Pure economic loss claims

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"Pure economic loss" has been defined as "a diminution of worth incurred without any physical injury to any asset of the plaintiff." (A.G. Ont. v. Fatehi 1984)

The law of negligence is the most important and best known part of the whole subject of tort law. Negligence has been most concerned with compensating those who suffer personal injury or property damage or both at the hands of other careless persons. This is the enduring legacy of the landmark Donoghue v. Stevenson case.

Personal injury and property damage, both of which are in the category of physical damage, ultimately lead to some economic loss too. If one is off work due to a personal injury, there are economic consequences which negligence law stands ready to address. The same can be said where one's vehicle was smashed and has been written off. One will be compensated for that property damage in economic terms. Almost all issues in law and wrongdoing can be reduced to money, which is the best available form of compensation.

Now, what if the only injury resulting from the negligence is economic? What if, for example, one accepts an employment position on what turns out to be careless representations of the employer? What if a contractor relies on an engineering report in constructing a shopping centre and the engineering advice turns out to be incorrect, leading to hundreds of thousands of dollars in re-design work and delays in opening? The Donoghue "neighbour principle" setting out a common law duty to take care is capable of being extended just as easily to other kinds of foreseeable losses. The question is whether the judges who shape this law will do so.

Appellate courts in Canada are just beginning to settle the law on whether someone should recover money if all that one has suffered by the negligence is economic loss. Hence the term pure economic loss. Historically, it was difficult to win a claim in this category, and while the courts are again opening their doors to it, the law is only emerging on the scope of protection that should be given to economic interests within a number of different classes of loss.

Reasons for Denying Economic Loss Claims

Contract law has traditionally governed the regulation of economic interests, such as in business generally. If a party is injured by the other side's failure to perform as promised, the injured party is entitled to receive, as compensation, that amount of money it would take to put it in the same position as if the contract had been fully performed. This is the enforcement mandate of contract law, and it is based most on the private agreements that the parties have voluntarily entered into.

The parties, in their freedom of contract and negotiation, can bargain to slightly increase or considerably reduce these damages.

If the law of torts also included the sphere of pure economic losses, that is to say -- impose a duty of reasonable care on parties to look out for the economic interests of others, the purpose of contract law would largely disappear. The empire of tort law would be all-encompassing; the role of contract law would be limited to what little is left over, such as expressly contracting out of tort liability or negotiating even better or stricter performance obligations than existed in the common law of tort, or by insurance.

There are several other reasons for the historic reluctance to permit pure economic loss claims to be based on a duty of care tort standard, than the desire to preserve two exclusive and independent private law domains (C.N.R. v. Norsk Pacific Steamship 1992). Stevens summarized the concerns into the following classes: administration, ability of defendant to bear the loss, the role of insurance, the value of the plaintiff's interest, morality and deterrence" (Negligent Acts Causing Pure Financial Loss: Policy Factors at Work 1973).

The principal concern continues to be the indeterminate scope of such far-reaching liability. As a pragmatic matter, some limits to liability are set in every area of law. Permitting recovery for pure economic loss would lead, in the words of a well known American judge, to "liability in an indeterminate amount for an indeterminate time to an indeterminate class. There must be some limits on recovery of money or individuals, businesses, the judicial system and society in general would become paralysed. Otherwise, every word and action by every person could have tortious consequences in some manner, at least on a theoretical basis.

Consider, for example, if a municipal official decided to turn down an application for a new business licence. Think of all the prospective employees, couriers, utility companies, suppliers, customers and even taxing authorities who could argue that this was a financial loss to them! Even their children might have a complaint as dependents. The interests and classes of possible plaintiffs are ill-defined, but the neighbour principle could be stretched to embrace a mind-boggling circle that could bring all government decision-makers, business and the courts to a halt.

All potential financial losses should not be vindicated in court. A Supreme Court of Canada judge recently said that "some limits on the potentially unlimited liability which can theoretically flow from negligence are necessary". Confining claims to only those persons who can prove physical injury is a convenient separating line, since the number and scope of persons so injured is likely to be much smaller than the number of usually inter-dependent economic victims. The complicated task of making further distinctions, establishing causation and precluding frivolous lawsuits is thus avoided. The floodgates remain closed.

This is another way of saying that plaintiffs claiming for only economic losses must accept this as a cost of living, or doing business, in our society. Accordingly, such costs should be built into our plans and actions. We should look outside of the law of tort, perhaps outside of all law, for ultimate protection of finances.

There are already many injuries in our lives, which the law does not recognize for compensation. One is surly behaviour of others. The law does not force anyone to be nice or good or generally fair to others. There are defences available to virtually all wrongs committed by someone, under certain circumstances. Another is the class of true accidents, where someone is injured but no one is adjudged negligent.

The law has its limits, even in enforcement. We know that many crimes go unpunished. Most civil wrongs also go unrequited, as some injured parties will pursue a remedy but many will not. All persons do not start off in life in exactly the same position. If the efficacy and reach of the law is to be limited, why not draw the line of neighbourliness at economic interests?

Another reason for denying recovery for pure economic loss is the policy to see economic interests as less worthy of legal protection than physical damage. In other words, there is a qualitative difference between these two categories of injury. The security of body and property has always enjoyed a higher priority in the law, than the protection of economic interests.

In criminal law, restitution is rarely ordered, in favour of other sentencing objectives and alternatives. Few constitutional remedies will entail monetary re-distribution. In the civil litigation process itself, any party's financial stakes are never fully protected. For example, the winning party will usually not recover enough costs from the losing party to pay the actual legal fees incurred in prosecuting the action.

Even in contract law, which is most allied to economic interests, rarely will a court compel the promised performance of a contract. It will rather rely on the less perfect remedy of damages. There is a premise in our legal system that life, dignity, liberty, security, democracy and other social values are more fragile than relative economic well-being, which can take care of itself, based as it is on the power structures of the marketplace.

Bodily injury and property damage are taken more seriously also because of the value of educating, rehabilitating, punishing and deterring people from causing that in the future. Security interests flow into a general sense of well-being in society. Therefore, this objective goes farther than mere compensation of the injured party.

Recovery Under Various Categories of Pure Economic Loss

To date these pure economic claims have been separated by judges into four categories to be dealt with here. They are negligent statements, negligent performance of services, relational economic losses, and economic losses caused by defective products or buildings.

Negligent Statements

The first recognized source of economic loss involved the reliance upon comments and representations which were negligently given. In the English case of Hedley Byrne & Co. v. Heller & Partners Ltd., an advertising agency requested its bank (A) to inquire into the credit worthiness of a third party client. This bank called the client's bankers (B) for this information to be freely given. They simply asked whether this client would be a good credit risk for [pounds

sterling] 100,000. Bank B replied that the client was a "respectably constituted company and considered good for its normal business requirements". The advertising agency went ahead and extended the credit to the client. These references turned out to be inaccurate, and the agency lost over [pounds sterling] 17,000 as a result of the client's default.

Since this information was provided by B under a disclaimer ("For your private use and without responsibility on the part of the bank or its officials"), B was found not liable to the agency. The Hedley Byrne rule means that there may be legal liability for gratuitous statements, negligently made, which are relied upon and cause economic injury to another. The Supreme Court of Canada has adopted the Hedley Byrne rule many times, including recently in Queen v. Cognos where a judge affirmed that it is "now an established principle of Canadian tort law".

Negligent Performance of Services

As in the case of negligent statements, one can be found liable in tort for failing to take reasonable care to perform a gratuitous service undertaken. Again, the voluntary assumption of the responsibility and the injured person's detrimental reliance on that undertaking, constitute the foundation of liability. If this relationship is found to exist, the plaintiff may recover pure economic loss.

Relational Economic Losses

This category comes as close as any to the spectre of indeterminate liability and allowing litigation which would overwhelm the judicial system. In this area, injury to one person may easily impair the financial position of related others.

The leading Canadian case is C.N.R. v. Norsk. In that case, a tug boat operator was towing a barge down a river. The barge negligently collided with a railroad bridge owned by the Crown (Canadian National Railway). The Crown made a claim for the physical property damage to its bridge. However, three other railway companies sued the tug boat owner too. They had a contractual right to use the same bridge and they claimed that they suffered economic losses as a result of this negligence which interrupted their use of it for a time.

The Supreme Court of Canada decision is fragmented and confusing, but the majority of judges allowed the claim, primarily on the basis of proximity of the damage and relationship. Just as with property damage, personal injury may lead to financial loss for others (e.g. relatives, creditors, etc.) who are related to the injured person.

Economic Losses Caused by Defective Products or Buildings

Users of defective or dangerous products or buildings may be injured in a purely economic way. In a recent Supreme Court of Canada decision, called Winnipeg Condominium v. Bird Construction, a building developed a defect with its exterior cladding. Pieces fell to the ground. A subsequent purchaser replaced the cladding and sued the builder for the considerable costs of doing so, owing to their negligence. A unanimous Supreme Court held that a duty of care in tort law arises between a builder and a subsequent user (e.g. owner and occupant) of the building,

where it is reasonably foreseeable that a construction defect presented a danger to those users. The buyer was allowed to recover its pure economic losses.

Conclusion

Damages for bodily and proprietary injury are recoverable under the general neighbour principle in Donoghue. Since many losses involve neither of these, but instead large amounts of only economic loss, some of it on the part of claimants many times indirectly situated, the courts continue to struggle with what kinds of economic losses can be compensated.

Until now, the courts have carved out four categories of economic loss that can be compensated. Recent cases from the top court demonstrates an intention to keep these categories restricted. In Hercules v. Ernst & Young, the Supreme Court of Canada found that auditors did not owe individual investors a duty of care with respect to investment losses. Only a few months ago, the same court unanimously said that negligence does not extend to damages for pure economic loss arising out of the conduct of pre-contractual negotiations and commercial tendering processes (Martel v. Canada 2000).

The challenge now appears to be to reconcile the four categories and the principles that underlie them, in order to provide clear guidance for parties who suffer pure economic loss in the future.