"The employee may be held liable in damages for the breach of any term of his contract of employment, whether express or implied, such as by his failure to use dure care or skill. The employer is entitled to damages for those consequences which might reasonably be expected to have been in the contemplation of the parties (at the time when the contract of employment was made) as likely to result from the breach."

and

"Mr Pardoe is, of course, quite correct in stating that there are few cases to be found where the employer has sued the employee for damages for breach of his contractual duty of care. This is not surprising. If the law is clear, then there is little if any virtue in reporting such cases. But from a practical point of view the employer, rather than suing for damages, which he is unlikely to recover, is more likely to dismiss the employee summarily. The submission that the "common expectation" of employees is that they will not be sued for damages for breach of their contractual duty of care, unless perhaps the breach was intentional, may well be right. There is, after all, no point in throwing goodmoney after bad and the need to maintain harmonious industrical relations is likely to be considered of greater importance than achieving a barren judgment."

See also:-

Morris v. Ford Motor Co Ltd (1973) 1 Q.B. in which the decision in Lister was strongly criticised by Lord Denning.

to be continued

In Part II:

7. The company's rights against its directors – the historical position
8. The company's rights against its directors – the current position
9. The director's position
10. The company's right not to sue and its effect.
11. Other points – Insolvency & Loans
12. Insurance points

"D & F ESTATES – THE FLOODGATES CLOSE"

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In a recent article, Roger Doulton posed the question "Who then is my neighbour now?" He concluded that far fewer people were now in law his neighbours than would have been the case as little as two years ago. Since publication of that article, the House of Lords has delivered its reasons for dismissing the Plaintiff's appeal in *D & F Estates Limited and Others v. Church Commissioners For England and Wales and Others* (The Independent, 15th July 1988). On the basis of that decision it is plain that Mr Doulton's neighbourhood has suffered extensive further depopulation.

In order completely to review the effects of that decision it would, be necessary to re-write large portions of the existing text books on tortious liability. That task is far beyond the writer's abilities. Hence, the purpose of this article is to attempt to provide a thumbnail sketch of some of the problems posed by the decision. To do this it is necessary, albeit briefly, to try and pinpoint the state of the law prior to the trilogy of cases (the other two being *Simaan General Contracting Company v. Pilkington Glass Limited* (1988) 2WLR 761 and *Greater Nottingham Co-operative Society Limited v. Cementation Piling and Foundation Limited* (unreported 23.03.88)) culminating in the decision in *D & F Estates.* This will involve retreading some heavily trampled ground, and for this I apologise.

The starting point inevitably is *Donoghue and Stevenson* (1932) AC 562 a majority decision of the Scottish House of Lords. Two brief passages need to be referred to; firstly the famous words of Lord Atkin:

> "... Who then in law is my neighbour? The answer seems to be persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the act or omissions which are called into question."

Secondly, the equally famous dictum of Lord MacMillan that:

> "The categories of negligence are never closed."

Self-evidently, Lord Atkin had in mind acts of omission or commission which would cause physical hurt to someone or something else. It is implicit in Lord Bridge's speech in *D & F Estates* that he could not have been contemplating either:

1. that the presence of the snail would not merely have diminished the value of Miss Donoghue's ginger beer or

2. that the presence of the snail caused no physical damage to the bottle or to its contents (although it is difficult to see how the contents can have remained undamaged).

One might conclude from Lord McMillan's dictum, however, that had a claim in either of these forms been advanced it would certainly have been considered.

In spite of the restrictions imposed by Lord Atkin, and perhaps because of the hope extended by Lord McMillan, *Donoghue v. Stevenson* has acquired

the status of a talisman. An example is provided by the speech of Lord Reid in *Dorset Yacht Co Limited v. Home Office* (1970) AC 1004, where, having stated that Lord Atkin's words did not carry the authority of statute, nonetheless

> "where negligence is involved the tendency has been to apply principles analogous to those stated by Lord Atkin."

Earlier in his speech Lord Reid said, in effect, that wherever proximity as defined by Lord Atkin existed, liability could be established, except if there were powerful reasons for not so doing. Seven years later Lord Wilberforce impliedly and Lord Salmon expressly adopted this test in *Anns v. London Borough of Merton* (ibid).

Lord Reid suggested that liability might not be found where, for example, the negligent act caused economic loss unrelated to physical damage. Previously, in *Hedley Byrne & Co Limited v. Heller & Partners Limited* (1964) AC 465 the House of Lords had held that in limited circumstances liability might be established. As Lord Morris said

> "... (in) situations in which one person voluntarily and gratuitously undertakes to do something for another (and) becomes under a duty to exercise reasonable care,"

then liability could be established. Lord Devlin said

> "wherever there is a relationship equivalent to contract there is a duty of care".

These statements have been widely relied upon as authority for the proposition that in particular cases, economic loss is recoverable irrespective of physical damage. This is unfortunate since on a restrictive view of the decision, neither formed part of the ratio decidendi of the cse which hinged upon the construction of an exclusion clause.

Indeed, the preferable view, it is submitted, is that contained in a line of authority culminating in *Spartan Steel & Alloys Limited v. Martin & Co (Contractors) Limited* (1973) QB 27. Lord Denning MR identified the problems facing the Courts:

> "the more I think about these cases (including *Hedley Byrne*) the more difficult I find it to put each into its proper pigeon hole. Sometimes I say: "there was no duty." in others I say: "the damage was too remote." so

much so that I think the time has come to discard those tests which have proved so elusive. It seems to be better to consider the particular relationship in hand and see whether or not as a matter of policy economic loss should be recoverable or not."

Having identified this rationale, Lord Denning MR with whom Lawton LJ concurred had no difficulty in holding that economic loss that flowed as a direct consequence of physical damage caused by negligence was recoverable but that the Plaintiffs' further economic loss, not related to the physical damage, was not.

It is, however, noteworthy that this policy – based approach had the merit of allowing the Court of Appeal to reconcile its decision in *Spartan Steel* with its own earlier decision in *Dutton v. Bognor Regis UDC* (1972) 2WLR 299. In that case, Stamp LJ had said:

"the injury which is one of the essential elements of the tort of negligence is not confined to physical damage to personal property but may embrace economic damage..."

It should also be noted that in that case Lord Denning MR held that there was no sense in distinguishing realty from personalty and therefore the principles in *Donoghue v. Stevenson* could be applied between the builders of a house and a subsequent purchaser. Previously it has been considered that the maxim "caveat emptor" precluded such claims.

Dutton was expressly approved by Lord Wilberforce in *Anns v. London Borough of Merton* (1978) AC 728. Following *Anns,* it was generally considered that the law could be distilled into four principles:-

1. The existence of a duty of care depended upon a two stage test, namely whether as between the wrongdoer and his victim there was a sufficient relationship of proximity such as to give rise to a duty of care; and if there was whether there were any considerations which ought to negative or reduce the scope of the duty; an example of the latter being cases of pure economic loss unrelated to physical damage.
2. The express approval of the *Dutton* principle that the builder could be liable to a subsequent purchaser for negligently building a house.
3. That the duty of care arises when the condition of the house is such that there is present or imminent danger to the health and safety of its occupiers.
4. The damages recoverable could include damages for economic loss flowing naturally from the physical damage, such as the costs of alternative accommodation.

I do not propose in this article further analysing either the decision of *Anns* or the wealth of comment which has been made concerning the decision. Three points should be noted, however. The first is that the courts have stated, and it is submitted correctly, that the two stage test cannot and should not be regarded as being universally applicable (see for example *Leigh & Sillivan v. Aliakmon Shipping Co Limited* (1986) AC 785. Secondly, that the "present or imminent danger to health or safety" was held in *Batty v. Metropolitan Realisations Limited* (1978) 1QB 559 to cover a situation where, although the Plaintiff's house had suffered no actual physical damage, the fact that the house was liable to fall down at any moment and was therefore valueless was sufficient. Thirdly, and perhaps pedantically, it is worth remembering that in *Anns* the House of Lords did not actually make any finding on liability; the House of Lords determined a preliminary issue on assumed facts.

I shall conclude this whistle-stop look at the development of the law up to 1987 with *Junior Books Limited v. Veitchi Co Limited* (1983) AC 520. I shall comment in more detail upon the decision in this case subsequently. In essence the majority of the House of Lords held that despite the absence of any averment that the floor laid by the Appellant-nominated sub-contractor for the Respondent Employer was actually damaged (although it was defective), the Respondent had incurred expenditure, including relaying the floor and the attendant disruption to their business, and was entitled to recover this expenditure. Lord Roskill noted that all damage, however caused, was economic loss since it was compensated by an award of damages. He suggested that *Spartan Steel* could no longer be regarded as good law. The majority, and especially Lord Fraser, also dismissed the argument that to allow claims of this sort would open the flood gates to litigation which led

> "to drawing an arbitrary and illogical line just because a line has to be drawn somewhere."

Clearly, not only was the result in *Spartan Steel* criticised, so was the policy underlying the decision.
Between 1983 and 1987, *Junior Books* was analysed up hill and down dale. Goff LJ in *Muirhead v. Industrial Tank Specialists Limited* (1986) QB507 concluded was at close as possible to being a contractual relationship

1. the "very close proximity" of the parties, which the House of Lords concluded was as close as possible to being a contractual relationship without a contract actually existing, and

2. the reliance of the Plaintiffs upon the Defendants,

and suggested rather diffidently that on the particular facts, the relationship was such that if those facts were proved, the Defendants could be held liable to the Plaintiffs.

This of course is almost entirely consistent with *Hedley Byrne.* It is also redolent of the policy approach adopted by Lord Denning MR in *Spartan Steel,* save only in the result, and effectively ignores Lord Fraser's attempt to move away from drawing an "arbitrary and illogical line". As Anthony May QC said in a recent lecture it is to find no principle at all. The difficulties were clearly summed up by His Honour Judge John Newey QC in an unreported decision, *Cosgrove v. Weeks* (27th February 1987):

> "The present state of the law concerning claims in negligence is by no means clear or certain, but I think that at the very least, I can conclude that there is no inflexible rule against such claims. Whether a duty of care not to cause such loss exists depends upon an examination of the closeness and nature of the relationship between the parties. Whether economic loss can be recovered as damages may depend not only upon foreseeability but also possibly upon their recovery being in accordance with public policy."

Muirhead, and to a lesser extent *Cosgrove,* represent the first attempts by the courts to close the floodgates opened by *Junior Books. Simaan* represents the courts giving a few brisk turns on the winch operating the gates. Bingham LJ summarised it thus:

> "Plainly, *Junior Books* contains in it the seeds of a major development in the law of negligence... it remains to be seen whether those seeds would be allowed to germinate... for the time being at least they would not."

Pilkington had supplied glazed units to Simaan. There was no suggestion of physical damage. However, the glass failed to comply with the employer's colour specification. Bingham LJ distingished *Junior Books* by noting that the relationship there had been between Employer and its nominated sub-contractor, as opposed to Main Contractor and supplier There was, he said, no meaningful sense in which Simaan could be said to have relied upon Pilkington, and neither had Pilkington assumed any responsibility for the glass, such responsibility being inconsistent with the structure of the parties' contractual arrangements.

With respect, the only basis for this distinction rests upon the special role in building contracts of nominated sub-contractors. In *Greater Nottingham,* a relationship of employer to nominated sub-contractor existed, and the only

distinction between that decision and *Junior Books* was that the parties had entered into a collateral warranty agreement covering selection of materials and design of piling. Mann LJ held that while there was no reason why a claim based on physical damage should not succeed, it would not be "just and reasonable" to impose a duty in tort when the parties had selected a contractual machinery to govern their relationship which was notably silent on the point. What the result would have been but for the warranty is of course a matter of guess work. It does, however, appear that by means of a pincer movement the Court of Appeal have distinguished *Junior Books* almost out of existence. It is curious that the Court placed such importance on the role of the nominated sub-contractor, since there are few more common relationships in building contracts. Likewise it is curious that the sub-contractor who had entered into a direct warranty agreement with the employer should be in a worse position than one who had not.

Nonetheless, it is easy to see how Dillon LJ had said in *Simann*

> "... I find it difficult to see that further citation from *Junior Books* can ever serve any useful purpose,"

and Woolf LJ said in *Greater Nottingham* that *Junior Books* was:

> "an exception to the general principle that economic loss is not recoverable in the absence of actual or apprehended physical damage."

D & F Estates represented the floodgates slamming shut. The Plaintiffs were the non-occupying leaseholders of a flat. At no time did the Plaintiffs have a contract with the Main Contractors, against whom the proceedings were brought and which concerned the costs of repair to plastering, future repair costs and loss of rent occasioned thereby, the plastering works having been carried out by a sub-contractor.

In the House of Lords, the only speeches delivered were by Lords Bridge and Oliver, with whom Lords Templeman, Ackner and Jauncey agreed.

Lord Bridge observed that it was more appropriate to go back to first principles than to attempt to analyze existing authorities which

> "speak with such an uncertain voice that no matter how searching the analysis... they yield no clear and conclusive answer."

In the following paragraph of his speech Lord Bridge, echoing Dillon LJ in *Simaan* and Woolf LJ in *Greater Nottingham* said of *Junior Books*

> "the decision of the majority is so far dependent upon the unique albeit non-contractual relationship between the pursuer and the defender in that case and the unique scope of the duty of care owed by the Defendant to the pursuer that the decision cannot be regarded as laying down any principle of general application in the law of tort or delict."

It must be considered that any remaining voice which the majority view in *Junior Books* had at the time of this decision has now been silenced for ever. By contrast, the dissenting judgment of Lord Brandon:

> "enunciates with cogency and clarity principles of fundamental importance which are clearly applicable to determine the scope of the duty of care owed by one party to another in the absence of ... any contractual relationship ..."

Lord Bridge derived two important principles from Lord Brandon's speech. Firstly, he quoted that:

> "It has always been either stated expressly or taken for granted that an essential ingredient in the cause of action relied on was the existence of danger or the threat of danger of physical damage to persons or their property."

In adopting those words, Lord Bridge clearly excluded the possibility of recovery of economic loss in the absence of physical damage, except in *Hedley Byrne* – type situations. Lord Bridge went on to note that although in Anns the liability of the Local Authority rested upon proof of present or imminent danger to the health and safety of the occupiers, the decision of the House of Lords was obiter on the liability of the builder. It has been assumed, notably by the learned editor of the Building Law Reports, that the decision only related to Local Authorities. However, Lord Bridge, again quoting Lord Brandon in *Junior Books,* noted that the duty of care found in *Donoghue v. Stevenson* was based upon the existence of physical injury to persons or their property. In an important passage on page 16 Lord Bridge stated:

> "If the hidden defect in the chattel is the cause of personal injury or of damage to property other than the chattel itself, then the manufacturer is liable. 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 and Stevenson* principle,"

the economic loss being recoverable in contract. He continued by saying

> "liability can only arise if the defect remains hidden until the defective structure causes personal injury or damage to property other than the structure itself".

Lord Bridge expressly declined to comment upon this part of the ratio in *Anns.* Consequently the extent of the damage to persons or property which Lord Bridge had in mind is not precisely clear. Lord Bridge himself, however, stated that he regarded his own decision in *Batty* as being unsound. As to the particular circumstances in *D & F Estates,* Lord Bridge indicated that the only damages recoverable were those arising out of the need to clean carpets and other items soiled by falling plaster and nothing else.

Comparing it with other decisions, clearly in *Simaan* there could now be no recovery unless, as Bingham LJ had suggeted, the glass had exploded causing, for example, one of Simaan's workmen to be blinded. Furthermore, the courts no longer have any discretion to interpret public policy, as was the case in *Spartan Steel.* Moreover, the result in that case may be too generous.

It will be recalled that the Plaintiffs recovered as damages the economic loss consequent upon the physical damage in the form of the loss of profits on the melt in progress at the time of the accident. Following *D & F Estates,* the proper view may be that the only damages recoverable were the costs of the physical damage to the metal. It must be open to question whether the loss of profit on that melt was recoverable.

Lord Bridge's second important point of principle again emanated from Lord Brandon's dissenting speech in *Junior Books.* Lord Brandon had stated that the principle upon which *Donoghue v. Stevenson* was based was that the "relevant property" that is the person or property injured was

> "property other than the very property which gave rise to the danger of physical damage concerned."

As I have said above, this distinction is difficult to follow since it is surely axiomatic that the presence of the snail caused damage to Miss Donoghue's ginger beer. Nevertheless, the effect of this in *D & F Estates* was that the House of Lords had no difficulty in holding that the plaintiffs could not recover costs of replacing the defective plaster unless the plaster, the damaged thing, caused physical injury to another thing. Hence, the cost of replacing the defective plaster was to be considered as pure economic loss. Lord Oliver stated that the decision in *Bowen v. Paramount Builders (Hamilton) Limited* (1977) 1 NZLR 394 in which the damages recovered had

included not only preventing the danger to health and safety but also restoring the building's aesthetic appearance, ("a transmissable warranty of fitness") was not to be regarded as reflecting English Law.

Both Lord Bridge and Lord Oliver preferred to be guided by the decision of the U.S. Supreme Court, *East River Steamship Corporation v. TransAmerica Delaval Limited* (1986) 106 S.Ct 2295 where Blackmun J held

> "Whether stated in negligence or strict liability no products – liability claims lies in admiralty when a commercial party injures only the product itself resulting in purely economic loss."

In a very important passage on page 17 Lord Bridge summarised the position;

> "If the same principle applies in the field of real property to the liability of the builder of a permanent structure which is dangerously defective, that liability can only arise if the defect remains hidden until the defective structure causes personal injury or damage to the property other that the structure itself. If the defect is discovered before any damage is done, the loss sustained by the owner of the structure, who has to repair or demolish it to avoid a potential source of danger to third parties, would seem to be purely economic."

Hence the Plaintiffs' recovery would be limited to the cost of cleaning or repairing the carpets and other items soiled or damaged by the falling plaster. However, Lord Bridge went on to say that this principle was to be tempered by the argument that a complex structure such as a building could well be divided into a number of separate elements each of which would, for the purpose of this test, qualify as "other property". Hence, while he held that the plaster could not be considered as a separate element from the decorative surface placed upon it, it was quite conceivable that defective foundations could be a separate element from the walls which they supported.

Accordingly, although Lord Oliver admited some difficulty in understanding the logical basis of the decision in *Anns,* it is at least tolerably clear that the "separate element" argument can be used to justify *Anns, Dutton* and the various other foundation cases. Indeed, as Lord Denning MR said in *Dutton*

> "the foundations of a house are in a class by themselves. Once covered up they will not be seen again until the damage appears".

It does, however, cast considerable further doubt on the decision in *Batty* by reason of the absence of damage.

Both of the principles identified by Lord Bridge were, to some extent, obscured by the final paragraph of Lord Oliver's speech in which, after expressing difficulty in understanding the logical basis of the decision in *Anns*, he said

> "that insofar as the case is authority for the proposition that a builder responsible for the construction of the building is liable in tort at common law for damage occurring through his negligence to the very thing which he has constructed, such liability is limited directly to cases where the defect is one which threatens the health or safety of occupants or of third parties and (possibly) other property. In such a case, however, the damages recoverable are limited to expenses necessarily incurred in averting that danger."

This of course flies in the face of much of what Lord Bridge said and is difficult to reconcile with much of Lord Oliver's own speech. It remains to be seen whether it will prove important.

D & F Estates is clearly an extremely important decision. Effectively it removes any prospect of recovery of pure economic loss, except in *Hedley Byrne* type situations, which remain untouched by *D & F Estates.* Indeed, in *Caparo Products plc v. Dickman* (The Independent, 10th August 1988) *Hedley Byrne* has again been followed. Except in such restricted circumstances, however, recovery for pure economic loss must be considered to be a thing of the past. There can be equally little doubt that the plaintiff preparing to issue proceedings in respect of a defective building will now think doubly hard about whether he can possibly bring a claim in contract, or breach of statutory duty. So far as both lawyers and insurers are concerned, the case has the merit of introducing a measure of certainty into an area of the law which was previously renowned for its difficulty. At risk, however, of appearing to be a harbinger of doom, it is apparent from the development of the case law that an element of ebb and flow takes place and it may well be in due course that Mr Doulton will find his former neighbours returning.