NEGLIGENCE AFTER

MURPHY v

BRENTWOOD DC

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FOREWORD

The Hon Mr Justice Robertson
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For more than two decades, the Legal Research Foundation has endeavoured to provide a forum for authoritative consideration of the existing law and an opportunity for a reasoned assessment of future directions.

A divergence in recent years has developed between the approach of New Zealand and English Courts to the existence of a common law remedy against builders, manufacturers and local authorities.

Although the focal point of this seminar is the recent decision of the House of Lords in Murphy v Brentwood District Council [1990] 3 WLR 414, which overruled Anns v The London Borough of Merton [1978] AC 728, there are wider and more fundamental issues. Not least are the validity of the perpetuation of labels such as contract and tort (with the dangers of the real issues thereby being obscured); the importance of policy considerations in the determination of liability for pure economic loss attributable to defects in manufacture or construction; and the extent to which these issues are for the Courts or for Parliament.

The Foundation has been fortunate in persuading a group of eminent academics to consider these and related issues and to have the benefit of the views of the President of the Court of Appeal of New Zealand whose influence in this (as in so many other areas) cannot be minimised.

This record of the formal presentations will be an invaluable aid to members of the legal community in this country (and further afield).

Judges’ Chambers
High Court
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THE LAW OF NEGLIGENCE IN NEW ZEALAND
AFTER MURPHY

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Introduction

Everyone interested in the development of the law of torts in New Zealand is well aware that in recent years there has been a widening divergence between the attitude of the courts in England on the one hand and in New Zealand on the other regarding the approach to be taken towards the resolution of the duty issue in negligence cases. Faced with a situation not precisely covered by existing authority the English courts have tended towards caution and to deny recognition of any novel duty of care. The New Zealand courts, by contrast, have been readier to allow the law of negligence to expand into new fields. They have not been deflected from their path by the plea that there is no precedent for imposing a duty in the particular circumstances. A clear example of this divergence, although not by any means the only one, is found in the cases concerning the ambit of liability of a builder or local authority for negligence in putting up or inspecting a defective building. It has been apparent for some time that the House of Lords had come to regret its decisions in Anns v London Borough of Merton and Junior Books Ltd v Veitchi Co Ltd, imposing duties on the local authority and builder respectively to take care to protect subsequent owners of the building from incurring loss through buying or paying for work on the building. In a series of decisions, to be examined in more detail shortly, the ambit of Anns was progressively cut back and Junior Books was marginalised as a case decided on its own very special facts. Now, in Murphy v Brentwood District Council, Anns has been overruled. In New Zealand, on the other hand, the Court of Appeal, after showing the way in Bowen v Paramount Builders (Hamilton) Ltd, has since embraced the result, if not all of the reasoning, in Anns. The Supreme Court of Canada has been no less enthusiastic. Anns has indeed been recognised as a pivotal case.

In these interesting circumstances our task today is to examine Murphy’s case and to assess its likely impact upon the development of the law in this country.

The decision in Anns was difficult and complex. In deciding whether, or the extent to which, it may retain importance we need to look carefully at what Murphy says about the various strands to its reasoning. In particular, we need to disentangle and consider separately four issues.

1. How, in principle, should we analyse duty issues in negligence? Might Lord Wilberforce’s two-stage test in Anns still be used as an aid in the duty enquiry?

2. What does Murphy decide about the recovery in negligence of pure financial loss? The answer to this question will lie at the heart of our discussion.
3. What are the implications of *Murphy* as regards a claim that a local authority is liable for *failing to act* - for a mere omission to help another?

4. How does *Murphy* leave the law as regards other issues bearing upon the negligence liability of public bodies?

These are all fundamental questions about the nature and scope of liability in negligence at common law.

Of course, *Murphy* being a decision of the House of Lords, it does not bind the New Zealand courts. While there remains the right of appeal to the Judicial Committee of the Privy Council, however, probably the Court of Appeal will not have the final say on the matter. As for the attitude of the Privy Council itself, the principle laid down in *de Lasala v de Lasala*, a case on appeal from the Court of Appeal of Hong Kong, presumably would be applied. In that case Lord Diplock, after observing that the Judicial Committee shares with the Appellate Committee of the House of Lords a common membership, said that the Judicial Committee is unlikely to diverge from a decision which its members have reached in their alternative capacity, unless the decision is in a field of law in which the circumstances of the colony or its inhabitants make it inappropriate that the common law in that field should have developed on the same lines in Hong Kong as in England. Whether there might be differing local circumstances in New Zealand will be considered below.

The Nature of the Duty Enquiry

In *Anns* Lord Wilberforce sought to explain how Lord Atkin’s neighbour principle in *Donoghue v Stevenson* can be understood as being of general application. Lord Wilberforce said, in words so familiar that they hardly bear repeating, that the question has to be approached in two stages. First, one has to ask whether as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter, in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.

At first it seemed that the *Anns* two-stage test would become the commonly accepted means for analysing all questions of duty. It was quickly accepted on a number of occasions in the New Zealand Court of Appeal, and later by the Supreme Court of Canada. It was regularly invoked by courts of first instance in common law countries. It was not long, however, before the House of Lords itself began to signal its doubts. The retreat started in *Governors of the Peabody Donation Fund v Sir Lindsay Parkinson &*
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Co Ltd\(^7\) where Lord Keith cautioned against treating Lord Wilberforce’s words as being of a definitive character and instead thought it appropriate to ask simply whether it was “just and reasonable” to impose a duty. Since then, in a series of decisions\(^18\) culminating in Caparo Industries Plc v Dickman,\(^19\) both the House of Lords and the Privy Council have levelled a sustained barrage of criticism at the Anns approach. In Caparo Lord Bridge reviewed these decisions, observing that they emphasised the inability of any single general principle to provide a practical test which can be applied to every situation to determine whether a duty of care is owed and, if so, what is its scope. His Lordship said that whether the courts will recognise a duty of care in any particular case depends on the foreseeability of the harm, the proximity of the relationship between the parties and, generally, considerations of fairness and reasonableness. These concepts of fairness and reasonableness are not, he noted, susceptible of such precise definition as would be necessary to give them utility as practical tests but amount in effect to little more than convenient labels to attach to the features of different specific situations which, on a detailed examination of all the circumstances, the law recognises pragmatically as giving rise to a duty of care of given scope. His Lordship proceeded to quote with approval the words of Brennan J in Sutherland Shire Council v Heyman,\(^20\) 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 stage two considerations.

Caparo perhaps marks the final rejection in England of the Anns approach to duty questions. Murphy does not say anything different about it. Lord Keith\(^21\) and Lord Oliver\(^22\) similarly reviewed the earlier decisions, several of them containing Lord Keith’s own judgments, and expressed a like conclusion.

Despite the criticism in England and Australia, the New Zealand courts so far, in cases prior to Murphy, have seen Anns as having a role to play in the development of New Zealand law. In Brown v Heathcote County Council\(^23\) Cooke P, delivering the judgment of the court, said that without necessarily subscribing to everything said by Lord Wilberforce in his well-known opinion in Anns, they had found it helpful to think in a broad way along the lines of his two-fold approach. His Honour expressed the question at the first stage as being whether the degree of proximity and foreseeability of harm was strong enough to point prima facie to a duty of care and at the second as whether there were other particular factors pointing against a duty. This kind of analysis was helpful in determining whether, in terms of Lord Keith’s analysis in Peabody, it is just and reasonable that a duty of care of a particular scope was incumbent upon the defendant. More recently, in Williams v Attorney-General,\(^24\) three of the five members of the court - Richardson, Casey and Bisson JJ - once more applied Anns, or Cooke P’s restatement of it in Brown. Cooke P himself asked simply whether it was “just and reasonable” to recognise a duty. The question for consideration now is whether it would be sensible for the courts here to continue to use the two-stage approach, notwithstanding that Anns itself has been overruled. Certainly the analysis of the duty question in Anns can stand independently of the actual decision in the case.

How far the criticisms of the Anns approach are justified depends to some extent on how
Lord Wilberforce’s words should be understood. One interpretation is that at stage one of the enquiry the sufficiency of proximity should be tested simply by the reasonable foreseeability of harm. This view has support from Woodhouse J in Takaro Properties Ltd v Rowling and possibly it is implicit in the earlier decisions of the Court of Appeal. As a matter of history, however, a duty has never been presumed in this way. There are, of course, various categories of case where loss is foreseeable yet no duty at all or only a very limited duty has ever been seen to arise. In addition, to presume a duty wherever harm is foreseeable and thereby to put the onus on the defendant to adduce good reasons in rebuttal can be seen as unjustifiably burdensome for the defendant and as productive of much uncertainty. However, the picture changes if the stage one issue is recognised as being concerned not only with questions of foreseeability but also with wider issues. In Yuen Kun Yeu v Attorney-General of Hong Kong Lord Keith said the expression “proximity or neighbourhood” was intended to be a composite one, importing the whole concept of necessary relationship between plaintiff and defendant which gives rise to the duty. His Lordship reiterated the point in Murphy. The same view has been taken in the recent New Zealand cases. Somers J in Takaro Properties took this as the true meaning of Anns and Cooke P’s judgment in Brown also is consistent with this approach. Any doubt about the matter has been removed by the decision of the Court of Appeal in Downsview Nominees Ltd v First City Corporation Ltd. Richardson J, delivering the judgment of the court, said that the degree of proximity or neighbourhood between the alleged wrongdoer and the person who has suffered damage is not a simple question of foreseeability of harm as between the parties, and involves the degree of analogy with cases in which duties are already established.

On this analysis it is difficult to understand what the House of Lords and the Privy Council see as being wrong with the Anns approach. Far from leading, in Brennan J’s words, to a “massive extension of a prima facie duty of care”, it is entirely consistent with Lord Bridge’s re-affirmation in Caparo of the importance of the traditional categorisation of distinct and recognisable situations as guides to the existence, the scope and the limits of the varied duties of care which the law imposes. Before any prima facie duty arises the relationship between the parties must be sufficiently proximate in accordance with the needs of the particular case, including considerations of certainty and the avoidance of indeterminate liability, and in the light of previous authority. Indeed the test in Anns in its terms is phrased more restrictively than the approach propounded by its detractors, for even after stage one has been satisfied the further limiting considerations contemplated in stage two must then be brought into account. Admittedly a stage two issue will not, it seems, arise very often. In Yuen Kun Yeu’s case Lord Keith said that the enquiry can arise only in a limited category of case where, notwithstanding that a case of negligence is made out on a proximity basis, public policy requires that there should be no liability. His Lordship identified the immunity of a barrister for negligence in the conduct of proceedings in court as one of these “rare” cases.

The stage two question does seem to fulfill a useful function. Normally it is, of course, incumbent upon the plaintiff to prove the existence of a relationship with the defendant such that a duty of care in law is seen to arise. The stage two issue is reserved for the case where the plaintiff proves the existence of a prima facie duty and the defendant, the onus
being on him, then seeks to establish a limiting or negativing factor. It operates like a
defence to a tort liability. Thus, to take Lord Keith's example, in a claim against a barrister
the plaintiff must establish the existence of a proximate relationship such that a duty can,
in principle, arise, in which case the defendant must show that the alleged negligence
occurred in the conduct of proceedings in court or, applying McCarthy P's test in Rees
v Sinclair, was closely and intimately connected with the conduct of the proceedings.
Again, in cases concerning local authorities, our primary concern today, it is up to the
defendant to prove, if he can, that the conduct of the authority did not involve merely
"operational" negligence but was founded upon considerations of policy or discretion
such as to negate an otherwise existing duty. We shall return to this point later on.

I think the real objection to the Anns approach is that it is expressed in a potentially
misleading way. It does not recognise explicitly that policy considerations may be highly
relevant at the first stage of the enquiry, but on the contrary might suggest to the
uninitiated that they are only brought into account at stage two. Richardson J in Downsview
has drawn attention to this misconception, but the language used in Anns nonetheless remains a potential source of misunderstanding. Certainly if the New
Zealand courts are to continue to make use of a two-stage approach - and as already in-
dicated there is merit in so doing - it might be best no longer to refer to Anns but explicitly
to reformulate the test (as opposed simply to interpreting it), so as to affirm (i) that foreseeability, proximity, fairness and reasonableness are all relevant at the first stage,
and (ii) that the second stage is reserved for the case where the defendant can point to a
consideration of policy which limits or negates a duty which would otherwise arise out of
the particular relationship between the parties. The judgments in Brown and Downsview have already gone most of the way, but a further word perhaps would be
desirable in the light of Anns' demise.

Possibly this whole question has been given more attention than it really merits. There
is a danger that undue concentration on matters of abstract analysis will obscure the
essential truth, that in deciding whether a duty will be recognised in novel circumstances
a judge is guided ultimately by his or her perception of the governing considerations of
policy. In the light of the debate which it has engendered, however, a discussion of this
aspect of the Anns decision seemed to be worthwhile.

Financial Loss

At this stage of our discussion we are not concerned with the liability of a local authority
or builder for physical injury or physical damage to separate property caused by faulty
work of construction or repair. Our interest is in the negligence, or any other, liability of
the authority or builder in respect of the economic cost of repairing or replacing the
property actually containing the defect. It must immediately be recognised that the courts
have not always found it easy to make the distinction. On the one hand the owner has
acquired already defective property and has suffered an economic loss in having paid too
much for it. On the other hand the defect may have caused or threatened physical harm
to the person or to the property itself and for this reason the claim for repair might be
treated as, or as analogous to, one for physical damage. As will be explained, the former
is now recognised as being the correct analysis, irrespective of whether physical harm is
caused or threatened. As for whether the loss is recoverable, we need to look at the divergent approaches to this issue in England and New Zealand prior to Murphy, to examine the actual decision in Murphy and to evaluate that decision. After that we shall consider briefly some options for reform.

**Background to Murphy**

The decision that initiated the whole recent line of authority is that of the English Court of Appeal in *Dutton v Bognor Regis U.D.C.* 30 Here a local authority was held liable to the owner of a house which had subsided after being built on a filled-in rubbish dump. The damage was treated simply as being physical. Five years later the decision, although not the reasoning, was affirmed by the House of Lords in *Anns*’ case. It was held that a local authority owed a duty to owners or occupiers who might suffer injury to health caused by defective foundations. Lord Wilberforce thought that the damage sustained by the plaintiff was “material, physical damage”. What was recoverable was the amount of expenditure necessary to restore the dwelling to a condition in which there was no longer a present or imminent danger to the health or safety of persons occupying and possibly expenses arising from necessary displacement. 31 Then in the *Junior Books* case the House of Lords seemingly went further, allowing recovery against a builder where there was no risk of injury to health or to other property. The plaintiff owners had engaged contractors to build a factory. The flooring work was sub-contracted by the main contractors to Veitchi Ltd. The work allegedly was done badly, so that the floor cracked and needed to be replaced. The owners sued Veitchi in negligence and succeeded. Although the defect had caused physical harm to the floor itself the claim was recognised as being for a financial loss. It was recoverable because of the close proximity between the parties. The relevant factors were summarised by Lord Roskill. 33 He thought it was of crucial importance that Veitchi Ltd were nominated sub-contractors, specialists in flooring, who were alone responsible for the composition and construction of the floor. Junior Books had relied on Veitchi’s skills and experience and Veitchi must have known this. The relationship between them was as close as it could be short of actual privity of contract.

The New Zealand courts were also showing that they were ready to embrace the head of liability first introduced in *Dutton*. In *Bowen’s* case, decided just before, and cited in, *Anns*, the Court of Appeal held that a builder who put up a house on inadequate foundations owed a duty of care to a subsequent purchaser of the building. Liability was founded on the builder having negligently created a hidden defect which was a source of danger to persons whom he could reasonably foresee were likely to suffer damage in the form of personal injuries or damage to property. The claim was seen simply as being for physical damage to the structure of the house. Richmond P thought that the cost of repairs actually incurred to prevent threatened damage was recoverable, whereas Woodhouse and Cooke JJ both thought the cost was recoverable whether or not the work had actually been carried out. 34 It was also made clear, by Richmond P and Woodhouse J, that the nature of the builder’s contractual obligations could not set a limit to the duty of care owed to third parties, although they could be relevant in determining whether the builder had been negligent. 35

In subsequent decisions the Court of Appeal moved away from the *Bowen* analysis. In
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*Mount Albert Borough Council v Johnson*[^36] a building developer erecting a block of flats on land known to have been filled was held liable to a subsequent purchaser of one of the flats for failing to take the foundations down to solid bottom. The court regarded *Bowen* as having decided that an owner of defective property can recover in tort for financial loss caused by negligence, at least where the loss was associated with physical damage. Furthermore, the developer owed a “non-delegable duty” to ensure that the building work was properly performed and could not avoid liability by engaging apparently competent independent contractors. Next, in *Brown v Heathcote County Council*[^37] the court held that the Christchurch Drainage Board, having failed to warn a local authority considering an application for a building permit that the land the subject of the application was susceptible to flooding, was liable to the applicants who went ahead and built a house on the land. In the Court of Appeal the Board’s duty was founded on the “marked and distinctive proximity” between the parties. Proof of a danger to health was not required. In the Privy Council the Board was held to have assumed a duty, because it had in the past habitually given the information without having been asked. Liability was, therefore, founded on an implied representation that there was no danger of flooding. Thirdly, in *Stieller v Porirua City Council*[^38] the defendant council had exercised its statutory power to inspect the plaintiff’s house during construction, before the plaintiff bought it, and had failed to notice that the stormwater drains were not connected to any outlet or that the weatherboards were of inferior quality. Once more the court imposed a duty, maintaining that the construction of houses with good materials and in a workmanlike manner was a matter within the council’s control. As in *Brown*, the council’s obligations were not confined to defects affecting public health and safety (although it was thought that in an extreme case the defects could in any event qualify on that basis), nor to defects damaging or threatening to damage other parts of the structure. It was enough that they reduced the value of the premises. The court awarded in addition substantial damages for the distress and inconvenience caused to the owners by their problems with the house. Lastly there is *Askin v Knox*,[^39] where a houseowner’s claim against a builder and local authority failed on the grounds that negligence on the part of either defendant had not been proved. Cooke P, in the course of delivering the judgment of the court, observed that negligence liability had been a difficult and in some respects a controversial development in the building control field, but in the view of the court a necessary one.

While all this was happening in New Zealand the English courts were having second thoughts. *Junior Books* marks the outer limits of liability which they were ever prepared to countenance. Since then there has been a total retreat. The first step back came in the judgment of Lord Keith in *Governors of the Peabody Donation Fund v Sir Lindsay Parkinson & Co Ltd.*[^40] His Lordship had difficulty in seeing how, having regard to the scope of the duty recognised in *Anns*, a non-resident owner could fall within it, as he would not be subject to any possible injury to health. *Anns* should, he thought, be restricted solely to claims by owner/occupiers. Then in *Muirhead v Industrial Tank Specialities Ltd*[^41] the Court of Appeal refused to apply the proximity principle in the case of a defective chattel. The relationship between manufacturer and owner was, it was thought, far less proximate than that between builder and owner. In two subsequent cases the Court of Appeal went further. In *Simaan General Contracting Co v Pilkington Glass Ltd (No 2)*[^42] glass panels supplied by the manufacturer to a building sub-contractor proved...
not to be in accordance with the specifications, as a consequence of which the owner withheld payment to the main contractors until the panels were replaced. The court decided that the main contractors could not bring a tort action against the suppliers, for two main reasons. First, the defendants had not voluntarily assumed direct responsibility to the plaintiffs for the quality of the glass. Secondly, a remedy could be pursued down the contractual chain, ending up with a contractual claim against the suppliers. To allow a direct claim would, it was thought, give rise to formidable difficulties. The claim would need somehow to be reconciled with other quite separate claims which might also be made, both by the owner in tort and by the sub-contractor in contract. It would also have to be determined how far the terms and conditions in the supplier’s contract should affect non-parties. If the terms circumscribed the duty otherwise owed it would be unfair to the non-party, but if the duty was unaffected by them it would be unfair to the suppliers and would make a mockery of contractual negotiation. In *Greater Nottingham Co-operative Society Ltd v Cementation Piling and Foundations Ltd* the Court of Appeal held that any duty of care owed by sub-contractors to the owners of a building was negated by the existence of a collateral contract between the parties, notwithstanding that the contract rendered their relationship in a sense *more* proximate than in *Junior Books*. The parties had, and took, the opportunity to define their relationship by means of a contract: and the silence of the contract as to the question of liability for the manner in which the work was executed was adverse to the establishment of a close relationship for the purpose of the law of tort in regard to economic loss.

In *D. & F. Estates Ltd v Church Commissioners for England* the House of Lords reviewed the existing cases and confirmed the retreat from *Anns*. The issue in this case was whether builders could be liable to the lessees of a flat in respect of the financial loss incurred by the lessees in renewing plaster work incorrectly applied by sub-contractors. It was held that they could not. *Junior Books* was a “unique” case and could not be regarded as laying down any principle of general application. Rather, to recognise a duty would be to impose on the builders for the benefit of those with whom they had no contractual relationship the obligation of one who warranted the quality of the plaster as regards materials, workmanship and fitness for purpose. Their Lordships regarded Lord Wilberforce’s “danger to health” argument with suspicion, Lord Oliver observing that this was quite a novel form of duty, being actionable by owner-occupiers in respect not of actual damage as normally understood but of damage consisting of the perception of personal injury. However they expressed no concluded view about it as on the facts there was no such danger. They also left open the possibility that one element of a structure could be regarded as distinct from another element, so that damage to one part caused by a hidden defect in another part might qualify as physical damage to “other property”. The recoverable damages might then include the cost of making good the defect, as essential to the repair of the property which had been damaged by it. Where, however, no physical damage had been inflicted, or where such damage was not to “other property”, the owner’s financial loss was not recoverable in an action in negligence. Their Lordships also thought that the builders could not in any event be liable for negligence by their independent contractors and rejected the notion of a non-delegable duty as applied by the Court of Appeal in the *Mount Albert Borough Council* case. Lord Bridge recognised that as a matter of social policy the Court of Appeal’s views might be entirely admirable,
but he could discover no basis upon which it was open to the court to embody this policy in the law without the assistance of the legislature.

The position in Canada and Australia needs brief mention. The Supreme Court of Canada has treated the owner’s loss as financial and imposed liability on a local council on an approach similar to that taken by the New Zealand courts. The High Court of Australia, by contrast, has declined to impose liability on a council on the grounds it was under no positive obligation to act, but has not made clear its views as to the liability of the builder.

The Decision in Murphy

D. & F. Estates appeared fatally to undermine Anns but did not actually overrule it. A direct challenge came with Murphy’s case. The defendant council, acting on the advice of consulting engineers, had approved a faulty design for the foundations of a house, with the result that the house was built with defective foundations. It later cracked and subsided and the owner, instead of repairing it, sold it for less than half its market value in an undamaged state. The owner sought to recover from the council the amount of the diminution in value and other losses and expenses. In the Court of Appeal the claim succeeded, on the ground that the condition of the house was such as to pose an imminent danger to the health or safety of the plaintiff while occupying it. In the House of Lords, however, a bench of seven Lords of Appeal held unanimously that the council owed the owner no duty to take care and that Anns should be overruled.

Those of their Lordships who delivered substantive judgments all found it necessary to devote close attention to the true nature of the plaintiff’s loss. They agreed that the loss in question was purely financial, that the “danger to health” argument was illogical and lacking in all principle and that no sensible distinction could be drawn between a mere defect of quality and a supposedly dangerous defect. Lord Keith, quoting with approval from the judgment of Deane J in Sutherland Shire Council v Heyman, thought that a claim for remedying a structural defect in property which already existed at the time when the owner acquired it could not be classified, as in Anns, as “material, physical damage”, for the building never existed otherwise than with its foundations in that state. The owner’s loss being purely economic, there was no logic in confining recovery to cases where a danger to health exists, or confining it to where some damage (perhaps comparatively slight) has been caused to the building but refusing it where the existence of the danger has come to light in some other way, such as through a structural survey. Lord Bridge made a similar analysis of Anns and pointed out that to require as part of the cause of action that a defect should pose a danger could lead to quite irrational and capricious consequences. He asked what the position would be where a defect does not constitute a present or imminent danger but will in due course become one, when the costs of repair will be much greater, or where a defect causes a sudden collapse of an unoccupied building. Lord Oliver, in perhaps the most illuminating judgment, said that if one asked “What were the damages to be awarded for?” clearly they were not to be awarded for injury to health of the plaintiffs, for they had suffered none. Equally clearly the description of the damage as physical or material did not withstand analysis. The manifestations of the defective nature of the structure by some physical symptoms were
merely the outward signs of a deterioration resulting from the inherently defective condition with which the building had been brought into being from its inception and could not properly be described as damage caused to the building in any accepted use of the word “damage”. The categorisation of the damage in Anns had, he thought, served to obscure not only the true nature of the claim but, as a result, the nature and scope of the duty upon the breach of which the plaintiffs in that case were compelled to rely.

Their Lordships all agreed that the “complex structure” theory could provide no escape from this conclusion. Lord Keith thought that it would be unrealistic to regard one part of a structure as being damaged by a hidden defect in another part as regards a building the whole of which had been erected and equipped by the same contractor. Where, however, electrical work had been done by a sub-contractor and a defect caused a fire which destroyed the building, it might not be stretching ordinary principles too far to hold the sub-contractor liable for the damage. Furthermore, even if the theory applied, it would not cover a local authority acting pursuant to an Act concerned with averting danger to health, not damage to property, nor a situation where a defect was discovered before it did any damage. Lord Bridge said that a critical distinction should be drawn between some part of a complex structure which does not perform its proper function in sustaining the other parts and some distinct item which positively malfunctions so as to inflict positive damage on the structure in which it is incorporated. His Lordship gave an example similar to that of Lord Keith, maintaining that the manufacturer of a boiler which exploded and damaged a house might be liable in tort on Donoghue v Stevenson principles. But where inadequate foundations lead to differential settlement and cracking, the structure as a whole is seen to be defective and as it deteriorates will only damage itself. Lord Jauncey considered that the only context for the complex structure theory in the case of a building would be where one integral component of a structure built by a separate contractor caused damage to other parts of the structure, for example a steel frame erected by a specialist contractor which failed to give adequate support to floors or walls. Liability for defects in ancillary equipment would be determined in like fashion.

The owner’s claim thus being for pure economic loss, their Lordships concluded that the local authority could not be liable in negligence to the owner, essentially for the same reasons as led them to their earlier decision in D. & F. Estates. First, if a duty were incumbent upon a local authority it would also be incumbent upon the builder. Lord Bridge affirmed that negligence by a local authority in securing compliance with building regulations could attract no greater liability than that attaching to the negligence of the builder whose fault was the primary tort giving rise to any relevant damage. Lord Oliver observed that their respective liabilities were not logically separable. (In D. & F. Estates, of course, their Lordships had already held that the builder was not liable where there was no danger to health.) Second, if the builder was to be liable, there could be no grounds in logic or principle for not extending a like liability to the manufacturer of a chattel. This would open the door to a mass of product liability claims which the law had not previously entertained. Third, all these claims for financial loss would involve the introduction of something in the nature of an indefinitely transmissible warranty of quality, and it was not desirable as a matter of policy that the courts should do this. Lord Keith recognised that Anns was capable of being regarded as affording a measure of...
justice, but as against that the impossibility of finding any coherent and logically based
doctrine behind it was calculated to put the law of negligence into a state of confusion
defying rational analysis. It was also material that Anns imposed a liability far beyond
that which Parliament had imposed upon builders alone by the Defective Premises Act
1972, a statute not adverted to in that decision. He considered that in what is essentially
a consumer protection field, there is much to be said for the view that the precise extent
and limits of the liabilities which in the public interest should be imposed upon builders
and local authorities are best left to the legislature. Lord Bridge observed that the
shoulders of a public authority are only "broad enough to bear the loss", quoting Lord
Denning MR from Dutton's case, because they are financed by the public at large. It was
pre-eminently for the legislature to decide whether these policy reasons should be
accepted as sufficient for imposing on the public the burden of providing compensation
for private financial losses. Lord Oliver acknowledged that there may be very sound
social and political reasons for imposing upon local authorities the burden of acting, in
effect, as insurers that buildings erected in their areas have been properly constructed.
Statute might so provide. It had not done so and it was not right for the courts not simply
to expand existing principles but to create at large new principles in order to fulfil a social
need of this kind.

In Department of the Environment v Thomas Bates & Son, a case decided at the same
time as Murphy, the House of Lords held, inevitably, that a builder was not liable to the
lessees of a building for the cost of remedial work which was necessary only for the
purpose of rendering the building fit to support its design load. The claim was in respect
of a mere defect in quality, making the plaintiff's lease less valuable than it would
otherwise have been, and loss of this kind was not recoverable in tort.

**Evaluation**

In Britain the decision in Murphy probably will not seriously prejudice the interests of
private homeowners, because alternative forms of protection are readily available.
Almost all owners of new residential buildings are covered by the National House
Building Council's warranty scheme and the remainder may have a right of action under
the Defective Premises Act 1972. In New Zealand there is only the Housing Corpora-
tion's Build Guard scheme, which provides only limited coverage and, it seems, is not
widely held. It is, therefore, far more likely that, absent a common law action, a property
owner in New Zealand will be without a remedy. It is this difference in background which
lends urgency to the question as to the likely impact of Murphy in New Zealand.

The judgments in D. & F. Estates and Murphy expose the serious difficulties raised by
the line of reasoning taken in Anns. They have confirmed what has long been apparent,
that to base recovery in negligence for the cost of repair of a faulty building on the
supposed existence of a danger to health to the occupants of the building or on the fact
that the defects have damaged the structure camouflages and obscures the true nature of
the plaintiff's claim. In any negligence action the plaintiff must show that he personally
has suffered actual damage. He cannot sue on the basis that he might suffer damage, let
alone that someone else might. Damages are awarded in respect of the cost of repair or
replacement of the property, not in respect of any anticipated injury. Furthermore, no test
was ever formulated for determining exactly when a defect can qualify as a danger, this perhaps because the question is incapable of resolution in any satisfactory manner. It might seem more plausible to base recovery on the defect having damaged the property containing it, but this also does not withstand analysis. That the plaintiff’s loss is financial is manifest from decisions involving defective buildings where no physical damage has happened and, perhaps, it is not certain that it ever will,71 or where, as in Murphy, the plaintiff has sold the house and is in no danger. A claim in respect of the defectiveness of property cannot mysteriously change in character because physical harm in addition is caused or threatened. After a false start in Bowen the New Zealand courts latterly have not relied upon the Anns reasoning in this respect. According to Lord Bridge in Murphy,72 they have carried the Anns doctrine to its logical conclusion in holding that the scope of the duty of care imposed by the law on builders and local authorities for the negligent performance of their functions embraces all economic loss sustained by the owner of a building by reason of defects in it arising from construction in breach of building bylaws or regulations.

This observation by Lord Bridge is not, I think, entirely correct. The obligation imposed on local authorities cannot be to comply with building bylaws or regulations as such, for in that case the authority would be setting its own standard of quality. The standard must be judicially imposed. In Stieller73 the court referred to the construction of houses “with good materials and in a workmanlike manner”, which gives the clue to the character of these claims. As has already been noted, their Lordships in Murphy recognised that they are not in the nature of actions in tort as normally understood but constitute, or are analogous to, actions for breach of a warranty of quality. The plaintiff’s loss is of an expected financial advantage, traditionally the concern of contract, rather than for damage to or loss of something the plaintiff already owned or possessed, the core concern of torts. In these circumstances their Lordships were persuaded that the owner’s claim had to lie in contract or not at all. This brings us to the crucial question, which is whether the New Zealand courts ought to do what the House of Lords has refused to countenance and decide, as a matter of policy, to support and develop a warranty of this nature, notwithstanding the lack of any privity of contract between the parties.

Sir Robin Cooke has argued extra-judicially, in a persuasive article, in favour of just this development.74 Sir Robin notes that modern English lawyers tend to assume that a warranty is necessarily contractual, but points out that the action for breach of warranty historically was treated as an action for deceit and that “warranty” is in any event only a label and the substance of the obligation is more important than the way it is classified. Sir Robin then turns to a host of American housebuilding cases to illustrate a growing tendency to give relief to purchasers of new houses by implying some form of warranty of habitability, and in so doing to dispense with the requirement of privity of contract. He suggests that purity of doctrine does not, therefore, inexorably compel the denial of remedies in this field and that the question is one as to merits and policy. In deciding whether they favour such a development Sir Robin points to a number of considerations to be brought into account. First, it would be feasible, although not obligatory, to draw a distinction between realty and personality. Secondly, the floodgates argument is entitled to some, but not necessarily decisive, weight. Thirdly, and most importantly, it is very
widely recognised that homeowners should have some remedy against negligent build-
ers, although opinion is probably much more divided in relation to commercial buildings. As regards dwellings it might be no exaggeration to say that the reasons pointing towards such a warranty as just and reasonable are overwhelmingly strong. Sir Robin concludes that he who puts into the community an apparently sound and durable structure, intended for use in all probability by a succession of persons, should be expected to take reasonable care that it is reasonably fit for that use and does not mislead. Unless compelling grounds to the contrary can be made out, and subject to reasonable limitations as to time or otherwise, the natural consequences of failure to take due care should be accepted.

In *Murphy* their Lordships did not think it desirable to expand upon existing law in the direction suggested by Sir Robin, primarily because they saw the implications as too far reaching. This was, they thought, a matter for the legislature, not the courts. They were bolstered in this view by the fact that United Kingdom legislature had intervened in the field only to a limited extent, by enacting the Defective Premises Act 1972. If we look first at the possible implications, clearly we must consider what the ambit of any proposed warranty would be. The Lords were particularly impressed by a perceived impossibility of drawing a distinction between defective buildings and defective chattels. In terms of ordinary negligence reasoning this view is indeed difficult to refute. However, once we move from the language of negligence to the language of warranty the difficulty may be seen to disappear, or at least to lessen, for a warranty of habitability in its nature can apply only to buildings. In the case of chattels the need for a remedy would seem to be less pressing.

Secondly, a question mentioned by Sir Robin and not adverted to in *Murphy*, is whether the courts might distinguish between commercial buildings and private dwellings. Professor J. A. Smillie has argued that they should. He points out that there are alternative forms of redress open to homeowners in Britain (as has already been noted), and that owners of commercial buildings can protect themselves by making use of assignable collateral warranties and "duty of care" agreements from contractors and consultants, by employing independent surveyors and valuers prior to purchase and by purchasing property protection insurance. In New Zealand owners of residential premises have only the limited coverage provided by the BuildGuard scheme, so it would be unfair to abolish the common law duty before an adequate alternative system for compensating for latent defects is made available. Owners of commercial buildings, however, have the same opportunities to allocate and spread the risk of loss from latent defects as their British counterparts. Smillie concludes that when the opportunity arises the Court of Appeal should, therefore, apply the *Murphy* decision to commercial buildings.

Smillie's general thesis is an attractive one. Certainly in the context of commercial property the reasoning in *Simaan*, preventing a tort (or warranty) action from undermining the contractual negotiation of risks and liabilities and limiting recovery to actions down the contractual chain, is especially compelling. The question is whether it is feasible for the New Zealand courts to draw the suggested distinction. Once again it helps to recognise that the action is one for breach of warranty, for Sir Robin Cooke has pointed out that the warranty of habitability as developed in American law does not apply to
commercial buildings. While difficult cases can be envisaged, assistance could, no doubt, be derived from the American cases. Whether the courts could or should do something similar with chattels, so as to distinguish between "consumer" and "business" sales, seems to me much more doubtful.

This may constitute a satisfactory solution as regards builders, but the somewhat invidious position of local authorities gives ground for some disquiet. Builders frequently are not available or able to satisfy any judgment against them, leaving the authority, and ultimately the local ratepayers, to bear the burden of the houseowner's loss. In principle, however, local authorities can be held liable in respect of the exercise or non-exercise of their supervisory responsibilities without too much trouble, for reasons which are considered later on. The real problem here perhaps lies in the doctrine of the concurrent liability of several tortfeasors, the merits of which are outside the scope of this paper.

We come finally to consider whether the introduction of a warranty of habitability is properly a matter for the legislature. There is, of course, no "right" or "wrong" answer. Certainly Parliament is better equipped to provide a comprehensive scheme identifying who can claim, setting appropriate limits on coverage and ensuring sufficient funding. Some proposals will be discussed below. While, however, there would probably be general agreement that a statutory solution is highly desirable, no adequate scheme exists in New Zealand at present, and if one were to be introduced it is most unlikely that existing houses would be covered. When the courts are next faced with a new construction claim they will, then, have to decide whether the common law can still give a remedy. It does seem that it can.

The recognition of non-contractual warranties in New Zealand law can be supported in terms of legal principle and well justified in terms of legal policy. As regards principle, the perceived difficulties arise from the rigid categorisation of claims as "tort" and "contract". A strict theory of privity of contract never took root in the United States in the same way as in the United Kingdom or New Zealand, rendering the development of the idea of non-contractual warranties correspondingly easier. Even so, the contract/tort dichotomy cannot be regarded as set in stone so far as New Zealand is concerned. Although a radical step, it would be in accordance with common law tradition for the courts now to recognise and enforce a private obligation not classifiable under either head but falling into a grey area between the two. It should be noted also that the courts are prepared to set standards for contracting parties which are not founded upon the parties' presumed intentions but which are imposed as a matter of law. They are not obviously barred from doing something similar in the absence of a contractual relationship. As regards policy, the risk in any particular case is limited to the cost of repair or replacement of the property in question and, perhaps, consequential loss. Only one person can suffer the loss, albeit that his or her precise identity may not be known or foreseeable, and thus there is no fear of liability in limitless amounts to an uncertain number of plaintiffs. Recognition of the obligation would, moreover, largely resolve the difficulties and anomalies created by the need to decide whether a defendant's negligence had caused damage to separate property, well exemplified by the discussion in Murphy of the circumstances in which a contractor might be liable for damaging part of an integrated
structure. While different reasoning is needed, for nowhere do the existing cases refer to "warranties of habitability", the way forward ought to be along this path.

If indeed the Court of Appeal, when the matter comes before it, were to take this view, the question arises as to the fate of any appeal to the Privy Council. The following points might be borne in mind. First, their Lordships in *Murphy* were concerned to show that the reasoning in *Anns* was unsound and that the owner's claim could not be accommodated by ordinary principles of negligence. They were not asked to address the line of argument advanced by Sir Robin Cooke and the relevant American authorities. Secondly, the United Kingdom legislature was presumed to have intended to cover the field by enacting the limited reform contained in the Defective Premises Act 1972. There is no New Zealand equivalent to this Act. The reform achieved here by the Contracts (Privity) Act 1982, giving certain designated third parties the right to sue on a contract made between others, is not in point, because the proposed warranty is not aimed at enforcing the builder's original contract as such. Thirdly, as has already been noted, the policy considerations favouring the warranty would seem to be considerably stronger in New Zealand than in England. My initial belief after *Murphy* was decided was that the Privy Council would settle the law similarly for New Zealand. This may prove to be too hasty a forecast.

Before turning to the proposals for reform, some attention should be given to what *Murphy* does not decide. It does not purport to bar negligence claims for pure financial loss other than those by an owner for the diminished value of defective property. As Lord Oliver observed, it does not at all follow as a matter of necessity from the mere fact that the only damage suffered by a plaintiff in an action for the tort of negligence is pecuniary or "economic" that his claim is bound to fail. The critical question, his Lordship said, is not the nature of the damage in itself, whether physical or pecuniary, but whether the scope of the duty of care in the circumstances of the case is such as to embrace damage of the kind which the plaintiff claims to have suffered. Lord Bridge also recognised that economic loss may be recoverable where there is a "special relationship of proximity" between the parties. Lord Keith and Lord Jauncey only mentioned recovery for negligently inflicted economic loss under *Hedley Byrne*, saying there was at the time of *Anns* no right to recover on any other basis. They did not positively rule out other cases for today: and their judgments would be far too narrow if they did suggest any such thing.

The difficulties associated with negligence claims for financial loss caused by acquiring already defective property do not apply in *Hedley Byrne* cases. These fall within mainstream principles, for the defendant does not seek the benefit of a non-contractual undertaking but interferes with the plaintiff's existing financial prosperity. Certainly this head of claim is available where an owner purchases defective property in reliance upon a negligent representation as to its quality or soundness, perhaps by a surveyor or, it may be, a local authority inspector. In non-*Hedley Byrne* cases, whether financial loss is recoverable naturally enough turns on the policy factors applicable to the instant case. It is odd that there have been few such claims in the United Kingdom. One example is the well known decision of Megarry VC in *Ross v Caunters*, where a disappointed legatee successfully sued her solicitor for negligence in the execution of the will under which she
had hoped to benefit. *Gartside v Sheffield, Young & Ellis* ⁸⁴ is the New Zealand equivalent of *Ross*. Claims for financial loss have succeeded in two recent cases before the Court of Appeal, both being novel in character. In *Williams v Attorney-General*, ⁸⁵ a particularly interesting case, the Customs Department forfeited a yacht being used for drug smuggling and then neglected to look after it. The plaintiff was the unpaid vendor of the yacht, innocent of any criminal conduct, who the Minister of Customs allowed in his discretion, after a considerable delay, to repossess the yacht. The plaintiff’s claim was, therefore, for financial loss in getting his yacht back in a damaged state. A duty of care was recognised because there was a close relationship between the parties, the plaintiff being the former legal owner of the yacht applying, to the defendant’s knowledge, for its recovery, to require the Department to take reasonable precautions was not onerous, and the plaintiff’s contingent interest in the yacht could not be dismissed as a mere spes. In *Downsview Nominees Ltd v First City Corporation* ⁸⁶ the receiver of a car dealership appointed by first debenture holders (Downsview Nominees), instead of simply discharging his duty to enforce the security and discharge the indebtedness, elected to carry on the business with a view to trading the company out of its difficulties. The company’s financial position thereafter declined disastrously, with the result that the second debenture holders (First City Corporation) suffered very substantial losses. The Court of Appeal once again imposed a duty. There was an immediate risk of harm to the interests of F.C.C. from continued trading by the receiver, a duty would not erode the responsibility which the receiver owed to the first debenture holders, the framework of the duty was defined and limited and there was thus no risk that receivers would be exposed to an indeterminate liability.

It is easy to point to many other cases where the question of recovery for negligently inflicted financial loss has been in issue. Sometimes policy has favoured a duty, ⁸⁷ sometimes it has not. ⁸⁸ No doubt the courts will continue to decide such cases on their particular merits. Factors like the danger of indeterminate liability, deterrence and the need to encourage the taking of care are familiar to us. Considerations of economic efficiency, loss spreading and the insurability of the risk may increasingly have a part to play.

**Reform**

On any view, legislative reform so far as defective buildings are concerned would be welcome. One might hope (piously, perhaps,) that the *Murphy* decision will provide the spur. One possible solution would be to introduce a statutory warranty of habitability along the lines of the Defective Premises Act 1972 in England. It will be recalled that under the Act the builder of a dwelling owes a duty to subsequent owners to see that the dwelling is properly constructed so that it is fit for habitation when completed. This alone would be an inadequate response, for there would be no guarantee that claims would actually be satisfied. It is essential that any remedy be properly funded. Another solution is that contained in the Building Bill 1990, ⁹⁰ which is based upon certain recommendations of the Building Industry Commission. ⁹⁰ The Bill provides in Part VII for the making of regulations to constitute a national building code and in Part VIII for certification by approved professional persons that a building complies with the requirements of the code.
Clause 49(2) provides that a building certificate shall signify that the certifier has used all reasonable skill and care, and clause 49(3) provides that a certifier shall not issue a certificate unless an approved scheme of insurance applies in respect of any civil liability of the certifier that might arise out of the issuing of the certificate. The purpose of the scheme apparently is to shift the burden of legal responsibility for non-compliance with building regulations away from local authorities, yet success in this respect seems unlikely while it is left up to the building owner to decide whether to employ a certifier or simply to rely on the council. Thirdly, the Building Industry Commission has recommended that further consideration be given to establishing a compulsory house guarantee scheme after the proposed national code is in place. The scheme would provide successive owners of a house with an assurance in the form of a guarantee that in the event of non-compliance with code requirements any necessary work would be done to bring the house up to the code standard. It would be funded by annual payments by builders and by one-off payments by owners on the issue of a building permit. The extent of the guarantee would depend upon an actuarial assessment, although for the purposes of reference the Commission pointed to a limit of A$40,000 in a somewhat similar scheme in Victoria. An equivalent figure in New Zealand would seem not to provide adequate protection to the homeowner, but in broad outline the scheme certainly deserves to be supported and developed. An alternative would be to revamp the Housing Corporation’s BuildGuard scheme, by raising its financial limits, extending the time for making a claim and making it compulsory that builders of new houses should enter it. Finally, a solution favoured by Professor Smillie is to require building owners of new residential accommodation to take out first party insurance cover against building defects as a condition of the grant of a building permit. Smillie suggests that this would provide adequate compensation to homeowners at reasonable cost, relieve local authorities of the burden of liability and, through their insurers, impose effective controls on builders.

Possible reform of the law concerning the liability of manufacturers for their defective products also needs to be considered. We must, of course, distinguish between claims for loss suffered in buying a sub-standard product and claims for damage done by the product. Our present concern is only with the former type of claim. Arguably the privity rule preventing a non-contracting purchaser from suing the manufacturer on any warranty of quality is too restrictive, at least in relation to consumer transactions. In Australia the rule has been modified and federal and some state legislation extend the benefit of the manufacturer’s warranties to the ultimate consumer acquiring title to the goods. Contracting out generally is forbidden. Under this kind of scheme the consumer can recover “loss of bargain” where the goods are not fit for their purpose, and also consequential loss. Reform in New Zealand along somewhat similar lines was proposed by the Contracts and Commercial Law Reform Committee in a Working Paper on Warranties in the Sale of Goods and, more recently, in the Vernon Report on Post-Sale Consumer Legislation in New Zealand. The latter report envisages that consumers of household goods and services should have a direct remedy against the supplier and other persons in the chain of distribution if the goods and services have failed to meet prescribed standards of quality. Although the action is described as sounding in tort, only the purchaser could sue and his remedies would be confined to repair, replacement, refund.
of the purchase price and "out of pocket expenses". Consequential loss would not be recoverable. The proposals have been criticised in a number of respects and whether any legislation eventuates remains to be seen.

Any reform imposing a liability on a builder, certifier, manufacturer or anyone else would need to take account of the limitation problem. It may be that particular provision would not be needed, for the Law Commission has recently put forward some proposals which would cater for these, and other, cases of potential difficulty. The proposals can be summarised briefly as follows: (i) there should be a common limitation period of three years, which would apply to all civil proceedings, the period commencing on the date of the act or omission which is the subject of the claim; (ii) the period should be subject to extension so that time would not run until the plaintiff knew or should have known of the following facts (a) the occurrence of the act or omission (b) the identity of the person responsible (c) the act or omission has caused harm, and (d) that the harm is significant; (iii) there should be a long stop period of 15 years which would override the extension provisions except where, inter alia, the absence of knowledge was caused by deliberate concealment by the defendant. So far Parliament has shown no sign of acting on these recommendations.

Omissions

Another major question of principle which arose in Anns and was mentioned in passing in Murphy concerns liability for omissions. As Lord Oliver observed in Murphy, the plaintiff’s complaint was not of what the defendant had done but what it had not done. It had failed to prevent the builder from erecting a sub-standard structure. Is there, then, in these cases any ground for saying that the defendant is under a duty to take positive action to prevent harm being suffered by a subsequent owner of the building? The question remains important in New Zealand at least for the time being: and even in England an authority’s liability for a negligent inspection resulting in physical loss awaits determination.

In Anns Lord Wilberforce found the true explanation of the duty in the requirement that the defendant as a statutory body should give proper consideration to the question whether to act or not. This does not seem right. Failure to give proper consideration to any particular matter is a ground for invalidity. For a court to impose liability on this basis confuses matters of public and private law. It also assumes that had proper consideration been given the council would have acted and thus the court makes the council’s decision for it. The plaintiff’s real ground of complaint is not a failure to consider but a failure to act in circumstances giving rise to an obligation to act.

One well established basis for a duty of positive action is where the defendant has in some way taken upon himself or herself a responsibility for acting. Reliance is not necessary, although it may sometimes constitute an alternative basis for a duty. The defendant may have assumed responsibility for a particular task or over a particular person. In the latter case the defendant may be required to look after that person or to prevent him or her from inflicting damage on another. These principles can be seen in operation in a
number of cases involving public bodies. A duty can arise possibly from the assumption of a public office, where the plaintiff is very closely and directly affected by the defendant's failure to act, or from the assumption of control over the person who caused the harm. A clear example is *Home Office v Dorset Yacht Co Ltd.*, where Lord Morris and Lord Pearson based the Home Office's liability for the damage done by escaping borstal trainees squarely on the defendant's obligation to control the trainees. The decision can be compared with *Yuen Kun Yeu v Attorney-General of Hong Kong*, where the Hong Kong Commissioner of Deposit-Taking Companies was not liable for failing to de-register a company being conducted fraudulently. The court relied particularly on the fact that the Commissioner had no power to control the day-to-day management of the company. His power was limited to putting it out of business or allowing it to continue. Recent actions against the police are also illustrative. In *Hill v West Yorkshire Police* the House of Lords held that the police could not be expected to protect all young women in the West Yorkshire area of England from the attacks of a murderer, but recognised that a person at a special, distinctive, risk might be able to sue. A possible example of a "special risk" case is the decision of the Supreme Court of Canada in *O'Rourke v Schacht*. Here a traffic officer attending the scene of an accident in which a car had knocked over a safety barrier was obliged to warn road users of the danger.

It seems to me that a duty in the "inspection" cases can be founded on the council having assumed a responsibility to safeguard the owner or having assumed control over the work of the builder. The decision of the High Court of Australia in *Sutherland Shire Council v Heyman* admittedly is not easily reconciled with this view. The claim against the authority failed, not because of the nature of the loss, but because a majority of the court considered that there was no sound basis for the imposition of a duty of positive action. There should, it was thought, always be reliance on the authority having performed its statutory functions properly. In this case, of course, the claim could succeed on the basis of the *Hedley Byrne* principle. The court did not discuss the possibility that the council had assumed responsibility by instituting planning and building control regulations and requiring builders to adhere to them. The significance of this idea of control was emphasised early on by Lord Denning MR in *Dutton* but was rejected in *Anns* in favour of the "proper consideration" argument. However clear support for it is found in *Curran v Northern Ireland Housing Association Ltd.* In this case the House of Lords held that a Housing Association which had exercised its statutory power to pay an improvement grant for the building of an extension to a house owed no duty of care to future owners to see that the extension was properly constructed, precisely because the Association possessed no powers to control the building operations analogous to those on which the decision in *Anns* depended. The Association could withhold payment of the grant if the works had not been executed to its satisfaction, but to hold that its power in this respect could support the duty contended for would be an "almost bizarre" conclusion.

The judgments in *Murphy* are somewhat equivocal about the basis for a duty to act. Lord Oliver said that Lord Denning's notion of control in *Dutton*, while going no way towards resolving many of the difficulties arising from the decision, might perhaps provide an acceptable basis for liability, but pointed out that this was specifically rejected in *Anns*. 
He later observed that *Dorset Yacht* could support the view that the relationship which existed between the authority and the plaintiff was such as to give rise to a positive duty to prevent the builder from inflicting injury, but that in subsequent cases, notably *Curran, Hill* and *Yuen Kun Yeu*, the House of Lords had been unable to find a like relationship in the case of other regulatory agencies with similarly wide powers. Lord Bridge\(^{116}\) said that he agreed with the principle laid down in the *Sutherland Shire Council* case, that any duty of the local authority to act must be based on the notion of reliance. He considered that there is nothing in the ordinary relationship of local authority, as statutory supervisor of building operations, and the purchaser of a defective building capable of giving rise to such a duty. The other members of the court preferred to leave the question open.\(^{117}\)

Lord Bridge's view seems far too narrow. As for Lord Oliver's references to *Yuen Kun Yeu* and other cases where no duty was owed, the control exercised by a public body regulating the construction of new buildings is far more detailed and specific than that found in these cases. This strict control does seem to constitute a persuasive reason for imposing on the body a duty to act. It does not seem desirable or in accordance with principle that a public body charged with supervisory or regulatory responsibilities should be able to turn a blind eye. Certainly private persons assuming control over others in analogous circumstances cannot do so.

**The Discretionary Function Immunity**

A further aspect of *Anns'* case, which bears upon the liability of public bodies as such and which deserves brief mention mainly for the sake of completeness, concerns the immunity of these bodies in respect of their exercise of discretionary functions. This immunity is founded upon the courts recognising that they should not usurp the functions of a public body, by questioning decisions or conduct founded upon broad economic, social or political considerations. In *Anns*\(^{118}\) Lord Wilberforce accordingly drew a distinction between decisions making or implementing policy on the one hand, in respect of which a public body may not be liable, and "operational" matters on the other, where policy is not challenged and in respect of which the body may be liable in the ordinary way. The distinction was accepted as part of New Zealand law in the interlocutory and final decisions of the Court of Appeal in *Takaro Properties Ltd v Rowling*.\(^{119}\) On appeal to the Privy Council\(^{120}\) it was affirmed that the policy/operational distinction does not provide a touchstone of liability but is expressive of the need to exclude altogether those cases in which the decision under attack is of such a kind that the question whether it has been made negligently is unsuitable for judicial resolution.

A good example of policy negating a duty is the decision of the House of Lords in *Hill v Chief Constable of West Yorkshire*.\(^{121}\) Lord Keith thought that to impose liability on the police for failing to catch a criminal might require the court to enquire into various matters of policy and discretion, for example as to which particular line of enquiry was most advantageously to be pursued and what was the most advantageous way to deploy the available resources. Many decisions about such matters would not be regarded by the courts as appropriate to be called in question yet elaborate investigation of the facts and significant diversion of police manpower might be necessary to ascertain whether or not
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this was so.\textsuperscript{122} The building cases, on the other hand, have involved mere operational matters. The question has been about not, say, the allocation of resources as between the different functions of local government but whether, having made the decision to set up an inspection system, there has been negligence in its implementation.

*Murphy* says nothing about the policy/operational dichotomy: and *Anns* accordingly remains a relevant source of common law principle. It has in fact been argued that the justifications for the concept may be catered for perfectly adequately by traditional private law principles of negligence: that an extra dimension of confusion is created by the need to determine what are policy and what are operational matters.\textsuperscript{123} The argument has force. It is true, for example, that private defendants equally may raise arguments concerning manpower and resources in deciding whether a duty has been broken. Again, the courts have not always clearly explained the nature of the distinction at issue.\textsuperscript{124} Even so, there is nothing unusual in the courts making use of more than one technique to achieve a desired result. The concept, properly understood, can be of value in focusing attention on the preliminary question whether ordinary principles of negligence ought to apply at all rather than on the later question whether in all the circumstances an appropriate standard of care has been attained. So understood, probably it should be treated as a “stage two” issue, as was suggested earlier, so that the burden rests on the defendant to negate a duty of care which would otherwise arise. The plaintiff is unlikely to have, and may well find it difficult to acquire, direct knowledge of any relevant policy considerations. It should be for the defendant authority to show a policy reason, if there is one.

**Summary**

1. Even though *Anns* has now been overruled in England, the case may remain influential with the New Zealand courts when deciding whether a duty of care ought to be recognised in novel circumstances. It needs to be clearly understood that policy factors are relevant at stage one as well as at stage two of the two-fold enquiry.

2. In *Murphy* the House of Lords decided that it was not desirable for English law to recognise a warranty on the part of a builder, actionable at the suit of subsequent purchasers not in contractual privity, that care has been taken to build a reasonably sound and habitable dwelling. Circumstances in New Zealand do, however, support the recognition of such a warranty.

3. A local authority exercising supervisory powers can be liable for failing to prevent loss being inflicted on another on the application of ordinary principles of negligence.

4. Whether a common law remedy against builders and local authorities will survive in New Zealand is uncertain. How best to afford protection to the owners of badly built houses deserves the immediate attention of Parliament.
1. See, for example, Caparo Industries Plc v Dickman [1990] 2 WLR 358 (HL), holding that the auditor of company accounts owes no duty of care to potential investors in the company and preferring the minority view of Richmond P in Scott Group Ltd v McFarlane [1978] 1 NZLR 663; Meates v Westpac Banking Corporation Ltd (unreported, 5 June 1990, PC 43/89), criticising the decision of the Court of Appeal in Meates v Attorney-General [1983] NZLR 308 that a government minister had a duty to take care to carry out a promise.


8. For cases where the Court of Appeal has asserted its freedom to develop the law in New Zealand as it thinks appropriate, see Bognuda v Upton & Shearer Ltd [1972] NZLR 741; North Island Wholesale Groceries Ltd v Hewin [1982] 2 NZLR 176; Busby v Thorn E.M.J. Video Programmes Ltd [1984] 1 NZLR 461.

9. The Minister of Justice has recently stated his view that the Privy Council plays a valuable role as New Zealand’s ultimate appeal court and that the right of appeal to it is unlikely to be abolished in the short term: see Christchurch Press, 7 January 1991, p. 4.


11. See infra at pp.14-5.


22. Ibid., at p.447.


27. [1986] 1 NZLR 22 at p.73.


32. No explanation was forthcoming as to why Junior Books did not sue the main contractors in contract.


34. [1977] 1 NZLR 397 at pp.414, 418, 425. The court also made an award for loss of rental and diminution in the value of the house even after repairs had been carried out.

35. Ibid., at pp.407, 419.


38. [1986] 1 NZLR 84.


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42. [1988] QB 758.
44. [1989] AC 177.
46. *City of Kamloops v Nielsen* (1984) 10 DLR (4th) 641; In *Rothfield v Manolakos* (1990) 63 DLR (4th) 499 the court was concerned with a dictum of Lord Wilberforce in *Anns*, that no duty was owed to a negligent building owner who was the source of his own loss. In *Peabody* [1985] AC 210 the claim of an owner who failed to comply with building regulations because of the negligence of his architect was dismissed partly for this reason. La Forest J in *Rothfield*, taking a narrower interpretation of Lord Wilberforce’s words, thought that a negligent owner would be treated as the source of his own loss only where, for example, he knowingly flouted the regulations or directives or was completely indifferent to the responsibilities put on him by the bylaws. Certainly *Peabody* must be open to criticism, for it is not clear that an owner ought to be identified with the negligence of his independent contractor, or that an owner in breach of regulation is necessarily to be treated as negligent.

47. As to which, see infra at pp.18-20.
49. [1990] 2 WLR 944.
50. Lords Mackay, Keith, Bridge, Brandon, Ackner, Oliver and Jauncey.
51. Their Lordships did not find it necessary to rule on whether the council would have discharged any duty by relying on competent independent contractors. *D. & F. Estates* would clearly suggest that the council had done enough.
52. [1990] 3 WLR 414 at pp.428-9, 431.
55. Ibid., at pp.443-444, 448.
56. Ibid., at p.431.
57. Ibid., at pp.438-9.
58. Ibid., at p.456.
59. Ibid., at p.439.
60. Ibid., at p.443.
61. Ibid., at pp.430, 435, 447-8, 457.
62. Lord Bridge (ibid., at p.436) thought there might be an exception where a building poses a danger to persons or property on neighbouring land or on the highway, where the owner ought to be able to recover from the builder the cost of protecting himself from potential liability to third parties. It is not clear why his Lordship thought that this situation ought to be treated differently. Lord Oliver (ibid., at p.448) expressed doubt about the suggestion.
63. Ibid., at p.433.
64. Ibid., at p.442.
65. Ibid., at pp.450-1.
67. The warranty protects successive owners against defects in materials and workmanship for a 2 year period and against structural defects for another 8 years. The builder is obliged to insure against liabilities arising under the scheme.
68. The Act imposes upon persons who undertake work for or in connection with the provision of a private dwelling a statutory duty, owed to subsequent owners, to see that the work taken on is done in a workmanlike manner and with proper materials, so that the dwelling will be fit for habitation when completed. It does not apply to buildings covered by the N.H.B.C. scheme.
69. The scheme was set up under the Building Performance Guarantee Corporation Act 1977 but in 1987 it was taken over by the Housing Corporation. Where the original builder of a residential building has entered into the scheme, the Corporation will indemnify a subsequent owner for the cost of remediing defects in materials and construction and any resulting damage to the structure. The term of the indemnity is limited to 3 years from commencement in the case of defects in materials and 6 years in the case of all other claims. Claims must be made in writing within 90 days from the date from which the owner became aware or should have become aware of the defect or damage. The Corporation in its discretion limits its liability in respect of all claims to $200,000, restricts the bringing of claims for “minor construction defects” to an 18 month period and excludes recovery for consequential loss. It also excludes its liability for loss resulting from a failure to comply with the terms of any permit required by a local authority.
70. Builders are not obliged to enter the scheme. Smillie reports ([1990] NZJ 310 at p.317, n 8) that up to 1987 the Guarantee Corporation issued indemnities in respect of only 24 per cent of new dwellings.
71. See, eg, *Batty v Metropolitan Property Realisations Ltd* [1978] QB 554 (CA) (house built on unstable land...
predicted to collapse within 10 years; Williams v Mt Eden Borough Council (1986) 1 NZBL 103,771; Todd, [1986] NZLJ 186 (house contained a "catalogue of defects" resulting in a weakened structure at risk in an earthquake but in no immediate danger of collapse).

73. [1986] 1 NZLR 84 at p.94.
74. "An Impossible Distinction" (1991) 107 LQR 46. This article is republished infra, at p.59
76. Infra at pp.18-20.
77. Infra at pp.17-18.
80. Ibid., at p.435.
81. Ibid., at pp.429, 452.
85. (1990) 1 NZLR 646.
86. (1990) 5 NZCLC 66,303.
88. See, eg, Van Oppen v Clerk to the Bedford Charity Trustees [1990] 1 WLR 235 (school under no duty to insure pupil against personal injury or to advise about insurance); Reid v Bush & Tompkins Group Plc [1990] 1 WLR 212 (employer not obliged to insure employee); B.D.C. Ltd v Hofstrands Farms Ltd [1986] 26 DLR (4th) 1 (courier not liable to recipient of envelope for loss caused by late delivery); Business Computers International Ltd v Registrar of Companies [1988] Ch 229 (creditor not liable to debtor for serving winding up petition at wrong address); South Pacific Manufacturing Co Ltd v NZ Security Consultants Ltd [1990] 3 NZBLC 101,605 (investigator reporting to insurance company about a company’s insurance claim owed no duty to creditors and shareholders of latter company). Note also Bell-Booth Group Ltd v Attorney-General [1989] 3 NZLR 148 (no negligence liability in field already covered by defamation).
89. On 6 September 1990 Parliament voted to carry forward this Bill, together with a great many others, to the next Parliamentary session.
91. Ibid., para 2.50, appendix 7.
92. Smillie points out (supra, n75 at p.316) that this scheme already provides better protection to the homeowner in a number of respects than that proposed by the Building Industry Commission.
93. Ibid., at p.317.
94. So far as the latter is concerned, debate has centred on the merits of a rule of strict liability. Such a rule has recently been enacted in the United Kingdom (Consumer Protection Act 1987) and proposed for Australia (Australian Law Reform Commission, Product Liability (1989, Report no 51)). The majority view in the Report of the Torts and General Law Reform Committee on Products Liability in 1974 was that the imminent introduction of the accident compensation scheme made a move towards strict liability unnecessary.
95. The Contracts (Privity) Act 1982 would seem not to apply, the ultimate consumer being neither sufficiently designated nor intended to be able to sue.
100. As regards the existing law, in Askin v Knox [1989] 1 NZLR 248 the Court of Appeal left open the question whether time runs from the date when the defect becomes discoverable, as favoured by a majority of the
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court in Mount Albert Borough Council v Johnson [1979] 2 NZLR 234 at p.239, or whether, following the House of Lords in Pirelli General Cable Works Ltd v Oscar Faber & Partners [1983] 2 AC 1, it runs from the date of the physical damage to the property. Now that Murphy has made it clear that Anns, Bowen and similar cases involve economic losses, it is apparent, and Lord Keith seemed to recognise (at p. 427), that the decision in Pirelli cannot be supported. The plaintiff in that case equally was suing in respect of a financial loss, which would have been suffered only when the defect was discovered.

102. [1978] AC 728 at p.755. This also was the explanation given by Wilson J delivering the majority judgment of the Supreme Court of Canada in the Kamloops case (1984) 10 DLR (4th) 641 at p.673.
103. The question as to the recovery of damages by the victims of invalid administrative action is discussed by Barton, "Damages in Administrative Law" in Taggart (ed), Judicial Review of Administrative Action in the 1980s (1986) pp.123-152.
104. See, eg., Barnett v Chelsea Hospital [1969] 1 QB 428 (doctor obliged to treat patient); Teno v Arnold (1974) 55 DLR (3d) 57 (vendor of ice-creams under duty to safeguard children); Hawkins v Clayton (1988) 164 CLR 539 (solicitor who had assumed custody of a will required to take reasonable steps to locate executor).
105. The Supreme Court of Canada has dealt with a number of such cases: see Horsley v McLaren (1971) 22 DLR (3d) 545 (boat owner under duty to rescue guest who had fallen overboard); Jordan House Ltd v Menow (1978) 38 DLR (3d) 105 (publican obliged to protect an inebriated customer); Crocker v Sundance Northwest Resorts Ltd (1989) 51 DLR (4th) 321 (competition organiser had to safeguard competitor).
106. See, eg, Kennedy v Karaka (1906) 27 NZLR 1118, Smith v Leurs (1945) 70 CLR 256 (parents obliged to control children); Commonwealth v Introvine (1982) 150 CLR 258 (school liable for not controlling pupil).
110. (1975) 55 DLR (3d) 96.
114. Ibid., at p.728.
115. [1990] 3 WLR 414 at pp.443, 449.
116. Ibid., at p.441.
117. Ibid., at p.419 per Lord Mackay, at p.425 per Lord Keith, at p.451 per Lord Jauncey. Lord Brandon agreed with Lord Keith and Lord Ackner agreed with Lords Keith, Bridge, Oliver and Jauncey.
120. [1987] 2 NZLR 700 at p.709.
122. Ibid., at p.63.
124. Some clarification is found in the recent decision of the Supreme Court of Canada in Just v British Columbia (1990) 64 DLR (4th) 689.
NEGLIGENT ECONOMIC LOSS IN AMERICAN LAW

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Introduction

I would like to begin with some general observations. Negligent economic loss has been of absorbing concern for British tort lawyers ever since the categorical ban on its recovery was lifted from negligent misrepresentation in Hedley Byrne v Heller.1 Hardly a year passed, especially after Dutton v Bognor Regis U.D.C.,2 that appellate courts were not confronted with the problem of staking out the limits of this duty of care. Perhaps it is not as puzzling as it appears at first sight that a groundbreaking decision should be followed by a cluster of litigation until the storm eventually subsides. But by comparison the American experience has been much more relaxed. As so often, in products liability as here, American decisions commenced their run forty years earlier, when Judge Cardozo in the 1920s sketched the outlines of liability for negligent misrepresentation.3 Since then decisions dealing with economic loss have been intermittent but never attained either the prominence or the frequency nationally or in any particular jurisdiction that has marked the British preoccupation with the subject. Indeed, the leading textbooks continue to give it little more than cursory treatment and not in its admitted context of “duty of care”;4 most casebooks, the principal vehicles of instruction, practically ignore it. In short, it is overshadowed, if not buried, by apparently more intriguing and divisive topics like mental disturbance, duties of affirmative action and products liability. Similarly, the volume of academic literature, usually a reliable barometer of topical and controversial subjects, bears no comparison with that in England and the Commonwealth.5

A second comparative aspect is the fascination with “principle” in British judgments, in contrast to the more pragmatic tenor of American legal opinions. It used to be fashionable to think of the Common law as much more fact-oriented and less theoretical than the Civil law, but this characteristic is nowadays more commonly found in America than in Britain and Australia. At any rate discourse on “duty” tends to become dissolved in a theoretical fog, in hopeless quest for inclusive generalization. This may be the legacy of Lord Atkin’s famous “neighbour” formula, itself derived from a biblical aphorism, which inspired later generations of judges to follow his example into elegant abstraction. This tendency has been exacerbated by wrangles over the respective ambits of “principle” and “policy”, in which these concepts often carry different meanings and “policy” is a taboo word suggestive of judicial legislation instead of denoting judicial creative thinking. This tendency has contributed, in the context of economic loss, to a reluctance for ad-hoc decisions in preference for the safer course of sticking to a well-worn formula.

By contrast, American legal thought is far less inhibited by generalization or formalism. Judges do not pretend that “adherence to rule can be pursued relatively neutrally, without regard to policies and reasons underlying or otherwise relevant to the rule. The purported
neutral application to rules is, they argue, a sham".\(^6\) And, as Summers and Atiyah concluded, "the more substantive method of legal reasoning characteristic of American law tends to break up the unity of legal concepts and this necessitates a greater willingness to look to the underlying purposes behind the rules".\(^6a\) Guidelines on "duty", if they exist at all, are open-ended and pragmatic and, being guides, are not given sufficient importance to become controversial.

If there is consensus on any aspect, it is that recovery for economic loss is narrower than for physical injury. Indeed, for bodily injury duty is, for all practical purposes, judged by foreseeability and plays no substantive role in the judgment process. "Duty" becomes relevant only on the periphery of legal obligation, such as omissions, mental disturbance, and economic loss. As regards the last, two aspects in particular have played a dominant role.

One is the relation between tort and contract. The Common law has only reluctantly and as yet imperfectly shed the chrysalis of the normal division of obligations into tort and contract. It took almost a century before Donoghue v Stevenson – and then by a slim majority of 3 to 2 – discarded the legacy of Winterbottom v Wright and recognised that a contractual obligation could engender a tort duty to third parties not in privity. And, as already mentioned, it was only 25 years ago that economic loss – hitherto considered the hallmark of contract law – was admitted within the scope of negligent misrepresentation. Even if American legal thought is less influenced by formalism, and succeeded many years earlier than the British in reaching these milestones, the contract/tort dichotomy is still apt to agitate the nerves of even the most emancipated Common law mind. As we shall see, even presumably so sophisticated a court as the U.S. Supreme Court invoked the formalistic argument that to allow the particular claim in tort would violate the distinction between contract and tort.\(^7\)

### Indeterminate Liability

Closer to the point is the celebrated warning by Judge Cardozo against "liability in an indeterminate amount for an indeterminate time to an indeterminate class".\(^8\) It directs attention to the allegedly disproportionate burden on defendants and society in the absence of substantial limitations on liability. The case, Ultramares Corp v Touche, presented the familiar problem of an accountant’s liability to third party investors for negligent misstatements in a company audit. How can we distinguish, it has been asked, the liability – strict liability at that – of a products manufacturer with this immunity even from negligence? Most significant, no doubt, is that, whereas the manufacturer is able to distribute the cost of accidents among his countless consumers, the auditor is limited to one client at a time.\(^9\) Insurance, if available at all, would become prohibitively expensive and lead to a shrinkage of the service, which is of substantial public benefit in providing access to information for the market. Moreover, the cost has to be borne by the client, while third party investors are "free riders" of a benefit without paying for it. Again, unlike the consumer, the investor is usually well placed to protect himself by making his own inquiries. To give him the benefit of a duty of care would expose him to the moral hazards of being lax in self-protection and advancing claim to losses of doubtful causality.
Without precisely articulating this economic thesis, the House of Lords recently followed Judge Cardozo’s three indeterminates in denying an auditor’s liability to the investing public. Yet despite the cogency of the preceding argument and the New York court’s reiteration of its earlier holding a few years ago, some American courts have broken rank. They discern no categorical distinction, as regards the likely extent of damage, between physical and economic loss pointing to the potentially disastrous consequences of a holocaust, to the high fees earned by accountants, and are content to leave the issue to foreseeability. In the forefront of this departure have been the ultra-liberal courts of New Jersey and California, which have generally pursued a hard line against corporate defendants in the interest of deterrence and compensation for the “little man”. Having regard to the fact that an overstatement of assets would likely serve the interest of that client, there is otherwise lacking any incentive for the auditor to adhere to professional standards of care and competence in a situation fraught with conflicting interests.

“Indeterminacy” has had the strongest appeal in situation where the plaintiffs are members of a larger group not directly, but only consequentially affected by the defendant’s negligence, as by damage to an object in which they have no proprietary or possessory interest. Examples are claimants whose business was interrupted by a closure of a bridge and employees who lost wages as a result of damage to their workplace.

The most adamant expression of this principle was by the 5th Circuit Court of Appeals in banc in State of Louisiana v M/V Testbank, ruling against any claims by shipping interests and others against a bulk carrier and a container ship whose collision caused a chemical spill and subsequent closure of a river channel. In the majority’s view, a hard-and-fast rule was preferable in maritime decisions even in the light of the argument from deterrence. “[I]t is suggested that placing all the consequences of its error on the maritime industry will enhance its incentive for safety. While correct, as far as such [economic] analysis goes, such in terrorem benefits have an optimal level. Presumably when the cost of an unsafe condition exceeds its utility there is an incentive to change. As the costs of an accident become increasingly multiples of its utility, however, there is a point at which greater accident costs lose meaning, and the incentive curve flattens. When the accident costs are added in large but unknowable amounts the value of the exercise is diminished”.

The court also rejected the argument based on nuisance on the ground that it was well-nigh impossible to separate here who among an entire community that had been commercially affected by an accident had sustained a pecuniary loss so great as to justify distinguishing it from similar losses by others. Besides, rephrasing the claim as a public nuisance did not change its essential character so as to permit recovery for an interest that the law has consistently refused to protect.

Still, there are a few decisions that have broken rank. A year earlier the 9th Circuit had allowed recovery to commercial fishermen who had been prevented from pursuing their living by an oil spill on public waters. Is the difference explainable as resting in the one case on the dominance of the oil industry in the Gulf region and in the other on the strong ecological sentiments against offshore oil exploration off California’s sensitive coastline? And then there is the New Jersey court which held a defendant, whose tank car
exploded causing a temporary closing of an airport, liable to an airline for interruption of their business.\textsuperscript{18}

The case for denying recovery in these situations is strengthened where the plaintiff is a better loss bearer. This might be because he is in a better position to estimate his exposure to the risk and able to absorb resulting losses. Typical are the cable cases, like \textit{Spartan Steel v Martin},\textsuperscript{19} where in the course of a road construction the contractor breaks an electricity line, interrupting the power supply to factories in the neighbourhood. Work stoppages from whatever source are a foreseeable risk of industrial operations, calculated into the price of their products. They can, moreover, be anticipated and guarded against more cheaply by the plaintiff, for example by maintaining an emergency generator. Economic efficiency thus points to the potential victim as the better "loss-avoider", as Calabresi would say.\textsuperscript{20}

\textbf{Direct Loss}

Situations where the plaintiff is directly, not consequentially, exposed to foreseeable loss most strongly resemble the stock tort paradigm. Foremost, of course, is the case of negligent misrepresentation to one to whom information or advice is passed directly or through an intermediary and who, as the defendant knows or should know, will place reliance on it in a particular transaction: the \textit{Hedley v Byrne} situation.\textsuperscript{21} Of special importance in the development of American law is Judge Cardozo's decision of \textit{Glanzer v Shephard}\textsuperscript{22} holding a public weigher liable in tort to the purchaser of a quantity of beans for certifying to the seller an overweight. Here the transmission of the certificate was not just a possibility, it was "the end and aim of the transaction, as certain and immediate and deliberately willed as if a husband were to order a gown to be delivered to his wife, or a telegraph company, contracting with the sender of the message, were to telegraph it wrongly to the damage of the person expected to receive it.... The bond was so close as to approach that of privity, if not completely one with it".

Another illustration of the same principle is that of the intended legatee whose bequest is frustrated by the negligence of the testator's attorney. California courts were the first to allow recovery, emphasising the defendant's awareness of the plaintiff's identity and likely size of her loss; also that otherwise the defendant's negligence would lack all sanction. Both factors are equally weighty. First, the relation between the attorney and the intended legatee is so close as to be non-contractual only by giving undue importance to the technical lack of privity. Indeed American courts, mindful that the bequest to the legatee was "the end and aim of the transaction", have not hesitated to treat the legatee as a donee beneficiary entitled to sue in contract, as well in tort.\textsuperscript{23} Secondly, it is only by happenstance that the attorney escapes liability to the testator himself: actually, the foreseeable loss is only transferred from the testator to the object of his bounty.

"Transferred loss" is even more clearly involved in two other situations, though its reality has escaped American no less than British courts. One is the case of a time charterer who sustains loss as the result of a collision with, or defective equipment supplied by, a negligent defendant. The highest courts in both jurisdictions have denied the charterer
compensation for resulting losses on the technical ground that only the owner or a person with a possessory interest in the ship has standing to sue. 24 The other case concerns damage to or loss of goods in transit where the purchaser has the risk of loss, but not the property. Again, recovery is denied on the ground that the plaintiff lacks the necessary standing. 25 Thus the one who has suffered the loss has no remedy, while the other who has the remedy has suffered no loss. Yet, in both cases the defendant's liability would have been the same if the owner instead of the purchaser had suffered the loss; by allowing the purchaser to recover, the defendant's liability would merely have been transferred from one to the other, thereby avoiding the spectre of indeterminate liability. German law which is even more constrained than the Common law by a categorical exclusion of economic loss in tort, has been remarkably inventive in contractual circumlocutions: its theory of "transferred loss" (Drittschadensliquidation), in effect urged by Goff LJ, 26 would have been a model for the Common law.

Insurance

A potent factor bearing on the relative capacity of the parties to bear the loss is the insurability of the risk. Except for professional liability, liability insurance is generally limited to personal injury and property damage. There can be no question that the availability of liability insurance has been a potent catalyst for the vast expansion of tort liability in American as in British law. 27 This is underlined by the very fact that the absence of such insurance has been a notable contributor to the survival of the immunity for economic loss.

Conversely, in many situations self-insurance by the potential victim is a more efficient way of absorbing the loss. As already discussed in connection with the interruption of electricity supply, the affected enterprise is better able to calculate and discount its potential exposure than would be the defendant and his insurer. So also in most cases of products liability, substantial economic losses, particularly loss of profits during repair or replacement, are incurred by businesses. These can generally look after themselves and in any event are not able to command the same compassion as victims of physical injury.

Economic theory has played only a modest role. Its general emphasis on deterrence as a primary means of reducing accident costs is in this context somewhat muted, as the before-mentioned passage from the Testbank case explained, by the frequently disproportionate cost of liability. Plaintiffs can thus be targeted in many situations as the better cost-avoiders. 28

Triangular Relations

The tension between contract and tort becomes particularly acute in triangular relations, i.e. where there is a contract between A and B and between B and C and the question is whether A owes a duty of care to C. The first batch of English economic loss cases looked rather favourably on extending liability to relationships "equivalent to contract". Besides Hedley Byrne 29 itself, there was Junior Books 30 and as late as 1990 Smith v Bush 31 where a valuer instructed by the lender was held liable to the purchaser/borrower for overvaluation of the property, their relation being described as "akin to contract". That
decision may have been influenced, though, by the fact that the plaintiff borrower had borne the cost of the valuer’s services.

The question comes to the fore especially in the context of construction projects. One difficulty in particular besets Junior Books and cases like it, which allowed a building owner to sue a designated supplier who was under contract (but only) with the main contractor. If we allow such a claim, how can we limit that liability to the extent assumed by the defendant in the contract? A lower standard of performance than that which would have been demanded by the legal standard of due care may have been stipulated or other exemption clauses agreed upon as a condition of his undertaking the job. But such defences are not ordinarily available against third parties in tort. Thus what told against a tort duty by the engineer to the contractor for under-valuation in Pacific Associates v Baxter, for example, was a provision in the head-contract for arbitration of such a dispute between owner and contractor and a specific disclaimer in that contract of personal liability of the engineer. Proponents of “vertical liability” have insisted on holding the subcontractor liable only to the contractual standard, but have been hard put to explain how. Clearly, a contractual theory such as has occasionally been put forward by American and German courts, would cleanly solve that problem.

It is also argued that the structure of the parties’ contractual relations was understood, perhaps even designed, to exclude complementary obligations in tort, such as that between the building owner, his engineer and the contractor. But in the absence of an expression to that effect, this is ultimately question begging.

American cases have looked both ways. On the one hand are jurisdictions, like California, which allow tort claims for economic loss in general by clearly foreseeable plaintiffs. These have included claims by contractors against supervising architects on the basis of the latter’s control over the former or, as the New Jersey court had it, because the contractors “share an economic relationship and community of interest with the architect on a construction project. The duty is based on circumstances establishing a direct and reasonable reliance by the contractor on the contracted performance of the architect when the architect knows or should know of the reliance”. The emphasis on reliance replicates the Australian High Court’s insistence on that element as necessary for the recovery of economic loss in tort. Also belonging to this group is the leading California case of J’Aire v Gregory Inc where a tenant recovered from a contractor for negligent delay in carrying out the performance under his contract with the owner. The agreement, it was said, was “intended to affect the tenant”. Besides these tort cases there are some others which occasionally succeeded in spelling out of the terms of the subcontract an intention to benefit the building owner and allowing him to recover as a third-party creditor beneficiary.

There is however a line of authority to the contrary. The leading Illinois case, for example, barred a subcontractor’s claim against a construction supervisor for the cost of redoing a portion of its work, although it left the plaintiff wholly without a remedy. In applying the same principle to an architect, the Virginia court commented that "the parties involved in a construction project resort to contracts and contract law to protect their
economic expectations. Their respective rights and duties are defined by the various contracts they enter. Protection against economic losses caused by another’s failure properly to perform is but one provision the contractor may require in striking his bargain. Any duty on the architect in this regard is purely a creature of contract.42

A comparison with other legal systems which have less difficulty in allowing recourse to such plaintiffs on a contractual basis raise the question whether the problem in Anglo-American law is not primarily structural rather than substantive. Do not the cases allowing recovery resort to tort in order to overcome a blind spot of our law of contract: to jump the privity gap? Arguably, this is a poor substitute for a contractual remedy which would be limited by the contract provision in regard to the standard of performance or other modifying terms. Tort law has found such problems somewhat vexing. Contract law also would obviate the duality in the defendant’s obligation, usually linked to strict performance in contract but to negligence in tort. Functionally, this disparity does not make any sense.

Is the privity rule based on more principled grounds? The argument is sometimes made that it would thwart the intention of the parties to a multilateral project to be placed under obligations they had no intention to assume. But this assumes too much. If they really desired not to be bound, they could easily so provide. Otherwise, it begs the question. In sum, the objection to claims of this kind seems to be less substantive than structural. The best solution would be to reform the contractual privity requirement; the second best to tolerate tort filling the gap subject to the safeguards discussed.

Defective Buildings

Linked to the foregoing are claims against a building contractor by subsequent purchasers of a defective dwelling or other structure. This is a situation which has received most of the attention of British courts. Here too an earlier inclination to resort to tort in order to fill the privity gap was later replaced by a strict distinction between damage to the affected structure (economic loss) and damage to other property (physical loss). This development, of peculiar interest to New Zealanders, has resulted currently in a divergence between English and New Zealand decisions.

American cases are quite divided. Illinois and Virginia generally follow the English view of D. & F. Estates and Murphy. The leading Illinois decision, for example, rejected the claim against a builder by a second owner of a home for the cost of repairing structural defects. Although presumably the defects could eventually have resulted in physical injury, “the hazard did not result in a member of the plaintiff’s family being struck by a falling brick from the chimney. The adjoining wall has not collapsed on and destroyed the plaintiff’s living room furniture. The plaintiff is seeking damages for the cost of replacement and repair of the defective chimney, adjoining wall and patio....The complained-of economic losses are not recoverable under a negligence theory”.

Significantly, however, the court extended the Illinois implied warranty of habitability to cover subsequent purchasers of residential buildings like the plaintiff in that case. In
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outcome, therefore, it reached the same conclusion as obtains in England under the Defective Premises Act 1972. This, in turn, raises an interesting reflection: was the decision in *D. & F. Estates* tacitly influenced by the protection afforded by this statute to residential dwellings, in practice confining the decision to commercial owners who, arguably, can better look after themselves? If so, that decision should have less precedential weight in jurisdictions like New Zealand which, at the moment, lack this statutory solution. One defect of the British judgmental style, which often conceals a court's real motivation behind a mask of abstract doctrine, is that it may be interpreted elsewhere without reference to its local context.

Other cases from a wide range of jurisdictions, however, support claims by subsequent purchasers for latent defects, citing the inexperience of ordinary home buyers and the fact that such purchasers would not have assumed the risk of latent defects. Moreover, even Illinois, otherwise a steadfast adherent of the “economic loss” rule, relented to allow recovery to school districts against asbestos suppliers for removal and repair costs on the ground that the toxic material had contaminated the whole buildings and had thus done damage to other property. But reminiscent of the House of Lords in *Murphy* repudiating the idea of diluting the notion of other property by resort to the notion of “complex structures”, the Illinois court guarded against “the use of some fictional property damage”, besides stressing the unique nature of the “defect” and the “damage” caused by asbestos. Indeed, claims by school districts for asbestos removal have generally succeeded in American jurisdictions, distinguishing between “contamination” and property damage and excluding asbestos from risks allocated by private bargaining.

**Defective Products**

In comparison with the British, American experience with the problems of economic loss caused by manufacturers of defective products is rich indeed. English case law on traditional liability for negligence can be assumed now to follow the guidelines established for defective structures in *D. & F. Estates* and *Murphy*. The only appellate case, *Muirhead v I.T.S.* dealing with a defective water pump which did not pose any risk of personal injury, rejected the claim for loss of profits, while allowing damages for the lost lobsters which had perished from asphyxiation. The strict liability of producers under the Consumer Protection Act 1987, giving effect to the EEC Directive of 1985, likewise expressly limits damages to personal injury (or death) and damage to other property, not damage to or loss of the defective product itself.

The diversity of American case law is its most prominent feature. The only (near) consensus appears to be on the identity of solutions alike for negligence and strict liability. On one extreme are jurisdictions adopting the same view as the British cases, with the distinction drawn according to whether the damage or loss emanates from damage to the defective product itself or to other property. The former is deemed economic, falling to the province of contract as one based on disappointed expectations in performance but with no distinction made between damages for loss of expectation and negative losses such as repair costs. This approach received a boost from the U.S. Supreme Court decision in *East River S.S. Co v Transamerica Delaval Inc* rejecting the claim of a charterer for
loss of profit caused by a defective turbine, for fear that otherwise “contract law would
drown in a sea of tort”.57 But as in most of the other cases following the same approach58
the defect here did not have any potential for physical damage,59 though this possible
distinction was expressly negated in the majority judgment. In giving this decision of the
U.S. Supreme Court its due, it should be borne in mind that it is controlling only for federal
maritime jurisdiction, not however for state law (with which most of the claims are
concerned) on which State supreme courts have the last word.60

A slight concession to the opposite view is suggested in the early landmark decision of
the California Supreme Court in Seely v White Motor Co61 where Traynor J allowed that,
had the “galloping” of the defective truck caused the physical damage to the truck, that
would have qualified as property damage and been recoverable from the manufacturer.
As it was, the wrecking of the truck was attributed by the jury to a different cause, with
the result that the claim for loss of profits and for money paid on the purchase price was
rejected. Other opinions have also flirted with the idea that “an accident involving some
violence or collision with external objects which results in physical damage will most
likely be treated as a tort action”,62 but such an intermediate position, depending on the
qualitative nature of the damage, even when occurring “through an abrupt, accident-like
event”, failed to persuade the U.S. Supreme Court, because “the resulting damage due to
repair costs, decreased value, and lost profits is essentially the failure of the purchaser to
receive the benefit of its bargain – traditionally the concern of contract law”.63

Another intermediate position turns on the nature of the risk, differentiating between
defective products which endanger and those which merely disappoint users. Tort
recovery is allowed at least when dangerous products cause the loss as a proximate result
of their danger potential and under dangerous circumstances, as when a pickup truck
went out of control as a result of a fractured defective weld in the axle housing.64 This was
the view shared also by Lord Denning in Dutton65 and pressed by Laskin J in his dissent
in the Canadian Supreme Court in Rivtow Marine Ltd v Washington Iron Works.66 It strikes
me as the best solution, since danger is the crucial element of tort and it is entirely
haphazard whether the danger will eventuate in damage to the some other property or to
the defective product itself. It would seem more consonant with principle to make the
distinction on the basis of the defect and its foreseeable potential rather than its chance
consequence.

Finally, at the other polar extreme, is the New Jersey decision in Santor v A.&M.
Karagheusian Inc67 which rejected all distinction between dangerous and merely shoddy
goods and held a manufacturer liable for the lesser value of a carpet due to a disfiguring
welt. (The seller had left town.) Reminiscent of the nominated subcontractor in Junior
Books, a California case reached the same result against the manufacturer of unusable
cans for packing abalone whom the intended consumer had specifically alerted to his
special needs.68 The U.S. Supreme Court’s comment was that cases like Santor “raise
legitimate questions about the theories behind restricting products liability, but we
believe that the countervailing arguments are more powerful. The minority view fails to
account for the need to keep products liability and contract law in separate spheres and
to maintain a realistic limitation on damages”.69 These seem paltry reasons. There is no
inherent value in keeping tort and contract in hermetic compartments, except for minds addicted to convention and pedantry. More significant it would be if the tort doctrine involved exposure to exceptional damages. Such, however, is not the case, because a manufacturer as seller is always exposed to liability for breach of warranty whatever the defect. Tort recovery merely substitutes the consumer for the buyer as plaintiff, and decisions to the contrary in effect confer undeserved windfalls on defendants. Judge Cardozo’s concern about indeterminate liability is not triggered by these cases.

Conclusion

Professor Gray, the editor of the second edition of Harper & James, several years ago commented on “the remarkable parallel between the American decisions on this point and those in Britain and the Commonwealth. These developments were largely independent of each other; the courts in our country rarely have cited British authority, and British courts rarely cite our decisions. Nevertheless the developments have been similar even to details in drawing the line on recovery”\(^7\).\(^{10}\) Alas, this statement is correct only in its most general sense. For one thing, there is, as we have seen, considerable diversity of outcome in American case law, as indeed there currently is between English and Australian decisions on the one hand and Canadian and New Zealand decisions on the other. For another, American law is much more fluid even within a particular jurisdiction: yesterday’s minority view is as likely to become tomorrow’s majority. A change in a state Supreme Court’s personnel, reflecting the advent of a different ideology, may bring drastic change, as occurred in California in 1987 when the liberal majority was unseated by popular vote and replaced by solidly conventional judges.\(^7\)\(^1\) The looser system of precedent is compounded by the great number of voices from sister jurisdictions. In British jurisdictions, by contrast, while a dramatic turn-about is not unknown — indeed occurred in this very context when *Anns* was overruled by *Murphy* — once the law has been authoritatively expounded it will in general represent the received wisdom into the dim future.
2. [1972] 1 QB 373 (CA).
4. In Prosser on Torts (5th ed. 1984) negligent economic loss is still buried among Interference with Contractual Relations (§ 129); Harper, James & Gray in the 1984 edition deal with it in a new chapter on Damages (§25.18), and found no more than footnote space for it in relation to products liability (§28.9 n 21).
6a. Idem.
7. Supra, n 68 and accompanying text.
11. Rosenblum v Adler, 93 N.J. 2d 324, 461 A. 2d 138 (1983); Bily v Arthur Young & Co, 222 Cal App 3d 289, hearing granted, which may presage reversal by the new conservative majority of the California Supreme Court.
12. Rickards v Sun Oil Co, 23 N.J. Misc. 89, 41 A.2d 267 (1945); Federal Commerce & Navigation Co v M/V Marathonian, 528 F. 2d 907 (2d Cir. 1975). In re Kinsman Transit Co, 388 F. 2d 821 (2d Cir. 1968) avoided the issue by deciding against the claim on ground of remoteness.
15. 725 F. 2d 1019 (1985), a 10: 5 decision
16. Ibid., at p.1029.
25. Leigh & Sillivan v Aliakmon [1986] AC 785; State of Louisiana, ex rel Guste v M/V Testbank, 752 F. 2d 1019, 1022 (“the prevailing rule [in Robbins] denied a plaintiff recovery for economic loss if that loss resulted from physical damage to property in which he had no proprietary interest”).
27. This has not been doubted since the article by Fleming James, “Accident Liability Reconsid-
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28. The ill reasoned pseudo-economics by Sneed J in Union Oil v Oppen (supra, n 17) was castigated by Posner in "Some Uses and Abuses of Economics in Law" (1979) 46 U Chi LR 281, 297-301 and served as a warning against judicial amateurism in this field.

29. See Wright & Nicholas, supra n 26; Fleming, supra, n 281, 297-301 and served as a warning against judicial amateurism in this field.


34. Supra, n 33.

35. New Zealand did so in the Contracts (Privity) Act 1982, but it is not believed that the Act would stretch to remedy the instant problem.


37. Murphy v Brentwood DC [1990] 3 WLR 944.

38. Redarowicz v Ohlendorf, 92 Ill. 2d 171, 441 N.E. 2d 324 (1982).


43. See particularly Markesinis, "Eternal and Troublesome Triangles" (1990) 106 LQR 556. For German law see Markesinis, The German Law of Torts (2d ed. 1990) 233-9; and Lorenz, "Some Thoughts about Contract and Tort" in Essays in Memory of Professor FH Lawson (1986) 86.


45. See Smillie, supra, n 34.
55. Section 5.
57. Ibid., at p. 866.
59. The decision has been distinguished on this ground in several cases: eg, *City of Greenville v WR Grace & Co*, 827 F. 2d 975, 977 (1987).
60. The House of Lords in *D. & F. Estates* and *Murphy* gave the impression that this decision represented the American viewpoint. All the same, the decision has had persuasive effect; eg, the 3d Cir. changed its prediction of Pennsylvania law in *Pennsylvania Glass Sand Corp v Caterpillar Tractor Co*, 652 F. 2d 1165 (1981) by reversing itself in *Aloe Coal Co v Clark Equipment*, 816 F. 2d 110 (1987).
61. 63 Cal. 2d 9, 403 P. 2d 145 (1965).
70. §25. 18A, vol 4, pp.624-5.
1. Introduction

The ruling by the House of Lords in Murphy v Brentwood District Council excludes liability in common law negligence for pure economic loss attributable to defects in buildings and, by extension, in chattels as well. By economic loss we mean the cost of repairing the defect or the diminution in value when repair is impractical plus consequential loss. It is "pure" economic loss because it results from a defect in the product (a term we use to include buildings and chattels) itself and not from damage to the product caused by some external source like fire or a falling object.

Previously, in Anns v Merton London Borough Council the House of Lords had endorsed recovery for product defect economic loss provided the defect posed an imminent risk to health and safety or danger to other property. Subsequent decisions in England and elsewhere, including New Zealand, suggested that recovery be allowed even for non-dangerous defects.

In this article we examine some issues raised by Murphy. In general, we ask, as the House of Lords did, whether negligence law should have any role in redressing this type of pure economic loss. Our intuition is that the strength of the case for recovery in negligence might vary depending on whether we are dealing with a defective chattel or a defective building. It is assumed in most cases, including Murphy, that the rule ought to be the same in either case. Therefore we first evaluate in detail the case for negligence liability for defective chattels. Then we consider whether there are any differences with defective buildings which might justify different conclusions. We also deal separately with the (at least theoretical) distinction between dangerous and non-dangerous defects asking whether it is a valid and viable one. That distinction was rejected preemptorily in Murphy.

Our criteria of analysis to this point is largely functional. Specifically, we ask whether negligence liability for product defect economic loss is likely in theory or practice to generate any net deterrence of social waste or injury, or to provide a practical mode of injury compensation. We conclude that the case for direct negligence liability for dangerous building defects caused by builder's negligence, although not overwhelming, finds some support on both deterrence and compensation grounds. The case is weaker for a similar action for dangerously defective chattels, and for non-dangerous defects generally.

But, regardless of the strengths and weaknesses of these arguments, we then consider whether the policy goals which might justify tort liability (for builders, manufacturers
and/or public authorities) might be better pursued through other means. In New Zealand the common law action for damages for personal injury has been deemed deficient and replaced by a scheme philosophically based on the notion of community responsibility. We discuss the case for a similar approach to building defect economic loss and find it attractive.

2. Chattel Defect Economic Loss

A. Non-Dangerous Chattel Defects

At the heart of commerce in chattels lies the contract of sale. The manufacturer sells under contract to the seller who in turn sells under contract to the buyer. The case for allowing the buyer to sue the non-privy manufacturer in negligence depends on two determinations. First, the contractual regime must be judged inadequate in some significant respect. Second, the negligence suit must be responsive to the perceived shortcomings of the contractual regime.

There are two significantly different ways in which the negligence duty could be integrated into existing commercial law. Negligence law can supplement valid contractual rights which the buyer has against the seller either by providing additional tort rights against the seller subject, in both instances, to their being limited by the terms of the contract. Alternatively negligence law can supersede the contractual rights and impose duties on the manufacturer regardless of the terms of the contract of final sale.

If the buyer has a valid claim in contract against the seller, is there any reason to recognise an additional action against the manufacturer in negligence? No doubt, the manufacturer’s negligence may be the reason a product fails to meet standards established in the final contract of sale. It may seem more just to hold the negligent manufacturer liable than the innocent seller. We might also hope that negligence liability would deter negligence in manufacture. Assuming that these are desirable goals is one thing. Believing that they can be achieved by the direct action in negligence is another.

Manufacturers and sellers will allocate the risk of liability to purchasers in their own contracts. The manufacturer may agree to indemnify the retailer if the law holds the retailer liable to the purchaser. The direct negligence suit would merely replicate the outcome which the parties had pre-determined in their own contract. It is sometimes thought that the direct negligence suit is more efficient than chain contract suits. But there is no reason to suppose that actual litigation between the manufacturer and seller will be common, or inappropriate when it does occur.

In other cases, the seller and manufacturer may agree that the seller will bear ultimate liability for product defect claims. Assuming we found this objectionable, negligence liability alone would not insure that liability would be brought home ultimately to the manufacturer. Once the negligence rule was established, the manufacturer could simply shift that liability back to the seller by contract. To ensure that the loss rested ultimately on the manufacturer the law would have to couple the negligence rule with a prohibition on contractual loss shifting back to the seller. This would be as inefficient as it would be
extraordinary. Presumably the decision to allocate the loss to the seller was a mutually beneficial decision made by experienced commercial parties. There is no a priori reason to believe that the legitimate goal of deterring negligence in manufacture will be sacrificed if the retailer bears the loss.¹¹ Contractual loss shifting is no more objectionable than, say, allowing potential defendants to carry liability insurance for personal injury negligence claims.

Therefore, assuming solvent retail sellers, allowing a buyer to sue the manufacturer directly in negligence as an alternative to suing the seller in contract will not determine who ultimately bears the loss. The negligence suit is superfluous in deterrence terms.¹² It may create the illusion of justice by appearing to place liability on the party responsible. Symbolic justice may be important, but the social problem of shoddy products does not seem to be the most pressing area in which to pursue it.

However, the direct action in negligence might make a significant difference to a plaintiff unable to realise judgment against a retail seller. Perhaps the seller has become solvent or left the jurisdiction or there are other purely practical reasons preventing the buyer from following an otherwise valid claim against the manufacturer through to actual damage recovery. The negligence action could serve as a form of compulsory insurance against such judgment-proof sellers. This clearly has a compensation rationale although, if buyer-compensation is the primary goal, strict liability or warranties probably make better sense.¹³

Altogether different issues arise if the action in negligence is completely independent from the terms of the contract of final sale. From the plaintiff's point of view, the negligence action may be useful whenever the action on the contract is likely to fail. Perhaps the contractual limitation period has expired. Perhaps the goods, although shoddy, were sold as such and met the contractual description. Perhaps the risk of defect was allocated to the buyer in the contract. Nevertheless, the plaintiff might hope that the court will hold the manufacturer liable for negligently circulating "defective" goods. In effect, to grant a remedy in negligence in such a case is to allow the buyer to improve upon the terms of the contract by suing in tort. One would only wish to do this if one believed that contract and sales law (including legislation) was unsatisfactory.

In the commercial sales market it is generally assumed that the parties themselves are in the best position to specify quality terms and price, and to allocate risk of breach between them. Naturally, not every commercial contract is the outcome of fair negotiation between equally empowered parties. However, there is no reason to assume that commercial buyers, as opposed to sellers or manufacturers, tend to be the generally vulnerable parties. In general the law ought to take care, as it usually does, to guard against actions in tort intended to circumvent contractual bargains.¹⁴

In contrast, it is commonly believed that inequality of bargaining power in the household consumer market supports special legal protection for the consumer purchaser. Many jurisdictions have accepted this rationale and enacted statutory consumer protection provisions which modify basic sales law.¹⁵ So, if there is a case for allowing the buyer to succeed in negligence when she would fail in contract, it is more cogent in the consumer
market, but only in jurisdictions whose consumer protection legislation is deficient. Isolating particular markets, such as the household consumer market, is not a typical common law approach, but it could be done.

While defining the elements of the common law action seems straightforward enough—negligence by the manufacturer (or seller) and a defect in the product purchased by the plaintiff—determining when they were satisfied could be problematic. True, in some cases defects are self-evident. If a consumer buys a new toaster for the purpose of making toast and it does not do that, it is defective. If that occurs because of careless assembly of the particular toaster, or indeed by a design defect, there is negligence. But other circumstances would prove more difficult to assess. What if the toaster worked well but only for 18 months? Is that a defect or merely inferior quality being the trade off for a lower price? What is a lower price? Perhaps in the process of free bargaining, the buyer has simply bargained poorly.

If the courts are to allow consumers to sue on the wider notion of defect in negligence in cases in which the consumer cannot succeed in contract, they must be prepared to review the substance of consumer contracts. In a given case, the court must know the price at which the product was sold, and then determine that the consumer got less than his or her money’s worth. There will be a great many cases where it will be far from clear that a judge is in a better position than the consumer to make that determination.

To the extent that a defect is merely a poor bargain, fault-based manufacturer liability ought to be premised on the manufacturer’s responsibility for the poor bargain. Dangerous defects and defects such as the toaster that wouldn’t work aside, it is not negligence per se to manufacture low quality goods. Indeed, lower quality goods sold to a reasonably informed public at a sufficiently low price play an important role in modern industrialised societies. Surely it is for the legislators to decide that shoddy goods may not be marketed on any terms at any price, and then to establish the minimum quality standards.

In some cases, the cause of so-called product defect economic loss is not the manufacturer’s negligence, but the selling price. The manufacturer quite deliberately manufactures and sells a lower grade product to a fully informed retailer. The retailer, without breaking applicable sales law, then markets the product to consumers at a substantially higher price. In the negligence suit, the consumer would be arguing that the product was defective in that the price was excessive relative to the quality. But often the manufacturer will have had no control over the price at which the product was sold by the retailer. In such a case, it would make no sense to impose fault-based liability on the manufacturer. It might make sense to hold liable manufacturers who had determined, or at least been aware of, the excessive retail price. But then, the fault in issue would be more akin to fraud than to negligent manufacture of “defective” goods.

Perhaps the best reason to reject the negligence suit as a tool of consumer protection is that private law suits are of limited use to individual consumers. Few consumers who believe that they have unfairly purchased shoddy goods are going to invest their own time, let alone legal fees and costs, in a negligence suit. The inadequacy of private litigation has
been demonstrated even in the case of defective automobiles where the damages may be relatively high. In fact, recognising the negligence suit as a tool of consumer protection could be dysfunctional in so far as it diverted attention from solutions which promised real change.

In summary, the case for allowing a buyer to use the courts to improve upon (rather than merely enforce) a contract depends on: (1) the belief that consumers will use private litigation; and (2) the belief that courts are better able to assess bargains than typical consumers. Even if these premises are sound, and we are sceptical that they are, they do not support the recognition of a direct suit in negligence which would override the terms of the contract of sale. First, the logical starting point to deal with unfair consumer contracts is the law of consumer sales itself. But, if one wished to develop rules to sanction manufacturers who are responsible for unfair consumer contracts, these would often have nothing to do with allegations of negligence in the manufacturing process itself. It follows that if an action in negligence for shoddy product economic loss were recognised, it ought only to be allowed to supplement a valid claim in contract. And then, its only impact should be to designate manufacturers as compulsory insurers against judgment-proof sellers.

B. Dangerous Chattel Defects

The next question is whether and how the analysis might change if the defect posed a significant risk of danger to health and safety or to other property. A defect may be regarded as dangerous in this sense if the reasonable person would have incurred the economic loss (repair or replacement) at that time in order to eliminate the danger. This test emphasises the probability and severity of harm rather than the imminence of harm per se and a court should be able to apply it with as much certainty as most other legal tests if it were of a mind to impose liability.

The rationale, if any, for treating dangerous defects differently from others does not lie to any great extent in the owner's claim for compensation. As emphasised in Murphy, from the owner's point of view it matters little whether the defect is dangerous is not. Once the dangerous defect becomes manifest, it has, like any other defect, the effect of rendering the chattel less valuable than it would have been without known defects. So, the direct negligence suit against the manufacturer must be rationalised otherwise, probably by a concern for accident deterrence.

Ordinarily, when a dangerous defect becomes manifest within a reasonable time after sale, the buyer will have a remedy in contract against the seller. Thus, in the typical case of a negligence suit against the manufacturer of a dangerously defective product the buyer will not be seeking to improve upon the terms of the contract of sale. That the defect is dangerous will not change the analysis of this situation from what it was in the case of merely shoddy products. The seller and manufacturer will have allocated this risk by contract, and negligence liability can not prevent this, even if we wished it to. The only impact the negligence rule would have is in the case of judgment-proof sellers. And, since this is a compensatory rationale, there is no reason to distinguish dangerous from nondangerous defects.
Next, consider the case in which damages relating to the dangerous defect cannot be obtained in an action on the contract of sale. There is no common law prohibition against commerce in dangerous or potentially dangerous goods, so there may be occasional cases in which the defect constitutes neither a breach of the contract nor a breach of relevant safety legislation. There may also be an occasional case in which a court concludes that the risk of defect has been allocated to the buyer in the contract. In this case, a negligence action for economic loss pertaining to dangerous defects is not subject to the same objections as the action pertaining to merely shoddy goods. In the case of merely shoddy products, it was suggested that the concept of “defect” is elusive in the absence of a contractual reference point but it is easier to define a dangerous defect objectively. In addition the deterrence arguments are stronger.

In effect, such an action would amount to a transmissible manufacturer’s warranty against dangerous defects caused by the manufacturer’s negligence. Implicitly, at least, this would have to be a warranty for a reasonable period of time. Manufacturers cannot be responsible for deterioration in perpetuity. The question of reasonable time could pose a difficult, but not impossible, task for the courts. This would be a compulsory warranty in that the action would lie regardless of the terms of the contract of sale (except express acceptance, in full knowledge, of the defect). The purpose of such an action would be to deter carelessness in manufacturing which leads to dangerously defective products. Once adopted, the negligence rule would increase the potential liability cost of the manufacturer, and would be expected to induce whatever additional quality control measures became cost-effective in light of the new exposure. In the event that the manufacturer shifted his liability risk back to the seller, a marginal increase in deterrence would still be predicted.

There may be another deterrent effect. The ultimate point of deterring dangerous defects is to prevent the injuries or property damage that such defects may cause. The speeches in Murphy assume that once a defect becomes manifest, the danger disappears because the user will immediately repair or remove the defective chattel. But, as Murphy itself shows, this is not necessarily so. Users may choose to expose themselves and others to the risk that the defect may cause physical harm to themselves or to others. True, in so doing they are running a risk of being held liable themselves in negligence to others, but often the risk will be discounted by the victim’s probable difficulty in proving that the user was aware of the defect. It is possible that the user would be more likely to repair or replace knowing that she would be indemnified. So, in the rare case when the user would not be indemnified by the seller, a right of indemnification from the manufacturer may encourage repair or replacement.

In addition, the negligence duty if borne by the manufacturer, may also have a small compensatory impact in favour of injured third parties. Although the victim may have a cause of action against the user, that person may not carry insurance or be otherwise able to satisfy a large personal injury judgment.

The negligence action for dangerously defective product economic loss seems to be a natural derivation of established tort principles. If damages for physical harm are
recoverable, why not damages to prevent defects from actually causing physical injury? According to standard functional analysis, the negligence action for dangerously defective goods is both coherent and plausibly useful. Where a contractual remedy already exists, the negligence rule will have virtually no impact. Where there is no contractual liability, its impact is difficult to predict without detailed empirical study. Our guess, and it is only a guess, is that the negligence action will neither generate significant costs nor induce major safety incentives.

3. Structural Defects in Building

A. Non-Dangerous Structural Defects
Our analysis and conclusions differ significantly when we move to structural defects in buildings. The main reason is that commerce in real property is conducted differently from commerce in goods. There is an active resale market in which the buyer typically gets little or no contractual protection. Another reason is that the stakes are higher. Individuals are far more likely to find litigation worthwhile when their homes become uninhabitable than when their dishwashers break down.

Consider first the possibility of allowing the action in negligence when the buyer does have a valid case in contract. For all practical purposes, this analysis is relevant only to the market for new buildings. In the typical resale transaction between two parties with no particular knowledge or expertise about building, the risk of latent defect will be allocated by contract to the buyer. To be of any use here the negligence action would have to override the contract, a possibility described later.

In the case of new buildings, usually the builder is also the seller. Obviously, the negligence action accomplishes nothing here. When the seller is not the builder, as in the chattels analysis, the negligence actions makes a difference only when the seller is judgment-proof and the builder is not. The case for judgment-proof seller insurance is somewhat stronger for buildings than chattels, at least in the residential home market. With buildings, the amount at risk is typically much larger, and residential home buyers are in a relatively poor position to take their own precautions. This makes some extra precaution such as insurance more attractive. And, with larger amounts at risk, it becomes more likely that owners would invoke their legal rights to obtain compensation. Potential liability might induce the builders to take more care in building, or in selecting sellers.

Of more practical significance is whether the law ought to recognise an action in negligence to recover damage associated with latent building defects in cases in which the buyer would not be entitled to recover in an action in contract against the seller. In effect, ought the law to recognise a mandatory warranty against latent defects caused by builder's negligence, which passes with title to successive owners? The case is somewhat different with buildings than chattels because of the relative importance of the resale market. The typical resale transaction between two parties with no special expertise in construction will allocate the risk of latent defect to the buyer. Although a buyer might well find it practical to turn to the courts to remedy serious structural defects, it is unlikely that the resale residential home buyer will have any contractual rights to exercise. In
contrast, the ordinary chattel consumer who will seldom find legal rights of any use will have a broad range of contractual rights against the seller, and often additional rights against the manufacturer. For this reason it is tempting to allow the courts to develop mandatory quality standards for buildings, especially for residential housing. The residential home buyer makes the single largest purchase of a lifetime with virtually no common law legal rights against the seller or builder.

But, here too, we face the difficulty that the notion of defect entails that the building falls short of some quality standards. If the court is going to go outside the standards established in the contract, as it must, it must develop a common law definition of "suitable" housing. While this is an appealing idea for residential housing, (even thought it would presumably have only prospective effect), it is an option better left to the legislature. The case for providing decent affordable housing for citizens is a political one, and it is already on the political agenda in most jurisdictions today. The economic ramifications of such a "suitability" warranty are too complex and potentially enormous to be instituted by judicial guesswork (or left to the fortuity of the evidence available in particular cases). The practical problems of refining the suitability standard are daunting. Are buyers better off in homes with crooked floors and peeling paint than in lower cost rental accommodation? At what price and at what opportunity cost?

B. Dangerous Defects

As with chattels, a stronger case exists for the negligence action in respect of building defects which can be identified as posing a risk to health or safety or other property. Essentially, we are considering a mandatory warranty against dangerous building defects caused by builder negligence which would pass with title to successive owners. The main rationale for such an action would be deterrence of builder negligence. We would also expect that owners who become aware of dangerous defects would be less inclined to pass them along to unsuspecting resale buyers if they were able to have them remedied by the builder.

The negligence action might also be justified on compensatory grounds. For one thing, the loss may be large enough to justify litigation. These defects tend to be very expensive, ordinarily they must be attended to, and they are not easily discovered by the typical buyer. In contrast we cannot say with the same confidence that the risk of product defects, even dangerous defects, is not rationally assumed by product consumers.

With due respect to the contrary views expressed in Murphy, negligence liability for dangerously defective structural economic loss seems to be a natural derivation from established tort principles. If damages for physical harm are recoverable, why not damages to prevent defects from actually causing that harm? The negligence action for dangerously defective buildings is coherent and possibly useful both as a deterrent and as a vehicle whereby a wronged consumer may obtain compensation. And, in contrast to the situation with defective products, residential home owners will frequently find themselves without a contractual remedy against the seller. Moreover, we might expect that the negligence action may be of some practical use to owners of the dangerously defective premises in that the cost involved will be worth incurring.
Some may object that the distinction between dangerous and non-dangerous defect cannot be made with certainty. For example, is it dangerous to “health” to cause a property’s value to drop or to reduce the owner’s pride of ownership so that anxiety or diminished “well being” results? We are less troubled by this. In the first place the Anns test for danger could be revised to drop the imminence requirements and to utilise a familiar reasonable person standard. In the second place the distinctions called for resemble those that have been developed in related areas of the law.

As to the distinction between buildings and chattels, we can invoke the traditions of the common law. Although perhaps more for historical than functional reasons, it has long distinguished the law governing real property from that governing chattels. It would be quite feasible to recognise a common law rule which applied to buildings alone.

The actual deterrence impact of potential negligence liability for dangerous defects is difficult to predict. If, for example, the typical negligent builder is likely to go bankrupt, say within five years of commencing business, liability rules of any sort are futile in deterrence terms (and in compensation terms unless they are coupled with a legislative scheme to insure solvency or otherwise provide insurance cover).

The impact of potential liability even on firms likely to stay in business is also difficult to predict. If we move from a situation in which builders have no incentive to build safely to one where they will be held liable in negligence for dangerous defects, it is reasonable to expect significant improvement in quality control. However, it would be rare to find a jurisdiction where there were no builder safely incentives. One might find, for example, that in any jurisdiction with significant legislative health and safety standards and enforcement, the reputable builder would already be taking all feasible quality control measures. Potential liability might have no marginal deterrent impact whatsoever. If not, the increased costs associated with the liability rule will have to be justified otherwise.

4. Is Tort the Answer at All?

So far we have concluded that the strongest arguments for negligence liability for product defect pure economic loss relate to dangerous defects in buildings. Contractual remedies fall short of providing reasonable certainly of compensation for the most likely victims of loss (resale buyers) so something more seems necessary to meet that goal. Negligence liability promises something in that regard as well as some deterrence.

But this does not mean that tort is necessarily the preferable solution. Commentators have called for legislative intervention in respect of compensation for building defects, both before and after Murphy. The common law has proved incapable of dealing consistently with the policy issues involved. Even people with different views about what the policy objectives should be seem dissatisfied.

Perhaps this is because a court’s institutional competence to deal with these questions depends largely on whether the necessary information is available and whether counsel
have been willing and able to put it before the court. Clearly the legislature is in a better position to commission such research from scratch and to bring a range of legal options to bear on the subject (if it is so inclined).42

There are other reasons for questioning the value of tort as the most appropriate response to the problem of defective buildings. In 1974 New Zealand scrapped tort as the means for dealing with the consequences of personal injury. The Woodhouse report, which inspired that revolutionary change, cited several reasons.43 It found the moral notion of "fault" to be an inadequate justification for common law negligence in that (a) the latter applied an objective standard regardless of the individual defendant's ability to meet that standard, (b) the obligation assumed by a defendant was disproportionate to the conduct deemed to be faulty (i.e., damages are "not measured by the quality of the defendant's conduct, but by its results") and (c) the defendant is not usually held personally accountable, damages being paid by a liability insurer. The Report also referred to the uncertainties of litigation which make outcomes (both in terms of liability and quantum of damage) dependent upon availability of evidence, financial and other pressures on the plaintiff to settle, the essential subjectivity of fact-finding and the application of the reasonable person standard and the possibility of contributory negligence. Another criticism was the "delay and suspense" necessitated by the procedures involved in a negligence claim; yet another the expense of the process. On top of all this, the Report seriously questioned the deterrent value of the negligence action. At least in the realm of personal injury it was thought to offer little if any marginal increase in deterrence over those incentives already existing (criminal sanctions, the instinct for self-preservation, conscience, etc.) especially when the "sanction" would usually be paid by a liability insurer.44 Although criticisms such as these have not been uniformly accepted as valid,45 they do have wide currency and have led to reform of personal injury law, especially in respect of motor vehicle accidents, in many jurisdictions.46

But perhaps even most important to the Woodhouse thesis than the itemised shortcomings of the negligence system as a response to the problem of personal injury was the view that the tort approach was fundamentally inappropriate. Tort provided remedies in some individual cases to individual victims who could find individual defendants. The compensation of injured victims (as distinct, perhaps, from the prevention of injury) was not so much a matter of individual responsibility as a community concern. The Report stated:47

This first principle [of community responsibility] is fundamental. It rests on a double argument. Just as a modern society benefits from the productive work of its citizens, so should society accept responsibility for those willing to work but prevented from doing so by physical incapacity. And, since we all persist in following community activities, which year by year exact a predictable and inevitable price in bodily injury, so should we all share in sustaining those who become the random but statistically necessary victims. The inherent cost of these community purposes should be borne on the basis of equity by the Community.

If all these considerations justify a radical departure from (or at least modification of) the common law approach to personal injury, and we believe they do, should similar
arguments be applied to other types of loss; specifically, for present purposes, financial loss attributable to building defects?

The litigation process seems to be no less time consuming and no less costly in building defect cases than in personal injury cases. In one Dunedin High Court case, Mr Justice Hardie Boys, in reference to the fact that the proceedings had been commenced more than five years before the eventual High Court hearing, observed:

> It is most regrettable that it has not been dealt with earlier, for costs have continued to escalate; and as well the builder has gone out of business, although it is not in liquidation.

Delay is inherent in the system. While crowded trial lists no doubt contribute to the problem, a process which requires attribution of cause and, in particular, blame is necessarily a lengthy one because of the need to collect the appropriate evidence. In addition uncertainties about the law may militate against quick settlement. The problems caused by delay are, as Mr Justice Hardie Boys pointed out, continued cost escalation and, because something as fundamentally necessary as accommodation is concerned, personal anxiety. By itself, the delay problem should be enough to provoke serious thoughts of reform.

Associated with delay is the problem of the cost of the process. The complicated nature of the factual and legal questions typically involved requires the allocation of significant legal and related resources. While estimates vary, it seems that nearly half of the money that changes hands in the sorting out of latent defect cases goes to legal costs and experts' fees.

The uncertainties of litigation makes claims relating to building defects something of a lottery, if not quite to the same extent as the Woodhouse Commission observed with respect to personal injury. The skill of counsel, availability and reliability of witnesses and other evidence, the financial pressures on the plaintiff to settle early and the availability of insurance or other resources to meet a judgment or settlement are all variables which might affect the outcome of otherwise meritorious claims. The underlying concern is that similarly deserving cases might be treated differently. Of course, this requires a value judgment about what are similarly deserving cases. Advocates of the traditional tort approach hold that victims who have suffered at the hands of a wrongdoer are more deserving of a legal remedy. Others, like us, take the view that victims of equal loss who are equally innocent (in the sense that contributory fault is not involved) deserve equal access to compensatory remedies. The negligence approach discriminates against victims, first on the legal criterion of fault by a defendant and second, by setting up practical hoops for the plaintiff to jump through to satisfy that legal criterion.

The deterrent value of tort in building defect cases may be overestimated by its advocates just as it was with personal injury. This is not to say that some incentives are not at work; rather that they are, at best, uncertain (as we discussed above), haphazard in their operation, perhaps counter productive, and can be achieved in other ways.
To the extent defendants can insure against liability for building defects, incentives to take care are severely diluted. There may be an indirect impact of adverse claims experience on defendants in the form of premium increases or policy cancellation. But insurers’ actions in this regard depend largely on conditions in the insurance market which usually relate to general interest rates. When interest rates are high insurers, seeking funds to invest, try to attract customers by lowering premiums and by being less particular about risks betting that increased exposure will be more than offset by increased returns on investment. On the other hand, when interest rates are low, insurers become much more concerned about “underwriting losses” and tend to increase premiums and pay closer attention to the nature of the risks they accept. They may even reject entire classes of risk. Any deterrent effect in this amounts to overkill. Firms may go out of business rather than face exposure to risk without insurance or some may continue without cover. The consumer loses in two ways. The number of suppliers is severely reduced. The likelihood of obtaining compensation in the event of loss caused by a firm remaining in business is significantly reduced. Even if premium adjustments are useful incentives they can be implemented through first-party insurance. There are also other regimes of control under building codes and regulations requiring approval of plans and inspection by public authorities.

As the Woodhouse Report did in dealing with personal injury, it is possible to build a case for a response to building defects which is based on community responsibility. The Woodhouse Report referred to a concern for the “predictable and inevitable price” of community activities. In reviewing the accident compensation scheme in 1988, the Law Commission reiterated this point, referring to the “inevitable and regrettably random consequences of essential or accepted social activity”. The Law Commission characterised the scheme as “citizen-wide social insurance ... concerned with income maintenance and fair support for living standards”. If supporting living standards is the goal, it seems reasonable to consider housing along with income maintenance. Moreover the concern is not just with providing housing but also with its quality. In a paper written for the Royal Commission on Social Policy, D H Thorns wrote:

The key issue in the New Zealand debate about homelessness is adequacy of housing rather than a dramatic increase in those with no shelter at all. The increasing costs of shelter have produced more people living in poorly maintained housing. . . .

We recognise that there will never be political consensus as to which is appropriately a matter of community responsibility. However we believe a respectable argument can be made that the generally recognised public obligation for ensuring the safety of buildings (given form in public health legislation and building bylaws) should also include responsibility for arranging for the compensation of those whose buildings (dwellings at least) suffer from latent defects.

5. Alternative Approaches

Policy makers who have sought to remedy perceived deficiencies in personal injury law
Pure Economic Loss

dominated by negligence theory, have often turned to some form of no-fault regime. By this we mean a scheme whereby the victims of loss obtain compensation, perhaps subject to limitation by amount and category of loss, without having to show that someone was to blame.62

For present purposes, no-fault schemes can be divided into two types; those funded by potential victims (first party schemes) and those funded by third parties. Examples of the first type are motor vehicle no-fault plans such as those in place in many North American jurisdictions63 and indeed the motor vehicle component of the Accident Compensation Schemes in New Zealand. Typical of the second type are workers' compensation schemes (including the earners' scheme under the ACC), where levies are paid by employers in respect of claims by employees, and some medical accident plans like that in Sweden where health care providers pay into a fund for the compensation of medical accident victims.64

A building defect compensation scheme could be of either type (or, indeed, a combination). Professor Smillie has described arrangements in place in Britain which amount to a first-party scheme.65 The National House-Building Council, a building industry organisation, makes available to buyers of new homes from builders or developers registered with the Council a 10 year warranty against defects in workmanship and materials (including major structural defects). It is transferable to successive owners and is backed by insurance. It is available at low cost (about 0.3% of the construction cost). It also provides incentives to avoid defects. Builders with bad claims experiences are subject to penalties including, ultimately, deregistration by the Council, no small measure in that most lending institutions require borrowers to obtain the warranty meaning that most buyers will only do business with a registered builder.

Another British example cited by Smillie66 is a specialised first-party insurance policy covering latent defects. One insurer offers cover for 10 years at a cost of about 1% of the value of the building. This policy is aimed at the commercial market but other insurers are starting to compete with the NHBC scheme in the housing market.

Purpose-designed cover, in the form of warranties or insurance policies, is necessary. Most ordinary homeowners' insurance does not cover latent defects, either because that is not within the perils insured against or because perils such as “faulty workmanship” are specifically excluded.67 Care must be taken in defining the terms of cover, particularly the time period during which defects must manifest themselves. Here a balance must be struck between cost and reasonable protection.68

Other policy choices would have to be made in terms of the administration of a first-party scheme. Smillie is content to leave it to the private insurance market.69 If the building industry is sufficiently well organised, as apparently it is in Britain, the scheme can be handled by a body representing its members.70 Alternatively, the job can be given to an existing or newly created government organisation.71
Then there is the question of whether the scheme is compulsory. This will depend on how attractive it is to buyers of homes (or commercial buildings) or the existence of other, informal, incentives such as conditions attached to housing loans. It may also depend on whether tort rights are formally abolished. If they are it may seem necessary to fill the gap completely. On the other hand an attractive scheme combined with the abolition of subrogation (perhaps less controversial than the formal abolition of tort rights) would have the effect of slowly killing off tort as a significant factor.

If the scheme is not funded by buyers (at least directly), there are three other possibilities; builders, local authorities, or central government. If builders were charged with payment they would, if market conditions allowed (determined by supply and demand), simply pass the cost onto buyers. To the extent builders bore the cost themselves, some deterrent effect might be achieved although it would be diluted by the loss-spreading nature of the scheme. In any event, other factors such as pressure from lenders (as in Britain) and building inspectors would be operating. Putting the burden on central government has the effect of spreading the loss further but this may been seen as unfair, especially if some localities are known to have more problems with building defects than others. Having local authorities bear the burden avoids this while giving effect to the idea that protection is a matter of community responsibility. Of course the cost would fall ultimately on ratepayers but this is roughly the same group (if ratepayers include tenants who pay rates indirectly) as that which realises the benefits of safe buildings. The costs are therefore spread among the class of occupiers rather than owners. Responsibility for costs may also provide local bodies with an incentive to exercise care in inspecting and approving construction, if this is thought necessary. However, in an era of government spending restraint, political action to assume more costs rather than “privatising” them is unlikely.

If there is a legislative solution, as most commentators propose, it will most likely involve a first party scheme with strong incentives for owners to participate, if not outright compulsion. It could well be administered by the private sector - possibly in conjunction with an existing public body like the Earthquake and War Damage Commission. Legislation will most likely arise in New Zealand if courts here follow Murphy leaving homeowners largely protected. But if New Zealand caselaw remains firmly on its present course exposing both builders and local authorities to liability in negligence, the principal players might well take the economically rational step of introducing a scheme themselves which would eliminate the inefficiencies of tort litigation without legislation. This has happened in Britain and is likely that that development was not unconnected with the trend in liability reflected in Anns and Junior Books. As Professor Smillie has indicated, the building industry in New Zealand has already taken the first steps in this direction.

A scheme of the type we envisage need not be confined to dangerous defects. There may be objection to dealing only with dangerous defects, either because the distinction is believed to be often too hard to make or because public policy calls for a broader focus. These objections can easily be accommodated in the definition of risk covered.
5. Conclusion

In the circumstances that prevail in Britain, the result, if not all the reasoning, in *Murphy* turns out to have been sound. Compensation for losses attributable to building defects is available through other, more efficient means which effectively spread those losses. Other incentives to take care (at least for builders) are in place. In New Zealand compensation through loss spreading has been a primary rationale for imposing negligence liability. It has been thought that this can be achieved through liability insurance, especially that held by builders. As Smillie has shown, this is largely an unfounded assumption insofar as it relates to builders. Accordingly actual liability has tended to fall back on local bodies’ ratepayers. While this can still be defended on compensation (through loss spreading) grounds and, to some extent, deterrence grounds, our view is that these goals can be achieved without the costs, delays and inequities inherent in the negligence system.
We are grateful to Professor John Smillie, University of Otago, for comment and criticism which we found invaluable. We are of course entirely responsible for the views expressed herein.

2. The House of Lords held that it makes no difference whether the defect is dangerous or not. While we accept that in either case the claim may be characterised as economic loss, that does not in itself resolve whether we might wish to recognise a tort duty for dangerous defects alone. More on that below.
3. As the Court observed the distinction between pure economic loss and that attributable to externally caused damage is sometimes not easy to draw in that some "internal" defects may be characterised as "external" in relation to other parts of the property. See D. & F. Estates Ltd v Church Commissioners for England [1989] AC 177 (HL).
6. We do not ignore the notion of "justice". Rather we incorporate it into our analysis. However we treat it with care, realising that arguments for or against a tort action are inevitably value-based with a subjective element. Our analysis is no freer of this than any other. We regard the issues under review as giving rise to two justice questions, not one. The just way to treat the victim does not always coincide with the just way to treat the causer of the harm.
7. The term "dangerous defect" is used as a short form for a defect which poses a significant risk to health or safety. This is explained more fully below. For the time being, assume that the analysis applies to goods which are merely shoddy, but in no way dangerous.
8. There may be a series of intermediate sellers selling to one another under contract. The analysis derived from the basic three-party commercial chain is easily extended to that variation. It is also possible that the user or owner may have obtained the product otherwise than by contract, by gift perhaps. While it is desirable that the law protect those people in the case of actual personal injury, the case for protecting the purely economic interests of donees is a weak one, especially, as will be demonstrated below, when there is no compelling reason to protect the interest of the buyer.
10. Sometimes, the manufacturer will take steps, such as by making express warranty claims, to bear the loss directly.
11. Manufacturers will have to "pay" retailers to bear this risk by selling at lower cost than they would otherwise. There is an obvious incentive to reduce this "cost" by reducing the risk. Presumably, the parties find it more efficient to have the seller bear the costs in the first instance. Perhaps transaction costs are much lower if the seller compensates the buyer. Sellers assess the risk of manufacturer negligence in setting the contract price, and in this way the consequences of negligence are brought home to the manufacturer. Consumers benefit from these efficient arrangements. True, market imperfections may allow poor or unscrupulous manufacturers to shift excessive defect cost to vulnerable sellers and thus distort ideal deterrence. However, in the world of commerce there is no reason to expect generally that sellers will be the vulnerable parties systematically victimised by manufacturers.
12. Adding negligence liability in this area may in fact undermine the compensation goal by adding too much deterrence. George Priest has suggested that increased categories of tort liability in the U.S. caused such a burden on insurers that they withdrew from some commercial markets entirely. See Priest, "The Current Insurance Crisis and Modern Tort Law" (1987) 96 Yale LJ 1521.
13. Note too a possible logical inconsistency. The proposition is that the manufacturer should be liable to guard against a collapse of chain obligations. But the manufacturer and seller may have allocated responsibilities between themselves so that the seller had no claim over against the manufacturer in respect of suits against it (the seller) for defects in the product.
15. Perhaps most common are the "merchantable quality" and "fitness for purpose" provisions of the Sale of Goods Act 1908, s16. Note too the Fair Trading Act 1986 which is not confined to consumer transactions.
16. We are not dealing here with fraud or misleading advertising. We are assuming here reasonably well informed parties. Impediments to full information can be addressed through consumer protection legislation or through intentional torts.
17. See the comments of Lord Brandon (dissenting) in Junior Books, supra, n 5 at p.552. Admittedly determinations like this have been reasonably common in merchantability cases under Sale of Goods legislation. See supra, n 15. There, however, these determinations are usually not coupled with the notion of fault as would be necessary under negligence. But see Milne Construction Ltd v Expandite Ltd [1984] 2 NZLR 163 (HC).
18. Indeed in some jurisdictions it is illegal for the manufacturer to try to influence retail price.
19. Forty American States have enacted so-called "lemon laws" to govern liability for defective new automobiles. Although the schemes differ, the common characteristic is manufacturer-financed arbitration as a viable alternative to litigation for consumer relief. For a comprehensive summary see Nowicki, Regulating and Resolving New Car Warranty Problems and Disputes (1987, unpublished doctoral thesis, Syracuse University).
20. Prima facie, the logical way to improve the law of contract would be to change the law of contract directly. This, however, the courts may be reluctant to do because contracts of commercial and consumer sales are so heavily regulated by legislation.
21. Suppose the defect is not imminently dangerous, but will inevitably become so over time. Ideally, from an efficiency and deterrence point of view, we would wish to encourage a small repair immediately than to risk a major repair later. Indeed, if the repair is delayed too long, a serious accident may occur. However, if the test is for imminent danger, the user might prefer to wait until confident that the risk would be regarded as imminent and thereby throw the cost onto the manufacturer, than to incur the cost herself. (This assures that buyers will be confident that they will be better off with a negligence claim than making repairs themselves. And it ignores that manufacturers might prefer to make the small early repair if the defect were brought to its attention than to risk the greater liability later). Our formulation avoids this and responds to the concerns expressed by Lord Bridge in Murphy, supra, n 1 at p. 440.
22. Although tort law has traditionally been more solicitous of personal injury than, eg, property damage. Perhaps a similar "ranking" might justify tort's intervention in dangerous rather than non-dangerous cases.
23. One cannot say that dangerous defects are always or are even generally more financially burdensome than others. Non-dangerous defects may be slightly less onerous in one sense. One can choose to drive an automobile with a defective coating of paint in preference to paying a substantial sum to repaint. This simply means that the owner values the loss at less than the cost of repair. However, if a product is truly dangerous, it ought to be repaired immediately or scraped, whatever the owner's preference.
24. Courts would be strict about this in a commercial context. However, this may also happen in consumer resale markets, such as the market for used automobiles. There an analogy to the residential home market (see below) may be appropriate.
25. It seems odd that the courts would pursue this goal indirectly through the negligence regime rather than directly by imposing such a warranty in sales law. Possibly, the courts feel that sales law is so heavily regulated by legislation that the role of common law is more restricted there than in negligence.
26. Supra, n 1 at pp. 426 and 432 (Lord Keith), pp. 435 and 437 (Lord Bridge) but cf p. 448 where Lord Oliver seems to envisage the situation in which the owner of a chattel, knowing it to be defective, courts the danger that represents.
27. The purchaser of the building (from the plaintiff) continued to live in it without making repairs.
28. That is, without empirical evidence.
29. Even for new homes contractual protection is usually minimal; there being no implied terms as to quality in the contract of sale for completed buildings, and contracts typically provide for a short maintenance period (insufficient for discovering latent defects).
30. See Brown "Murphy: Out of the Frying Pan into the Fire" (1990) 6 Prof Neg 150, 153.
31. See Lord Brandon's comment in Junior Books, supra, n 17. According to traditional economic theory, 'value' is essentially a subjective matter. Each consumer allocated his/her resources according to individual choice. Tort litigation would necessarily second-guess this process.
32. By mandatory warranty we mean one that would override the terms of the contract, even those that purported to contract out of the warranty. If the buyer has a contractual or statutory remedy, the only thing the common law can do is to offer judgment-proof seller insurance. Since the contract or statutory remedy was likely to lie against the builder already it is not of much use.
33. See Brown, supra, n 30. See also Olowosoye, "Murphy, Anns and Pure Economic Loss" (1990) 6 Prof Neg 158.
34. At least consumer expectations about remedies are different. The buyer of a chattel that turns out to be defective tends to expect the seller to put it right. That is less so when a building is concerned.
35. See supra, n 21 and accompanying text.
36. For example, in respect of liability for nervous shock and indeed other types of economic loss. Note, however, that while these arguments support the feasibility of tort liability in a narrow category, it does not follow that tort is necessarily the answer. Later we argue for a non-tort, non-sales contract solution under which definition problems, such as they are, can be reduced to relative insignificance.
37. Some structures, such as stationary cranes, might be difficult to classify but that is unlikely to be a common problem. (See Rivtow Marine Ltd v Washington Iron Works [1974] 5 SCR 1189.)
38. In Murphy only Lord Keith mentions deterrence and he seems skeptical about its effect; supra, n 1 at pp. 432-3.
39. We have so far only dealt with the liability of builders or other sellers. We have not dealt with the liability of public authorities for failing to comply with duties or exercise powers to inspect buildings to ensure compliance with relevant statutory standards. We have chosen to regard this as outside the scope of the present paper although we return to the theme of public responsibility below in the context of alternative approaches.


42. This is not to say that legislative and common law regimes cannot co-exist. But if the legislature has studied and acted upon the problem of dangerous (or, for that matter, shoddy) buildings courts should pause before acting independently of the statutory regime.


44. Other criticisms mentioned such as the problem of lump-sum awards and difficulties with regard to rehabilitation relate specifically to personal injury and are not applicable here.

45. This is especially true of the deterrence argument which has been the subject of considerable discussion in the law and economics literature. See, eg, Posner, Economic Analysis of Law (2nd ed, 1977).

46. For a review of the literature relating to this reform in Canada, see Brown, supra, n 30 at p.436 about possible liability for the cost of rectifying defects which pose a danger to neighbouring property.

47. Supra, n 43 at p. 40.

48. Sloper v Murray Ltd, High Court, Dunedin, A 31/85, 22 November 1988, Hardie Boys J.

49. Ibid., at p.2. The action had originally been commenced in the District Court but, because the damage was found to exceed that court’s jurisdiction (due in part to escalation of costs over time), it was removed to the High Court in April 1985, some three and a half years before the hearing. Other reported cases show that delays of three to five years between commencement and hearing are not uncommon for cases that go to trial. Two or three years can be added for those cases that go on to the Court of Appeal. See, eg, Stieller v Porirua County Council [1986] 1 NZLR 23 (CA), writ issued 1979, High Court hearing 1983, Court of Appeal, 1986; Brown v Paramount Builders [1977] 1 NZLR 394 (CA), writ issued 1970, High Court 1975, Court of Appeal 1976; Mount Albert Borough Council v Johnson [1979] 2 NZLR 23 (CA), writ issued 1973, Court of Appeal hearing 1978.

50. Even in Murphy, which supposedly settled the law in England, there were musings about possible exceptions to the no-liability approach. See, eg, Lord Bridge’s discussion (supra, n 1 at p.436) about possible liability for the cost of rectifying defects which pose a danger to neighbouring property.

51. Smillie says “approximately 40% of liability insurance premium revenue is absorbed by legal costs and experts’ fees”: supra, n 41 at p.313. This figure may not cover all plaintiff’s costs nor all the public expense involved in providing the facilities of the court. Another aspect, seldom mentioned in tort discussions, is the added burden of possible insurance litigation. For example, the Mount Albert Borough Council, after being successfully sued for negligence in connection with a building defect (a matter being finally resolved in the Court of Appeal: see Mt Albert Borough Council v Johnson, supra, n 49) then commenced proceedings against its insurer which had denied it an indemnity. That case itself went to the Court of Appeal (see Mt Albert Borough Council v NZMCI Co Ltd [1983] NZLJR 200 (CA)).

52. This factor accounts for the prevalence of cases involving “deep pocket” local authorities as defendants. Surely an inefficient way to provide insurance.

53. One such restriction might be a “long stop” limitation period. Discovery of loss after the period would disqualify the claimant. The problem is that tort tries to balance the interests of both plaintiffs and defendants. In accommodating (legitimate) concerns of defendants, the system can short change plaintiffs.

54. In New Zealand builders are in fact unlikely to have insurance protecting against liability for latent defects. See Smillie, supra, n 41 at p.312. If indeed they cannot insure, they may be judgment-proof in which case the threat of tort liability is academic.

55. In the U.S. this occurred during the “insurance crisis” of the mid-1980s. See Priest, supra, n 12. Perhaps the most dramatic consequence was the withdrawal of entire fields of medicine, such as obstetrics, from some communities.

56. Priest, ibid., at p. 1225.

57. Of course the public authorities themselves may require incentives to carry out their functions properly. Tort law may arguably have a role to play here. We think other arrangements would do a better job. More on this below (see infra, nn 75-78 and accompanying text).

58. Supra, n 43.


60. Ibid., paras 44-5.
62. Although it may be necessary to show the loss was caused in a particular way, eg, by accident rather than disease.
63. See Brown, supra, n 46.
65. Supra, n 41 at p. 313.
66. Ibid., at p. 314.
67. For Canadian examples of judicial ingenuity in getting around this, see Cominco Ltd v Commonwealth Insurance Co (1985) 13 CCL1 51 (BCSC); Todd’s Men & Boys Wear Ltd v Diamond Masonary Ltd (1985) 12 CCL1 301 (Alta QB); But of Bird Construction Ltd v US Fire Insurance Co (1985) 18 CCL1 92 (Sask CA).
68. Somewhere between 10-15 years seems to have achieved a reasonable balance in Britain. Differences in construction methods and other conditions in New Zealand (see Withnall, supra, n 40 at p.200) may support a different period.
69. Smillie, supra, n 41 at p. 317.
70. Apparently the NZ Master Builders’ Federation is soon to implement a scheme. See Smillie, ibid.
71. This idea is not new in New Zealand. See the Building Performance Guarantee Corporation act 1977. The scheme had several shortcomings which meant it was not greatly used. It was repealed in 1987. The Housing Corporation now provides an indemnity under its Buildguard scheme. See Smillie, ibid., at p. 313. In addition, the Building Industry Commission has floated the idea of a statutory authority. See Smillie, ibid., at p. 316. A further possibility is a combined public-private venture like the Earthquake and War Damage Commission. Premiums are collected with fire insurance premiums by private insurers but administered by a public body with responsibility for compensating specific kinds of loss not covered by the typical private insurance policy.
72. In New Zealand the scheme established by the Building Performance Guarantee Act 1977 had a short life because it did not attract sufficient support: see ibid.
73. See Smillie, supra, n 41 at p. 317. This has essentially been the case with Sweden’s medical accident scheme. See Oldertz, supra, n 64.
74. There could be of course several contributors. The Building Industry Commission floated the idea of a scheme jointly funded by home buyers and builders. See Smillie, supra, n 41 at p.316.
75. An idea that is bound to have its detractors. See Fleming, “Requiem for Anus” (1990) 106 LQR 525 at p. 528.
76. Note this argument among others might support the view that local authorities be liable in tort in these types of cases. For reasons expressed above, however, we prefer other means.
77. But this may have adverse effects such as undue delays in the processing of permits. See Building Industry Commission, Reform of Building Controls (1990) vol 1 p. 24.
78. Even if owners pay, however, that cost could be expected to be passed onto tenants in rents.
79. See supra, n 71.
80. Smillie, supra, n 41 at p.317.
81. The other principal distinction we have drawn is that between buildings and chattels. Again that was mainly for the purpose of assessing the value of tort liability. While it would be possible in theory to create a no-fault scheme for chattel defects our perception is that the need does not exist; that contractual or other consumer law remedies are sufficient.
82. See Bowen v Paramount Builders [1977] 1 NZLR 394 at p. 419 per Woodhouse J.
83. Smillie, supra, n 41 at p. 311.
AN IMPOSSIBLE DISTINCTION*

The Rt Hon Sir Robin Cooke
President of the New Zealand Court of Appeal

In a famous passage in *Dutton v. Bognor Regis Urban District Council*¹ Lord Denning M.R. said:

"Mr. Tapp submitted that the liability of the Council would, in any case, be limited to those who suffered bodily harm: and did not extend to those who only suffered economic loss. He suggested, therefore, that although the council might be liable if the ceiling fell down and injured a visitor, they would not be liable simply because the house was diminished in value. He referred to the recent case of *S.C.M. (United Kingdom) Ltd. v W. J. Whittall & Son Ltd.*²

I cannot accept this submission. The damage done here was not solely economic loss. It was physical damage to the house. If Mr. Tapp's submission were right, it would mean that if the inspector negligently passes the house as properly built and it collapses and injures a person, the council are liable: but if the owner discovers the defect in time to repair it—and he does repair it—the council are not liable. That is an impossible distinction. They are liable in either case.

I would say the same about the manufacturer of an article. If he makes it negligently, with a latent defect (so that it breaks to pieces and injures someone), he is undoubtedly liable. Suppose that the defect is discovered in time to prevent the injury. Surely he is liable for repair."

It is to be noted that nowhere in the passage do the words *contract* or *tort* appear. Whether or not their omission was deliberate or merely a result of the natural sweep of Lord Denning's language, it is significant that he was able to state the law (as he held it to be) without invoking those technical, yet ill-defined, concepts. Although they have become major rubrics in modern expositions of the common law, they do not always stand for clearly differentiated compartments. There may be overlapping. For that proposition, so far as English authority is concerned, one need do no more than cite the scarcely less famous judgment of Oliver J. in *Midland Bank Trust Co. Ltd. v. Hett Stubbs & Kemp*,³ holding that a solicitor's duty of care to a client arises in both contract and tort. Nor did Lord Denning use in the passage quoted the word *warranty*, a term which historically is consistent with liability in either tort or contract.⁴

The main theme of the present article will be that in relation to (for instance) the liability in negligence of builders, manufacturers and local authorities, the true issues are becoming obscured by the use of the labels *contract* and *tort*. The policy choices confronting the courts are certainly not easy. But the choice can be unconsciously evaded, rather than made, if we begin by affixing to the suggested liability one of these labels and then go on to deduce the consequences by a process of *a priori* reasoning.

For a serving judge who has had some part in trying to decide a controversial legal issue, and who may have to return to the task, whether to write on it extra-judicially can be a rather delicate question. On this occasion I am impelled to do so by several considerations.
First, there are the best of precedents. The case against *Anns v Merton London Borough Council* has been cogently presented at the highest legal level in the United Kingdom extra-judicially as well as judicially, an illustration being Lord Oliver of Aylmerton’s 1988 Sultan Azlan Shah Law Lecture, “Judicial Legislation: Retreat from Anns,” which put forward much of the reasoning contained in his Lordship’s speech a little earlier in *D. & F. Estates Ltd. v. Church Commissioners for England* and now more fully developed by him in *Murphy v. Brentwood District Council*.

Secondly, there are some linked considerations stemming ultimately, I believe, from the same root cause, namely the sheer volume of case law and legal writing in the English-speaking world. The responsibility of the House of Lords is to pronounce on the law of the United Kingdom. To a slightly increasing extent their Lordships are referred by counsel to decisions in other countries, but the practice is still limited and rather haphazard. Moreover, even when cases decided in another jurisdiction are cited, the constraints on judicial time and associated factors are such that, entirely understandably, they may not receive attention in depth.

To illustrate those points it may be mentioned, albeit in no querulous spirit, that the latest New Zealand Court of Appeal case in the line that began in 1976 with *Bowen v. Paramount Builders Ltd.* was not cited by counsel in *Murphy*, according to the list appearing in the *Weekly Law Reports*, and is not cited in any of the speeches there. Since 64 cases were cited to them their Lordships might well not have been much assisted by one more, and it is true that *Askin v. Knox* did not embody any significant change from our earlier thinking; but possibly it might have been of some small help on an aspect which troubled Lord Mackay of Clashfern L.C., who spoke of:

> “difficulty in reconciling a common law duty to take reasonable care that plans should conform with byelaws or regulations with the statute which has imposed on the local authority the duty not to pass plans unless they comply with the byelaws or regulations and to pass them if they do.”

In *Askin* that did not seem to the court a practical difficulty. An argument for strict or absolute liability based on building byelaws made under statutory powers was rejected as going too far, though it was accepted that whether due care had been taken to comply with the byelaws was relevant in considering negligence. In New Zealand liability has been firmly anchored to negligence, which was found in *Askin* not to be made out on the facts of a rather stale claim (20 years; allegedly negligent persons dead). Ironically, in commenting on an unsatisfactory disharmony between New Zealand and English law, the judgment mentioned that relevant cases had fallen to be decided in New Zealand before the House of Lords had settled the corresponding English law and that then the New Zealand cases had not been cited in the House of Lords.

By the way of only one further illustration, the prevailing trend of opinion in New Zealand has been that, if a case be approached in terms of Lord Wilberforce’s two-stage test in *Anns* (which has been seen as a convenient basis for organising thinking, with ample inbuilt flexibility at both stages), the first stage entails much more than foreseeability. Many contingencies, even quite unlikely ones, are reasonably foresee-
able. The degree of foreseeability and the nature and magnitude of the risk are always relevant in deciding whether prima facie there should be a duty of care. I tried to say this in *Scott Group Ltd. v. McFarlane*, a case about auditor’s negligence and the take-over of a public company, but obviously failed culpably to do so, as my judgment was misunderstood in the House of Lords in *Caparo Industries Plc. v. Dickman*. The result is that it may be necessary to resort to the pages of the *Law Quarterly Review* to escape condemnation for heresy.

Thirdly, and this is by far the most important reason for writing something, we are concerned here with basic questions of common law principle and approach. The inevitable separate development of the common law continues apace, but this subject is one of those described by Lord Keith of Kinkel in the judgment of the Privy Council in *Rowling v. Takaro Properties Ltd.*

"upon which all common law jurisdictions can learn much from each other; not: because, apart from exceptional cases, no sensible distinction can be drawn in this respect between the various countries and the social conditions existing in them. It is incumbent upon the courts in different jurisdictions to be sensitive to each other’s reactions; but what they are all searching for in others, and each of them striving to achieve, is a careful analysis and weighing of the relevant competing considerations."

As has been recognised, that is exactly the approach that has been attempted in New Zealand for many years.

It may be doubted whether there is any overseas jurisdiction where the work of the United Kingdom courts is more deeply respected and influential than it is in New Zealand; and we do what we can to be sensitive. It is trite to say, however, that within any jurisdiction there are judges with different outlooks and that prevailing national judicial moods change from time to time. Few tort lawyers would dispute that the spirit which animated the unanimous decision in *Anns* and the majority decisions in *Dorset Yacht Co. Ltd. v. Home Office* and *Donoghue v Stevenson* is different from that which now prevails in the House of Lords and Privy Council. It cannot be a difference in carefulness or logic or powers of analysis. As is to be expected from judges of such eminence, the one approach is as well-reasoned as the other. In the end it is a difference in value judgments. And when there is a swing in ruling value judgments in one jurisdiction the problem for another jurisdiction can be whether to imitate it in the interests of uniformity.

Without qualifying in the least what has just been said about deep respect, the observation may be respectfully offered that, while English and Scottish appellate judges naturally differ *inter se*, perhaps equally naturally their general approach seems quite noticeably distinguishable from those followed in, say, Canada, the United States of America and Australia. There is an impressive and distinctive homogeneity about the House of Lords and the Privy Council (disturbed only by an occasional incursion). Currently its main characteristic is perhaps legal conservatism. At all events, what follows is an attempt to show that the structure which is *D. & F. Estates, Murphy, and Department of the Environment v. Thomas Bates & Son Ltd.* may be all the better for
a little fresh air and is not incapable of admitting it. Building partly on some of the thinking in their Lordships' speeches and adding some materials quarried from the rich, if daunting, mines of North American jurisprudence, it may be possible to fashion something that accommodates justice and the needs of developed society without violating any doctrinal proprieties.

**Distractions and diversions**

Some of the debate in this field has a scholastic or arid character, appearing to do little to get to the heart of the real issues. For example, if a house subsides and parts crack because of the defective foundations, is there much profit in arguing about whether this should be classified as physical damage or purely economic loss? No one seems to doubt any longer that, if a builder negligently constructs a house with a hidden dangerous defect, he will be liable for personal injuries suffered by the occupants in consequence before the defect is reasonably discoverable. All the Law Lords who delivered full speeches in *Murphy* evidently so accept\(^{23}\); and it also seems entirely clear that the mere fact that the builder was the owner makes no difference,\(^{24}\) so Lord Denning was right at least when he said\(^{25}\) *Bottomley v. Bannister*\(^{26}\) is no longer authority. But their Lordships in *Murphy* repeatedly state likewise that the same applies to damage to property other than the house itself. If the householder’s books or furniture suffer water damage as a result of negligently-created latent structural defect, he can presumably recover from the a negligent builder.

Exemplary and nominal damages aside, a plaintiff awarded monetary redress for damage to his property is essentially being compensated for economic loss. It is in his pocket, not in his person, that he has suffered. The distinction between "pure" economic loss and economic loss flowing from deprivation of the *use* of property is especially thin, as in the example of damage to a householder’s car.

Perhaps even more metaphysical is the debate about the complex structure concept — whether a house is one whole item of property or an assembly of integrated parts.\(^{27}\) That anything should turn on this, that it should be a subject of grave discussion in the highest court of a land, gives it curiosity value and the charm going with fine points of law. As a touchstone for answering practical questions, it may not turn out to be reliable. A result suggested, though possibly not actually decided, by opinions in *Murphy* is that if a contractor supplies only part of a house, such as the electrical system or boilers or steel framing, he owes a duty of reasonable care to successive owners to safeguard them from economic loss caused by damage to other parts of the building; yet not if he supplies the whole house.\(^{28}\) The smaller the role, the greater the responsibility. It must be respectfully questioned whether such a distinction can survive.

Another difficulty in seeking to dispose of the issues by the proposition that "pure" economic loss is not recoverable in tort, although caused carelessly, is that major exceptions have to be made. It is enough to murmur *Hedley Byrne*.\(^{29}\) The conventional rationale for the negligent advice exception is that the duty stems from reliance and a special relationship of proximity.\(^{30}\) Yet the liability of a local authority for a building
inspector's negligence has been based, by courts which uphold it, on control. There seems nothing false or contrary to common sense in saying that purchasers of houses rely on the local authority that controls building in the district to exercise its powers responsibly and with reasonable care. If the argument then becomes that the relationship is nevertheless not sufficiently proximate, this is to introduce another term eluding definition, as pointed out by Lord Oliver— who adds that there are other cases, such as Ross v. Caunters, not explained by the reliance theory.

A further shortcoming of the "pure" economic loss criterion is brought out by Lord Bridge of Harwich in Murphy when he expresses the opinion that a building owner ought to be entitled to recover in tort from a negligent builder expenditure necessarily incurred in obviating damage so as to protect himself from liability to third parties outside the property. His Lordship states that this is so "in principle," and it would not seem easy to devise a principle that would distinguish convincingly between the owner's liabilities to his neighbours and to his tenants or visitors. Indeed it may not be nonsensical to say that, if the owner is entitled to recoup the cost of saving from harm people on adjoining properties and in the street, the same should apply to the cost of protecting himself and his family. Lawyers nervous of the potential reach of Lord Atkin's Donoghue v. Stevenson principle based on the Christian ethic often argue on the lines that the common law must stop short of enforcing love of one's neighbour or altruism as a legal duty; making the point that the right to pursue self-interest underlies many rules of law. It would be paradoxical if the rules in this field were to treat solicitude for one's neighbour as more deserving of encouragement than preservation of the safety of one's own household.

Other labels which in the end may be more semantic than practically useful are proximity and incrementalism. Something has already been said about the first; I shall return to it shortly. In the High Court of Australia there are broadly two different schools of thought, epitomised by the two terms. Much will be found on the subject in Essays on Torts, produced for the 1989 seminar in Professor P. D. Finn's series at the Australian National University, Canberra. A valuable essay reviewing from this point of view English as well as Australian authorities is contributed by Justice McHugh, who declares himself an incrementalist but emphasises that questions of policy must come in. He adopts as the proper approach to the duty question a passage in the speech of Lord Diplock in the Dorset Yacht case including the following:

"But since ex hypothesi the kind of case which we are now considering offers a choice whether or not to extend the kinds of conduct or relationships which give rise to a duty of care, the conduct or relationship which is involved in it will lack at least one of the characteristics A, B, C or D, etc. And the choice is exercised by making a policy decision as to whether or not a duty of care ought to exist if the characteristic which is lacking were absent or redefined in terms broad enough to include the case under consideration. The policy decision will be influenced by the same general conception of what ought to give rise to a duty of care as was used in approaching the analysis. The choice to extend is given effect to by redefining the characteristics in more general terms so as to exclude the necessity to conform to limitations, imposed by the former definition which are considered to be inessential. The cases which are landmarks in the common law, such as Lickbarrow v.
An Impossible Distinction

Mason, Rylands v. Fletcher, Indermaur v. Dames, Donoghue v. Stevenson, to mention but a few, are instances of cases where the cumulative experience of judges has led to a restatement in wide general terms of characteristics of conduct and relationships which give rise to legal liability.

On that approach a judge who leans against extending a duty of care to a situation not hitherto ruled upon can say that the addition would not be incremental, or not sufficiently so. Brennan J. is the leading exponent of the approach in Australia, and his views have commended themselves in the House of Lords. A problem is that, if a judge prefers to hold — fundamentally for policy reasons — against the addition, he is likely to describe it in quite emotive language which a judge otherwise disposed would not employ. Thus in Sutherland Shire Council v. Heyman Brennan J. stigmatised the first stage of Lord Wilberforce's Anns test as involving a "massive" extension of a prima facie duty of care (on an interpretation which, as already explained, has not prevailed in New Zealand) and in Murphy Lord Keith has spoken of the passage in Lord Denning's Dutton judgement set out at the beginning of the present article as involving an unacceptable "jump".

Such epithets are undoubtedly justified in the light of the views held by those distinguished judges. It has to be remembered, though, that what is a jump to one person may be quite a small and necessary step to another. The fons et origo of this chapter of the law in England was the 1971 judgment of Cusack J. in the Queen's Bench Division in Dutton. The judge's discussion of the law takes only three pages of the report, although he records, not "too seriously," that at one stage of the argument he felt that no book would be left unopened. He relied on Donoghue v. Stevenson and other personal injuries cases; and, noting Lord Macmillan's declaration that the categories of negligence are never closed, added the following conclusion:

"The purpose of the building byelaws, including the inspection of the site of the building in the course of erection, is the protection of the public. There is ample authority for saying that if a local authority exercises its statutory powers to the injury of a member of the public, the injured person may be entitled to sue: see for example McClelland v. Manchester Corpn. In my view it must be in the contemplation of those who gave approval to building works that such approval will affect subsequent owners of the house. The council, through its building inspector, owed a duty to the plaintiff. The inspector was negligent. The council should therefore, on the facts as I find and the law as I believe it is, be found liable."

Evidently Cusack J. saw his decision as a natural incremental application of principle.

So, too, as to proximity. The leading Australian exponent of that requirement is Deane J., who has said that identification of it should not be either ostensibly or actually divorced from notions of what is "fair and reasonable". When held to exist, the term proximity announces a result rather than articulates a concept.

One last point about labels. References to judicial legislation, in what Lord Diplock would have called a dyslogistic sense, are of course helpful in emphasising forcefully that a particular solution is not approved. As well, however, it may conduce to perspective to remember that when a truly new point arises any solution of it is truly judicial legislation.
Dutton’s case was no doubt in that class. Counsel for the appellant council is reported to have opened in the Court of Appeal by saying:

“The case raises for the first time in this country the question whether where someone like a local authority, exercising a right to inspect during manufacture or construction of buildings or goods, negligently approves the construction or manufacture so that the property or the goods turn out to be less valuable to the ultimate purchaser than they would have been if there had been no negligence, the ultimate purchaser will have a right of action in tort against the inspecting body.”

No matter how Dutton was decided, the case was destined to make new law.

Murphy is in one sense a more striking instance of judicial legislation than Anns, indeed one of the most striking instances in the history of English law, for, as the Lord Chancellor said, it was the overruling of a decision taken after full consideration by a committee consisting of the most eminent members of the House of Lords; whereas Anns did not overrule any previous decision of any court. The decision in Murphy could not justly be criticised on that account, however, as the Law Lords were undoubtedly entitled to change the existing common law if satisfied that it was unsatisfactory.

A straighter path
Parts of the speeches in Murphy accord closely with the thinking of the leading writer on construction law, Mr. I. N. Duncan Wallace Q.C., and in particular his contributions to this Review. For a knowledgeable account of the factual background to the basic problem, one cannot do better than quote a passage in his 1989 article:

“Until the D. & F. case, and in particular Lord Oliver’s speech in that case, there seems to have been little or no understanding or discussion in the English appellate or other courts of the fact that the presence of physical damage may be technically as well as legally entirely irrelevant to the existence of even the most serious physical defects in a building, or indeed of non-compliance with bye-laws. Many defects are of such a kind that a building may be totally unsafe, but as yet not even microscopic chemical or other damage may have occurred. Bad workmanship, such as carelessly placing steel reinforcement in the wrong position, or a poor design specifying inadequate reinforcement, may mean that a beam will be mechanically incapable of carrying its full designed working load, though as yet it may not have failed (for example where an occupier later wishes to install furniture or equipment in a previously lightly loaded building and carries out a survey which discloses the error). Again, defects such as the absence of adequate surcharge drainage arrangements or the omission of a damp proof course, whether due to failure of design or of contract compliance or to simple bad workmanship, may produce no damage if discovered before seasonal or other, perhaps quite exceptional, flooding occurs, which if it does occur may do serious damage to render the house unsuitable. Very often, of course, some superficial cracking may be an early indication of movement and potential future structural failure, and this is particularly true of the differential settlement which is the usual result of inadequate foundations. This cracking and settlement may often cease and present little or no further problem beyond a need for superficial redecoration; on the other hand it may continue progressively to a point which requires radical solutions, including new foundations, to prevent structural failure. Other structural failures may be sudden and catastrophic, and not conveniently progressive with earlier symptomatic
'damage' before the moment of failure. By contrast some defects may develop very slowly and imperceptibly as a result of chemical action, such as inadequate concrete cover leading to rusting and swelling of reinforcement, and later to cracking of concrete, or the presence of sulphides in bricks or calcium chloride additives or high alumina cement in concrete, leading to progressive decay analogous to a human disease of a Cartledge v. Jopling character.

When one contemplates such facts, it is easy to see the force of Lord Denning’s observation that a distinction between liability for remedial expenditure and liability for injury is impossible. Further powerful support for that view was furnished in Anns by Lord Wilberforce and Lord Salmon, with the concurrence of Lord Diplock, Lord Simon of Glaisdale and Lord Russell of Killowen. The only qualification of it in Anns is that Lord Wilberforce held that a cause of action arises when the state of the building is such that there is present an imminent danger to the health or safety of persons occupying it. But beyond that Lord Wilberforce expressly left any issue of remedial action open. Then again no less a lawyer than Laskin J. thought that “Prevention of threatened harm resulting directly in economic loss should not be treated differently from post-injury cure.”

Yet in Murphy judges of the eminence of Lord Mackay of Clashfern L.C., Lord Keith of Kinkel, Lord Bridge of Harwich, Lord Oliver of Aylmerton and Lord Jauncey of Tullichettle all unite in treating the distinction which Lord Denning called impossible as, on the contrary, a fundamentally sound distinction which should be restored and preserved. And they use quite strong language in rejecting the opinion of the Denning-Wilberforce-Laskin school. Words such as “capricious,” “somewhat superficial,” “a state of confusion defying rational analysis,” “wholly unconvincing,” “fallacy,” “impossible” itself, appear in the Murphy speeches. Lord Brandon of Oakbrook and Lord Ackner concur without delivering separate speeches.

With such strong voices on each side, there is a very strong temptation to say that both must be right. In an analytical sense, that can indeed be said. The thought permeating the speeches in Murphy, repeated again and again in varying language to the same effect, is encapsulated in the following words of Lord Bridge in D. & F. Estates:

“But if the hidden defect is discovered before any such damage is caused, there is no longer any room for the application of the Donoghue v. Stevenson principle. The chattel is now defective in quality, but is no longer dangerous. It may be valueless or it may be capable of economic repair. In either case the economic loss is recoverable in contract by a buyer or hirer of the chattel entitled to the benefit of a relevant warranty of quality, but is not recoverable in tort by a remote buyer or hirer of the chattel.”

That is incontestable if the starting premise is that the only relevant head of negligence liability in tort requires injury to the person or actual damage to other property. Once those limits are taken as absolute save for exceptions which do not apply, there is of course no problem at all in rejecting tort liability. The permeating theme of Murphy and other recent House of Lords cases is only another way of saying the same; and it could be said no more authoritatively and forcefully than in the speeches of their Lordships. Moreover, as the speeches underline, the limits are perfectly consistent with Donoghue v. Stevenson,
a case of alleged illness where no issue arose about economic loss. On the other hand, the
majority speeches in *Donoghue v. Stevenson* were patently not meant to close the cat-
egories of liability in negligence, so the decision in that great case could certainly not be
said actually to require the decisions now reached in *D. & F. Estates, Murphy* and
*Thomas Bates*. Analytically it was open to the House of Lords in those recent cases to
decline to take further the ideas which won the day in *Donoghue v. Stevenson*. But,
analytically, it was just as open to the House as constituted in the *Anns* and *Dorset Yacht*
cases to take the more expansive approach. (I avoid the adjective “liberal” in this context
as being emotive.) The choice was a policy one.

In making the more restrictive choice the present-day House of Lords have placed weight
on the opinion of the Supreme Court of the United States of America, delivered by
Blackmun J., in *East River Steamship Corporation v. Transamerica Delaval Inc.*,
*a case decided in the Admiralty jurisdiction of that court in which a products liability
claim relating to the manufacture of turbines was held not to lie where the product
malfunctioned and injured only itself. There Blackmun J. expressed concern that
“contract law would drown in a sea of tort.” The theme of the opinion is that damage to
a product itself is most naturally understood as a warranty claim. One policy reason given
is that the increased cost to the public that would result from holding a manufacturer liable
in tort for injury to the product itself is not justified. Warranty liability was treated as
excluded by the particular agreements entered into between the several parties in that
case. It was accepted that where a warranty claim lies repair costs (*inter alia*) are re-
coverable. Realism would seem to suggest, therefore, that the route to a more direct
solution to the issues in *Murphy* and the associated cases may begin with examination of
the proper scope of warranty law.

**Warranty law in America**

In the United States of America, products liability claims appear to be governed mainly
by state law and within the jurisdiction of state courts without rights to appeal to or review
by the federal Supreme Court. Nevertheless it may be supposed that the *East River Steamship*
case will be influential. It will have pleased, to some extent, those commen-
tators who have argued that strict products liability has been carried too far in state
courts, inhibiting entrepreneurial and manufacturing initiatives of public benefit. But
note the following passage in the *East River Steamship* opinion:

> “Contract law, and the law of warranty in particular, is well suited to commercial
> controversies of the sort involved in this case because the parties may set the terms
> of their own agreements. The manufacturer can restrict its liability, within limits,
> by disclaiming warranties or limiting remedies. . . . In exchange the purchaser pays
> less for the product. Since a commercial situation generally does not involve large
> disparities in bargaining power, *cf.* *Henningsen v. Bloomfield Motors, Inc.* we see
> no reason to intrude into the parties' allocation of the risk.”

To that passage Blackmun J. for the court appended a footnote:

> “8. We recognise, of course that warranty and products liability are not static bodies
> of law and may overlap. In certain situations, for example, the privity requirement
> of warranty has been discarded. *E.g., Henningsen v. Bloomfield Motors, Inc.* . . .
In other circumstances, a manufacturer may be able to disclaim strict tort liability... Nonetheless, the main currents of tort law run in different directions from those of contract and warranty, and the latter seem to us far more appropriate for commercial disputes of the kind involved here."

**Henningsen v. Bloomfield Motors, Inc.**, referred to in both the body of the judgment and the footnote with apparent approval or at least without disapproval, is a leading case in which it was held in New Jersey, after a survey of the gradual erosion of the doctrine of privity in other state jurisdictions, that:

"... an implied warranty of merchantability chargeable to either an automobile manufacturer or a dealer extends to the purchaser of a car, members of his family, and to other persons occupying or using it with his consent. It would be wholly opposed to reality to say that use by such persons is not within the anticipation of parties to such a warranty of reasonable suitability of an automobile for ordinary highway operation. Those persons must be considered within the distributive chain."  

Modern English lawyers tend to assume, as did Blackmun J., that a warranty is necessarily contractual. In *Finnegan v. Allen*, where Mr A. T. Denning K. C. persuaded Lord Greene M.R. that it was "quite fantastic" to suggest that a valuer's letter was a warranty that he had valued in accordance with his instructions, the Master of the Rolls said "Warranty is one of the most ill-used expressions in the legal dictionary, but its essence is contractual in nature and must be pleaded in terms sufficient to assert that contractual relationship." Legal historians tell us, however, that until the time of Lord Holt an action for breach of warranty was grounded in tort, being treated as a species of deceit. Again warranty is a label and the substance of the obligation is more important than the way in which it is classified, though classification will be relevant for some purposes, such as (arguably) applying some limitation statutes. In Williston on Contracts it is said that one of the great developments of the law of warranty in the twentieth century is the gradual erosion of privity of contract; and that a new form of action not necessarily grounded in either contract or tort has evolved: an action for breach of constructive warranty.

Whatever may be the most appropriate classification of implied warranty liability, the Supreme Court's *East River Steamship* opinion was deliberately qualified by leaving room for such liability extending to third parties. This serves to underline the relevance of looking at the way in which American courts have applied the concept in cases about housebuilding. No American cases on that subject or on the subject of local authority liability are mentioned in the speeches in *D. & F. Estates, Murphy* and *Thomas Bates*. Professor Fleming has spoken of "one-sided and misleading" references to American case law. I suggest that this may be seen as an example of the problems created by the volume of available materials and other factors mentioned earlier in the present article.

In turning to the American housebuilding cases, I must make it clear both that I have been unable to undertake any comprehensive search and also that there are undoubtedly a number of states that, so far, continue to adhere to the privity requirement. I am not sure
how many, if any, states remain in which there is no redress whatever for remedial expenditure necessarily incurred by a "downstream" purchaser, even though negligence on the part of the builder or a controlling local authority be proved. But it has been stated judicially that by 1980 at least 35 state courts had afforded some measure of protection for purchasers of new homes by implying some form of warranty of habitability. And in this particular field there seems to be a growing tendency to dispense with the privity requirement, in line with what Williston applauds as a general achievement and the United States Supreme Court apparently accepts as legitimate in some fields at least.

For clear and scholarly judgments illustrating the trend, mention may be made of the opinions of Clark J. in the Supreme Court of California in Pollard v. Saxe & Yolles Development Co.; Lewis C.J. in the Supreme Court of South Carolina in Terlinde v. Neely; Clark J. in the Supreme Court of Illinois in Redarowicz v. Ohlendorf; Prater J. in the Supreme Court of Mississippi in Keyes v. Gay Bailey Homes, Inc.; Locher J. in the Supreme Court of South Carolina in Terlinde v. Neely; Prather J. in the Supreme Court of Mississippi in Keyes v. Gay Bailey Homes, Inc.; and Thayer J. in the Supreme Court of New Hampshire in Lempke v. Dagenais. Some extracts from the judgment last cited, when the New Hampshire court changed its law (just as the House of Lords did in a different direction in Murphy), convey many of the reasons found in this line of cases. The following quotations omit references to the cases and writings cited. Although of some length, they are given because American reports are not always readily available:

"We have previously denied aggrieved subsequent purchasers recovery in tort for economic loss and denied them recovery under an implied warranty theory for economic loss ... The policy arguments relied upon in Ellis for precluding tort recovery for economic loss, in these circumstances, accurately reflect New Hampshire law and present judicial scholarship ... and, as such, remain controlling on the negligence claim. However, the denial of relief to subsequent purchasers on an implied warranty theory was predicated on the court's adherence to the requirement of privity in a contract action and on the fear that to allow recovery without privity would impose unlimited liability on builders and contractors. Thus we need only discuss the implied warranty issue.

... There has been much judicial debate on the basis of implied warranty. Some courts find that it is premised on tort concepts.

... Other courts find that implied warranty is based on contract.

... Other authorities find implied warranty neither a tort nor a contract concept, but 'a freak hybrid born of the illicit intercourse of tort and contract ... Originally sounding in tort, yet arising out of the warrantor's consent to be bound, it later ceased necessarily to be consensual, and at the same time came to lie mainly in contract.'

... Regardless of whether courts have found the implied warranty to be based in contract or tort, many have found that it exists independently, imposed by operation of law, the imposition of which is a matter of public policy.
We continue to agree with our statement in Elliott that '[implied] warranties are not created by an agreement ... between the parties but are said to be imposed by law on the basis of public policy. They arise by operation of law because of the relationship between the parties, the nature of the transaction, and the surrounding circumstances.'

... numerous jurisdictions have now found privity of contract unnecessary for implied warranty.

... In keeping with judicial trends and the spirit of the law in New Hampshire, we now hold that the privity requirement should be abandoned in suits by subsequent purchasers against a builder or contractor for breach of an implied warranty of good workmanship for latent defects.

Numerous practical and policy reasons justify our holding. The essence of implied warranty is to protect innocent buyers. As such, this principle, which protects first purchasers ... is equally applicable to subsequent purchasers ... The mitigation of caveat emptor should not be frustrated by the intervening ownership of the prior purchasers. As a general principle, '[t]he contractor should not be relieved of liability for unworkmanlike construction simply because of the fortuity that the property on which he did the construction has changed hands.'

... First, '[c]ommon experience teaches that latent defects in a house will not manifest themselves for a considerable period of time ... after the original purchaser has sold the property to a subsequent unsuspecting buyer.'

... Second, our society is rapidly changing. 'We are an increasingly mobile people; a builder-vendor should know that a house he builds might be resold within a relatively short period of time and should not expect that the warranty will be limited by the number of days that the original owner holds onto the property.' ... 'the ordinary buyer is not in a position to discover hidden defects ...'

... Third, like an initial buyer, the subsequent purchaser has little opportunity to inspect and little experience and knowledge about construction.

... Fourth, the builder/contractor will not be unduly taken unaware by the extension of the warranty to a subsequent purchaser. 'The builder already owes a duty to construct the home in a workmanlike manner ...' And extension to a subsequent purchaser, within a reasonable time, will not change this basic obligation.

... Fifth, arbitrarily interposing a first purchaser as a bar to recovery 'might encourage sham first sales to insulate builders from liability.'

... Economic policies influence our decision as well. '[B]y virtue of superior knowledge, skill, and experience in the construction of houses, a builder-vendor is generally better positioned than the purchaser to ... evaluate and guard against the financial risk posed by a [latent defect] ...'

... It is clear that the majority of courts do not allow economic loss recovery in tort, but that economic loss is recoverable in contract.

... We agree with courts that allow economic recovery in implied warranty for subsequent purchasers, finding as they have that 'the contention that a distinction should be drawn between mere "economic loss" and personal injury is without merit.'
The court stressed that the implied warranty does not go beyond the use of the customary standard of skill and care. It is not strict liability. The builder is not an insurer. Further, it was said that the warranty is limited to a reasonable period of time. In England and Wales, the Latent Damage Act 1986 may sufficiently meet this point. The New Zealand Law Commission has recommended the same longstop limitation period, 15 years.

**Negligence by inspectors**

It is possible to deal here more briefly with the American law as to local authority liability in this field, for the position is conveniently summarised in Speiser, Kraus and Gans, *The American Law of Torts.*

"The authorities are apparently split on the subjection to liability of a municipality for the negligence, etc., of its safety inspectors—building inspectors and the like. The divergence seemingly stems from the 'general duty'—'special duty' dichotomy. If, in a jurisdiction, the duty owed by the municipality is deemed only a 'general' one owed to the public at large, then that municipality is not liable. But where this 'general duty' doctrine has been repudiated and rejected, the municipality (and/or its inspectors) may be held liable for inspectors' negligence.

A leading case holding a municipality and its municipal building inspector liable, and reiterating a [sic] repudiating the 'general' or 'public' duty role, is *Wood v. Milin.* This case holds that when plaintiffs' house partially collapsed due to serious structural and plumbing defects, the municipal building inspector is liable to plaintiffs for causing their losses by his negligence. Moreover, since plaintiffs, husband and wife, were owners of the house in joint tenancy, each of them could recover $25,000, the statutory ceiling on municipal liability. Evidence showed that when the wood frame of the house was completed, the inspector observed that the rafters and floor joists had not been constructed to building code requirements. Moreover, when the house was completed he failed to conduct a final inspection as required by the building code. He also knew he had not issued an occupancy permit for the house certifying that no code violations existed, as required by law. (At trial, experts testified that the construction and location of the joists supporting the main floor were defective and violated the building code, and that these defects existed at the time of original construction and caused the house's partial collapse. Additional testimony stated that the plumbing problems resulting from code violations which also existed at construction).

Some other cases have reached a similar result of liability.

On the other hand, in jurisdictions that cling to, and still espouse, the 'general' or 'public' duty principle, that concept has been held to bar recovery against a municipality or its inspector(s) for the latter's negligence."

As the Wisconsin Supreme Court crisply put it in *Wood v. Milin* "a duty to all is a duty to none." There is as much logic in holding the employing authority liable when an inspector carelessly allows a house to be built on unstable soil as there is when a pointsman carelessly signals a driver into an inevitable collision. As already mentioned and has been demonstrated by the Privy Council in *Brown v. Heathcote County Council,* where inspections are habitually carried out before the issue of a permit the duty of care may be rationalised on the grounds of reliance or assumption of duty—if those concepts are regarded as helpful. Like much else in the broad field now under discussion, it is a question more of label or classification than of substance.

Where the local authority has been directly responsible for allowing a substandard house
on the market, so that it is not merely a case of vicarious liability, the grounds for imposing liability are even stronger. In *City of Kamloops v. Nielsen*, the leading decision in this field in the Supreme Court of Canada, the evidence gave rise, as Wilson J. said in her judgment, to a strong inference that the city, with full knowledge that the work was progressing in violation of the byelaw and that the house was being occupied without a permit, dropped the matter because one of its aldermen was involved. In those circumstances it seems altogether unsurprising that a remedy in negligence was allowed to the purchasers from the alderman. The case was touched on with a hint of disapproval in *Murphy*, but without allusion to the facts just mentioned.

**The merits**

It is not easy to pinpoint in the speeches in the *Murphy* group of cases reasons why, as a matter of substantial justice, the United States courts which favour a housebuilder’s liability to third parties for negligence, or a local authority’s liability for carelessness on the part of inspectors, are wrong. Obviously this is partly explained by the fact that the House of Lords were not referred to any of the relevant decisions. But that is not the sole explanation. Their Lordships do not purport to approach the issues from the point of view of substantial justice—“the merits” as practising lawyers say. They are concerned rather with doctrinal difficulties or assumptions, and the floodgates argument. There is also an important point about legislation covering the field, to which I must return shortly.

With regard to doctrine, the difficulties would seem largely to disappear if the enlarged and commonsense conception of warranty is admitted. A number of observations by present members of the House of Lords tend to confirm this and can be seen as sowing the seeds for future growth of the law in a rational way, should the merits be thought to point in the direction of development. Lord Bridge’s reference in *D. & F. Estates* to the benefit of a relevant warranty of quality has already been quoted. Lord Keith in *Murphy* combines both the doctrinal and the floodgates arguments by speaking of the opening of “an exceedingly wide field of claims, involving something in the nature of a transmissible warranty of quality.” In *D. & F. Estates* Lord Oliver has said that to hold the manufacturer liable in tort for making good the defect would be to attach to goods a non-contractual warranty of fitness which would follow the goods into whosoever’s hands they came. His Lordship regarded this as unsupported by authority (with of course the major exception of Lord Denning) and contrary to principle. With respect, there is much force in that analysis if one has not been given the opportunity of taking into account the relevant American expositions of principle.

The warranty approach would not naturally be apt as a basis for holding a local authority liable for negligence in inspection, but there seems to be no doctrinal difficulty here. If it be accepted that the authority’s duty of care stems from control (and consequent reliance by home owners), there is nothing irrational in holding that the duty extends to taking reasonable care not to cause, or contribute to causing, economic loss to home owners. The risk of economic loss from being misled into the purchase of a home which deceptively looks stable is one of the very kinds of risk which the duty would be imposed to guard against. Remedial expense is precisely the kind of loss which due care would be likely to avert. In effect this is confirmed by the judgment of the Privy Council in *Brown*
v. Heathcote County Council\textsuperscript{92} upholding a judgment for the cost of remedial works against a drainage board whose inspector had been negligent in granting an approval without checking flood levels. More generally, in D. & F. Estates Lord Oliver accepted\textsuperscript{93} that the recovery of damages in negligence for pure economic loss is "now firmly established in New Zealand," referring to a case\textsuperscript{94} in which the Court of Appeal had been concerned with the local authority’s liability as well as that of the builder.

Notwithstanding the Brown case and what was said by Lord Oliver in D. & F. Estates, it is reasonably foreseeable that we in New Zealand may be faced with an argument that, as to the liabilities of both builders and local authorities, New Zealand common law should now change course in the light of the recent House of Lords decisions. It would be inappropriate for me to comment on that issue. The point to be made here is that, for the foregoing reasons, purity of doctrine does not inexorably compel the denial of remedies in this field; the question is one of the merits or policy. The issues becomes, in Lord Keith’s phrase in Peabody Trust v. Sir Lindsay Parkinson Ltd.,\textsuperscript{95} whether it is just and reasonable that a duty of care of particular scope be incumbent on a defendant; and, as Lord Fraser of Tullybelton said for the Privy Council in The Mineral Transporter,\textsuperscript{96} some limit or control mechanism has to be imposed upon the liability of a wrongdoer towards those who have suffered economic damage in consequence of his negligence. Undoubtedly this requires, as Lord Keith has emphasised,\textsuperscript{97} a careful analysis and weighing of all the competing considerations. Several elementary considerations stand out here.

First, it would be feasible, though not obligatory, to draw a distinction between realty and personalty, as is traditionally done in many branches of the law. The liability of a manufacturer of goods need not be the same as that of a housebuilder. Quite apart from the fairly basic distinction between land and chattels, generally speaking a house is expected to last longer than a product, though that is not invariably so. Products liability questions can be considered separately and in the light of any legislative background. Secondly, the floodgates argument is entitled to some weight, but not necessarily decisive weight, otherwise Donoghue v. Stevenson\textsuperscript{98} itself would never have been decided as it was. Thirdly—and this is surely particularly significant—it is very widely recognised that home owners should have some remedy against negligent builders. Opinion is probably much more divided in relation to commercial buildings. It can be said that purchasers of such buildings should be able to look after themselves. The American cases on the warranty of habitability do not extend to them. In the New Zealand Court of Appeal all the relevant cases that we have had to consider so far have been about dwellings.

As to dwellings, the policy considerations which moved the English courts in Dutton and Anns, and United States courts in cases already cited, are so powerful that they have inspired independently the Defective Premises Act 1972, reflecting the finding of the Law Commission that considerable disquiet had been expressed in recent years about the operation of caveat emptor in the purchase of dwellings.\textsuperscript{99} In the light of the American cases it is especially interesting that the Commission recommended and the legislature enacted what is in effect a transmissible warranty of habitability ("a duty to see that the work which he takes on is done in a workmanlike, or as the case may be, professional
manner, with proper materials and so that as regards that work the dwelling will be fit for habitation when completed "). It might be no exaggeration to say that the reasons pointing towards such a duty as just and reasonable are overwhelmingly strong. Nor is there anything in the recent House of Lords cases to suggest that their Lordships think that home owners should be totally without remedy for negligently-caused economic loss.

Some changes can only be achieved by statute, and the desirability or otherwise of making them must be left to the legislature. An obvious example is a longstop limitation period, as was recognised in Askin v. Knox. Another possible example is an upper limit or cap on damages awards against local authorities, on the ground that the community should not bear the whole burden of one citizen’s loss, even though the community’s representatives or officers have been at fault. As has been seen in the case of Wisconsin, some American states have enacted general provisions of this type. The initiative as regards protective legislation seems best left, however, to potential defendants, since they are usually represented by organisations or comprise pressure groups much better equipped to advance a case at the general level than the unorganised multitude of plaintiffs. In any event the onus should be on those who ask for protection to show that it is needed. The advice of law reform bodies is of course also valuable.

Nor would the courts wish to intrude by development of the common law if legislation already covers the field. It is at this point that one of the most difficult questions in the recent House of Lords cases arises. In Murphy the Lord Chancellor gave decisive weight and the other Law Lords considerable weight to the existence of the Defective Premises Act. It was thought that it would not be a proper exercise of judicial power to uphold Dutton and Anns in so far as those decisions accepted duties of care wider or other than the duties imposed by the Act. There may be some doubt whether this accords with the true intention of the Act. Section 6(2) expressly provides that any duty imposed by or enforceable by virtue of any provision of the Act is in addition to any duty a person may owe apart from that provision. Even in relation to the obligations imposed by their draft Bill, the Law Commission expressly left any future development of the common law free to take effect.

In New Zealand we are disposed in matters of public policy to try to develop the common law, so far as necessary and with due caution, on a course parallel with that chosen by Parliament. We have been influenced by such approaches as that of Lord Diplock in Erven Warnink v. J. Townend & Sons (Hull) Ltd. where, in a passing-off case, weight was given to the increasing recognition by Parliament of the need for more rigorous standards of commercial honesty. The consumer-protection policy of our Fair Trading Act 1986, an Act which has some application to land as well as goods, might be relevant when some of the questions discussed in this article arise for further judicial consideration.

In England and Wales, it may be argued, the need for common law development does not arise in the building negligence field, because Parliament has enacted the duties specified in the Defective Premises Act and at the same time has excepted from the Act approved schemes, an exception covering the National House-Building Council’s 10-year warranty scheme. It has in fact been argued by a New Zealand commentator, Professor J. A.
Smillie, that in their jurisdiction the House of Lords are correct in the belief that the imposition of a general common law duty is not necessary in order to provide house owners with adequate protection against loss for latent defects. He suggests that altogether the warranty scheme, plus the Act, plus the valuers’ duty of care to house purchasers now established in such circumstances as are illustrated by Smith v. Eric S. Bush,106 sufficiently meet the needs of justice. As to New Zealand on the other hand he argues that, in the absence of any scheme with the wide application of the N.H.B.C. one, the existing New Zealand common law as to housebuilding negligence should be maintained unless and until compulsory insurance by new residential building owners is introduced by legislation (which he advocates).

It is certainly striking that in Murphy Lord Keith was able to say107 that most litigation involving Anns consists of contests between insurance companies. There has been no suggestion that such is the position in New Zealand. Therein lies one of the background differences. It may be as well to add that in New Zealand liability in damages for personal injury caused by accident is abolished in favour of statutory compensation.108 Nevertheless accident prevention is an important statutory objective, and remedial measures to that end would tend to save community costs. But those are local considerations. For present purposes it may be more useful to note that, as to England, Mr. Duncan Wallace, taking a view radically different from that of Professor Smillie, argues109 that the “approved scheme” section of the Defective Premises Act should be removed, as serving “no useful purpose save to provide a producer-oriented escape route for invested interests”; and that there should be a range of other legislative reforms. He suggests inter alia “more considered legislation regulating tortious liability for defective buildings as a whole.”

I am not sufficiently well-informed to venture a view about the overall adequacy of the present English system for protecting home owners. Perhaps the following suggestion may appertain more to the outlook of a judge. The likely incidence of insurance (“cost-spreading”) is a factor in working out negligence liability,110 but need not be the dominant one. From the point of view of evolving common law principle, the dominant policy factors should be the straightforward canons of conduct generally accepted in the community, however imperfectly observed by most of us. After all, it is from ethical considerations rather than any theory of loss-spreading that Donoghue v. Stevenson derives.

Fifteen years ago, as a junior appellate judge in Bowen v. Paramount Builders Ltd.,111 I would have preferred to await the then pending decision of the House of Lords in Anns before the court tried to decide the law of New Zealand, but did not see why the law of tort should necessarily stop short of recognising a duty not to put out carelessly a defective thing, nor any reason compelling the courts to withhold relief in tort from a plaintiff misled by the appearance of the thing into paying too much for it.112 The Anns decision came later and was broadly to the same effect as ours, though the reasoning was rather different. In the subsequent New Zealand cases it was easy to harmonise with Anns. No one has betrayed the slightest inclination to pick up and run with the slightly older ball dropped in Bowen. The more recent turn of events in England leaves me with nothing for
it but to do so myself. In the intervening years I have at least learnt that there is nothing magic in the word *tort*.

The point is simply that, prima facie, he who puts into the community an apparently sound and durable structure, intended for use in all probability by a succession of persons, should be expected to take reasonable care that it is reasonably fit for that use and does not mislead. He is not merely exercising his freedom as a citizen to pursue his own ends. He is constructing, exploiting or sanctioning something for the use of others. Unless compelling grounds to the contrary can be made out, and subject to reasonable limitations as to time or otherwise, the natural consequences of failure to take due care should be
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2. [1971] 1 Q.B. 337.
13. Ibid., p. 254.
27. Ibid., at pp. 438-439, 456.
29. See for example [1990] 3 W.L.R. at pp. 427 and 441.
37. Ibid., at pp. 41-42.
39. (1787) 2 Term Rep. 63; 100 E.R. 35.
40. (1868) L.R. 3 H.L. 330.
41. (1866) L.R. 1 C.P. 274.
42. [1932] A.C. 562.
47. Grote v. Chester and Holyhead Ry. Co. (1848) 2 Ex. 251; 154 E.R. 485 (railway bridge); Brown v. T. &
An Impossible Distinction


49. [1971] 2 All E.R. at p. 1009.
50. [1912] 1 K.B. 118.

A leading example of this usage is in the speech of Lord Bridge in Murphy [1990] 3 W.L.R. at p. 434.

Lord Wilberforce needs no defenders, but it does seem perhaps a little hard to reject the option of building on his work in Anns, which he manifestly did not intend to be the last word on the subject, because he did not go on to discuss the recoverability of remedial expenditure incurred at an earlier stage: see [1990] 3 W.L.R. at p. 418.
60. Some of the reasons for the American development are forcefully put in Inglis v. American Motors Corporation (Oh.App.) 197 N.E. 2d 921 (1964) in a passage adopted in Williston. "Courts today have taken cognizance of the evolution of merchandising whereby today's retailer, as contrasted to one in bygone days, is in most instances the conduit through which sales are made. Through this change in relationship the purchaser has relied solely on the reputation of the manufacturer and its advertising which is disseminated through various media such as television, radio, newspapers and the like, extolling the virtues of the product and is primarily directed at the ultimate consumer. From the cumulative efforts of this advertising and upon its reliance, the sale is made before the purchaser ventures to the retailer's place of business."

73. If the liability be regarded as purely contractual, the recognition of third party rights is in harmony with the majority judgments in the High Court of Australia in Trident General Insurance Co. Ltd. v. McNiece (1988) 165 C.L.R. 107.
75. As to the builder, authority appears to have been fairly evenly divided in 1981, according to an annotation in 10 A.L.R. 4th 385. See further the cases collected by Mr. Duncan Wallace in (1978) 94 L.Q.R. at pp. 70-72.
76. Redarowicz v. Ohlendorf 441 N.E.2d 324 at p.329 (1982), a decision of the Supreme Court of Illinois.
78. 271 S.E.2d 768 (1980).
79. Supra, n. 76.
85. 134 Wis.2d 279 (1986).
88. Ibid., at p. 673.
89. [1990] 3 W.L.R. at p. 434.
90. [1990] 3 W.L.R. at p. 430.
92. Supra, n. 86. The board of the Judicial Committee was Lord Templeman (who delivered the judgment), Lord Keith, Lord Brandon and Lord Griffiths and Sir Robert Megarry. The judgment puts it at p. 726. "... authorities such as the Drainage Board exist to protect the ignorant and those whose little knowledge is dangerous."
97. Supra, text to n. 18.
100. Supra, n. 11
102. Ibid. at pp. 433, 441, 451, 457.
103. Para. 73 of their report, supra, n. 99.
110. See Mayfair Ltd. v. Pears [1987] 1 N.Z.L.R. 459 (car parked without authority catching fire for unknown reasons; owner held not liable for fire damage to parking building).
112. Ibid., at pp. 423-424.