The perennial problem of pure economic loss

Not being able to recover economic loss is an issue constantly bedevilling construction. Barristers Chris Bryden and Georgia Whiting of the Chambers of Timothy Raggatt QC, 4 King’s Bench Walk, analyse why it is a particular problem for large multi-party projects.

KEY POINTS
- Common law has traditionally recognised a duty to take care to avoid causing physical injury to persons or property, but has been reluctant to recognise a tortious duty to avoid non-physical or purely economic loss.
- This contrasts with the contractual position, where it is recognised that the purpose of privity of contract is to provide for remedies in respect of identifiable losses by contracting parties.
- It is accepted that contractual damages in such circumstances can be intended to cover economic losses.
- In the absence of a contractual relationship, courts have been reluctant to impose a similar responsibility in tort.
- The basis of the exclusionary rule can be considered as the desire to impose a limit on the type of relationships giving rise to a claim, as well as the number of parties.
- It is essential that contractual provisions are put in place allowing the recovery of pure economic loss, as it is likely that tortious remedies will be exceptional.

This article considers the concept of pure economic loss in tortious claims and, in particular, the exceptions which have developed in the English law, and their relevance to construction law practitioners.

Whilst the common law has traditionally recognised a duty to take care to avoid causing physical injury to persons or property, it has historically been reluctant to recognise a tortious duty to avoid non-physical or purely economic loss, even where such loss was reasonably foreseeable. This contrasts with the contractual position, where it is recognised that the purpose of privity of contract is to provide for remedies in respect of identifiable losses by contracting parties, and that contractual damages in such circumstances can be intended to cover economic losses. In the absence of a contractual relationship, courts have been reluctant to impose a similar responsibility in tort. The basis of the exclusionary rule can be considered as the desire to impose a limit on the type of relationships giving rise to a claim, as well as the number of parties.

Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd [1973] QB 27 is the classic authority pertaining to the recoverability of pure economic loss by an action in negligence. In that case a production company which manufactured (unsurprisingly) steel, was shut down for a period of time as a result of a power cut. The processing of one of the steel sheets was disrupted by the power cut and it was established to be as the result of the defendant’s negligence. It was held that the value of the damaged steel sheet could in principle be recovered as property damage, but that the claimant’s loss of profits during the period the factory was out of operation were unrecoverable as they amounted to pure economic losses.

There exists a major exception to the common law’s general exclusion of liability in negligence for pure economic loss. The foundation for this exception can be seen from the House of Lords’ authority of Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465. Hedley established that the essential pre-requisite for a claim for economic loss to be able to be brought to be a ‘sufficiently proximate relationship’. Hedley involved the negligent advice of a financial adviser giving advice...
to a third party where he knew that the third party would rely on that advice (and they reasonably did so). Thus, it was established that in limited circumstances – if a duty of care arose in the making of statements – that pure economic loss in tort could be recoverable in English law.

A full analysis of the cases which followed Hedley is not within the scope of this article, but it is pertinent to analyse a number of crucial cases relating to the development of the pure economic loss doctrine and the exceptions thereto.

The House of Lords in Anns v Merton Borough Council [1978] AC 728 considered a claim relating to the construction of a property. Lord Wilberforce labelled structural damage to a house as foreseeable physical damage, and so allowed a claim against the local authority for negligence, whilst recognising that damage needed to be suffered in order to make out that claim. This left only policy to curtail liability as virtually any event could be foreseen.

The scope for recovering such damages was however curtailed by the subsequent decision of the House of Lords in Murphy v Brentwood District Council [1991] 1 AC 398, overturning the decision of a differently constituted House in Anns. In that case, the claimant was the purchaser of one pair of semi-detached houses, sold by ABC Homes. The foundations to the house took the form of a concrete raft which had been approved by the council on the recommendation of independent consulting engineers. After ten years or so, serious cracks began to appear in the walls of the house. After investigation, it transpired that the concrete raft had subsided, causing the cracking. The claimant sold the house for some £35,000 less than its estimated worth and sued the council’s building control department. At first instance, the judge found the council negligent in considering the suitability of the design and that their duty of care had not been discharged by the advice of competent independent engineers.

The House of Lords, overturning the trial judge’s decision found that a builder did not owe a duty of care to a remote purchaser in respect of pure economic loss suffered through the defective construction of a building. This was decided on the basis that, for policy reasons, the common law duty to take reasonable care does not apply to building control in circumstances where no physical injury had been suffered and the loss is purely economic. This case suggests that, in most circumstances, there will be no legal recourse in respect of pure economic loss against building control which has approved defective plans.

Demonstrating the problem
A recent case which revisited the case law in this area is Sainsbury’s Supermarkets Ltd v Condeck Holdings Ltd [2014] EWHC 2016 (TCC), which also illustrates the difficulties in proving either an assumption of responsibility or reasonable reliance.

The judge gave summary judgment against the claimant, rejecting the argument that the defendants owed it a duty of care to prevent the pure economic losses it suffered. Stuart Smith J gave a useful overview of the case law in respect of the exception to the rule against recovery. The judge held:

‘... it will not be sufficient to establish ... an assumption of responsibility [by the director personally] if the director does no more than act in a way that is consistent with his position as a director.’

The judge was not persuaded that the director in question had done any more than act in the usual manner consistent with the role of a director. In terms of the assumption of responsibility, the judge outlined that it will only be in rare circumstances that a sub-contractor could be said to have assumed responsibility for a building owner where there was no contract in place between them. He went on to state:

‘... there is generally no assumption of responsibility by a sub-contractor or supplier direct to a building owner, [as] the parties have so structured their relationship that it is inconsistent with any such assumption of responsibility.’

Once again it is clear that policy decisions form a significant part of the decision-making process and that policy has not altered significantly since Murphy.

While the outlook may appear bleak for those seeking to claim pure economic loss by way of the assumption of responsibility exception, the law is by no means settled in this area, and there are creative ways in which a party can still seek to claim such damages. In particular the distinction between property damage and pure economic loss as set
out in *Anns* may in certain circumstances remain available. The issue in *Anns* considered in *Murphy* was the distinction between physical damage, which is recoverable, and economic loss, which is not. A careless builder is liable for physical injury, but that does not extend to a person knowing of the defect, choosing to stay in the house, and being financially injured afterwards by a loss as a result of the defect.

**Complex structure theory**

There is a further potential exception to the rule against recovery of pure economic loss pursuant to the 'complex structure theory' as set out in *D & F Estates Ltd v Church Comrs for England and Wales* [1989] AC 177.

Pursuant to this theory, complex structures such as houses are considered as comprising of distinct elements and therefore damage to one of those elements caused by defects in another may give rise to a claim for physical damage. However, this theory is not without its difficulties, and it is arguably artificial to think of a consumer purchasing a property as a whole but then viewing adjacent walls or rooms in that house as constituting separate forms of property giving rise to distinct private law rights. Indeed, whilst *D & F Estates* has not been expressly overruled, the Court of Appeal in *Bellefield Computer Services Ltd v E Turner & Sons Ltd* [2002] EWCA Civ 1823 refused to apply the theory, and it has been said that this approach is no longer tenable particularly in light of *Murphy*.

**The Defective Premises Act 1972**

The *Defective Premises Act 1972* provides a statutory right to claim for damages for defects in dwellings: the right of action requires neither a contractual link between claimant and defendant nor the need to show a duty of care in negligence between them in relation to 'pure economic loss'. However, this will not assist where limitation is in issue.

**The Latent Damages Act 1996**

The *Latent Damages Act 1996* will come to the assistance of a property owner whose property was damaged before they acquired it but who was unaware of the damage at the time they acquired it. By virtue of s 3 of that Act, a fresh cause of action will accrue in respect of the new owner as against the defendant on the date when they acquire their interest in the property. However, the Act is arguably of limited assistance as the owner must prove actionable damage, and many latent issues discovered by new owners will be regarded as defects in the building as opposed to damage to it. It will therefore also not assist in all likelihood in respect of pure economic loss claims (for example due to a lower resale value) as a result of *Murphy*.

**The nominated sub-contractor**

It seems then, that after a period of expansion to the extent that, after *Anns*, whether a duty of care was owed seemed to depend on simply a question of policy, the law has contracted again to a tighter test of liability. A duty of care is based on proximity, and damages for economic loss can only be awarded if there is foreseeable physical injury to the plaintiff or his property. It is worth mentioning, however, the interesting case of *Junior Books v Veitchi* [1983] AC 520 in which the House of Lords (considering an appeal from the Scottish courts) decided that the plaintiffs could recover economic loss which was not parasitic because in that case there was no physical injury to the plaintiff or his property, but merely faulty work. This case was, of course, before the retreat from *Anns* in *Murphy*, which seems to reaffirm that economic damages need to be linked to physical injury. This view is supported by the Court of Appeal decision in *Simaan General Contracting Co v Pilkington Glass Ltd* [1988] 1 All ER 345 where Dillon LJ said of *Junior Books* that it had:

‘... been the subject of so much analysis and discussion that it cannot now be regarded as a useful pointer to any development of the law. It is difficult to see that future citation from *Junior Books* can ever serve any useful purpose.’

It seems to be settled that the decision in *Junior Books* can be treated as anomalous and distinguished by the unique contract issues in that case.

**Conclusion**

It is clear that non-recoverability or otherwise of pure economic loss is likely to be of significant importance to those working in the construction industry. It is an issue which is likely to arise frequently in respect of large multi-party construction projects, which will bring into play the questions of third party right, limitation and collateral warranties (or more often, where these have not been obtained). It is therefore essential that contractual provisions are put in place allowing the recovery of pure economic loss, as it is likely that tortious remedies will be exceptional. **CL**