a less intensely adversarial way. The European Court of Justice permits member states to make observations on cases in which they are not directly concerned. Perhaps something on the lines of an American *amicus* brief might be given a trial, although there are obvious practical difficulties. Cases in the world of finance generate large quantities of paper and usually last a long time, even at the appellate level. The prospect of yet more volumes of paper and even longer speeches is not enticing given the great pressures to which the courts are already being subjected. But if the occasions for the use of *amicus* brief, and the manner of use, were both very strictly controlled some good might ensue. This idea would of course have important implications in fields far distant from our subject this evening, and I have detected no signs of such an initiative in the United Kingdom. Nevertheless, the idea should not perhaps be rejected out of hand.

These are questions of practicalities. The methodological problems are not necessarily insuperable, for after all, in some Commonwealth countries, in the United States and in Germany the courts are managing, albeit not without a struggle, to find some less contorted ways of achieving recovery for pure economic loss. Why not take a leaf out of their book? Before answering this question, let me briefly indicate what sort of solutions are in the air.

Some possible solutions

When considering these it is important to distinguish between negligent misstatement and economic loss, since it is possible to have liability for negligent misstatement but not for other forms of economic loss. Or for some form of economic loss, but not for negligent misstatements. So one must choose whether to have one or both or neither; or only in limited circumstances.

This is an essential first step. The choice must be conscious, and made in recognition that it may require deviation from logic.

Let us concentrate for this evening on negligent misstatement, in which I include statements that a job has been carefully done when it has not. In so concentrating, we must always look over our shoulders at the implications which our choices may have for the law relating to economic loss.

Two broad strategies present themselves, which we may call the Victorian and the interventionist. The Victorian calls up the old-fashioned notions of self-reliance and bad luck. The potential victim is expected to do as much as possible to ensure that he does not become an actual victim, and to mitigate the consequences if the worst befalls. Thus, he should be cautious about taking the carefulness of others on trust, and should try to verify what they have done. He should also avail himself to the full benefit of any contractual remedies against third parties—ie, in our illustrations he should enforce rights along the continuous lines. Then, as a long stop, he should try to cover himself by insurance against the consequences.

In effect, therefore, the law should be returned to its state before *Hedley Byrne* and the Misrepresentation Act 1967. Studying the literature, one has the impression that this solution is regarded as unthinkable; so much so that nobody gives it serious thought. But it is not ridiculous. Commercial life was not fatally hindered by the absence of a remedy before the 1960's, when the incentive to alertness had not been masked by the existence of a remedy in tort. Moreover there is real intellectual substance in the distinction between physical and spoken carelessness. In the former, the consequences are frequently thrust upon the victim against his will, as where the motorist runs over the pedestrian. Whereas the person who relies on careless words has chosen to rely on them. To deny the injured party a recovery would not be indefensible intellectually, and it would have the oft-forgotten general economic benefits already mentioned, which might as a matter of social policy be seen to justify the hardship to the individual.

On this view, therefore, one would simply abolish the law of tort, so far as concerned careless misstatements. Attractive as this would be for those who have to administer the law, realism suggests that it is not a practical contemporary option, at least at its most austere extreme. People have become too accustomed to the idea that every injury needs a remedy, and after 35 years, their legal advisers have become too used to this particular kind of recovery, for a return to the old regime to be feasible.

Thus, one must accept that at least to some degree, potential victims cannot be left to their own devices, and that an interventionist strategy must have a part to play, even if combined with constraints on the availability of remedies for pure economic loss. Such strategies, which could be cumulative, might take a number of forms, particularly intervention by the state, by professional bodies, and by the courts, through the development of non-tortious remedies.

Interventionist

Intervention by the state could aim to forestall losses or to compensate victims, or both. The installation of statutory disciplinary measures in the case of bad work by professionals—and that is the source of economic loss with which the business world is most concerned—would do something to raise standards and make losses less likely. But it is expensive to run, and would not help the victim whose adviser has been, notwithstanding his exposure to sanctions, either incompetent in the general, or slipshod in the particular.

Another possibility would be to have a state-run scheme for assuring the victim of compensation. This could operate through a statutory right of action, which would make the existing tortious remedies redundant. It would have the attraction that policy-making would be left in the hands of those who have the time, capabilities and breadth of perspective to devise a workable framework in a way which the courts cannot. But the difficulties of arriving at a formulation which is sufficiently precise to avoid precisely those uncertainties,

oscillations and false starts which have characterised development via the common law, and yet sufficiently flexible to cope with new situations, are formidable indeed. Unless the task is performed with great imagination and skill the courts charged with the administration of the new remedies might find themselves trapped in a regime which is neither practical nor susceptible of change, thus making the position worse, not better.

As an alternative to, or as a reinforcement of, direct state intervention, there could be a strengthening of internal controls, through the medium of either state-sponsored self-regulatory organisations (such as those now installed in the United Kingdom under the Financial Services Act 1986) or through autonomous professional institutions. In whichever shape these could have some general impact in raising standards of competence by weeding out the useless, and a disciplinary function could be made an example of the careless remind the profession from time to time that carefulness is called for. This would do some good, but not, I suspect, very much. Ideally, it could be reinforced by a self-regulatory safety net, guaranteeing to those who have suffered from third-party professional negligence financial compensation for their losses. Admirable as this would be in theory, current experience of these schemes is not encouraging. Claims happen comparatively infrequently, but are very large when they do happen. Unless an arbitrary upper limit was introduced, which largely defeats the purpose of the scheme, the cost to the individual professionals of financing the compensation fund is likely to be more than they are willing, and indeed able, to bear.

Finally, the courts might yet again try to devise a new and more satisfactory solution of their own. This is not an option which holds out much promise in the United Kingdom, for however cosmopolitan the court may wish to be in its receptiveness to foreign solutions it is probably locked by now too firmly into its own precedents to make much progress except (if the expression may be forgiven) at a snail's pace. Statutory intervention may well be the only way of breaking the

log jam, and the record of Parliament in the field of civil law reform is most discouraging.

Consumer protection

Other systems, not so irrevocably in the grip of binding precedents may, however, be better placed, and I therefore offer a few concluding thoughts on how the problem might there be tackled. First of all, the court could dust down *Donoghue* and give it new life, not as a source of general learning on negligence, but as the foundation for a modern law of consumer protection. The auditor's or surveyor's report could be treated simply as a product, with rules relating to damage caused to third parties by products put into circulation transferred directly from *Donoghue*. The report would thus be regarded as directly analogous to a ginger beer bottle. This idea has many attractions, conspicuous amongst them are its economy of intellectual effort, and the fact that it builds upon an area of law which already works quite well in practice.

The problem is that there is one vital difference between the two categories. The ginger beer is intended for one, or at the most two, consumers; so that whereas the population of potential claimants is very large the number of potential claimants per bottle is self-limiting. There are no endless vistas of multiple liability. This is not generally true as regards negligent misstatements. Certainly there can be situations where only one potential claimant exists. *Hedley Byrne* itself was an example, for the bank reference was invited by and directed to the suppliers alone. But there are other documents which are either addressed to the world at large (such as the marine chart) or to a large class of persons whose identity may be unknown and perhaps not yet even determined (for example potential investors in a company). So here again we have the floodgates fear, and the courts will I believe be driven by it into just the same sort of morass as has engulfed them when trying to work through the medium of more general formulations of the duty of care.

Expanded law of contract

A quite different solution would be to develop a new remedy by expanding the law of contract. The German courts have been impelled to this approach by the unsatisfactory features of the Civil Code regarding vicarious liability, and the American courts have been allowed to experiment with it more freely, albeit not very consistently, by their more relaxed approach to the doctrine of consideration. The intellectual structures of the contractual approach are complex and difficult.²⁸ For present purposes, I need only say that they employ two related concepts. First the proposition that a contract provides an “umbrella of protection” to those whom it was to protect, and second the concept of “transferred loss”, which enables the party who is the beneficiary of a promise and the party who has suffered loss from a breach of the promise to be treated as if they were the same person.

These ideas, worthy of close study as they are, are liable to encounter formidable obstacles if presented to the English court—and there is nothing in the reports to suggest that the arguments have been cosmopolitan enough or bold enough even to put them in play. The fact, if it is a fact, that in England the law is inching towards a doctrine of *non-cumul*, whereby as between immediate contracting parties their contract prevails over any liability in tort and the fact, if it is a fact, that in certain very limited situations the contracting party is entitled to recover for losses suffered by another; these are exceptional cases. I find it rather hard to see, in the light of the approach adopted in *Donoghue* how the existence of a contract as part of the factual background could be a help rather than a hindrance, especially as no court, so far as I am aware, has tackled the question of deciding how in triangular situations, the obligor is bound by the terms of his own contract (to which the obligee is not a party), or of the obligee’s contract, to which he, the obligor, has never engaged himself. These are however questions into which English law has locked itself, by decided authority, and which courts in Malaysia should feel free to address anew, in the light of fresh ideas coming from Germany, the United States, and other jurisdictions whose work I have had no opportunity to explore.

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A most valuable introduction to these developments, with particular reference to the law of Germany and the USA, is contained in “An Expanding Tort Law — The Price of a Rigid Contract Law”, BS Markesinis (1987) 103 LQR 354.

So far, so reasonably good. By no means so easy however are the practical implications of this new approach. It is true that it would be made to work in the simple triangular situations illustrated in Appendix II, Group G. But how is it to deal with the type of network relationships which generate the really big claims? If we look at Group F, Figure 14, I cannot see any way in which the contracts along the continuous lines could be diverted or expanded so as to create enforceable non-delictual rights along the dotted lines. Nor does this

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doctrine explain what happens when the contracts in the net are on different terms. Is the plaintiff's contract to prevail, or the defendant's? Or should neither set of terms be applicable? If the latter, what is the justification for treating this as a contractual solution at all?

Conclusion

To sum up: All the possibilities which I have briefly discussed are open to serious objection. It is true that the idea of simply abolishing the cause of action

for negligent misstatement, on the ground that it now imposes on the professional men potential liabilities of a size which is simply too great, and which are too erratic in their incidence for them or their liability insurers to sustain, is by no means absurd. But a return to the plainest form of self-help would be psychologically hard to promote, now that we have decades behind us when injured persons have learned to expect to be compensated somehow, by someone, for any form of mishap.

If one looks at the prophylactic methods for dealing with negligent misstatements by forestalling them we must acknowledge that they provide at best only a partial answer. Educative measures, if vigorously pursued, will raise the general level of competence, and certification will filter out the hopeless.

Perhaps the existence of disciplinary powers will promote improved performance, although I suspect that very often the reaction of the professional world at large will simply be relief that the lightning has struck elsewhere.

In truth, we must recognise that every professional man, however generally competent and however conscientious, knows that he must fall victim to error from time to time, and can do no more than hope that the consequences will be slight. No system of training and certification can prevent the occasional disaster.

Should the consequences of such disasters therefore be remedied by the professions at large, or perhaps by the state? The history of professional compensation funds—such as the fund which provides a remedy for defalcations by solicitors—has not been happy. The really large claims tend to stem from activities of large and wealthy firms, and the smaller, less well-endowed practitioners keenly resent the large contributions which they have to make for the purpose of keeping the compensation fund afloat. One possibility is to impose a statutory limit of liability, which for centuries has been found necessary to protect the shipowning industry from extinction. But I am unable to see on what basis a limit could be fixed, given the wide varieties of size and type which claims for negligent misstatement may assume.

As for a state-funded compensatory scheme, it hardly seems a political possibility, at a time when such schemes are absent from fields where the social needs are so much more obviously pressing.

If one turns to remedial methods, the creation of a statutory cause of action, regulating the victim's claim against the careless party, has real attractions. It would liberate the courts at a stroke from the need to live with obsolete and possibly conflicting precedents, and would leave room for a proper exploration and balancing of the complex social, economic and ethical factors which it is beyond the compass of the courts to achieve. Still, the legislature has to be

persuaded to find the time and energy which the task would require; and there is the technical difficulty of drafting a definition of liability in terms sufficiently precise to avoid the generation of a body of court decisions just as numerous and unsatisfactory as those the statute is intended to replace. Most importantly, there is a risk that a statutory formulation would trap the business community into a static legal relationship at a time when the world of commerce is rapidly on the move.

Finally, the evolution by the courts of an entirely fresh juristic approach will be less straightforward than some commentators appear to believe. For the moment I cannot see how these can work in any but the simplest triangular situations. In the large scale networks, the contracts are so numerous and so widely dispersed that there seems no reason to prefer one rather than another as the foundation of the injured party's derivative contractual rights. Indeed if one looks at the much simpler chain that we find in *Donoghue v Stevenson* the notions of the contractual umbrella and transferred loss do not seem to work, since the plaintiff there had no contract at all, and her friend's contract was not with the manufacturers but with the cafe proprietor.

If this all sounds rather pessimistic that is not my intention. I desire only to assure the business community that the conspicuous failure of the courts to produce a solution which is found convincing even by the courts themselves is not due to any want of effort, for there are many obstacles in the way. What the current state of the law does demonstrate is to my mind that if a solution is to be found in my host country—and events will quite soon demand a solution—it is unlikely to emerge from a conscientious study of reported cases in the UK, US, Australia and elsewhere with the aim of extracting the essence of the former learning so as to apply it to the conditions now prevailing on the other side of the globe. As even a glance at the literature will show this effort is likely to be fruitless.

Rather, I suggest that the opportunity should be taken to attack the problem entirely afresh from a different angle, on two fronts. First,

by a general appreciation of the social, economic, cultural and—very importantly—ethical context which a law of negligence should reflect. In other words, the question should be asked and answered: What kind of law of negligence is appropriate to our culture, in our situation, in our times? Is it to be centred on self-reliance, or welfare, or mutuality, or something else?

The second stage is to identify the individual interests of those concerned so that within the general conception of the law these interests may be balanced in the fair and practical way

This is a formidable task, possibly capable of achievement only on a regional rather than a national basis. How it could be performed I am not qualified to say but I am sure of this, that an essential step must be to develop data and to consult those whose interests are at risk. Economists, sociologists and other intellectuals should talk to practical men and women, to bankers, investors, financiers, entrepreneurs, accountants, engineers, valuers, insurers and the like to discover what they want and need, and what the practical consequences of various legal policies in the field of professional negligence might be.

It might well transpire that such a symposium would produce no immediate result, in the sense of a consensus about what the law ought to be. But it would create an armoury of ideas, a store of reliable, as distinct from anecdotal or intuitive or ill-informed, notions upon which the law-makers can draw when they are called upon to lay down principles and to apply them in practice.

Such an effort would be quite new. Nothing of this kind has been attempted in any legal system of which I have knowledge. Is it not nevertheless worth the attempt?

At the conclusion of his Third Sultan Azlan Shah Lecture Lord Oliver of Aylmerton offered the following words, written in the year 1602,²⁹ as an aphorism to be borne in mind in the administration of the law today:

A change in things advisedly established (no evident necessity requiring it) has resulted in inconveniences many more and greater than the evils that were intended to be remedied by such changes.

In response I will end with some words written not long after 1602 by that great essayist and Lord Chancellor, Francis Bacon, which may perhaps speak more directly to the needs of today:

He that will not apply new remedies must expect new evils; for time is the greatest innovator.³⁰

Eight hundred years after Henry Plantagenet, the common law lives on. In this time of innovation it must look forward with imagination and resource.

It is my hope and expectation that the new countries will harness the ancient strength of the common law to subdue the new evils with new remedies. 

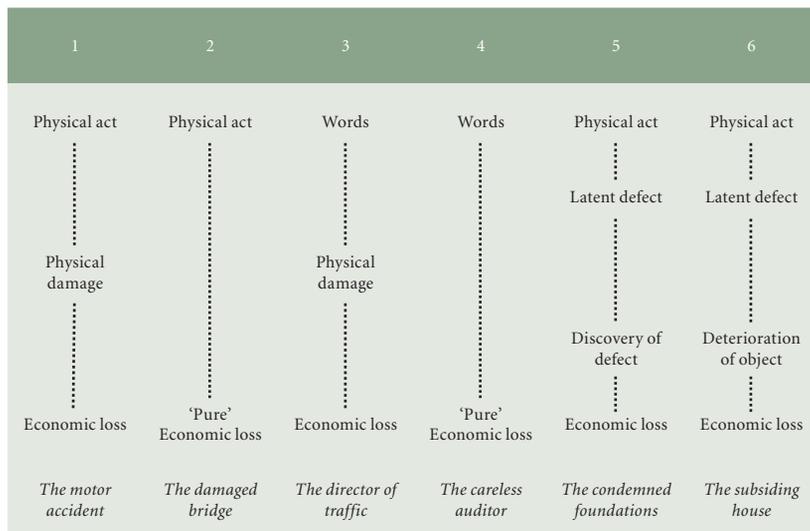
Editor's note

The decision of the House of Lords in *Anns v Merton Borough Council* [1978] AC 728; [1977] 2 All ER 492, was overruled by the House of Lords in the subsequent case of *Murphy v Brentwood District Council* [1991] 1 AC 398; [1990] 2 All ER 908, HL. See also the opinion of Lord Oliver in *Murphy*.

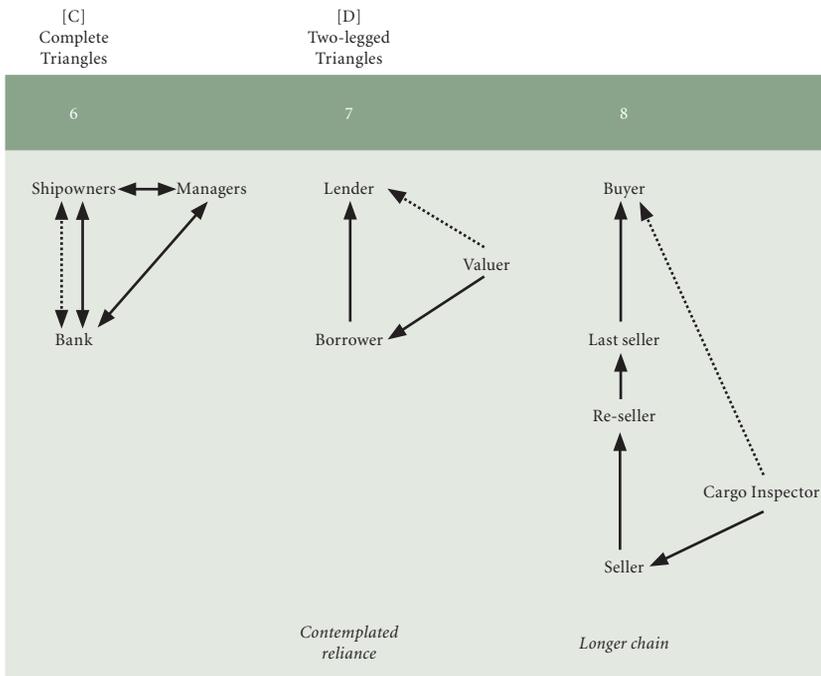
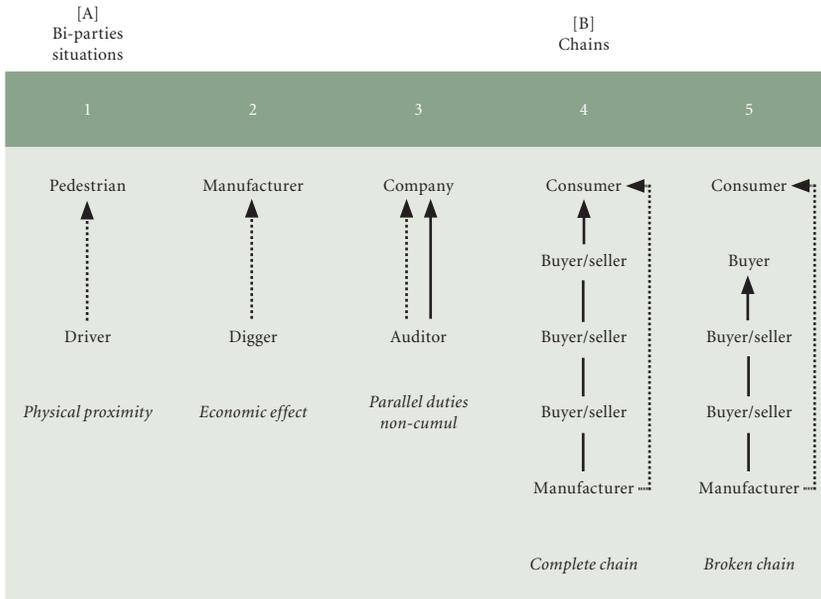
For a more detailed critique of *Anns v Merton Borough Council*, see *Judicial Legislation: Retreat from Anns* by Lord Oliver, chapter 3, above.

³⁰ *Of Innovations* (1625).

Appendix I: Causes of Loss

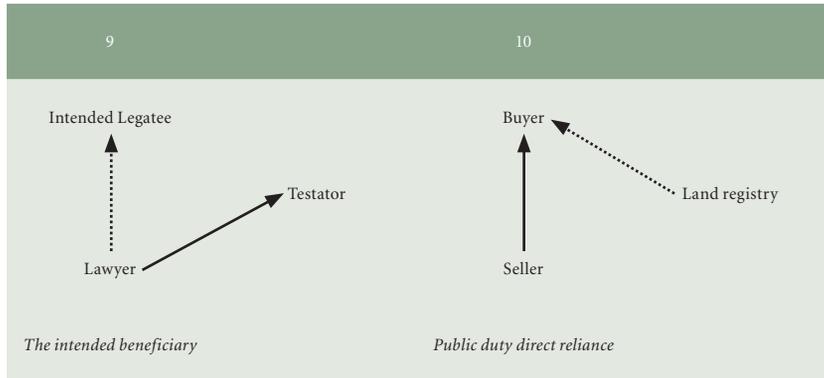


Appendix II

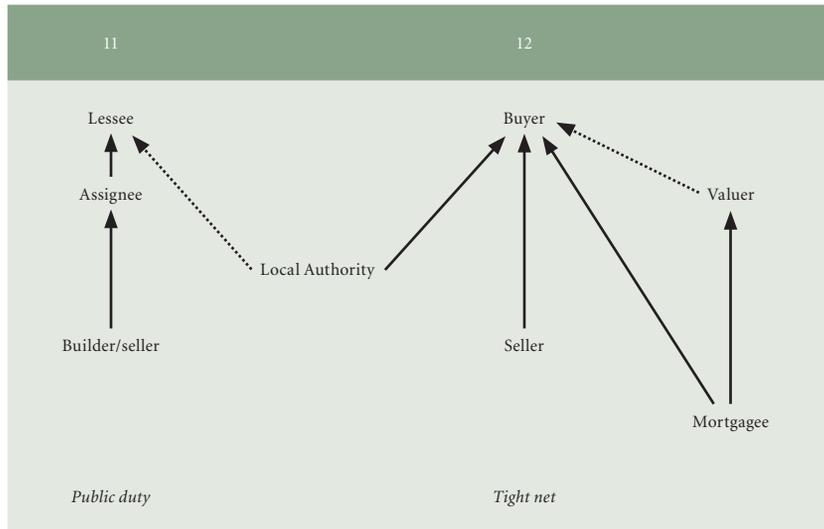


Appendix II (continued)

[E]
One-legged Triangles

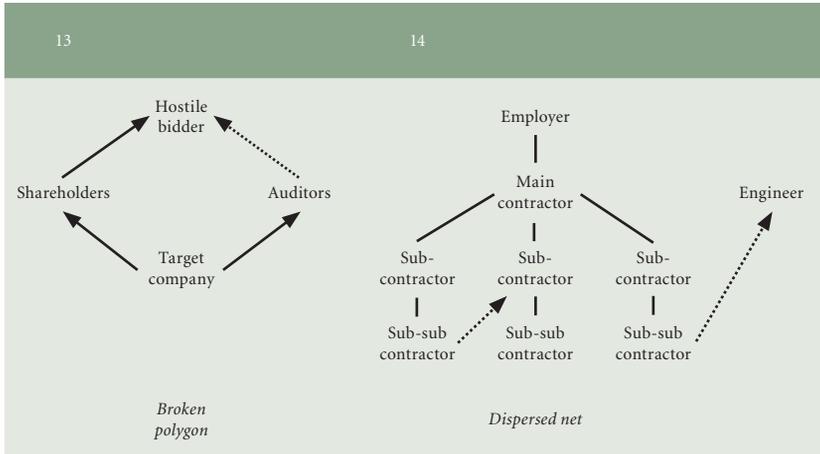


[F]
Nets



Appendix II (continued)

[F]
Nets
(continued)



[G]
Transferred rights

