



Financial Loss A “will-o’-the wisp” cover ?

Presentation at LUG conference

September 2010



Financial Loss

Aim of presentation :

- *LUG FL workgroup - initial feedback*
- *Financial Loss – is the law of England changing ?*
- *Financial Loss unpackaged – do we understand the cover we give ?*

Financial Loss

Key take-away points

- *tort law affecting FL in UK largely unchanged
But it is still a ‘developing’ area of law and some interesting recent cases and pointers .*
- *significant growth of demand for FL cover – now seen as mainstream liability cover*
- *certain level of confusion in market over extent of cover given under FL covers*
- *real exposure lies in contract liability for FL (the elephant in the room)*
- *significant potential exposures in other countries*

Financial Loss

FL cover -
What's in a
name ?

Is it..... ?

- *Financial Loss*
- *Economic Loss*
- *Pecuniary Loss*
- *Consequential Loss*

Financial Loss

FL cover -

What's in a
name ?

Textbook definition ('economic loss')

....situations in which one person's negligent conduct causes another person to suffer an injury which is not to his person or property

Liability policy ('financial loss')

any pecuniary loss cost or expense incurred by any person other than the insured and not in respect of injury loss or damage as covered under the main policy.

Financial Loss

Legal overview

Injury and damage

Negligent injury and damage

- *Redress under civil tort law*

Intentional injury and damage

- *Civil redress and criminal offence*

Economic loss

- *Negligent - economic loss*
- *Intentional – economic loss*

Generally no legal redress in either case (except fraud or where provided by financial regulation)

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Legal overview

"The philosophy of the market place presumes that it is lawful to gain profit by causing others economic loss"

Goff LJ Aliakmon 1985

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“Anglo-Australian law has never accepted the proposition that a person owes a duty of care to another person merely because the first person knows that his careless act may cause economic loss to the latter person. Social and commercial life would be very different if it did. Indeed, leaving aside the intentional tort cases, a person will generally owe no duty to prevent economic loss to another person even though the first person intends to cause economic loss to another person”

McHugh J, (dissenting) Hill v Van Erp 1997

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So what do we mean by damage ?

It is not :

Radioactive contamination of land (Merlin v BNF 1990)

...and then again it may be ...

*Overflow from one site to another containing plutonium
(Blue Circle v MOD 1998)*

It is not :

Incorporation of potentially dangerous and defective product into a building (Pilkington v CGU 2004)

It could be:

The deposit of dust on people's carpets (Hunter v Canary Wharf 1997)

It is:

The deposit of silt during dredging operations (JAN De NUL 2002)

Financial Loss

**So what do we
mean by damage ?**

It is not:

'Damage' to the end product by a defective ingredient
(Bacardi v Thomas Hardy 2002)

It is not:

Damage to a building caused by defects therein
(Murphy v Brentwood 1991)

It is:

Sub molecular changes to a Degas painting
(Quorum v Schramm 2002)

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Financial Loss

Why does English law approach economic losses and physical losses differently ?

- philosophy of the market place
- historical development of the common law of tort
- economic interests inferior to interests in real property
- such losses are too remote or unforeseeable
- proximity
- no ‘assumption of responsibility’ for such losses
- not fair, just or reasonable to impose such a duty
- indeterminate losses / floodgates
- availability of redress under contract

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Why does English law approach economic losses and physical losses differently ?

“ the nature of the hazard, namely, the cutting of the electricity supply. This is a hazard which we all run.....the supply is usually restored in a few hours so the economic loss is not very large. Such a hazard is regarded by most people as a thing they must put up with – without seeking compensation from anyone. Some there are who install a stand-by system. Others seek refuge by taking out an insurance policy against breakdown in the supply.

But most people are content to take the risk on themselves.

When the supply is cut off, they do not go running round to their solicitor. They do not try to find out whether it was anyone’s fault. They just put up with it. They try to make up the economic loss by doing more work the next day. This is a healthy attitude which the law should encourage ”

Lord Denning M.R. Spartan Steel 1973

(my underlining)

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Is this likely to change ?

Financial Loss

Is this likely to change ?

Recap

*'Donoghue' recognised the existence of a duty of care to avoid carelessly inflicted injury to our neighbours
This was quickly recognised as equally applicable to damage to property.*

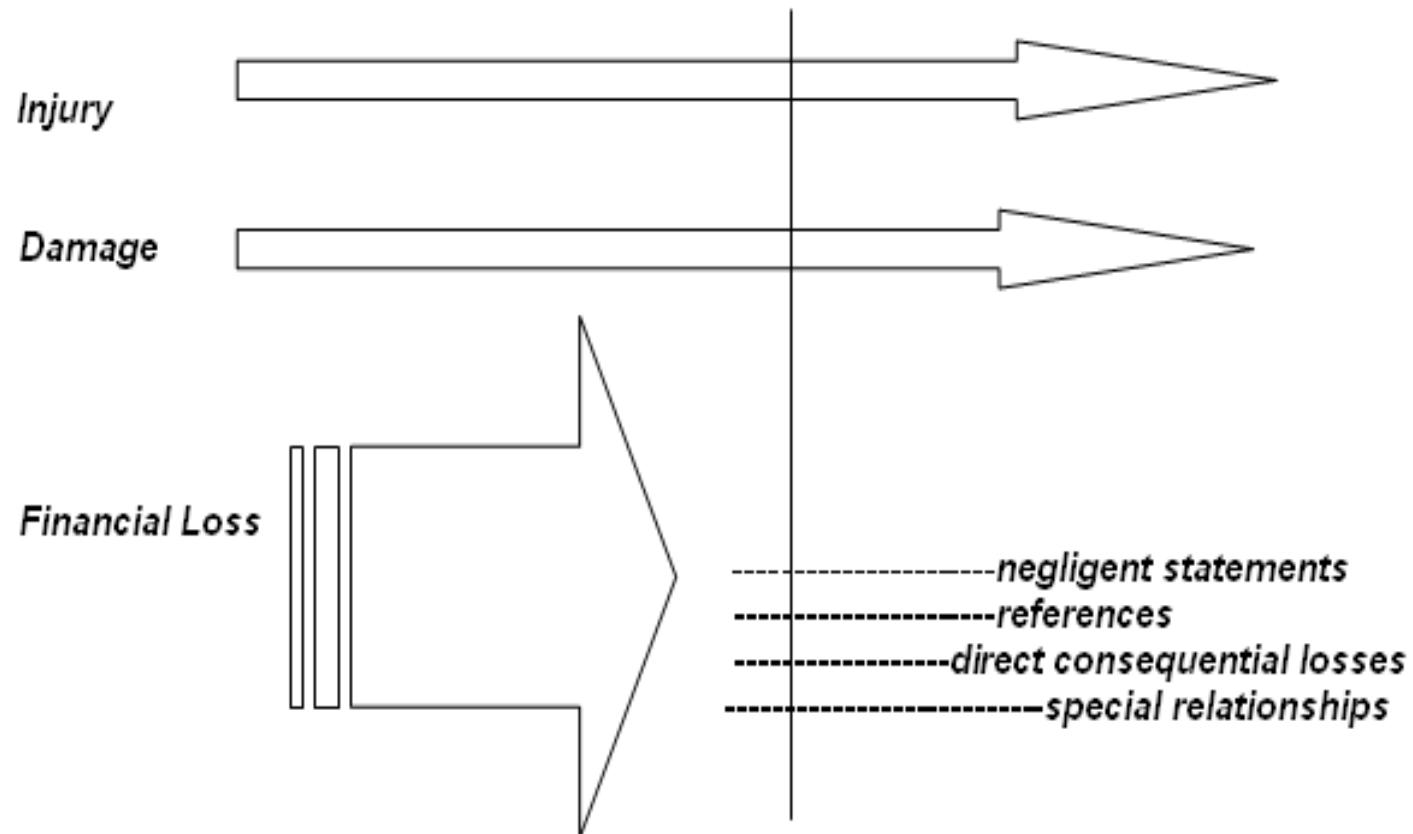
And in 1964 (Hedley Byrne) this duty of care was extended to pure economic loss as a result of negligent misstatements.

And in the 1990's (Spring v Guardian) to careless references

But 'Murphy' 1991 generally held to set a limit to such liability for pure economic loss claims.

Financial Loss

Duty of care threshold



Financial Loss

Types of economic or financial loss (textbook) :

- directly inflicted pure economic loss
- consequential economic loss
- relational (parasitic) economic loss
- diminished value of defective building or product
- **negligent misstatements and services**
- nonfeasance

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Types of economic or financial loss (insurers' perspective) :

- claims against professionals
- claims against manufacturers of goods
- claims against providers of services
- claims against public authorities
- 'random' or relational economic loss claims

Financial Loss

Pressures for
change.

Consider :

- *Logic*
No real inner logic ?

“The impossibility of finding any coherent and logically based doctrine behind it (the decision in Anns) is calculated to put the law of negligence into a state of confusion defying rational analysis”

Lord Keith – Murphy

“I am able to see no circumstances from which there can be deduced a relationship of proximity such as to render the builder liable in tort for pure pecuniary damage sustained by a derivative owner with whom he has no contractual or other relationship” Lord Oliver – Murphy

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Economic loss: Just an exclusionary Rule ?

“The critical question is not the nature of the damage 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 sustained”
(Lord Oliver – *Murphy v Brentwood DC* 1991)

“The infliction of physical injury to the person or property of another universally requires to be justified. The causing of economic loss does not”
(Lord Oliver – *Murphy v Brentwood DC* 1991)

Financial Loss

Pressures for
change.

Consider :

- *...to search for any single formula which will serve as a general test of liability is to pursue a will-o'-the wisp...*

Lord Oliver Caparo 1990

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Pressures for change.

Consider :

- *Products liability – ‘reliance on skill’ / ‘assumption of responsibility’ argument*
- *Floodgates argument (rejected in Canadian National Railways 1992 and Lord Roskill in Junior Books)*

“ ...the proximate relationship test just mentioned that the ability to control the extent of liability in negligence lies. The history of the development of the law in the last 50 years shows that fears aroused by the floodgates argument have been unfounded”

- *Human rights*
- *Very existence of liability insurance*
- *Moral argument against that of economic efficiency and utilitarianism (the social and moral and personal dimension)*

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On the one hand looms the probability, often amounting to a certainty, of damage to the individual, which in some cases will be serious and may indeed be irreparable. The entire future prosperity and happiness of someone who is the subject of a damaging reference which is given carelessly but in perfectly good faith may be irretrievably blighted.

Against this prospect is set the possibility that some referees will be deterred from giving frank references or indeed any references.

Lord Lowry Spring v Guardian

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This argument fails to be considered on the assumption that, but for the overriding effect of public policy, a plaintiff who is in the necessary proximate relation to a defendant will be entitled to succeed in negligence if he proves his case.

To assess the validity of the argument entails not the resolution of a point of law but a balancing of moral and practical arguments.

This exercise could no doubt produce different answers but, for my own part, I come down decisively on the side of the plaintiff.

Lord Lowry Spring v Guardian

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Consider :

Customs and Excise v Barclays 2006 (House of Lords)

“....it seems to me that the outcomes (or majority outcomes) of the leading cases cited above (Caparo/Hedley Byrne / Spring /White v Jones etc) are in every or almost every instance sensible and just, irrespective of the test applied to achieve that outcome. This is not to disparage the value of and need for a test of liability in tortious negligence, which any law must propound if it is not to become a morass of single instances. But it does in my opinion concentrate attention on the detailed circumstances of the particular case and the particular relationship between the parties in the context of their legal and factual situation as a whole”

Lord Bingham

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Consider :

*Law Commission
Administrative Redress – Public Bodies and the Citizen
Consultation June 2008
Report May 2010*

Restrictions on Compensation for Pure Economic Loss
(s.3.168)

“What is clear is that there is no general test in the tort of negligence for pure economic loss but looking over the history of cases on the matter, it is clear that there has been an incremental expansion of liability for pure economic loss”

(s. 3.175)

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Consider :

Impact of law and legal thinking in other countries and EU

(Court of Appeal in New Zealand) ...which is well known to be tender in its approach to claims in negligence involving pure economic loss “ (Lord Keith Spring v Guardian Assurance plc)

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Other countries

Murphy has not been accepted or followed in several other common law jurisdictions

“Whatever may be the position in the UK, homeowners in NZ do traditionally rely on local authorities to exercise reasonable care not to allow unstable houses to be built in breach of byelaws”

(Cooke P. in the Court of Appeal of NZ in *Invercargill City Council v Hamlin 1994*)

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Other countries

“...in the present case the Judges in the NZ CoA were consciously departing from English case law on the ground that conditions in NZ are different. Were they entitled to do so ? The answer must surely be ‘yes’. The ability of the common law to adapt itself to the different circumstances of the countries in which it has taken root is not a weakness but one of its greatest strengths”

(Lord Lloyd – Privy Council *Invercargill City Council v Hamlin* 1996)

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Other countries

France

Whatever act of one person causes damage to another person,
that person must put right that damage

(Art. 1382 of the Civil Code)

Any loss *prima facie* recoverable, focusing on the wrongful
event rather than the nature and extent of specific legal rights of
the plaintiff.

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Summary

So generally the common law recognises no duty of care to avoid causing economic loss to another.

The general exceptions are :

- **Negligent statements**
- **Special advice / references**
- **Special relationships**
- **Consequential loss**

Tort and other areas of law

General Legal liability for financial or economic loss

- **Tort** – with a few exceptions, generally the English law of tort provides no redress
- **Contract** – damages are recoverable for those foreseeable losses that flow directly from the breach of contract.
- **Statute and statutory duty** - generally breach of statutory duty will not found an action for damages but a developing area of law. There are a few limited areas where protection of consumer financial interest has been the subject of specific laws.

Financial Loss

Legal scenarios and outcomes and current position on legal redress

Scenario Loss	Cost of damage	Immediate consequential loss	Other economic loss	
Damage to property of claimant by defendant	✓	✓	✗	Spartan Steel
Economic loss of claimant arising from damage to TP property by defendant	NA	NA	✗	Relational or ricochet damages or losses
'Damage' to building owned by claimant caused by defect therein	Construed as economic loss	Construed as economic loss	✗	Murphy
'Damage' to product supplied caused by defect therein	Construed as economic loss	Construed as economic loss	✗	Bacardi
Economic loss of claimant caused by action of defendant	NA	NA	✗	Veitchi / Weller / Pride ..

Financial Loss

Likely response of a typical UK liability policy to particular loss scenarios (insured = defendant)

Scenario Loss	Cost of damage	Immediate consequential loss	Other economic loss	
Damage to property of claimant by defendant	✓	✓	✗	Spartan Steel
Economic loss of claimant arising from damage to TP property by defendant	NA	?	✗	Relational or ricochet damages or losses
'Damage' to building owned by claimant caused by defect therein ; defect caused by defendant	Construed as economic loss	Construed as economic loss	✗	Murphy
'Damage' to product supplied caused by defect therein	Construed as economic loss	Construed as economic loss	✗	Bacardi
Economic loss of claimant caused by action of defendant	NA	NA	✗	Veitchi / Weller / Pride ..

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.....and now we will consider in some more detail
developments arising from some other recent cases
.....from a slightly different perspective !

Network Rail v Conarken & Farrell

- Network Rail Infrastructure Ltd v Conarken Group Ltd, and Network Rail Infrastructure Ltd v Farrell Transport Ltd
- High Court
- July 2010
- Mr Justice Akenhead



Network Rail v Conarken & Farrell

- Farrell:
- Tractor
- level crossing
- East Coast Main Line
- May 2003
- overhead power line for the railway
- electrical explosion
- railway line was shut for 4 hours
- £4,800 repair bill



Network Rail v Conarken & Farrell

- Conarken:
 - railway bridge
 - East Coast Line
 - July 2002
 - crashed into the parapet
 - extensive damage to the bridge
 - railway line was shut for five days
 - £166,000 repair bill
-
- The above costs are not in dispute



Network Rail v Conarken & Farrell

- The complication... Network Rail also held Farrell and Conarken liable for costs that NR were contracted to pay to the Train Operating Companies (TOC's) who used the railway lines
- Operation of the railway is governed by contractual arrangements between Network Rail and the TOC's
- If the railway line is closed then NR have to compensate the TOC's in accordance with the provisions of "Schedule 8" of the particular contractual agreements



Network Rail v Conarken & Farrell

- Those amounts were £1,017,000 (Conarken) and £127,000 (Farrell)
- The motor insurers took the view that the Schedule 8 amounts were too remote for NR to be able to claim for, or not foreseeable on the part their insureds
- 1,365 bridge strikes (2008/09)



Network Rail v Conarken & Farrell

- South Australia Asset Management Corporation v York Montague Ltd (1996)
- Caparo Industries Plc. v. Dickman (1990)
- SCM (United Kingdom) Ltd v WJ Whittall and Son Ltd (1971)
- “when a defendant by his negligence causes *physical* damage to the person or property of the plaintiff, in such circumstances that the plaintiff is entitled to compensation for the physical damage, **then he can claim, in addition, for economic loss consequent on it.**” (Denning)



Network Rail v Conarken & Farrell

- Spartan Steel & Alloy Ltd v Martin & Co (Contractors) Ltd (1973)
- "...that the law provides for deserving cases. If the defendant is guilty of negligence which cuts off the electricity supply and causes physical damage to personal property, that physical damage can be recovered...and also any economic loss truly consequential on the material damage ...

Such cases will be *comparatively few* they will be *readily capable of proof* and will be *easily checked*. They should be and are admitted." (Denning)



Network Rail v Conarken & Farrell

- Muirhead v Industrial Tanks Specialities (1985)
- Junior Books Ltd v Veitchi Co.Ltd. (1983)
- Akenhead concludes:
 - in cases involving physical damage, economic loss can be recovered if it is demonstrably consequential upon the physical damage.
 - However, an essential quality of the economic loss is that it must be closely associated with the physical damage and the work done to repair or replace the damaged property.

Network Rail v Conarkan & Farrell

- The question is therefore one of “remoteness” for which the test is “reasonable foreseeability”
- Test for this – the Wagon Mound case in 1961 (Overseas Tankship (UK) v Morts Docks).
- The foreseeability test is objective. It is based on what a reasonable man would have foreseen as a consequence of the tort (the negligent act), had he applied his mind to it.



Network Rail v Conarken & Farrell

- Ehmler and another v Hall (1993)
- Driver crashed his car into a car showroom
- The car showroom had been let (to another party).
- The plaintiffs (who owned the car showroom) did not receive the rent from the tenant while the showroom was being repaired
- Plaintiff's therefore sued for the lost rent
- Pure economic loss? No
- "The loss of rent arising out of the damage to the building was consequential upon the damage: it was not pure economic loss."



Network Rail v Conarken & Farrell

- He found in favour of the plaintiff, Network Rail, and said that they can recover as part of the claim, the amounts that NR were required to pay to the TOC's by dint of the Schedule 8 obligations.
- Really?
- Surely it cannot follow that it was in the reasonable expectation of a tractor driver crossing a level crossing or lorry driver driving underneath a railway bridge to be aware of or foresee this contractual undertaking between Network Rail and a Train Operating Company?
- Who knows what contractual undertakings are undertaken between a railway company (Network Rail) and a train operating company... it could be anything.



Network Rail v Conarken & Farrell

- On the other hand, Ehmler and another v Hall...
- This is, in fact, a claim for damage to property (not a pure economic loss claim)
- Suppose instead that the TOC's had sought to recover from the motorists for their lost profits following this loss of use of the railway line. *This* would have been a pure economic loss claim. No damage to their property. Just a pure economic loss claim. As such it would not have been recoverable in law.



Shell v Total

- Shell v Total
- Court of Appeal
- March 2010
- Buncefield explosion – 2005
- Total were responsible for the operation of the oil storage depot
- Shell used the depot to store oil which they owned
- The oil storage tanks were destroyed – Shell did not own
- The oil was destroyed – Shell did own



Shell v Total

- Total accepted liability for the loss of Shell's oil
- Total denied liability for the lost profit that Shell suffered, consequent on the destroyed tanks and pipelines
- Total said, "only a legal owner or someone with an immediate right to possession of property has the right to claim damages for economic loss which is the consequence of damage to such property."
- Exclusionary rule:
- "no duty is owed by a defendant who negligently damages property belonging to a third party, to a claimant [i.e. another party, not the third party] who suffers loss because of a dependence upon that property or its owner."



Shell v Total

- Shell said... they had a **beneficial ownership** in the oil storage tanks and pipelines
- They had a point
- Shareholder / beneficial interest / legitimate interest in the damaged property / could claim for the lost profits that flowed as a consequence
- The Court of Appeal agreed
- Not a pure economic loss claim
- but instead a claim for lost profits that flowed from the loss or damage to property which it (beneficially) owned
- **third party property damage** claim



Shell v Total

- a duty of care is owed to a beneficial owner of property (just as much as to a legal owner of property) by a defendant who could reasonably foresee that his negligent actions would damage that property;
- if, in breach of duty, property is damaged by the defendant, that defendant will be liable not merely for the physical loss of that property, but also for the foreseeable consequences of that loss such as the extra expenditure or loss of profit **the beneficial owner incurs**; and
- provided that the beneficial owner can join the legal owner in proceedings, **it does not matter that the beneficial owner is not himself in possession of the property** at the time of the incident.
- May be appealed to the Supreme Court...



Shell v Total

- How far can you take the argument about having a beneficial ownership in property arising out of a beneficial interest?



Conclusion (in the interim...)

- The law is dynamic
- Judges take different routes to an outcome of fairness
- It's actually not clear exactly where the law lies
- The law is uncertain and unstable

