

- 1 Recent developments:
 - (a) Fitness for purpose: *Kingspan v. Borealis*
 - (b) Statutory implication of warranties and causation: *Trebor Bassett v. ADT*
- 2 Old favourites reviewed:
 - (a) Efficacy exclusions
 - (b) Contamination cases.

I - RECENT DEVELOPMENTS

Fitness for purpose: *Kingspan v. Borealis* [2012] EWHC 1147

- 3 This case had many similarities to earlier litigation involving the same defendant manufacturer (*Balmoral v. Borealis* [2006] 2 Lloyd's Rep 629) which was determined by the same judge (Christopher Clarke J). A 48-day trial concluding in July 2011 spawned a 243-page judgment handed down on 1 May 2012.
- 4 Borealis supplied a polymer called Borcene to Kingspan, which then used the polymer in the manufacture of kerosene tanks for outside use in Europe. The tanks were manufactured using a process known as rotomoulding, a process described by the judge in his earlier judgment as follows:

“A quantity of polyethylene in powdered form (the charge) is placed into one of the two halves of a steel mould, which are then clamped together. The mould, which is mounted on the arm of a machine, is introduced into an oven and continuously rotated on two axes at a low speed (typically 4- 8 revs/min), so that all parts of the interior surface of the mould pass through the pool. The charge becomes tacky and then melts in the heat (of up to around 300° C), forming a molten pool. As the powder becomes tacky it starts to stick to the mould. More powder sticks to particles that have become tacky before. As a result a layer of viscous, largely immobile, liquid forms over the entirety of the mould. The wall thickness distribution of the melt is largely determined at this stage. The product has, however, to remain in the oven in order to eliminate the bubbles (trapped pockets of gas) in the melt. After about 20 minutes the mould is removed from the oven and cooled. At this stage crystallization of the melt will occur. The crystallizing melt will

shrink away from the mould, the rate of crystallization being dependent, in part, on the rate of cooling. When the polyethylene is sufficiently cool, the tank, as it has now become, is removed from the mould. A very high proportion of rotomoulding production is of tanks of one form or another.”

5 From late-2003 onwards, a significant proportion of the oil tanks made using Borcene cracked. Kingspan brought proceedings seeking damages (originally pleaded at £100M but subsequently reduced to about £40M) for misrepresentation and also for breach of the obligation to supply goods which were fit for purpose. These claims failed for a variety of reasons (not the least of which was that the huge variation in the failure rates between different Kingspan factories plainly indicated that issues in relation to quality control during the manufacturing process were at play). Few interesting points of general application emerge from the inevitably detailed and technically complex judgment, save for the following:

(a) **Incorporation of terms:** Borcene was originally supplied by Borealis UK. In 1999 or 2000, Borealis decided that it wished all sales from 1 January 2001 to be made by Borealis Denmark and it sent out letters to that effect to its customers. There was an issue as to whether these letters were received. Borealis Denmark’s standard terms applied Danish law, which was more favourable to Borealis than English law – not least because Danish law provides no remedy for misrepresentation. Christopher Clarke J applied *Circle Freight v. Medeast* [1988] 2 Lloyd’s Rep 427 in holding that Borealis Denmark’s general terms and conditions were incorporated into the supply contracts, since those terms were:

- (i) referred to on the face of every one of hundreds of invoices supplied by Borealis;
- (ii) included with each such invoice;

(b) **Fitness for purpose:**

- (i) Danish law incorporates Part 1 of the UN Convention on *Contracts for the International Sale of Goods* 1980, Article 35 of which provides:

“(1) The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract.

(2) *Except where the parties have agreed otherwise, the goods do not conform with the contract unless they:*

(a) *are fit for the purposes for which goods of the same description would ordinarily be used;*

(b) *are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement*

...”

- (ii) Kingspan asserted that the effect of Article 35 was to impose an obligation that the Borcene was fit for the purpose of manufacturing rotomoulded tanks which met the industry standard for the longevity of external oil tanks in Europe (10 years). Borealis contended that it was wrong to import any standard of longevity into the question of fitness for purpose;
 - (iii) The judge concluded that the nature of the relevant obligation was that the Borcene *could* be used to produce a tank which would last for the requisite period. In rejecting Borealis’s submission about longevity, the judge observed that a requirement of suitability for purpose could not sensibly lack any temporal connotation;
 - (iv) However, whether the tanks *would* last for the requisite period depended on a large number of factors outside the control of the material supplier (including design stresses, manufacturing qualities, wall thickness etc). On the evidence the judge concluded that the Borcene was fit for the purpose which he had described.
- (c) **Exclusion Clauses:**
- (i) In his earlier judgment in the *Balmoral* case, the judge had held *obiter* that Borealis’s exclusion clauses were unreasonable. He reasoned that a blanket exclusion of liability would be unreasonable if it required the customer to assume the entire risk of a latent defect in the supplier’s product. His approach was therefore consistent with that of the Court of Appeal in *Bacardi v. Thomas Hardy* [2002] 2 Lloyd’s Rep 368;
 - (ii) In the *Kingspan* case, Borealis argued that the judge had been wrong as to the conclusion he had reached on the issue of reasonableness in the earlier

litigation. Because the contracts in the present case were found to be international supply contracts, the judge held that the provisions of UCTA 1979 did not apply. He went on to state, however, that it should not be assumed that he would have followed his earlier decision; nor could it be assumed that he would not have done so.

Statutory implication of warranties and causation: *Trebor Bassett v. ADT* [2012] EWCA Civ 1158

6 Cadbury UK retained ADT to design, supply and install a fire suppression system for a popcorn production line in Pontefract. The popcorn was produced by an inherently dangerous method called the “oil pop method”, which involves heating the popcorn in pans of soya oil over a naked gas flame until it reaches a temperature at which it pops.

7 In June 2005, a serious fire occurred which destroyed a manufacturing area in the Pontefract factory. The fire occurred because popcorn had overheated, leading it to smoulder. An air drop when the popcorn was passed into a hopper may have caused a transition from smouldering to flaming. In any event, a fire developed in the hopper which was contained for about 8-15 minutes before it escaped.

8 It was common ground that:

- (a) the fire suppression system should automatically have discharged CO2 into the hopper;
- (b) if the fire suppression system had discharged CO2 into the hopper then the fire would have been extinguished.

9 The fire suppression system did not discharge CO2 into the hopper as it should have done. At first instance, Coulson J held that this was because ADT had failed to design the CO2 suppression system with reasonable skill and care.

10 Coulson J went on to hold that:

- (a) Cadbury too was at fault given its failure to:
 - (i) segregate the “oil pop” production line from the rest of the building;
 - (ii) install sprinklers;

(b) applying *Vesta v. Butcher* [1989] AC 852, the damages recoverable by Cadbury should therefore be reduced by 75% for contributory negligence.

11 Cadbury appealed, contending that the judge should have held that ADT's contractual duties went beyond a mere obligation to exercise reasonable skill and care and that there was therefore no scope for apportionment. In particular, Cadbury argued that:

(a) There was an absolute obligation to supply a system which accorded with a specification which had been attached to ADT's quotation. The specification specifically imported a requirement to comply with a British Standard (BS5306 Part 4) which distinguished between different types of fire and prescribed different rates for the application and quantity of CO₂;

(b) There was an express contractual term that the goods supplied should be of good quality. For the purposes of that provision, the system as a whole should have been regarded as the goods supplied;

(c) The contract was one for the supply of services under which goods were also to be supplied, importing implied terms as follows:

(i) **Pursuant to s.4(2) of the SGSA 1982** an obligation that the goods supplied (ie the system) should be of satisfactory quality;

(ii) **Pursuant to s.4(4) of the SGSA 1982** an obligation that the goods supplied should be reasonably fit for the purpose of extinguishing a fire in the hopper.

Express & Implied Terms: "Goods"

12 The Court of Appeal considered that whether the system could properly be described as "goods" was a matter of impression. The Court noted that the system was not an "off-the-shelf" system or product, but a bespoke system. What was important was not so much the inherent quality of the component parts of the system but the skill with which they were to be selected, integrated and installed. In the circumstances, Tomlinson LJ:

(a) held that it would be "wholly artificial" to regard ADT as having contracted to supply a system which could be equated with "goods";

(b) cited, with approval, Coulson J's view that:

“... what made it a system (as opposed to a random selection of equipment) was the design: the pulling together of all the relevant information into a designed system that used CO2 to suppress fire ... Accordingly, the most important element of the workscope was that done by the defendant’s designers ...”

(c) concluded that:

“What ADT was agreeing to supply was primarily design skills and care in exercising them, not goods, and the goods which they did supply were of good quality”.

13 These conclusions were sufficient to dispose of Cadbury’s arguments based on both the express term as to the quality of goods and also the implied terms arising under s.4 of the SGSA 1982. Tomlinson LJ also concluded that Cadbury had not made ADT sufficiently aware of the nature of the “oil pop” process or its hazards for ADT to have been aware of the particular purpose for which the system was being supplied. Such a conclusion suggests that a significant degree of specificity may be required before an implied term can arise as to the fitness of goods for the particular purpose in question.

The Specification

14 The Court of Appeal also rejected the argument that the Specification imposed an absolute obligation. Tomlinson LJ seems to have been impressed by Coulson J’s view that the provision of a facility to trigger the manual discharge of the CO2 negated any construction to the effect that automatic discharge was warranted. Ultimately, Tomlinson LJ:

(a) applied *dicta* of Nourse LJ in *Thake v. Maurice* [1986] 1 QB 644 and Lord Denning MR in *Greaves v. Baynham Meikle* [1975] 1 WLR 1095 to the effect that the professional man is not usually to be regarded as warranting that he will achieve the desired result;

(b) pointed out that whether a developed fire would successfully be suppressed would “depend on an infinite number of variables, most beyond the control of the supplier of a fire suppression system”;

(c) also concluded that the Specification could not provide the basis for the finding that there was a contractual obligation on ADT to ensure the operation of the system in the event of fire.

Causation

- 15 An incident in 2004 occurred in which a fire occurred in a hopper which was not extinguished by the ADT system. The judge concluded that this incident (and the contemporaneous reaction to it) meant that no-one at the claimants (at the time or thereafter) believed that the CO2 system would definitely prevent the escape of fire from the hopper.
- 16 ADT had argued that *if* its contractual obligations were absolute, then:
- (a) the 2004 incident demonstrated to the claimants that ADT was in breach of those obligations;
 - (b) the claimants did nothing in response to their knowledge of ADT's breach of contract;
 - (c) based on an unreported decision of the Court of Appeal in *Schering v. Resibel* (1992), this meant that there was a break in the chain of causation.
- 17 Coulson J had been impressed by this argument, but did not formally resolve it. Tomlinson LJ was less impressed, suggesting *obiter* that there would need to be evidence of relevant knowledge "*at an appropriate level within Cadbury's management to impress Cadbury with corporate knowledge of what had occurred*". Whether or not the decision in *Schering* is correctly to be distilled as turning on either a break in the chain of causation or (as Hobhouse LJ believed in *County v. Girozentrale* [1996] 3 All ER 834 at pp.858-9) or the crystallisation of the duty to mitigate the consequences of a breach of contract, the identification of the relevant person for the purposes of attribution of knowledge would depend on questions of the delegation of duty within the relevant organisation and the system of supervision which the claimant could reasonably have been expected to have in place.

II - OLD FAVOURITES REVIEWED

Efficacy Exclusions

- 18 It is common for product liability policies to exclude liability arising out of the failure of a product to perform its intended function. Such exclusions may inevitably cut down the scope of meaningful cover, particular where the product in question is a safety-critical component

or piece of equipment. However, even in the case of such products, extravagant modes of failure may still arise (for example, the brakes of a lorry might “explode” thereby causing damage to other property or injury to bystanders), so that the exclusion cannot be portrayed as emasculating all cover under the policy – in such circumstances, it will not be possible to surmount the very high hurdle (see *The ‘TFL Prosperity’* [1984] 1 WLR 48, as explained in *GNER v. Avon* [2001] 2 Lloyd’s Rep 649 at [31]) which must be satisfied before an exclusion will be struck down as being repugnant to the cover provided.

19 The impact of efficacy exclusions in product liability policies continues to arise in practice on a frequent basis, although such clauses have not been the subject of review by the English courts in past couple of years. The available jurisprudence therefore remains slight, but indicates – as is to be expected – that the Courts will apply a restrictive to the construction of such clauses. Thus:

(a) in *Wyeth v. Cigna* [2001] Lloyd’s Rep IR 420, Langley J (with whom the Court of Appeal agreed) held that an efficacy exclusion was not triggered in a pharma-PL claim in which the third party claimants were alleging that their conditions had been aggravated by taking benzodiazopine (as distinct from alleging that their conditions had not been alleviated by it);

(b) in *Reilly v. NIG* [2009] Lloyd’s Rep IR 488, the efficacy exclusion applied to “*the failure of any fire or intruder alarm switchgear control panel or machinery to perform its intended function*”. The Court of Appeal held that if the system failed to operate due to a problem with a master cylinder, then such a failure could not be attributed to machinery; however a failure of the system caused by the failure of an actuator piston to latch properly would be a failure of machinery.

20 While the guidance in *Wyeth* might be thought relatively clear, that in *Reilly* is rather harder to apply in practice. The fact that many efficacy exclusions are expressed in less precise terms than the exclusion in *Reilly* may, however, avoid the need to make fine line distinctions as to the precise point at a failure occurs.

21 Efficacy exclusions are not, however, an exclusively British problem. In *Selected Seeds v. QBEMM PTY Limited* [2010] HCA 37, the High Court of Australia had to consider the effect of such an exclusion in circumstances where seed which was represented to be (premium) Jarra grass seed was in fact summer grass seed (a weed). The third party purchasers sought damages for the cost of eradicating summer grass from their land and for loss of use of the

land in the meantime. The High Court of Australia decided the case on the basis of an analysis of causation which it adopted from *Wyeth*: the cause of the damage to the land was the introduction of the weed, not the failure of the seeds to produce Jarra grass; thus the efficacy exclusion did not apply.

Contamination cases

- 22 The LUG paper on financial losses makes it topical briefly to revisit the law in relation to cases where a defective ingredient is used (with non-defective ingredients) to produce some greater product.
- 23 The relevant principles can be stated shortly:
- (a) where a contaminated/defective ingredient is introduced into the production process, the end product:
 - (i) may be defective and valueless; but
 - (ii) cannot be said to have been “damaged” by the introduction of the contaminant since it did not exist other than in its defective state;
 - (b) accordingly, a claim against the supplier of the contaminant will be a claim for economic loss rather than a claim for direct physical damage to property
 - see *Bacardi-Martini v. THP* [2002] 2 Lloyd’s Rep 379 at [11]
 - (c) a policy which indemnifies against liability for physical damage will therefore not respond (without more) to a claim arising from the introduction of a contaminant or defective ingredient into the manufacturing process – see, eg, *Rexodan International v. Commercial Union Assurance* [1999] Lloyd’s Rep IR 495, *James Budgett Sugars v. Norwich Union Insurance* [2003] Lloyd’s Rep IR 110.

DAVID TURNER QC

4 New Square
LONDON WC2

12 September 2012

Direct Line: 020 7822 2131
Email: d.turner@4newsquare.com