

THE CANADIAN APPROACH TO NEGLIGENT  
MISREPRESENTATION: A CRITIQUE OF THE  
RELIANCE MODEL OF LIABILITY

by

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A thesis submitted in partial fulfillment of the requirements for  
the degree of

Master of Laws

in

The Faculty of Graduate Studies

(Faculty of Law)

We accept this thesis as conforming  
to the required standard

The University of British Columbia

August 2003

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Date August 29, 2003

## ABSTRACT

The Canadian Approach to Negligent Misrepresentation: A  
Critique of the Reliance Model of Liability

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This thesis is presented on recent developments in the law of negligent misrepresentation in Canada, focusing on the debate surrounding the appropriate basis of liability and its significance in commercial settings. Since *Hedley Byrne* first opened up the law of negligence to careless words and economic loss, there has been some confusion as to the precise nature of the duty of care. Two models of liability have competed for recognition, one based on voluntary assumption of responsibility by the defendant and one based on reasonable reliance by the plaintiff. The former is in fact a hybrid model of liability which has elements of traditional contract and traditional tort liability. The latter is more consonant with traditional tort liability alone.

In 1997, the Supreme Court of Canada adopted the reliance model of liability. In considering the appropriateness of the reliance approach, I examine the underlying philosophies and policy objectives relevant to tort law generally and negligence law specifically. The significance of corrective justice and distributive justice theories are considered, the latter increasingly being raised in argument before the courts. The role of economic efficiency in determining the appropriate form of liability is also considered. A large part of my research concerns the interplay of the many other policies, some conflicting, which the courts have identified as part of the duty of care issue in negligence. Some of these policies include the need to deter harmful behaviour, the desire to promote independence and self-sufficiency, and concerns about overlap with contractual principles.

I argue that in adopting the reliance model Canada's highest court has sacrificed, among other things, coherence of approach by the law to economic dealings and certainty in the law's application. I argue that a hybrid model based on voluntary assumption of responsibility or consent is the most effective way to balance the competing policies and theories of responsibility in this area.

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## CITATION AND LANGUAGE NOTES

I have endeavoured to follow the citation protocols of the *Canadian Guide to Uniform Legal Citation*, 5th ed. (Toronto: Carswell, 2002). Neutral citations, for instance, appear as parallel citations if the case is reported (e.g., *M. Hasegawa & Co. v. Pepsi Bottling Group (Canada) Co.* (2002), 213 D.L.R. (4th) 663, [2002] 7 W.W.R. 600, 2002 BCCA 324). In the footnotes, when citing cases, I have included no more than two parallel citations for report services, but in the Table of Cases, I have included all those readily available. Pinpoint numbers in the citations refer to page numbers unless otherwise specified (e.g., para. for paragraph). In referring the reader to other places in the thesis, “*supra*” and “*infra*” refer to earlier and later footnotes, and “above” and “below” refer to earlier and later passages in the narrative.

In researching this thesis, I found myself starting to use more words ending in “ism” than I had done previously, words like instrumentalism, contractualism, neo-liberalism, etc. Instinctively, I hesitate to use these and other very specialized words, but they have a purpose, I discovered, which is to save space. I have included most of the difficult ones in the glossary following Chapter 5.

In Chapter 4, there is a comparative survey which includes the United Kingdom, Australia and New Zealand. For the sake of brevity, in Chapter 4 and elsewhere in the thesis, I refer to the collection of these three countries together with Canada as the Commonwealth. I recognize that generalizing about the Commonwealth position from these four countries is a gross oversimplification, omitting as it does many Commonwealth jurisdictions with different and varied approaches to the law, including some like the Maldives and Mozambique, which have no common law component at all.

Finally, I have placed negligent misrepresentation cases into three main groups and given them names: “direct advice”, “basic contract” and “free rider”. These categories are described and graphically represented in three figures in section 3.5. As I explain, these expressions are my own and not generally accepted terminology in this context.

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## ACKNOWLEDGEMENTS

I wish to express my appreciation to my wife, Christine Matthews, who planted the idea of going back to school for a year to further my legal studies, and whose enthusiasm was inspiring. Also, I would like thank: the U.B.C. Law School library staff for their assistance in setting up electronic research accounts, providing information about new releases, and helping me locate hard-to-find volumes in storage; the LL.M. seminar leaders, Professors Wesley Pue and Joel Bakan for introducing me to new ideas about and approaches to the law; the law firm of Fraser Milner Casgrain, and particularly Kelly Geddes, for background information about the *Micron Construction* case and for making copies of court documentation; and Capilano College, for making this year possible.

## Chapter 1

### INTRODUCTION

The use of words, a defining human characteristic, is subject to legal regulation in a number of ways. Criminal sanctions flow from using words to promote hatred, to commit perjury and to obtain property through fraud; we must honour our promises in contracts or risk claims against us; and we can be held civilly liable if we injure others by deceit or if we defame them. The question to be examined in this thesis relates to the nature of civil responsibility to others when we are *careless* with our words. To what degree are we or should we be responsible to others for the reliance they place on our words in such circumstances?

In proposing a thesis on the common law relating to negligent misrepresentation I had to consider whether more ink was justified in this already heavily inked area. William Paley's comment almost 200 hundred years ago is as apt today as it was then:

...when a writer offers a book to the public upon a subject on which the public are already in possession of many others, he is bound by a kind of literary justice to inform his readers, distinctly and specifically, what it is he professes to supply and what he expects to improve.<sup>1</sup>

In this introduction I hope to justify more words on this topic. After a brief discussion of the nature of the claim, I describe my thesis plan (what I profess to supply) together with a proposal for improvement.

#### **1.1 THE NATURE OF THE CLAIM**

Liability for negligent misrepresentations outside of contractual or fiduciary relationships is a relatively new addition to the common law. It involves responsibility for pure economic loss.<sup>2</sup>

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<sup>1</sup> From the preface to William Paley, *Principles of Moral and Political Philosophy*, 20th ed. (London: Printed for J. Faulder, 1814). This same passage was quoted in the preface to the first edition of Geoffrey Cheshire's contracts text, *The Law of Contract* (London: Butterworths, 1945) and reprinted in later editions (the most recent edition is Michael Furmston, *Cheshire, Fifoot & Furmston's Law of Contract*, 14th ed. (London: Butterworths, 2001)).

<sup>2</sup> While there is some doubt, most opinion now supports the view that cases involving careless words causing physical loss (i.e., personal injury or property damage) fall to be decided under general negligence principles: see discussion in Lewis N. Klar, *Tort Law*, 2nd ed. (Scarborough: Carswell, 1996) at 174-78. Negligent misrepresentation causing physical loss is not considered in this thesis.



Only since 1963 and the seminal House of Lords decision in *Hedley Byrne & Co. v. Heller & Partners Ltd.*<sup>3</sup> has Anglo-Canadian law recognized such a claim. Two elements of the claim were novel. Negligence law was being extended to cover words, and to cover pure economic loss.<sup>4</sup> One of the concerns with extending liability in this way was the spectre of indeterminate liability. Misinformation could lead to extraordinary financial losses. Words and money can travel great distances and with ease. The courts have addressed this and other concerns by circumscribing the liability rules for negligent misrepresentation. Ordinary negligence rules, which may be sufficient to found a duty of care in cases of physical loss, are not adequate to the task in this area. Something more is required. All five Law Lords wrote judgments in *Hedley Byrne*. Simply put, they decided that liability for careless words was premised on the need for a “special relationship” between the parties, which was conceived as an analogue to fiduciary and contractual relationships, relationships where such liability has already been recognized. What constituted a special relationship was not entirely clear but two requirements were stressed: reliance by the information recipient, on the one hand, and voluntary assumption of responsibility by the information provider, on the other. The former focuses on the expected behaviour of the plaintiff (in response to the defendant’s conduct) and the latter looks to some form of assent by the defendant. More recently, the House of Lords in *Williams v. Natural Life Health Foods Ltd.*<sup>5</sup> appears to have adopted voluntary assumption of responsibility as the touchstone of liability. In Canada, the Supreme Court of Canada has favoured a test based on foreseeable and reasonable reliance: see *Hercules Managements Ltd. v. Ernst & Young*.<sup>6</sup> Both of these concepts have difficulties. Neither is consistently defined in the case law. Another problem is that the two concepts often appear together (as they did in *Hedley Byrne*) and their relationship is not always clearly settled. Further, the contexts in which they are to be applied are not always well defined. Do they only apply to economic loss cases, for instance? Or could they have broader application in negligence or tort law generally?<sup>7</sup>

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<sup>3</sup> (1963), [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.) [*Hedley Byrne* cited to A.C.]

<sup>4</sup> In fact, negligently caused economic loss could already be recovered, but only in a limited context: see *infra* note 696 and accompanying text.

<sup>5</sup> [1998] 1 W.L.R. 830, [1998] 2 All E.R. 577 (H.L.) [*Williams* cited to ALL E.R.].

<sup>6</sup> [1997] 2 S.C.R. 165, 146 D.L.R. (4th) 577 [*Hercules* cited to S.C.R.].

<sup>7</sup> See Kit Barker, “Unreliable Assumptions in the Modern Law of Negligence” (1993) 109 Law Q. Rev. 461 at 462-63. The weaknesses and strengths of these concepts will be analyzed in the following chapters.

A test of liability based on reliance fits the traditional model for tort liability, one where legal responsibility is *imposed* by reference to a fixed standard of conduct. Voluntary assumption of responsibility, on the other hand, bears some resemblance to the contract model, where the parties have the power to define the nature of their relationship. H.L.A. Hart described the difference between rules of liability in contract and tort as follows:

There is some analogy...between...general orders [i.e., rules of conduct backed by the threat of force, such as the criminal law] and the law of torts, the primary aim of which is to provide individuals with compensation for harm suffered as the result of the conduct of others. Here too the rules which determine what types of conduct constitute actionable wrongs are spoken of as imposing on persons, irrespective of their wishes, 'duties' (or more rarely 'obligations') to abstain from such conduct. ...But there are important classes of law where this analogy with orders backed by threats altogether fails, since they perform a quite different social function. Legal rules defining the ways in which valid contracts or wills or marriages are made do not require persons to act in certain ways whether they wish to or not. Such laws do not impose duties or obligations. Instead, they provide individuals with *facilities* for realizing their wishes, by conferring legal powers upon them to create, by certain specified procedures and subject to certain conditions, structures of rights and duties within the coercive framework of the law.<sup>8</sup>

The duty of care in negligent misrepresentation based on assent or voluntary assumption of responsibility is analogous to the contract model, but it is not identical. For instance, an agreement is not required. The choice is solely the defendant's whether the duty is undertaken. Also, the level of care will be typically set according to the usual standard in negligence law: the standard of the reasonable person, or possibly a modified standard based on a reasonable person similarly situated to the defendant. Such an approach incorporates elements of both traditional tort and contract liability.

Throughout the thesis, for brevity, I frequently refer to the "foreseeable and reasonable reliance" test as the reliance model, and the "voluntary assumption of responsibility" or "assumption of responsibility" tests (they are generally taken to mean the same thing) as the consent model.

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<sup>8</sup> H.L.A. Hart, *The Concept of Law*, 2nd ed. (Oxford: Oxford University Press, 1994) at 27-28. Hart went on to describe a system of law made up of primary duty-imposing rules and secondary rules which confer powers: see c. V. Secondary rules include a subset which he referred to as "rules of change". Rules of change comprise in part private power-conferring rules such as the rules relating to the formation of contracts, which in effect contemplate "the exercise of limited legislative powers by individuals" (at 96).

## **1.2 THESIS PLAN**

### **1.2.1 Research Approach**

The nature of the analysis of an area of law, such as this one, depends on the type of research undertaken. No standard or agreed taxonomy of legal research categories seems to exist. One attempt at classification was put forward in a report on law and learning to the Social Sciences and Humanities Research Council of Canada<sup>9</sup> – it identified four main areas of legal research: conventional research, legal theory, fundamental research and law reform research.<sup>10</sup> *Conventional research* is the process of locating, updating, analyzing and synthesizing legal rules, usually for the purpose enabling legal practitioners to resolve specific legal problems. This type of research is sometimes referred to as doctrinal research. Comparative and historical legal research is possible using conventional research methods.<sup>11</sup>

*Legal theory*, or theoretical research, while it may be grounded in conventional research attempts to go one step further by providing a unifying theory or perspective. Legal theory is described in the *Law and Learning* report as follows:

Legal theory...is explanatory and evaluative: it seeks to tell us, for example, how judges do or should decide cases, or how particular solutions do or should reflect underlying values in the law. Inevitably, therefore, legal theory makes certain assumptions about the nature of knowledge, language, law or society, and risks leaving such assumptions unstated and unexplored.<sup>12</sup>

The idea of developing a unifying legal theory based on underlying social policies, values or objectives is not new. In one of the most famous common law cases, *McAlister (Donoghue) v. Stevenson*,<sup>13</sup> Lord Atkin outlined a general principle in the field of negligence law based on the concept of neighbourhood or proximity. His neighbour principle drew on moral teaching which he believed was ingrained in British law; specifically, he based his principle on the golden maxim that you should do unto others as you would have them do unto you. He was thus able to bring the existing categories of negligence under one analytical framework, a

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<sup>9</sup> Canada, Report to the Social Sciences and Humanities Research Council of Canada by the Consultative Group on Research and Education in Law, *Law and Learning* (Ottawa: Supply and Services Canada, 1983) [*Law and Learning* report].

<sup>10</sup> *Ibid.* at 65-71. At 66, the authors point out that while these terms might help to typify research for the purposes of comparison, each is an artificial construct not likely to be a completely accurate characterization of any particular work. Further, these research approaches are not mutually exclusive.

<sup>11</sup> However, both historical and comparative research can also take on an interdisciplinary dimension and therefore become fundamental research, described below.

<sup>12</sup> *Law and Learning* report, *supra* note 9 at 68.

framework, it should be noted, which at the time the case was decided did not include careless words. In more recent times, a similar struggle is underway as courts grapple with determining an appropriate theory of liability to explain fiduciary doctrine outside of established categories.<sup>14</sup> This could have implications for how the liability should be approached in negligent misrepresentation.

A theory, properly so-called, should have predictive value<sup>15</sup> and not be purely descriptive. There is a danger when fashioning a new theory that it will merely describe elements or conditions of liability from past cases without carefully considering whether future cases with those same elements ought also to attract liability. A theory soundly based on underlying policies, values and objectives should avoid this pitfall.

The *Law and Learning* report describes both conventional and theoretical research as research “in” the law. Academics involved in *fundamental research* proceed from the assumption that research “in” the law is limited and that to gain a deeper understanding of the law it is necessary to look outside the law. The social sciences, economics, politics, philosophy, psychology, to name a few external disciplines, all can offer valuable insights into the law. The interdisciplinary component is what characterizes fundamental research, however, perhaps more significant than its non-legal perspective is the frequent use of non-traditional means of analysis, such as statistical and empirical analysis.<sup>16</sup> Reliance on external data may show that a theoretically attractive branch of the law is not working well in practice. The *Law and Learning* report describes fundamental research as research “on” the law.

*Law reform research* is research which is directed at bringing about change in the law. The *Law and Learning* report points out that some of the interdisciplinary research in this area is undertaken by groups with a partisan bias espousing a particular viewpoint. This can result in

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<sup>13</sup> [1932] A.C. 562, [1932] All E.R. Rep. 1 [*Donoghue* cited to A.C.]. This case is discussed in more detail in Chapters 3 and 4.

<sup>14</sup> Fiduciary doctrine is described in section 4.2.2.

<sup>15</sup> Certainly in the “hard” sciences, theories are tested by their predictive ability.

<sup>16</sup> It should be noted that these seemingly extra-legal methods of research are not completely foreign to more traditional research. For example, in interpreting legislation, particularly constitution provisions, courts may consider the external context, or legislative facts, using Brandeis briefs. A Brandeis brief may include evidence in the form of statistics, surveys, reports, studies, etc. It is not uncommon for such evidence to be used now to challenge cultural stereotypes and to present non-traditional perspectives. See Ruth Sullivan, *Statutory*

a lack of rigorous criticism by its authors.<sup>17</sup> A second more serious problem in the opinion of the *Law and Learning* report is that much of the law reform research is “located toward the doctrinal end of the methodological spectrum” and, as a result, fails to deal with difficult issues.<sup>18</sup>

As mentioned, the various research approaches are not mutually exclusive<sup>19</sup> or, to borrow a phrase from constitutional law, are not watertight compartments. For example, policy considerations<sup>20</sup> and the search for underlying theories and principles have always been a part of traditional or conventional legal analysis, albeit with roles that have been and still are confined or limited. But the historical focus on doctrinal research and limited use of other types of research touches on what is the central criticism of the *Law and Learning* report, i.e., that we (Canada) “must take all types of research – especially fundamental research “on” the law – much more seriously”.

In my thesis I include all these forms of research. However, the primary focus is on research “in” the law.

#### **1.2.1.1 Research “In” the Law**

When the House of Lords in *Hedley Byrne* conceived of liability for careless words based on a special relationship between the parties, they were expanding the common law incrementally and by analogy (to fiduciary and contractual relationships). The Supreme Court of Canada in *Hercules*<sup>21</sup> decided that it was no longer appropriate to treat negligent misrepresentation as a discrete area of negligence. The Court brought it under the umbrella of the general “neighbour principle” theorized in *Donoghue* and modified in *Anns v. Merton London Borough Council*<sup>22</sup> and later Canadian cases.<sup>23</sup> Under this general approach, duty of care is analyzed in

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*Interpretation* (Concord, Ontario: Irwin Law, 1997) at 130-31, and Peter W. Hogg, *Constitutional Law of Canada*, 4th ed. loose-leaf (Scarborough: Carswell, 1997) c. 57.

<sup>17</sup> This argument would not apply to publicly funded research by law professors.

<sup>18</sup> See the *Law and Learning* report, *supra* note 9 at 70. A survey, for example, of B.C. Law Reform Commission (now the B.C. Law Institute) reports reveals a large number of works with little or no interdisciplinary analysis. It should be noted, however, that most law reform commissions do strive for impartiality, which, according to the report, is more difficult for those pursuing privately funded interdisciplinary work.

<sup>19</sup> See *supra* notes 10 and 16.

<sup>20</sup> The infusion of policy into legal reasoning borders on being interdisciplinary in some areas, such as when courts consider free and fair competition in economic torts cases.

<sup>21</sup> *Supra* note 6.

<sup>22</sup> (1977), [1978] A.C. 728, [1977] 2 All E.R. 492 (H.L.) [*Anns* cited to A.C.].

two stages. The focus at the first stage is on proximity or neighbourhood, i.e., the specific relationship between the parties. At the second stage the focus shifts to other considerations which extend beyond the parties themselves. According to *Hercules*, the test at stage one in the careless words context is foreseeable and reasonable reliance. One effect of adopting this test has been to limit the defendant's power to control his or her exposure to liability when giving advice or information. Canada now takes a quite different approach to England, the birthplace in the Commonwealth of the tort of negligent misrepresentation; in England, the defendant's assent is a pre-condition to liability.

My "internal" research focuses on an examination of the competing philosophies, policies and social objectives in this area to determine whether they support the new Canadian approach. Underlying the law of torts generally is the principle of corrective justice.<sup>24</sup> In *Whiten v. Pilot Insurance Co.*,<sup>25</sup> LeBel J., in dissent on another point, referred to this principle:

152 Since [the Middle Ages], in the common law, tort law has been viewed primarily as a mechanism of compensation. Its underlying organizing structure remains grounded in the principle of corrective justice, although policy concerns may play at times a considerable part in determining the outcome of a particular case, as, for example, in actions based on the tort of negligence.<sup>26</sup>

Corrective justice refers to the idea that undeserved losses or gains should be eliminated. It protects the existing distribution of wealth primarily through compensation. The question to be explored is, what is or should be an "undeserved" loss or gain according to this principle? Related to this idea of justice is Lord Atkin's theory of legal responsibility, referred to above, based on religious or moral tenets. These ideas are generally considered to be deontological in nature, i.e., concerned with the inherent nature of duty.

Other considerations, external to the relationship, are also examined. Conceptions of distributive justice, for instance, traditionally viewed as foreign to tort law, are now being discussed with more frequency in the case law. Some of the different forms of distributive justice relevant to this area include those based on "deep pockets" and loss spreading. Of the

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<sup>23</sup> The neighbour principle and duty of care analysis more generally is discussed in section 3.4.

<sup>24</sup> Corrective justice can be considered "internal" because of its acceptance as an underlying theory by the courts, but it could also be classed as a branch of philosophy and its analysis a form of external research. The same can be said of distributive justice, although it is more "external" because it is not generally accepted as a relevant consideration. Again, this difficulty of classification only highlights the overlap between the various types of research.

<sup>25</sup> [2002] 1 S.C.R. 595, 209 D.L.R. (4th) 257, 2002 SCC 18 [*Whiten*].

more clearly recognized “external” policies, some support the imposition of duties of care. For example, there is the need to protect members of the public from certain kinds of behaviour and to deter harmful conduct. Against these policies must be balanced various counter policies which support restraint in recognizing duties of care. For instance, there is the idea that the law should promote self-sufficiency and independence. Certainty is another important objective the courts have recognized. And in the field of economic negligence, special considerations arise. Besides the indeterminacy problem already mentioned, there are concerns that the doctrines of free and fair competition and freedom of contract will be negatively impacted. Finally, a special consideration that relates to negligent misrepresentation is that freedom of speech will be diminished without a carefully prescribed conception of liability.

These theories and policies are examined with a view to determining which model of liability in negligent misrepresentation most effectively balances the competing objectives served by the law.

#### **1.2.1.2 Research “On” the Law**

In addition to research in the law, I consider an external perspective: the vantage of the economist. The law and economics movement was developed principally in the United States as a means of scientifically assessing the merit of various legal rules and policies. In part, it is a response to the failure of utilitarianism to offer a measurable technique for assessing the happiness of the population in question.<sup>27</sup> The economic analysis of law assumes that individuals are rational, that they seek to maximize their wealth, and that they respond to incentives. The idea of wealth maximization plays a central role in law and economics theory. For some theorists like Richard Posner and Guido Calabresi wealth maximization is a normative precept. For others like Ronald Dworkin it lacks the status of a “value”.

Another important component of economic theory is the concept of “efficiency”. Efficiency standards allow economists to compare different states of affairs. In this context, the measured “state” is wealth. Existing or proposed laws can be judged according to how efficient they are in maximizing wealth. A bad law would be one that wastes resources.

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<sup>26</sup> *Ibid.* at para. 152.

<sup>27</sup> See M.D.A. Freeman, *Lloyd's Introduction to Jurisprudence*, 7th ed. (London: Sweet & Maxwell, 2001) at 557.

Needless to say there have been criticisms of the some of the basic assumptions of law and economics theory. For instance, efficiency determinations do not account for what could be a prior unfair distribution of wealth. In this respect, it bears some resemblance to the idea of corrective justice. Another criticism of law and economics theory is that it does not account for values that cannot be quantified in financial terms.

I do not propose to challenge the law and economics theory itself, however, but rather to examine the theory primarily as it relates to tort law, and to determine if it offers any insights into the appropriate basis of liability in negligent misrepresentation. There has been little scholarship in this particular area. Part of reason is the special status of “information”, as opposed to more traditional forms of property or services, in economic theory. Information is difficult to value and easy to reproduce. Other difficulties relate to the range of contexts in which negligent misrepresentation claims can arise. They can arise in simple advice situations like *Hedley Byrne*, in the context of contractual negotiation or performance, or in wider contexts, such as the auditors’ liability cases, where large numbers of shareholders or investors rely on corporate financial statements. There is also a considerable range of differences depending on the particular defendant. For instance, a large bank will likely be able to spread liability costs more efficiently than a small firm of accountants.

As will become apparent, given the complexity of the questions involved, making a final decision about the most efficient rule of liability would require complex experimentation with different rules. Possible avenues of such research are suggested in the final chapter.

### 1.2.2 Thesis Outline

This thesis is about what the appropriate basis of liability for negligent misrepresentation causing pure economic loss should be. The emphasis is on the duty question as opposed to the other elements of the cause of action. As mentioned, *Hercules* brought the *Hedley Byrne* claim under traditional negligence duty analysis and in the process, intentionally or not, sacrificed the voluntarism that was part the law previously, at least according to *Hedley Byrne*. A recent decision of the British Columbia Court of Appeal, *Micron Construction Ltd. v. Hongkong Bank of Canada*,<sup>28</sup> highlights the significance of this change. A bank was held liable for a

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<sup>28</sup> *Micron Construction Ltd. v. Hongkong Bank of Canada (sub nom. Keith Plumbing & Heating Co. v. Newport City Club Ltd.)* (2000), 184 D.L.R. (4th) 75, [2000] 6 W.W.R. 65, 2000 BCCA 141, rev’g (11 June 1998), Vancouver



negligently prepared credit reference given gratuitously to a construction contractor. As a result of its reliance on the reference, the contractor suffered damages. Without more, this is not remarkable case. However, the bank had given its opinion with a disclaimer of liability. By focusing on the reasonableness of the contractor's reliance and the not the assumption of responsibility by the bank, the Court of Appeal was able to find the bank liable. In Chapter 2, I discuss the facts in detail and introduce the problems posed by the reasoning. The following chapters explore the law in more detail.

Chapter 3 looks first at general tort theory including corrective justice and various instrumentalist objectives (economic analysis is included here). Next, the idea of duty of care in negligence is considered, tracing its development from *Donoghue* up to the present. The final section considers the implications of the many theories and policies for an approach to liability in negligent misrepresentation. In Chapter 4, the focus shifts from the theoretical to how the theory has manifested itself in the law. At the end of the chapter there is a comparative analysis with the law in four other countries: the United Kingdom, Australia, New Zealand and the United States. Chapter 5 is described briefly in the next section.

### **1.3 PROPOSAL FOR IMPROVEMENT**

Chapter 5 sets out my conclusions why the reliance model of liability is flawed. I argue that in order to most effectively balance the competing policies and objectives in this area a new model should be substituted based on consent. I include some specific proposals for improvement. I suggest how the consent the model could be clarified and implemented, and I also set out some indicators of consent that could be used to assess whether a defendant has assumed an obligation in a particular case.

Recognizing that the reliance test in *Hercules* is here to stay for a while, I have included a brief section on how to "manage" the current reliance regime in terms of controlling liability. The final section makes some suggestions for further study.

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C953064 (B.C.S.C.), additional reasons at (28 September 1998), Vancouver C953064 (B.C.S.C.), leave to appeal to S.C.C. refused 264 N.R. 200 (note), 152 B.C.A.C. 23 (note), 250 W.A.C. 23 (note) (S.C.C.). Although this case is reported under the name, *Keith Plumbing & Heating Co. v. Newport City Club Ltd.*, the only contestants at trial and on appeal were Micron Construction Ltd. and the Hongkong Bank of Canada. For this reason, it is commonly referred to as the *Micron Construction* decision, and I refer to it as such throughout this thesis. Paragraph references are to the Court of Appeal decision.

## Chapter 2

## THE MICRON CONSTRUCTION DECISION

In February 2000, the British Columbia Court of Appeal handed down a decision<sup>29</sup> which has been described as “revolutionary”<sup>30</sup> and which has significant implications for the banking community, other professional organizations, and advice-givers generally. In an apparent break with almost 40 years of precedent starting with the seminal case, *Hedley Byrne*, the B.C. Court held that an inaccurate banking credit opinion which included a standard disclaimer of responsibility was actionable. There is a concern about the potential “chilling effect” the decision will have on the willingness of institutions and professions to provide gratuitous advice and information.<sup>31</sup>

Although the argument before the three appeal judges was almost exclusively concerning fraud,<sup>32</sup> Esson J.A., writing for the majority of the Court, dispensed with this argument summarily,<sup>33</sup> and based his judgment on the law of negligent misrepresentation. Besides being an interesting story about grandiose plans, high flyers and business risk, this case also focuses attention on one of the more difficult areas of the law: liability for careless words. The Canadian courts have recently broken ranks with other jurisdictions in their treatment of this area and *Micron Construction* serves to highlight the importance of having fair and workable principles – a predictable set of guideposts – for the commercial world when it comes to

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<sup>29</sup> *Micron Construction*, *supra* note 28.

<sup>30</sup> Susan A. Griffin, “Hedley Byrne Revisited” in *Torts – 2001* (Vancouver: The Continuing Legal Education Society of British Columbia, 2001) c. 2 at 2.1.14. Susan Griffin is a partner with Fraser Milner Casgrain, the law firm representing the Hongkong Bank of Canada in the *Micron Construction* case. See also Jan Weir, in “B.C.C.A. Overrules *Hedley Byrne*” (June 2000) 20 *Lawyers Wkly.* No.7, 15, who described the decision as “radical”.

<sup>31</sup> Griffin, *ibid.* at 2.1.22.

<sup>32</sup> In its factum, the appellant Micron Construction only raised the issue of fraudulent misrepresentation, and the written argument of the respondent Hongkong Bank of Canada only responded to that issue. Similarly, the focus of the oral argument before the British Columbia Court of Appeal was on fraudulent misrepresentation: Kelly Geddes interview, June 13, 2002. Kelly Geddes, a former partner with Fraser Milner Casgrain, was part of the team presenting the case for the Hongkong Bank of Canada.

<sup>33</sup> Esson J.A. held that the fraud argument raised a credibility issue and that it was not open to the Court of Appeal to disturb the factual finding of the trial judge that there had been no intent to deceive: *Micron Construction*, *supra* note 28 at para. 27.

liability for negligent misinformation. While a successful suit against a bank for careless advice might not inspire a *cri de cœur* for a change in the law from many customers, a closer look at the judgment reveals that it has broader implications worth considering.

## **2.1 FACTS OF MICRON CONSTRUCTION**

A large-scale project was conceived by a number of Hong Kong “industrialists and developers”<sup>34</sup> to develop an 18-hole executive golf course, a country club house and an adjacent residential area in Squamish, British Columbia. As well, the developers contemplated as part of the project the conversion of an existing building in downtown Vancouver into a luxurious business, social and recreation club (“city club”) to complement the golf and country club facilities in Squamish. The corporate vehicle for the developers of the city club was Newport City Ltd. (“Newport”), the general contractor was Ledcor Industries Ltd. (“Ledcor”), and the banker for the developers was the Hongkong Bank of Canada<sup>35</sup> (“Bank”).

Only the city club went beyond the planning stage, construction of which began in July 1994. Micron Construction Ltd. (“Micron”), which had won the bid on the supply and installation of form-work and the placing of concrete for a total of \$1.4 million, was the first major trade on the job after demolition. Ledcor had pressed the Bank for confirmation that the financing<sup>36</sup> was in place a number of times, and the Bank knew that any assurances would be passed on to subtrades bidding on the city club. The Bank, through one of its representatives, Mr. Tam, had provided some letters which Ledcor felt were not sufficient because they were qualified.<sup>37</sup> Finally, Mr. Tam provided the following letter which concluded with a disclaimer of responsibility:

*Confidential*

September 29, 1994

TO WHOM IT MAY CONCERN

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<sup>34</sup> As described by the Hongkong Bank of Canada: *Micron Construction, ibid.* at para. 3.

<sup>35</sup> The Hongkong Bank of Canada is now called the Hongkong and Shanghai Banking Corporation or HSBC.

<sup>36</sup> As noted in the reasons for judgment, the financing arrangement for the city club was not typical for construction projects of this magnitude. Instead of the Bank giving a commitment to provide sufficient funds to complete the project, all that was offered was a line of credit with no obligation of advance funds unless fully secured: *Micron Construction, supra* note 28 at para. 5-6.

<sup>37</sup> These two written communications had provided that financing was “subject to final approval and necessary legal documentations” and “subject to fulfilment of certain security and documentation requirements”, respectively: *Micron Construction, ibid.* at para. 11.

Dear Sir/Madam

RE: NEWPORT CITY CLUB LTD.

This is to confirm that the captioned company has maintained an operating account with this Bank, to which loan facilities of low to medium eight figures have been authorized, on secured basis, to finance the acquisition and renovation of their premises at 1155 West Georgia Street, Vancouver.

The said account is being operated as agreed.

*This bank reference is given at the request of the captioned and without any responsibility on the Bank and its signing officers. [emphasis added]*

This was taken as an assurance that secure financing was in place and this assurance was passed on to some of the subtrades, including Micron. In fact, security for the financing was not fully in place. Shortly after writing this letter, Mr. Tam left the employment of the Bank and starting working as a financing consultant with an office in the same building as Newport. Newport was one of his clients. The trial judge and the Court of Appeal accepted the fact that, despite the appearance of a conflict of interest, Mr. Tam did not intend to mislead.<sup>38</sup> However, the Court of Appeal did find that he had at least acted without reasonable care in drafting this letter given that it was not qualified in the clear way in which the earlier communications had been which was likely the result of his lack of impartiality at this time.<sup>39</sup> After two consecutive progress payments were delayed, Micron and its bank, the Royal Bank, sought further assurances from the Hongkong Bank of Canada. In early November, over the phone, both the account representative who had taken over for the now departed Mr. Tam and the branch manager negligently asserted, but again without intent to deceive, that financing was secure.<sup>40</sup> Micron concluded that the lateness of the payments was the result of bureaucratic delay. The trial judge found that these oral assurances were clarifying “extensions” of the September letter, but the Court of Appeal found that they were separate unqualified assurances as the financial wherewithal of the developers.<sup>41</sup> The significance of this distinction was important to how the disclaimer in the September letter related to these later conversations.

By January 1995, it became clear that the security for the financing required by the Bank was not going to materialize – Newport was unable to meet its commitments and the project was

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<sup>38</sup> *Ibid.* at paras. 35, 41-42.

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.* at para. 57.

<sup>41</sup> *Ibid.* at para. 105.

closed down. Micron commenced an action against the Bank for negligent and fraudulent misrepresentation. The Bank believing that its disclaimer of responsibility provided a clear answer based on *Hedley Byrne* applied for dismissal by way of a summary trial.<sup>42</sup>

## **2.2 IN THE BRITISH COLUMBIA SUPREME COURT**

Micron argued that a summary trial was not appropriate to deal with a claim of fraudulent misrepresentation. The trial judge held that Micron had not placed sufficient evidence before the Court to support the fraud claim, but dismissed the Bank's application to dismiss as premature giving Micron a chance to adduce additional evidence. The order of dismissal was made with liberty to renew, which the Bank did several months later. The same trial judge heard the renewed application. She held that the evidence did not support a finding that the representations were false, or that the Bank's representatives knew they were false or made the representations recklessly. Micron's claim for fraudulent misrepresentation was therefore dismissed.<sup>43</sup>

Concerning the negligent misrepresentation claim, the trial judge did not deal specifically with whether the conduct of the Bank was negligent as distinct from fraudulent. But it was apparent that she believed the disclaimer, which was almost identical to the one in *Hedley Byrne*, was conclusive of the negligent misrepresentation claim.<sup>44</sup> Given her finding that the representations were not false, this would have been sufficient reason to dismiss this claim.

## **2.3 IN THE BRITISH COLUMBIA COURT OF APPEAL**

Micron appealed to the British Columbia Court of Appeal. The only respondent was the Bank, the claim having been dropped against the other defendants. Micron's appeal was based solely on fraudulent misrepresentation. Presumably, counsel for Micron believed the negligent misrepresentation argument would be unsuccessful because of the disclaimer.

As mentioned, the fraud claim was dismissed in short order.<sup>45</sup> However, without the benefit of written argument,<sup>46</sup> Esson J.A. went on to write a groundbreaking judgment based on

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<sup>42</sup> Pursuant to British Columbia, *Rules of Court*, r. 18A.

<sup>43</sup> *Micron Construction*, *supra* note 28 at para. 25.

<sup>44</sup> *Ibid.* at para. 26.

<sup>45</sup> *Supra* note 33.

negligent misrepresentation.<sup>47</sup> The majority of the Court of Appeal was of the view that while the fraud issue had been based in part on *viva voce* evidence the factual issues concerning the negligent misrepresentation claim were based almost entirely on written evidence. The Court of Appeal was therefore in as good a position as the trial judge to resolve these issues.<sup>48</sup>

Esso J.A. accepted *Queen v. Cognos Inc.*<sup>49</sup> as authority for the required elements for an action for negligent misrepresentation: 1) duty of care based on “special relationship”, 2) false misrepresentation, 3) negligence, 4) reasonable reliance on the misrepresentation, and 5) damages.<sup>50</sup> He held that were it not for the disclaimer, it was clear that Micron had established all five elements. However, while the disclaimer had no bearing on the second, third and fifth elements, it had a significant bearing on the first and fourth elements, duty of care and actual reasonable reliance.<sup>51</sup> Perhaps the most interesting and significant part of the Court of Appeal’s analysis, then, had to do with its treatment of the disclaimer.

As mentioned in Chapter 1, the Supreme Court of Canada in 1997 in *Hercules* clarified some of the uncertainty concerning the first element, duty of care or “special relationship”. Esso J.A. concluded that *Hercules*, which brought negligent misrepresentation within the *Anns* framework of analysis, had rejected the voluntary assumption of responsibility theory from *Hedley Byrne*.<sup>52</sup> The new test at stage one of *Anns* was foreseeable and reasonable reliance, with limitations not relevant to this case to be considered at stage two.

The resolution of *Micron Construction* therefore depended on whether the test of foreseeable and reasonable reliance was met. Foreseeability was not an issue in this case. The reasonableness of the reliance, according to *Hercules*, was to be determined by reference to various *indicia*.<sup>53</sup> Esso J.A. found that the *indicia* were all present on the facts and was prepared to assume,

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<sup>46</sup> Kelly Geddes interview, *supra* note 32.

<sup>47</sup> A more detailed discussion of the analysis in *Micron Construction* appears in Chapter 4, where negligent misrepresentation is discussed in a broader context – see section 4.3.3.3.

<sup>48</sup> *Micron Construction*, *supra* note 28 at para. 30.

<sup>49</sup> [1993] 1 S.C.R. 87, 99 D.L.R. (4th) 626 [*Cognos* cited to S.C.R.]. *Cognos* is discussed in more detail in Chapter 4 (section 4.3.3.1).

<sup>50</sup> *Micron Construction*, *supra* note 28 at para. 59, and *infra* note 634 and accompanying quote, where the elements are set out in more detail.

<sup>51</sup> *Micron Construction*, *ibid.* at para. 59.

<sup>52</sup> *Ibid.* at paras. 82-83

<sup>53</sup> See *infra* note 646 and accompanying list of factors.

absent the disclaimer, that the reliance was reasonable.<sup>54</sup> In discussing the relevance of the disclaimer to the reasonable reliance question, Esson J.A. emphasized certain factual similarities between *Hedley Byrne* and *Micron Construction*:

- 1) Each case involved a business setting where the plaintiff was considering whether to enter into a contract with a party whose creditworthiness was uncertain.<sup>55</sup>
- 2) In both cases, the reason for the plaintiff's inquiry was that it would incur heavy costs and liabilities in advance of payment by the other party.<sup>56</sup>
- 3) As in *Hedley Byrne*, there was no alternative source of information for the plaintiff in this case.<sup>57</sup>
- 4) Each case involved standard banking disclaimers, which were not clear to those not versed in banking practice.<sup>58</sup>

He also noted some factual distinctions:

- 1) The communication in *Hedley Byrne* was not directly between the plaintiff and the defendant bank but through an intermediary (the plaintiff's own bank). Here, the communication was initially between Ledcor directly (on its own behalf and on behalf of "incoming trades" including Micron) and the Bank.<sup>59</sup>
- 2) In the initial communication in *Hedley Byrne* it was made clear that the information was sought "without responsibility on your part". A majority of the Law Lords stressed this fact. Here, there was no such qualification in the request; in fact, Newport, when it saw a draft of the September letter, had asked that the disclaimer be removed. The disclaimer in this case was therefore entirely unilateral.<sup>60</sup>
- 3) In *Hedley Byrne* it was more a case of an error in judgment. Here, there was a clear case of negligence on the part of the Bank – little effort to give a fair assessment had been made.<sup>61</sup>
- 4) In *Hedley Byrne* there was just the one reference. Here, in addition to the September letter containing the disclaimer, there were the November oral communications which were not qualified by a disclaimer.<sup>62</sup>

Was it still reasonable to rely on the information in the face of the disclaimer? Esson J.A. concluded that it was. He focussed on two of the facts just listed: that there was no alternative source of information and that the disclaimer was unclear. In the result, the Court of Appeal set aside the dismissal of the action by the trial judge and remitted the case to the trial court to assess damages.

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<sup>54</sup> In fact, Esson J.A. preferred the expression "justifiable reliance". See *infra* note 653.

<sup>55</sup> *Micron Construction*, *supra* note 28 at para. 65.

<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.* at paras. 94, 102.

<sup>58</sup> *Ibid.* at para. 98.

<sup>59</sup> *Ibid.* at para. 65.

<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.* para. 81.

<sup>62</sup> *Ibid.* paras. 43-57, 104-06.

Ryan J.A., in dissent, was of the opinion that the disclaimer was determinative of the negligent misrepresentation claim, just as it had been in *Hedley Byrne*.

## 2.4 HARD CASE?

Is *Micron Construction* a case that turns on a unique set of facts, or is it a marked departure from the approach taken by the courts since *Hedley Byrne* (at least until *Hercules*)? If it is the former, the case is not of singular importance. If the latter view is accepted, the adage “hard cases make bad law” may be appropriate. Was Esson J.A. distorting the law in this particular case to avoid a harsh result creating a bad precedent in the process?

On the first point, that this is a unique case, a closer look at the facts as found by the majority is necessary. In finding that Micron reasonably relied on the written and verbal communications with the Bank, Esson J.A. emphasized that the Bank was Micron’s only source of information and that the disclaimer was unclear. These factual findings are questionable. Concerning the lack of an alternative source, while information from the Bank may have been the most comforting, Micron could have approached Newport, or even the Hong Kong industrialists, for additional financing details. And concerning the disclaimer’s lack of clarity, the statement that the information was given “without any responsibility on the Bank” is a standard wording, as acknowledged by the Court, and does not seem particularly arcane. Micron’s president testified that the disclaimer “sounds like boiler plate” and that “there has to be some truth in the top part of the letter”.<sup>63</sup> This suggests that he understood the disclaimer’s meaning; it was more that he did not think he should have to take it at face value. If Esson J.A. were relying heavily on these factual inferences in support of his reasonable reliance conclusion, which seems to be the case, his reasoning is unconvincing because the inferences were not justified.

Even accepting these factual inferences, however, it should also be noted that they were factual *similarities* with *Hedley Byrne*. Why then a different conclusion? One reason, of course, was Esson J.A.’s argument that *Hercules* changed the law affecting the significance of these facts? But he didn’t stop there. At the end of his judgment he added that the Bank, having failed on the reasonable reliance issue even with its disclaimer, “would have been liable on the law as it

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<sup>63</sup> *Ibid.* at para. 116.



stood before *Hercules*”<sup>64</sup>. This somewhat cryptic comment is not supported by authority, particularly *Hedley Byrne* itself.

And what of the other facts Esson J.A. emphasized? The other factual similarities with *Hedley Byrne*, i.e., that both cases involved a business setting and that the defendant’s creditworthiness was important to a plaintiff who was advancing significant credit, do not raise any particular issues relating to the disclaimer. However, the factual distinctions merit some comment. The first one, that in *Hedley Byrne* the communication was through the plaintiff’s bank as intermediary whereas in *Micron Construction* the communication was initially with Ledcor directly (on its own behalf and on behalf of Micron), is not much of a distinction. As far as Micron was concerned it was communicating through an intermediary or agent, at least initially, just as in *Hedley Byrne*. True, in the later November conversation, Micron was communicating directly with the Bank, but whether communication is direct or through an agent does not seem to be of great significance. In *Hedley Byrne*, for example, the representation was treated as if it were made directly.<sup>65</sup> The communications in the two cases were sufficiently similar in terms of directness; this first distinction should not have been given any appreciable weight.

The second distinction was that in *Hedley Byrne* the inquirer made it clear that the information was sought without an expectation of responsibility on the part of the bank whereas in *Micron Construction* there was no such initial qualification. Esson J.A. quoted at some length three of the five Law Lords in *Hedley Byrne* who would have found liability but for the disclaimer. He argued that they all placed some weight on the fact that not only the response but also the inquiry was qualified.<sup>66</sup> This appears at first glance to be a significant difference. Of the three Law Lords, Lord Pearce mostly clearly referred to the importance of both the initial request and the disclaimer. However, he did not say the disclaimer by itself would have been insufficient to prevent the assumption of a duty.<sup>67</sup> The other two did not base their decision

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<sup>64</sup> *Ibid.* at para. 107.

<sup>65</sup> See *Hedley Byrne*, *supra* note 3 at 482 (per Lord Reid).

<sup>66</sup> *Micron Construction*, *supra* note 28 at para. 72.

<sup>67</sup> *Hedley Byrne*, *supra* note 3 at 539-40.

on this fact.<sup>68</sup> A strong argument could be made therefore that the majority in *Hedley Byrne* would have reached the same conclusion if only the response had been qualified.

The third distinction was that *Micron Construction* involved a clear case of negligence bordering on recklessness whereas in *Hedley Byrne* there was a mere error in judgment. Lord Reid did mention in passing that the complaint was “not negligence in the ordinary sense of carelessness, but rather misjudgment.”<sup>69</sup> However, the case was not decided on that point, but rather the threshold issue of whether a special relationship or duty of care existed. A closer examination of the degree of carelessness would have been necessary if the duty issue had been resolved in favour of the plaintiff. Generally, mere errors in judgment are not actionable in negligence. Whether liability for such errors (akin to the strict liability occurring in contract for broken promises and inaccurate representations) ought to be recognized in negligent misrepresentation is another question. But there was no indication in *Hedley Byrne* that the existence of the duty was dependent on the degree of negligence involved. This distinction does not justify a different conclusion. If Esson J.A. were arguing that the disclaimer was not clear enough to oust responsibility for recklessness or gross negligence as opposed to ordinary negligence, that point was not apparent. His complaint with the disclaimer, discussed above, seemed to be that it was generally vague and not even sufficient to shield the defendant from a claim for ordinary negligence.

The fourth distinction, the fact that there were multiple representations in *Micron Construction* unlike in *Hedley Byrne*, does not support a contrary result either. Esson J.A. held that the question whether the disclaimer extended to the November conversations was academic, because even if it did Micron’s reliance was still reasonable.<sup>70</sup> In other words, the number of representations simply reinforced his conclusion as to the reasonableness of the reliance, but had no bearing on the disclaimer’s effectiveness. He had already held that the disclaimer was ineffective because the Bank was the only source of information and the disclaimer was unclear.

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<sup>68</sup> All five judgments are discussed in more detail in section 4.1.

<sup>69</sup> *Hedley Byrne*, *supra* note 3 at 489.

<sup>70</sup> *Micron Construction*, *supra* note 28 at para. 106.

A further distinction has been put forward as a basis for limiting *Micron Construction* and supporting the finding that the disclaimer was ineffective: the personal conflict of interest of Mr. Tam, the Bank representative providing the initial credit reference.<sup>71</sup> The spectre of bias, however, was not something on which Esson J.A. based this part of his decision. The discussion of Mr. Tam's conflict of interest was in the section of his reasons dealing with negligence, specifically, whether Mr. Tam had exercised reasonable care in providing the assurances relating to the financing. This relates to the third of the five elements of the negligent misrepresentation claim. When Esson J.A. continued with his discussion of the disclaimer and *Hedley Byrne*, relating as it does to the first element, he did not refer back to the conflict of interest question. Esson J.A. apparently did not consider this relevant to the question of the reasonableness of reliance in the face of the disclaimer.

To summarize the position thus far: If the Court of Appeal's finding that the disclaimer was ineffective turned on the facts and not the new legal regime, it is questionable because the two factual inferences most strongly relied on were not supported by the evidence, and further, even if they were, they did not justify the Court's conclusion (these same inferences could also have been drawn in *Hedley Byrne*). Also, none of the factual differences with *Hedley Byrne* were of sufficient importance to allow the Court (and the plaintiff) to ignore the terms under which the financing information was provided. The facts of *Micron Construction* are not that unique.

Despite Esson J.A.'s statement that the Bank would have been liable on the law as it stood before *Hercules*, he did take a close look at the changes in the law after *Hedley Byrne* and particularly as brought about by *Anns* and *Hercules*. He concluded that *Hercules*, in adopting the foreseeable and reasonable reliance test at the first stage of *Anns*, had rejected the voluntary assumption of responsibility theory. This meant that a disclaimer, if it were an effective shield to a claim for negligent misrepresentation in the past, was now just one more circumstance courts consider in deciding the reasonable reliance question. But does *Hercules* go this far? Accepting the facts as Esson J.A. found them, does the new test in *Hercules* allow for the disclaimer to be overridden? Or did Esson J.A. distort even the new law? There is considerable doubt whether La Forest J., when he fashioned the new test for liability in

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<sup>71</sup> See, for example, Susan A. Griffin, "Hedley Byrne Revisited" in *Torts - 2001* (Vancouver: The Continuing Legal Education Society of British Columbia, 2001) c. 2 at 2.1.19.

*Hercules*, anticipated that disclaimers in cases like *Hedley Byrne* would no longer be as effective.<sup>72</sup> He did not have to consider the question directly because there was no disclaimer in the case before him. Although a conclusion on this matter was not clearly reached during the summary trial proceedings in *Micron Construction*, it seems that the trial judge and the parties were proceeding on the basis that a *Hedley Byrne*-type disclaimer would still be a full answer to a negligent misrepresentation claim. The appeal judgment in *Micron Construction* launches a discussion about what *Hercules* has really done. Whether *Micron Construction* is a misinterpretation of a fundamentally sound approach to negligent misrepresentation or whether the reliance model of liability is itself fundamentally flawed is the subject of the next three chapters.

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<sup>72</sup> This point is discussed in more detail in section 4.3.3.2.

## Chapter 3

### IN THEORY – A CONCEPTUAL FRAMEWORK

#### **3.1 INTRODUCTION**

Theoretical approaches to the law are numerous and varied or, to paraphrase Lord Lloyd of Hampstead, there are many rooms in the mansion that is jurisprudence.<sup>73</sup> One method of classification separates these approaches into two main camps: analytical jurisprudence and normative jurisprudence.<sup>74</sup> These two camps are not mutually exclusive and various theories, perspectives and expositions of the law challenge distinctions that might be drawn between them (e.g., normative ethics versus metaethics), or have elements of both (e.g., critical legal studies, feminist perspectives).<sup>75</sup>

Analytical jurisprudence generally concerns critical, explanatory and value-free assessments of the law.<sup>76</sup> Sometimes the assessments are philosophical in nature, examining the internal logic of a system of rules; sometimes the investigations are more empirical in nature. Analytical jurisprudence has many strands and continues to develop new ones.<sup>77</sup> Some established areas include the analysis of basic concepts such as cause and responsibility, the creation of conceptual frameworks, the rational justification of institutions and practices, and the examination of the relation between social objectives and the law.<sup>78</sup>

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<sup>73</sup> See *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at 10.

<sup>74</sup> See generally Simon Deakin, "The Evolution of Tort" (1999) 19 *Oxford J. Legal Stud.* 537, and Jules Coleman, "Tort Law and Tort Theory: Preliminary Reflections on Method" in Gerald J. Postema, ed., *Philosophy and the Law of Torts* (Cambridge: Cambridge University Press, 2001) at 183.

<sup>75</sup> See *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at c. 13, 14.

<sup>76</sup> Even this statement requires qualification, however, because not all analytical jurists believe in the complete separation of law and morals. Hart, for instance, argues for an "inclusive" or "soft" positivism which recognizes the binding value of moral principles provided certain conditions are satisfied: see *The Concept of Law*, 2nd ed., *supra* note 8 at 250-54. Others still maintain the more traditional positivist belief that legal status can never be determined by moral argument: see *Lloyd's Introduction to Jurisprudence*, *ibid.* at 334.

<sup>77</sup> Postmodernism, poststructuralism, deconstruction theory, and discourse analysis – which deal in part with whether objective truth is ascertainable, and with the logic of language systems and their hidden assumptions – can be characterized as forms of analytical criticism.

<sup>78</sup> See generally *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at c. 6 (*passim*).

Normative jurisprudence, on the other hand, generally concerns the rightness or wrongness of the law based on various conceptions of justice, fairness and morality.<sup>79</sup> It involves making value judgments, i.e., it is evaluative not explanatory. Because there are no universally accepted, and some might say provable, standards of right and wrong, it depends less on “logic” and empiricism than analytical jurisprudence. Some normative analysis focuses on the consequences of the legal response (e.g., utilitarianism, distributive justice), and some is deontological in character, i.e., it is concerned less with the consequences of the legal response and more with duty and responsibility without regard to extrinsic effects (e.g., corrective justice). The maxim “Let justice be done though the heavens may fall”<sup>80</sup> reflects the essence of much deontological theory.

Another way to classify legal criticism is to focus not on the sometimes difficult separation between analytic and normative approaches, but on the degree to which law is or should be used to further various goals. Viewed this way, the areas of analytical jurisprudence which deal with social objectives, though not evaluative, bear some resemblance to normative approaches which are consequentialist in nature. The two main camps in this method of classification, then, are those which are instrumentalist in nature, and those which consider duty and obligation without reference broader social objectives. In this chapter, I adopt this method of classification. In the next section, I consider corrective justice, the main deontological approach to tort law. Following this I review the main instrumentalist approaches. The remaining two sections deal with the duty of care concept. In duty of care analysis, courts refer to both deontological and instrumentalist theory, but they do so using the language of proximity and policy. Proximity and policy analysis is reviewed with particular emphasis on duties to avoid pure economic loss. The last section considers whether these approaches, subsumed as they are in the duty analysis, provide any insight into how the courts ought to define the duty to use words with care.

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<sup>79</sup> The word “normative” in this context can cause some confusion. Rules or norms prescribe a course of conduct and are distinguishable from their underlying facts. The study of what “ought” to be or “should” be, as opposed to what “is”, is normative. In one sense, therefore, the study of law generally is normative. I use the word here in the sense described above, i.e., meaning evaluative in terms of rightness or wrongness.

<sup>80</sup> From the Latin “Fiat justitia, ruat coelum”.

### 3.2 TORT LAW AS AN END IN ITSELF – CORRECTIVE JUSTICE

There is strength in the argument that tort law, for the most part, developed as a legal response based on a general conception that one has a moral responsibility for harm caused to another,<sup>81</sup> and not as a tool for furthering social objectives. In England, ideas about broader purposes and functions that the law might serve beyond meting out “justice” in the particular case came well after basic rules of liability were in place. Some commentators such as Stephen Perry and Ernest Weinrib argue that principles of moral responsibility still form the main theoretical basis of tort law.

It is clear that while cause may have played an important role in early English tort law, it was not the whole story. In fact, the development of this area of the law from the eighteenth century to the beginning of the twentieth century was largely concerned with the increasing importance of fault as an element of liability.

Current jurisprudential debate in tort law tends to focus on two specific theories: corrective justice theory (which can be considered a deontological approach) and law and economics theory (which is instrumentalist, and is discussed in the next section). Both involve normative assessments of tort law.<sup>82</sup>

Most discussions of corrective justice begin with Aristotle and his *Nicomachean Ethics*.<sup>83</sup> In his description of justice in Book V,<sup>84</sup> Aristotle refers to two particular forms of justice which have

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<sup>81</sup> Other forms of responsibility have been debated in more general legal and moral discourse. Besides causal responsibility, one taxonomy also includes role responsibility (based on being in a position of authority in relation to some activity), capacity responsibility (based on the mental capacity of the actor), liability responsibility (based on various notions of fault) and collective responsibility (based on the connection a plurality of individuals has to the activity in question): see Christopher Kutz, “Responsibility” in Jules Coleman & Scott Shapiro, eds., *The Oxford Handbook of Jurisprudence and Philosophy of Law* (Oxford: Oxford University Press, 2002) at 548-49. See generally Ellen F. Paul, Fred D. Miller & Jeffrey Paul, eds., *Responsibility* (Cambridge: Cambridge University Press, 1999) and Edgar Bodenheimer, *Philosophy of Responsibility* (Littleton, Colorado: Rothman, 1980).

<sup>82</sup> Benjamin C. Zipursky, “Philosophy of Private Law” in Jules Coleman & Scott Shapiro, eds., *The Oxford Handbook of Jurisprudence and Philosophy of Law* (Oxford: Oxford University Press, 2002) c. 16 at 623-31. Zipursky criticizes both these approaches because they ignore the state’s role as “enforcer” of private rights of action (at 631-32).

<sup>83</sup> The following brief summary is based on the original work: see Aristotle, *Nicomachean Ethics*, trans. by David Ross and revised by J.L. Ackrill & J.O. Urmson (Oxford: Oxford University Press, 1998) at V.4, 8. This work, as is the case with his other surviving writings, was likely drawn from lectures notes and was not meant to be read. It is divided into ten “books” and is in many respects incomplete and disjointed; it was almost certainly put together by later editors. See Jonathan Barnes, *Aristotle: A Very Short Introduction* (Oxford: Oxford University Press, 2000) at 4-5.

been considered important in the field of private law by later commentators: distributive justice and rectificatory justice (or corrective justice). Distributive justice, according to Aristotle, provides for the distribution of a state's bounty (property and honours, for example) according to merit, but he may have been also thinking of a private law application, such as how partners in a business would share according to contribution. It is unlikely, however, that he had in mind tort law as we conceive it today when he described distributive justice. His account of corrective justice, on the other hand, is clearly concerned with justice in civil disputes generally. It does not question the fairness of the prior distribution of wealth, and assumes the parties are equally deserving. Where one party "inflicts" injury on another, restitution not punishment is required. It assumes a situation where the loss of the injured is equal to the gain of the person inflicting the injury. Justice seeks the intermediate (alluding his idea of the "golden mean" developed elsewhere in the *Nicomachean Ethics*) and restores equality. The parties were equal before and now are two units apart; by requiring the return of the gain to the victim the balance is restored. Aristotle realized that in many cases (such as those involving physical injuries) the person inflicting injury would not ordinarily receive a gain in the traditional sense, but he suggested that for the purposes of his theory he would assume some kind of notional gain equal to the estimated loss.

Aristotle apparently contemplated a form of causal responsibility underlying his idea of corrective justice, but he also recognized that causation alone would not be sufficient. There were degrees of wrongdoing. Assuming voluntariness, the two culpable forms of wrongdoing were deliberately caused harm (premeditated action was worse than acting out of passion) and harm caused contrary to "reasonable expectation" (what he referred to as *misadventure* and what we now refer to as negligence).

The Aristotelian concept of justice (both corrective and distributive justice) has been criticized as an elaborate statement of the obvious, i.e., that justice requires the rendering to each what she is owed. The argument is that Aristotle fails to provide the necessary details for determining precisely what is a person's due, and therefore his concept of justice is not a useful

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<sup>84</sup> Book V is one of four books on moral virtue and is devoted entirely to justice.



one.<sup>85</sup> This criticism is a little exaggerated, however, at least concerning corrective justice. It is true that the boundaries of corrective justice are less than clear when considered in relation to specific types of conduct, and certain forms of causation and fault, but the framework is there. Key to Aristotle's philosophy is the presumed initial state of equality which must be restored when disrupted. The details relating to conduct, cause and fault must be worked out to reflect the particular legal system adopting this form of justice.

The political and legal philosophy of Immanuel Kant, the interpretation of which is subject to debate, has been applied by some modern tort law theorists to give normative substance to corrective justice. While Kant's social contract theory may underlie his political and legal writing,<sup>86</sup> arguably more important for tort theory is his doctrine of right.<sup>87</sup> Bound up in Kant's idea of right are his notions of freedom, free will, and reason. Right refers to the set of conditions whereby one person's will can be unified with the will of another under a universal law of freedom. The principle of right also applies to actions: a right action is one that does not impinge on the free will or freedom of others.<sup>88</sup> While Kant appears to be concerned about the *potential* effect of actions in determining their "rightness", the normative quality of the action derives from its conception by a free-willing self-determining individual, not its actual effect. He writes:

[A]n action done from duty derives its moral worth, *not from the purpose* which is to be attained by it, but from the maxim by which it is determined, and therefore does not depend on the realization of the object of the action, but merely on the *principle of volition* by which the action has taken place, without regard to any object of desire.<sup>89</sup> [emphasis by Kant]

<sup>85</sup> One notable exponent of this view is Hans Kelsen: see *What is Justice? Justice, Law, and Politics in the Mirror of Science* (Berkeley: University of California Press, 1957) at 125-136. See also Ernest J. Weinrib, *The Idea of Private Law* (Cambridge, Massachusetts: Harvard University Press, 1995) at 66-68 for a summary of this critique.

<sup>86</sup> See Immanuel Kant, "Theory and Practice" [or "On the Common Saying: This May Be True in Theory, but It Does Not Apply to Practice"] [1793] in Hans Reiss, ed., *Kant: Political Writings*, trans. by H.B. Nisbet, 2nd ed. (Cambridge: Cambridge University Press, 1991). See also Wolfgang Kersting, "Politics, Freedom, and Order: Kant's Political Philosophy" in Paul Guyer, ed., *The Cambridge Companion to Kant* (Cambridge: Cambridge University Press, 1992) at 353-58, and Gregory C. Keating, "A Social Contract Conception of the Tort Law of Accidents" in Gerald J. Postema, ed., *Philosophy and the Law of Torts* (Cambridge: Cambridge University Press, 2001).

<sup>87</sup> The doctrine of right and other related concepts, such as the categorical imperative, were developed in two main works: see Kant's "Fundamental Principles of the Metaphysics of Morals" [1785] and "Critique of Practical Reason" [1788] in Allen W. Wood, ed., *Basic Writings of Kant*, trans. by Thomas K. Abbott (New York: Modern Library, 2001).

<sup>88</sup> See Kersting, *supra* note 86 at 344-45.

<sup>89</sup> See "Fundamental Principles of the Metaphysics of Morals" in *Basic Writings of Kant*, *supra* note 87 at 158.

A lie, for Kant, therefore violates the principle of right action, even if in the particular case some good results from it.

A modern exponent of corrective justice as a foundational theory of tort law following in the tradition of Aristotle and Kant is Ernest Weinrib. Professor Weinrib and a few other writers such as Stephen Perry and Jules Coleman have provided a counterbalance to the predominance of instrumentalist theorizing in the last thirty to forty years. Professor Weinrib argues that the Kantian idea of right fills the void left by Aristotle's failure to explain why equality should be presumed.<sup>90</sup> Kant's equality is not referenced to money or power, but to moral freedom and the power of self-determination. "Accordingly, the equality of corrective justice acquires its normative force from Kantian right."<sup>91</sup> Weinrib believes that corrective justice is *the* underlying theory and is based on a special morality *internal* to tort law. There are two aspects of this internalism: first, corrective justice only concerns the relationship of doer and sufferer and is not oriented to some external ideal; and second, the morality is founded on doing and suffering (i.e., causation is a "constitutive of tort law as an identifiable legal field").<sup>92</sup> Tort law, for Weinrib, is an end itself.<sup>93</sup> The point has been made, however, that while corrective justice is generally considered a deontological theory, it is concerned with consequences in a limited sense, i.e., obligation based on a disruption of the status quo and the required restoration of the prior balance.<sup>94</sup> Perry argues that to the extent corrective justice theorists focus on the victim's loss and the moral obligation of the causer to pay compensation, they are treating corrective justice as a form of "localized distributive justice".<sup>95</sup>

Another version of corrective justice is Coleman's "annulment theory", which holds that the wrongful gains and losses that must be corrected or annulled are not the responsibility of the

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<sup>90</sup> *The Idea of Private Law*, *supra* note 85 at 76-83.

<sup>91</sup> *Ibid.* at 82. It should be noted that while Kant's doctrine of right has important implications for tort liability, Kant did not specifically refer to tort law or the civil law equivalent of delict in his writings: see Richard W. Wright, "Right, Justice and Tort Law" in David G. Owen, ed., *Philosophical Foundations of Tort Law* (Oxford: Oxford University Press, 1995) at 166.

<sup>92</sup> See Ernest [J.] Weinrib, "The Special Morality of Tort Law" (1989) 34 McGill L.J. 403.

<sup>93</sup> In Ernest J. Weinrib, "Understanding Tort Law" (1989) 23 Val. U.L. Rev. 485 at 526, the author poetically concludes that tort law, like a loving relationship, has no ulterior end, and in that sense "tort law is just like love"!

<sup>94</sup> Deontological ethics in its purest form holds that certain acts are intrinsically wrong regardless of consequences, for example, the Kantian idea that it's wrong to tell a lie even if it hurts no one and has only positive results. But the consequentialist aspect of corrective justice, at least the version described above, is limited in the sense that doesn't look beyond the parties themselves.

causer but of society generally.<sup>96</sup> Under this theory the importance of cause is diminished. Compensation would be funded through a fault pool – persons at fault in the relevant activity would be required to pay into a fund regardless of whether they caused any injury. This version of corrective justice has not been generally accepted and has been criticized as being distributive justice (and not just a localized variety) dressed in another guise.<sup>97</sup>

Despite copious work on corrective justice theory, there is still no consensus about the extent of its application. Its relevance to actions causing physical loss seems clear. Beyond that, there are questions. For instance, are duties of affirmative action covered by theory?<sup>98</sup> Are losses which result from indirect forms of causation requiring the reliance of the plaintiff properly targets of corrective justice? Concerning the nature of the loss, there is doubt whether pure economic loss is a “protected interest” in moral responsibility.<sup>99</sup> Given that pure economic loss often occurs indirectly as a result of the plaintiff’s reliance, the need for corrective justice in this context is doubly tenuous. While some judges may hold that tort law generally is grounded in corrective justice,<sup>100</sup> its application in certain contexts is far from clear.

### **3.3 TORT LAW AS AN INSTRUMENT**

Tort law furthers several social objectives, that is, it is “pluralistic”.<sup>101</sup> In this section, I consider the two most significant consequentialist viewpoints relevant to tort law, those relating to distributive justice and wealth maximization.<sup>102</sup> In the last part of this section, I

<sup>95</sup> Stephen R. Perry, “The Moral Foundations of Tort Law” (1992) 77 Iowa L. Rev. 449 at 467-474.

<sup>96</sup> Jules L. Coleman, “Tort Law and the Demands of Corrective Justice” (1992) 67 Ind. L.J. 349.

<sup>97</sup> See, for instance, Stephen R. Perry, in “Comment on Coleman: Corrective Justice” (1992) 67 Ind. L.J. 381. In the face of the criticism of Perry and others, Coleman modified his annulment theory in “The Mixed Conception of Corrective Justice” (1992) 77 Iowa L. Rev. 427. The difference between the mixed conception and the more traditional doing-suffering model is that the focus is on the loss not the wrong. Under the mixed view not all wrongs causing loss are the subject of corrective justice, only those causing wrongful loss for which the wrongdoer is responsible (at 444). Coleman leaves open for further examination what types of wrongdoing are covered by his mixed conception of corrective justice.

<sup>98</sup> Kant’s doctrine of right does not cover nonfeasance: see *The Idea of Private Law*, *supra* note 85 at 97.

<sup>99</sup> Stephen R. Perry, “Protected Interests and Undertakings in the Law of Negligence” (1992) 42 U.T.L.J. 247.

<sup>100</sup> See LeBel J. in *Whiten*, *supra* notes 25 and 26 and accompanying quote.

<sup>101</sup> See Izhak Englund, *The Philosophy of Tort Law* (Aldershot, Hants, England; Brookfield, Vt.: Dartmouth Pub. Co., 1993) at 64-70, and Bruce Chapman, “Pluralism in Tort and Accident Law: Toward a Reasonable Accommodation” in Gerald J. Postema, ed., *Philosophy and the Law of Torts* (Cambridge: Cambridge University Press, 2001) at 276.

<sup>102</sup> When discussing consequences and normative legal theory it is important to distinguish between the factual consequences of an act or omission and the consequences of the legal response. For example, in utilitarian theory the rightness or wrongness of certain behaviour may be judged according to its consequences (sometimes referred to as act utilitarianism). Similarly, the value of a particular law may be judged according to

look at some “general” functions of tort law, such as compensation and deterrence – the debate here is teleological but non-evaluative in a moral sense.<sup>103</sup>

### 3.3.1 Distributive Justice

Put simply, distributive justice is concerned with the way assets and entitlements are shared among members of a society. As mentioned, Aristotle’s sketchy account of distributive justice is seemingly less directed toward private disputes than it is to “constitutional” arrangements. Distributive justice occurs “in distributions” of honour and money, whereas it is corrective justice which occurs “in transactions” between individuals.<sup>104</sup> According to Weinrib, however, Aristotle’s classification is conceptual not empirical and neither form of justice has an exclusive mandate over one particular part of the empirical world. If, for example, a society decides to distribute the cost of accidents among participants in the relevant activity rather than have the primary causer restore equality “correctively”, this simply reflects two different conceptions of the interaction in question.<sup>105</sup> In modern times, debates over which is the appropriate approach frequently arise in the context of automobile insurance and workers’ compensation programs.

One of the most significant recent treatises on justice, and distributive justice in particular, is John Rawls’ *A Theory of Justice*, first published in 1971 and revised in 1999.<sup>106</sup> He expresses his general conception of justice as follows:

All social values [or social primary goods] – liberty and opportunity, income and wealth, and the social bases of self-respect – are to be distributed equally unless an unequal distribution of any, or all, of these values is to everyone’s advantage.<sup>107</sup>

Injustice, then, becomes “inequalities that are not for the benefit of all”.<sup>108</sup> Rawls’ theory and the principles he derives are based on a modified form of “social contract” theory. Instead of

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its consequences (sometimes referred to as rule utilitarianism). For instance, lawmakers may adopt a certain rule, e.g., “stand by your word”, because of a belief it will benefit society as a whole, and to the degree it succeeds in meeting that objective it is a good law. See generally Paul Edwards, ed., *The Encyclopedia of Philosophy* (New York: Macmillan, 1967) s.v. “utilitarianism” (vol. 8 at 206).

<sup>103</sup> I draw no distinction between various terms such as function, goal, aim, end, purpose, social objective, etc. used in the context of this type of analysis.

<sup>104</sup> *Nicomachean Ethics*, *supra* note 83 at V.2 (1131a1).

<sup>105</sup> See *The Idea of Private Law*, *supra* note 85 at 69-71.

<sup>106</sup> John Rawls, *A Theory of Justice* (Cambridge, Massachusetts: Harvard University Press, 1971) and *A Theory of Justice*, rev’d ed. (Cambridge, Massachusetts: Harvard University Press, 1999). Rawls also developed his ideas on justice in another work, *Political Liberalism* (New York: Columbia University Press, 1993).

<sup>107</sup> *Ibid.*, *A Theory of Justice* (1999) at 54.

resorting to a fictional contract our forebears entered into (in the tradition of Hobbes, Locke and Rousseau), he imagines a suitable “original position” where a hypothetical committee of individuals would decide upon the best social theory. These individuals would frame a social structure under a “veil of ignorance”, i.e., without knowing the details of their own positions. In this way, they would not be tempted to create principles which serve their own or others interests. This process yields what Rawls calls “justice as fairness”.

Rawls argues that two principles of social justice would be adopted together with two priority rules.<sup>109</sup> The first principle is the principle of equal liberty under which each person is to have an equal right to basic liberties (e.g., the right to vote and to hold public office, freedom of speech and assembly, liberty of conscience and freedom of thought, various legal rights, such as freedom of the person, freedom from arbitrary arrest, and the right to hold personal property).<sup>110</sup> The second principle concerns the distribution of wealth and income and other economic and social resources besides personal liberty. This principle allows for social and economic inequalities provided they benefit the least advantaged overall. This part of the second justice principle is referred to as the “difference principle”.

The first priority rule ranks liberty (the first principle) over economic and social resources (the second principle). Basic liberties may be restricted only for the sake of liberty, i.e., to strengthen the total system of liberty, but not for increasing the lot of the disadvantaged (for example). The second priority rule ranks the second principle of justice over efficiency,<sup>111</sup> which means, in part, that maximizing the sum of advantages would not be just if the least advantaged did not also benefit.

The two principles of justice and the priority rules relate to institutions (by this Rawls means the basic structure of society, which includes such things as the system of government, markets

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<sup>108</sup> *Ibid.*

<sup>109</sup> The final formulation of these two principles together with two priority rules appears in *A Theory of Justice* (1999), *ibid.* at 266-67. The justice principles are formulated slightly differently in *Political Liberalism*.

<sup>110</sup> *A Theory of Justice* (1999), *ibid.* at 53. The basic liberties, the subject of the first principle, are the highest order of social primary goods. Freedom of contract, according to Rawls, is not a basic liberty and is therefore not protected by the priority of the first principle (at 54).

<sup>111</sup> When Rawls refers to “efficiency” he means Pareto optimality: *ibid.* at 58. Pareto optimality is described below in section 3.3.2.4.

and systems of property).<sup>112</sup> How does Rawls' theory apply to tort law? One commentator suggests that it does not require any tort system at all, given that the focus is on a constitutional order.<sup>113</sup> It is not entirely clear, for instance, whether Rawls contemplates some kind of government obligation, based on his justice principles, to compensate victims of tortious behaviour. His theory may be too general for the specific concerns of tort law.

It should be noted that Rawls recognized that separate principles apply to individuals and their actions (within the context of the overarching institutional principles). He outlines a principle of fairness together with certain natural duties.<sup>114</sup> The principle of fairness requires a person to do his part as defined by the rules of an institution provided the institution is just (i.e., it satisfies the two principles of justice) and the person's participation is voluntary (voluntariness can be based on an express or tacit undertaking, or simply by accepting benefits). The natural duties include the duty to help others in need provided there is no excessive risk (Rawls refers to this as a duty of "mutual" aid), the duty not to harm or injure another, and the duty not to cause unnecessary suffering.

Rawls' second principle deals with how major institutions ought to regulate the distribution of income and wealth,<sup>115</sup> and an individual's duties are predicated on that principle. But if these institutions (including a society's economic system) do not operate according to this principle,<sup>116</sup> it is wasteful exercise to model a tort system based on his theory without the possibility of the necessary underlying structural change. It is unlikely Rawls' theory of social justice will be adopted in its entirety anytime soon.

There is a general consensus that current tort law regimes play a relatively small role in effecting distributive justice. Damage awards usually protect the pre-existing distribution of

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<sup>112</sup> *A Theory of Justice* (1999), *ibid.* at 47-52.

<sup>113</sup> See John B. Attanasio, "Aggregate Autonomy, the Difference Principle, and the Calabresian Approach to Products Liability" in David G. Owen, ed., *Philosophical Foundations of Tort Law* (Oxford: Oxford University Press, 1995) at 305-06. However, Attanasio does state that the primary good "self-respect" arguably supports a system of accident deterrence based on the Calabresian approach to products liability.

<sup>114</sup> *A Theory of Justice* (1999), *supra* note 106 at 93-101 and 293-343. Rawls does not develop the individual justice principles in much detail, implying that they are sketched in for the sake of completeness.

<sup>115</sup> *Ibid.* at 79.

<sup>116</sup> It seems clear our capitalist, free market system does not promote equality, given that the principle of "survival of the fittest" is ingrained in it and produces, if not requires, both winners and losers. Rawls states that one of the natural duties of individuals is not to harm or injure others. While this may be generally accepted as a principle concerning physical harm, our market system sanctions economic harm provided it is "legal".

wealth.<sup>117</sup> However, some areas of tort law (in some jurisdictions) are influenced by distributional aims. For example, most States in the United States impose strict liability on manufacturers for injuries caused by product defects;<sup>118</sup> to the extent that the law in these jurisdictions reflects a “deep pockets” approach, a limited form of distributive justice is being dispensed. The same can be said of jurisdictions with no-fault workers’ compensation schemes. And in negligence law generally, courts have recently begun to openly consider the distributional effects of recognizing (or not) a duty of care.<sup>119</sup> But despite these influences, it is corrective justice that most clearly explains tort law today.

### 3.3.2 Law and Economics

Given the importance of compensation as a remedy in tort law, it is not surprising that some of the theoretical research in this field is of an economic nature – it is even less surprising when the research relates specifically to economic negligence. In the last 40 years, particularly in the United States, the economic analysis of law has become one of the most dominant theoretical perspectives, not just in tort law, but in law generally.<sup>120</sup> In the following discussion, I canvass some of the main tenets of the law and economics movement and its influence on the law of torts.

#### 3.3.2.1 *The Enterprises of Law and Economics*

Professor David Friedman refers to three enterprises of law and economics: 1) to predict the economic consequences of a given law, 2) to explain the existence of rules we observe, and 3) using economic analysis to decide what the law should be.<sup>121</sup> The first two enterprises are *analytical* in nature (some law and economics scholars refer to predictive and descriptive

<sup>117</sup> Robert M. Solomon, R.W. Kostal & Mitchell McInnes, *Cases & Materials on The Law of Torts*, 5th ed. (Toronto: Carswell, 2000) at 502.

<sup>118</sup> *Restatement (Third) of Torts: Products Liability* §§ 1-2 (1998).

<sup>119</sup> See, for example, *McFarlane v. Tayside Health Board* (1999), [2000] 2 A.C. 59, [1999] 4 All E.R. 961 [*McFarlane* cited to A.C.]. *McFarlane* is discussed in more detail below in section 3.4.

<sup>120</sup> Over 100 years ago, Justice Oliver Wendell Holmes predicted that the future study of law would belong to “the man of statistics and the master of economics” in “The Path of the Law” (1897) 10 Harv. L. Rev. 457 at 469. In the 1960s, economic analysis of law started in earnest with commentators on anti-trust law, and with the publication of seminal articles by Guido Calabresi, “Some Thoughts on Risk Distribution and the Law of Torts” (1961) 70 Yale L.J. 499, and Ronald H. Coase, “The Problem of Social Cost” (1960) 3 J.L. & Econ. 1. With the first edition of Richard Posner’s *Economic Analysis of Law* (Boston: Little, Brown, 1973) economic analysis had arrived as a fully-fledged general theory of law.

<sup>121</sup> David D. Friedman, *Law’s Order: What Economics Has to Do With the Law and Why It Matters* (Princeton: Princeton University Press, 2000) at 15-17. See also Jules L. Coleman, “Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law” (1980) 68 Cal. L. Rev. 221 at 221-22.

analysis as *positive* analysis);<sup>122</sup> the third is *prescriptive* (and to the degree that the “oughts” and “shoulds” rest on ethical or moral judgments, it is also *normative*). Predicting the economic effects of laws is rarely contentious. It is hard to argue that understanding the consequences of a law, economic or otherwise, is not helpful for those studying or making law, especially when those consequences are less than obvious. Ideally, it will involve empirical study to verify the accuracy of the predictions: the law either increases wealth or it does not. Describing the law as a wealth-maximizing tool is more problematic.<sup>123</sup> Posner admits that not all laws are concerned with economic results, but he argues that the common law (i.e., the law comprised of judge-made rules) is best explained as a system of wealth maximization. And while this goal might not have been clearly articulated in the past, it should not be surprising that judges were moving in this direction given that many common law doctrines date back to the nineteenth century when *laissez-faire* ideology was prevalent among the educated classes.<sup>124</sup> Prescriptive and normative analysis is the most controversial aspect of law and economics theory. Following this enterprise, laws that do not increase wealth are considered bad and the prescription is change so that they do. Wealth maximization must be accepted not only as a laudable social objective but also as the overriding social objective.

All three enterprises, predicting, explaining and prescribing, rely on a number of basic assumptions about human behaviour. Prescriptive analysis, in particular, also depends on concepts of efficiency. A state of affairs or a proposed change is efficient if it promotes an “allocation of resources in which value is maximized”.<sup>125</sup> Policy-makers and judges who subscribe to law and economics theory need to be aware of the different conceptions of efficiency in order to determine if *and how* the objective of wealth maximization will be achieved by their decisions.

### 3.3.2.2 Core Assumptions

The economic analysis of law proceeds from the assumption that individuals are rational maximizers motivated by self-interest (not to be confused with selfishness) and the assumption that people respond to incentives. From this flow three principles: 1) the law of demand,

<sup>122</sup> See, for example, Michael J. Trebilcock, “Law and Economics” (1993) 16 Dal. L.J. 360 at 362.

<sup>123</sup> See Richard A. Posner, “Wealth Maximization and Tort Law: A Philosophical Inquiry” in David G. Owen, ed., *Philosophical Foundations of Tort Law* (Oxford: Oxford University Press, 1995) at 100-101.

<sup>124</sup> Richard A. Posner, *Economic Analysis of Law*, 5th ed. (New York: Aspen Law & Business, 1998) at § 2.2.

<sup>125</sup> *Ibid.* at § 1.2.



which posits an inverse relation between price and quantity demanded, 2) people seek to increase their "wealth" by maximizing the difference between costs and revenues, and 3) in a free market (i.e., one permitting voluntary exchange), resources are drawn to their most valuable uses.<sup>126</sup>

An individual maximizes his wealth when he allocates his resources such that they have the most value to him. If he can purchase an asset for less than he would be prepared to pay, or sell an asset for more he would be prepared to take, in both cases, he increases his wealth by the difference. Society maximizes its wealth when all its resources are distributed such that the aggregate individual valuations cannot be increased.

Professor Ronald Dworkin is of the view that there are practical difficulties with the concept of wealth maximization, aside from objections that it is a normative standard. He notes in particular the problems of cyclicity and path-dependency. Cyclicity arises because of the "grass is greener" phenomenon. The same goods may be valued more in your neighbour's hands than in your own. This could theoretically result in the same goods being transferred back and forth between individuals, each time resulting in an increase of social wealth. Such a possibility he argues is "disagreeable" in a standard of social improvement. The second problem, path-dependency, is likely more common. For instance, a person may acquire a "good" fortuitously (e.g., by accident, lottery or even inheritance) and be unwilling to sell it unless he were paid a much higher price for it than he would be prepared to pay for it ordinarily. If a significant number of people and goods are involved in this type of situation then the final distribution achieving wealth maximization will be dependent on the order of the intermediate transfers. Most law and economics scholars are not concerned with these possibilities, however, either because assumptions of rationality exclude them or because the concern is primarily with commercial enterprises where such arbitrariness is less likely.<sup>127</sup>

Do individuals respond to legal rules, whether in tort, contract, or other areas by evaluating costs and benefits as economists predict? Are legal costs and benefits treated the same way as other costs and benefits? Determining the accuracy of the assumptions and principles upon which the economic analysis of law is based requires empirical testing. Professor Michael

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<sup>126</sup> *Ibid.* c. 1.

<sup>127</sup> See Ronald M. Dworkin, "Is Wealth a Value" (1980) 9 J. Legal Stud. 191 at 192.

Trebilcock believes that law and economics theory will “ultimately be judged by the empirical validity of its propositions.”<sup>128</sup>

### 3.3.2.3 *Wealth Maximization as a Norm*

The idea of wealth maximization, which is at the centre of law and economics theory, is considered a moral precept for many jurists.<sup>129</sup> The law and economics movement adopted this concept partly because of the failure of utilitarianism to provide a solution to the problem of inter-personal utility comparisons. How is one person's happiness to be measured in relation to another's? It is necessary to have some fixed standard of utility in order to measure whether an action or change in policy, which improves the position of some and worsens the position of others, increases utility overall. Wealth maximization replaces the vague notion of utility. The fixed measure is price. Different individuals may value “goods” differently, but the unit of valuation is fixed.<sup>130</sup>

While law and economics theory may have addressed the measurement problem by substituting wealth for happiness (aside from the practical difficulties just noted), it is subject to more substantive objections. For instance, like utilitarianism it fails to deal with distributive concerns. A move from distribution 1 to distribution 2 is judged by whether an increase in utility or wealth has occurred. However, the prior and resulting distributions are not evaluated according to any standard of fairness.<sup>131</sup> Another criticism relates to consequentialism or “outcome morality” generally: A person may be justified in violating a principle of right action simply because an overall benefit occurs.<sup>132</sup> There is also a problem of incompleteness, in that this theory fails to account for values that cannot be quantified in financial terms.

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<sup>128</sup> See Trebilcock, *supra* note 122 at 363.

<sup>129</sup> Guido Calabresi and Richard Posner are two of the most well-known proponents of this view. For a thorough challenge to the normative content of wealth maximization, see Dworkin, “Is Wealth a Value”, *supra* note 127.

<sup>130</sup> This assumes that each person places the same value on a dollar (or other monetary unit), an assumption that some argue is clearly false: see *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at 559.

<sup>131</sup> See Trebilcock, *supra* note 122 at 365-66, and Anthony T. Kronman, “Wealth Maximization as a Normative Principle” (1980) 9 J. Legal Stud. 227 at 242 who concludes that the law “should be used to mitigate the effects of the natural lottery; for the law to intensify them is perverse.”

<sup>132</sup> See Jules L. Coleman, “Efficiency, Utility, and Wealth Maximization” (1980) 8 Hofstra L. Rev. 509 at 511. The force of this criticism, of course, depends on how one defines right action and whether one accepts a deontological approach to duty and responsibility. See generally Ronald M. Dworkin, *Taking Rights Seriously* (Cambridge, Massachusetts: Harvard University Press, 1977).

A more basic criticism of wealth maximization as a moral objective is that it is unclear why wealth should be considered a worthy social goal. Dworkin explains that there are two ways of looking at wealth as a value. First, wealth may be seen as a “component of social value”, i.e., something which by itself makes society better off. Second, it may be thought of as an “instrument” of value, i.e., an improvement in social wealth is not desirable for its own sake, but for other improvements that wealth can produce that are valuable in themselves.<sup>133</sup> He rejects both the component-of-value and the instrumentalist arguments: the former because money has no intrinsic value, unless one is a “fetishist of little green paper”,<sup>134</sup> and the latter largely because of the difficulty in demonstrating a clear connection between wealth and various independent conceptions of value.<sup>135</sup>

### 3.3.2.4 *Efficiency and Wealth Maximization*

In normative economic analysis, wealth maximization is accepted as an ideal. An efficiency determination allows an analyst to establish how a change affects wealth.<sup>136</sup> It should be noted that wealth maximization and efficiency are not the same thing. Efficiency standards provide a means of comparing states of affairs and can be used to compare different “characteristics”, whether they concern wealth, utility or some other ideal.<sup>137</sup>

The two principal efficiency concepts in law and economics analysis are the Pareto criteria<sup>138</sup> and Kaldor-Hicks efficiency.<sup>139</sup> Pareto efficiency (or Pareto optimality) describes a situation where it is impossible to make change without making at least one person believe he is worse off.<sup>140</sup> Others may believe they will benefit by change, but the fact that one person will believe he is worse off means the situation is Pareto-optimal. Pareto superiority refers to a change where at least one person will believe he is better off, but no one will believe he is worse off,

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<sup>133</sup> Dworkin, “Is Wealth a Value”, *supra* note 127 at 194-95.

<sup>134</sup> *Ibid.* at 201.

<sup>135</sup> *Ibid.* at 205-19.

<sup>136</sup> See Trebilcock, *supra* note 122 at 363.

<sup>137</sup> See Coleman, “Efficiency, Utility, and Wealth Maximization”, *supra* note 132 at 521.

<sup>138</sup> The Pareto criteria are named after the person who identified them, Vilfredo Pareto, an Italian economist writing at the turn of the twentieth century.

<sup>139</sup> Kaldor-Hicks efficiency is based on the work of two British economists, Nicholas Kaldor and John Hicks. See, for example, Nicholas Kaldor, “Welfare Propositions of Economics and Interpersonal Comparisons of Utility” (1939) 49 *Econ. J.* 549, and J.R. Hicks, “The Foundations of Welfare Economics” (1939) 49 *Econ. J.* 696 and “The Valuation of Social Income” (1940) 7 *Economica* 105.

<sup>140</sup> Robert Cooter & Thomas Ulan, *Law and Economics*, 3rd ed. (Reading, Mass.: Addison Wesley Longman, 2000) at 12.

i.e., there are no losers. Where such a change occurs the resulting position is Pareto-superior to the prior one.<sup>141</sup> The two Pareto criteria are related in that a Pareto-optimal situation is one where no further changes are possible that are Pareto-superior.<sup>142</sup> Pareto-superior changes are most easily imagined where they involve simple small-scale voluntary transactions (e.g., a contractual exchange between two persons) with no negative impacts on third parties. But with larger-scale transactions, distributions and changes it is likely that at least one person will consider himself adversely affected and a Pareto-superior move will not be possible. This is problematic. As Dworkin writes:

It would be absurd to say that judges should make no decision save those that move society from a Pareto-inefficient state to a Pareto-efficient state. That constraint is too strong, because there are few Pareto-inefficient states; but it is also too weak because, if a Pareto-inefficient situation does exist, any number of different changes would reach a Pareto-efficient situation and the constraint would not choose among these.<sup>143</sup>

Dworkin's last point is particularly relevant if a judge is confronted with a choice of rules to govern a particular form of liability, each resulting in Pareto optimality. The judge would have no economic criterion for choosing one rule over another. And flipping a coin is an especially arbitrary solution when it is recognized that different changes can result in *different* states of Pareto optimality, i.e., states with different allocations of resources. Given that different Pareto-optimal distributions are Pareto non-comparable, a reasoned choice between the different distributions would have to be made on non-efficiency grounds.<sup>144</sup> Paretian standards, then, are somewhat idealistic and impractical in the context of legal changes which are generally widespread in their effect. Most social policies and legal rules produce both winners and losers.<sup>145</sup>

Kaldor-Hicks efficiency addresses the impracticality of the Pareto criteria. According to this test social change will be efficient provided that there are sufficient gains so that the winners could, *hypothetically*, compensate the losers for their losses making them indifferent to the change, and still have gains left over for themselves.<sup>146</sup> Social policies that produce winners

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<sup>141</sup> Note that establishing "optimality" and "superiority" depends on subjective assessments of good, not objective ones: see *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at 558.

<sup>142</sup> Coleman, "Efficiency, Utility, and Wealth Maximization", *supra* note 132 at 513.

<sup>143</sup> Dworkin, "Is Wealth a Value", *supra* note 127 at 193.

<sup>144</sup> See Coleman, "Efficiency, Utility, and Wealth Maximization", *supra* note 132 at 513.

<sup>145</sup> See *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at 558.

<sup>146</sup> See Trebilcock, *supra* note 122 at 364.

and losers become justifiable. And there is no requirement under Kaldor-Hicks that compensation in fact be paid to the losers. This is what distinguishes Kaldor-Hicks efficiency from Pareto superiority; if the compensation were actually paid to the losers the move would be Pareto-superior.<sup>147</sup> There are at least two reasons for not requiring compensation under Kaldor-Hicks: 1) some losers deserve to lose (e.g., where the law breaks up an inefficient monopoly) and 2) it may be costly to compensate losers (the Kaldor-Hicks test assumes compensation will be costless but there may be significant transaction costs).<sup>148</sup> However, other than the "greater good" argument, there does not seem to be any persuasive conceptual reason why losers should be content in all cases to be without a right of compensation.

One of the main criticisms of the Kaldor-Hicks approach is its sacrifice of voluntarism. Unlike Pareto efficiency, a solution is "coercively imposed after some third-party determination of costs and benefits".<sup>149</sup> According to Trebilcock, "[n]eo-classical economists in general attach strong normative value to regimes of private exchange and private ordering..."<sup>150</sup> In private dealings, there is in effect a presumption that the exchange will benefit the parties involved, and a distrust of an outside decision preventing or inhibiting their arrangement. However, limits to consent are recognized even in private dealing, and the presumption would be rebuttable by reference to forms of market failure (e.g., failing to consider externalities) or transaction-specific factors, such as contracting or information failures.<sup>151</sup> These latter factors, it should be noted, touch on the true voluntariness of the transaction. In the context of broad-scale initiatives (e.g., consumer protection schemes, where Kaldor-Hicks is more relevant), the lack of voluntariness is perhaps less objectionable. Such interferences with the power of choice are an accepted part of social welfare economies which have abandoned unqualified *laissez-faire* ideology.<sup>152</sup>

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<sup>147</sup> See Lloyd's *Introduction to Jurisprudence*, *supra* note 27 at 558.

<sup>148</sup> *Ibid.*

<sup>149</sup> C.G. Veljanovski, *The New Law-and-Economics: A Research Review* (Oxford: Centre for Socio-Legal Studies, 1982) at 40.

<sup>150</sup> Trebilcock, *supra* note 122 at 364.

<sup>151</sup> *Ibid.*

<sup>152</sup> Posner is not too concerned about the lack of voluntariness under Kaldor-Hicks. An alternative approach, he says, "is to try to guess whether, if a voluntary transaction had been feasible, it would have occurred". That is, using all available data and assuming transaction costs are zero, would the parties have structured the transaction so that it was efficient. See Posner, *Economic Analysis of Law*, *supra* note 124 at § 1.2. This seems

Another somewhat related criticism relates to the competence or capacity of "collective decision makers e.g. legislatures, regulators, bureaucrats or courts, to adopt policies or laws that will unambiguously increase net social welfare".<sup>153</sup> Are most judges, for example, competent to analyze the complex mixes of costs and benefits relevant to efficiency findings in most cases, i.e., those without the simplest factual and legal matrices? Posner believes they can; money is a measurable standard unlike utility.<sup>154</sup> Presumably, reliance on expert witnesses would be expected to assist the court.

The effect of legal change on efficiency must not be overrated, however. In outlining his well-known Coase Theorem, Professor Coase argued that if certain conditions are satisfied the affected parties will settle upon an efficient arrangement regardless of the legal position.<sup>155</sup> Specifically, he argued that where the activity of one party harms another it does not matter from an efficiency standpoint who has the legal entitlement (the causer or the party harmed) provided transaction costs are zero. Implied in the requirement of zero transaction costs is the existence of a free market which will allow the parties to negotiate an efficient solution if necessary. Coase used a number of scenarios to illustrate his point, but his analysis centred on a conflict between adjoining landowners, a rancher and a farmer.<sup>156</sup> In the absence of each other's business, they would increase production (more cows or more crops) until marginal revenue equalled marginal private cost to maximize their wealth. With conflicting uses, however, an externality problem arises. Assume that the boundaries are clear but that there is no fence. As the rancher increases his herd, some cows wander onto the farmer's land and damage his crops grown on part of his land. Two possible legal rules are: 1) the farmer is responsible for fencing his own property and must accept any crop damage if he does not (this

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somewhat artificial, however, because in the majority of cases the real question would be whether a particular business would voluntarily assume responsibility for certain externalities.

<sup>153</sup> Trebilcock, *supra* note 122 at 364.

<sup>154</sup> See Richard A. Posner, "The Value of Wealth: A Comment on Dworkin and Kronman" (1980) 9 J. Legal Stud. 243, for example.

<sup>155</sup> See Coase, "The Problem of Social Cost", *supra* note 120. Professor Coase won the Nobel Prize in Economic Science in 1991 largely because of his theorem.

<sup>156</sup> He also referred to the famous English case involving a confectioner and a doctor whose businesses were in adjoining buildings, and where a similar analysis would apply: *Sturges v. Bridgman* (1879), 11 Ch. D. 852 (C.A.). In that case, the noise and vibrations from a confectioner's machines interfered with a doctor's business. The Court of Appeal case analyzed the case on the basis of nuisance principles not economic efficiency. But as Coase saw it, the problem "was essentially whether it was worth while, as a result of restricting the methods of production which could be used by the confectioner, to secure more doctoring at the cost of a reduced supply of confectionery products": *ibid.* at 2.

could be called a “self-reliance rule”) and 2) the rancher is responsible for damage resulting from cattle trespass (a “causation rule”). Traditional legal analysis centres on causation and fairness and the common law has in fact adopted a cattle trespass rule.<sup>157</sup> Coase believes the problem should be analyzed in terms of efficiency. Suppose the trespassing cows would cost the farmer \$100 per year in crop damage if he did not fence his crops, and that the cost of building and maintaining a fence around the crops would be \$50 per year. The yearly cost to the rancher to build a fence on his ranch to keep the cattle in would be \$75. If the self-reliance rule applies the farmer will fence his crops at a cost of \$50 for a savings of \$50 (instead of absorbing a \$100 loss he builds the fence for \$50). If the causation rule applies, the rancher could build a fence on his property for \$75 for a savings of \$25 (instead of paying \$100 in damages he only pays \$75). It appears the first rule is more efficient. But does it make a difference? If the causation rule applies and the parties are rational maximizers, it makes more sense for the rancher to pay \$50 to build a fence around the crops and give a portion of the \$25 savings to the farmer as an incentive for him to agree to this.<sup>158</sup> Thus, regardless of which rule applies the most efficient solution, a fence around the crops, is reached.

A few points need to be mentioned about this analysis.<sup>159</sup> First, while the total wealth maximized is the same regardless of the applicable legal rule, the distribution of the wealth is different depending on who is responsible. If the self-reliance rule applies the farmer saves \$50. If the causation rule applies and assuming they split the \$25 savings to the rancher because the fence is built around the crops, the rancher saves \$37.50 (instead of paying \$100 damages he only pays \$62.50) and the farmer profits an additional \$12.50 – the total savings and additional profit is \$50. Or, another way of looking at it, if the rancher is not responsible for the externality (the damage to the crops) his cost/benefit balance remains the same and the farmer loses \$50, but if the rancher is responsible he loses \$62.50 and the farmer gains an additional \$12.50: two very different results on an individual/corporate level. Second, and related to the first point, because different legal rules will produce different distributions, the

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<sup>157</sup> The common law rule is based on strict liability, although in some jurisdictions it has been modified by legislation (in British Columbia, for example, see *Livestock Act*, R.S.B.C. 1996, c. 270, s. 11, which creates a defence of “reasonable care”).

<sup>158</sup> These numbers are based on the discussion of the Coase Theorem in Cooter & Ulan, *supra* note 140 at 82-84, somewhat simplifying the variables in Coase’s article (*supra* note 120).

<sup>159</sup> The Coase Theorem has generated a copious and detailed literature. It is my intention here just to highlight some of the key corollaries and qualifications.

initial legal entitlement will affect the way the parties are able to spend their money which in turn could affect demand for and the price of goods in the future, even if only slightly (this assumes the parties do not have identical spending habits).<sup>160</sup> Third, transaction costs are never zero. The Coase Theorem treats all obstacles to bargaining (including bargaining costs, emotions, private information, and strategy) as transaction costs.<sup>161</sup> Generally, transaction costs are lower in the context of private dealing (e.g., negotiating a private contract) and higher in the context of activities which more frequently give rise to tort claims (e.g., driving a car or distributing a consumer product, where negotiating a contract with every other driver or every potential consumer would be prohibitively expensive).<sup>162</sup> In the simple example of the rancher and the farmer, if the causation rule applies and the transaction costs are less than the difference between the two levels of efficiency (i.e., less than \$25, the difference in savings between the two fence options) then it still pays for the rancher to build the fence around the crops. After absorbing the transaction costs there are still savings left to split with the farmer. However, if the transaction costs exceed \$25 then there is no incentive to bargain. At this level, the court should adopt the self-reliance rule because it is the more efficient one. By doing this, however, the court completely ignores the fact that one party must take a loss because the party who caused it stands to lose more if he is held responsible. Professor Weinrib refers to this as the “causal nihilism” of the Coase Theorem.<sup>163</sup> But not all situations with high transaction costs work out this way. Manufacturers are the most efficient reducers of accident costs with respect to defective products and a strict liability approach has been adopted generally in United States largely because of it.

Despite these and other “frailties”, the Coase Theorem highlights the limitations of legal intervention in certain cases and its effectiveness in others in bringing about an “efficient” resolution to a problem.

### **3.3.2.5 Efficiency and Tort Law**

Much of the law and economics scholarship in the United States on tort law deals with modelling liability rules to minimize both accident costs and accident avoidance costs. Three

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<sup>160</sup> See Posner, *Economic Analysis of Law*, *supra* note 124 at § 3.6.

<sup>161</sup> Cooter & Ulan, *supra* note 140 at 290.

<sup>162</sup> In most cases transaction costs rise with the number of parties involved. See Posner, *Economic Analysis of Law*, *supra* note 124 at § 3.6.

<sup>163</sup> Weinrib, “The Special Morality of Tort Law”, *supra* note 92 at 404.



particular areas have attracted the most attention: products liability, medical malpractice and automobile insurance. Besides the debate over the appropriate liability rules (strict liability or negligence liability, for example), the commentary also addresses questions relating to the defences which should be available (contributory negligence, consent, etc.) and the measurement of damages (particularly in the area of non-pecuniary loss).<sup>164</sup>

The earliest recognition in clear numerical terms of the role of efficiency in tort case law was by Judge Learned Hand in *United States v. Carroll Towing Co.*<sup>165</sup> It was a negligence case and the main question was the extent of the duty of the owner of a moored vessel to prevent the vessel from breaking loose and causing damage to other vessels. Judge Learned Hand held that the duty of the owner "to provide against resulting injuries is a function of three variables: (1) The probability that she will break away; (2) the gravity of the resulting injury, if she does; (3) the burden of adequate precautions." He continued by setting out the so-called Hand Formula, where probability was called P, the injury L and the burden B. Liability, he said, depended on whether B is less than P multiplied by L, or, in algebraic terms, whether  $B < PL$ .<sup>166</sup> In other words, if the cost of preventing the accident is less than the cost of the accident itself, failing to take care to prevent the accident is negligent (or, in the language of law and economics, inefficient).

As Posner explains, the Hand Formula is good as far as it goes, but must be modified to work as a formula for optimal accident avoidance. This becomes apparent when it is recognized that P varies with the precautions taken, B. He gives the example of a driver who by slowing down could avoid having an accident. Posner's starts with PL equalling \$10 (assume P is .001 and L is \$10,000) and then observes the effect of varying B:

Suppose that our PL of \$10 would be totally eliminated by the driver's reducing his speed by 25 m.p.h. at a cost to him of \$9. But suppose further that PL could be reduced to \$1 by the driver's reducing his speed by only 5 m.p.h., at a cost to him of only \$2. This implies that to get PL down

<sup>164</sup> See Trebilcock, *supra* note 122 at 370.

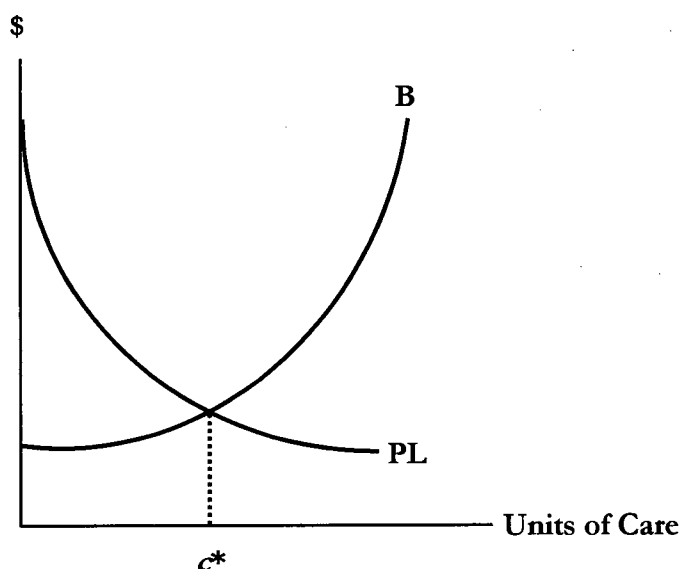
<sup>165</sup> 159 F.2d 169 (2d Cir. 1947). Posner points out that "the method it capsulizes" was not new; he cites two earlier cases, one from England and one from the US: *Blyth v. Birmingham Waterworks Co.* (1856), 156 E.R. 1047, 11 Ex. 781 (the defendant water company was found not negligent in failing to bury its pipes deeper at great expense to prevent the low probability of pipes freezing and bursting, and causing damage to plaintiff's house – per Baron Alderson) and *Adams v. Bullock*, 227 N.Y. 208, 125 N.E. 93 (C.A. 1919) (the defendant trolley company was found not negligent in failing to take expensive precautions to prevent electric shock given the low probability of accident; the plaintiff boy had dangled an 8-foot wire over a bridge – per Cardozo, J.). See Posner, *Economic Analysis of Law*, *supra* note 124 at § 6.1.

<sup>166</sup> 159 F.2d 169 at 173 (2d Cir. 1947).

from \$1 to zero costs the driver \$7 (\$9-\$2), for a net social loss of \$6. Clearly we want him to reduce his speed just by 5 m.p.h., which yields a net social gain of \$7. This example shows that expected accident costs and accident prevention costs must be compared at the margin, by measuring the costs and benefits of small increments in safety and stopping investing in more safety at the point where another dollar spent would yield a dollar or less in added safety. Fortunately the common law method facilitates a marginal approach, simply because it will usually be difficult for courts to get information on other than small changes in the safety precautions taken by the injurer.<sup>167</sup>

Posner illustrates this with a figure:<sup>168</sup>

**Figure 3.3-1 The Marginal Hand Formula**



*Explanation.* Fig. 3.3-1 shows that the risk (PL) is not static, but related to the amount of care exercised (B), which seems obvious, but which is not reflected in the original Hand Formula. The vertical axis represents costs in dollar terms, and the horizontal axis units of care. As more care is exercised (curve B), the probability of injury (P) diminishes and with it the overall risk (curve PL). Curve B rises on the assumption that units of care are scarce and the price increases with the amount purchased. Curve PL declines on the assumption that as more care

<sup>167</sup> Posner, *Economic Analysis of Law*, *supra* note 124 at § 6.1. In a footnote, Posner describes the math involved:

The marginal Hand Formula is easily derived with a bit of calculus. The problem is to find the optimal level of care ( $c^*$ ) i.e., the level that will minimize the social costs of accidents,  $PL$ , plus the costs of accident prevention,  $B$ . Both  $P$  and  $B$  are functions of the potential injurer's care,  $c$  (we are assuming that potential victims can do nothing to prevent the accidents – their optimal care is zero). Mathematically, the problem is to minimize  $A$ , the total social costs of accidents, with respect to  $c$ , where  $A(c)$  (total accident costs as a function of amount of care) =  $P(c)L + B(c)$ , both  $P$  and  $B$  being functions of  $c$  also. Provided that certain fairly natural conditions are satisfied, minimization requires taking the first derivative of  $A$  with respect to  $c$  and setting the resulting expression equal to zero:  $P_L + B_c = 0$ , or  $B_c = -P_L$ . In words, care is optimized when a small change in  $B$ , the expenditures on care, reduces (hence the negative sign) expected accident costs by the same amount. This is the point  $c^*$  in [Fig. 3.3-1 above].

<sup>168</sup> This figure is a reproduction of Fig. 6.1 in Posner, *Economic Analysis of Law*, *ibid.* See also Cooter & Ulan, *supra* note 140 at 314-16 for an explanation of the need for marginal values of  $B$  and  $P$  for the Hand Formula to be more accurate.

is taken there is a diminishing effect in reducing risk. The point of intersection of the two curves represents the optimal level of care. To the left of  $c^*$ , the defendant is negligent. To the right, there is an inefficient expenditure of resources, because for each additional dollar of care spent there is not an equivalent or greater reduction in risk.

There is another sense in which the Hand Formula must be qualified. In the context of accident avoidance, it assumes risk neutrality. This is a workable assumption, because of the relatively well-established market for insurance against personal injuries (and damage to property). But in the commercial context, this assumption breaks down. Business actors are generally assumed to be risk averse due in large part to the unavailability of affordable insurance against business losses.<sup>169</sup> Contract law and disclaimers of liability can play an important role in reducing risk (PL) in the commercial setting (particularly where the parties are able to deal directly with each other). Where contract law is an effective means of controlling risk, it is arguably a preferable way to reduce costs than a market-wide application of the Hand Formula which usually interferes with private ordering.<sup>170</sup>

It is unlikely Judge Learned Hand intended to put forward a comprehensive economic approach to tort law; he does not refer to wealth maximization as a normative standard, and Posner admits as much.<sup>171</sup> More probably Judge Hand was simply holding that in cases of property damage economic considerations affect the level of care required, i.e., where a less expensive solution to a more expensive problem exists, a reasonable person would take the precaution.<sup>172</sup>

While Posner has no problem applying the economic approach generally, other writers see financial analysis as much more limited. As Professor John Fleming noted:

Negligence is not just a matter of calculating the point at which the cost of injury to victims (that is the damages payable) exceeds that of providing safety precautions. The reasonable man is by no

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<sup>169</sup> See discussion of the *Norsk* case, *infra* note 178 and accompanying text.

<sup>170</sup> Posner, *Economic Analysis of Law*, *supra* note 124 at § 6.1. See also Trebilcock, *supra* note 122 at 368-69, where he makes the point that contract law is efficient in the sense that it discourages carelessness in the exchange process.

<sup>171</sup> In Richard A. Posner, "A Theory of Negligence" (1972) 1 J. Legal Stud. 29 at 32, where he discusses Learned Hand's contribution and refers to Hand "unwittingly" adumbrating an economic meaning of negligence.

<sup>172</sup> For the implicit use of the Hand Formula in this context in a Canadian case, see *Vaughn v. Halifax-Dartmouth Bridge Commission* (1961), 29 D.L.R. (2d) 523, 46 M.P.R. 14 (N.S.S.C.) per MacDonald J.

means a caricature cold blooded calculating Economic Man...[C]ourts remain sceptical as to their ability, let alone that of juries, to pursue economic analyses.<sup>173</sup>

With respect to risks involving personal safety or health, Commonwealth authority, particularly, is loath to recognize an economic justification.<sup>174</sup> To the extent that utility is relevant, it is usually confined to cases involving public agencies, where the “social utility” of the defendant’s actions (in the sense of health or safety benefits generally as opposed to direct financial gain) may be balanced against the risk of injury in the particular case.<sup>175</sup>

Coleman denies that the Hand Formula is an “efficiency” calculation at all. He argues that just because an economic argument is relevant to the determination of fault does not mean that “liability based on fault is justified on efficiency grounds, or that in awarding compensation to the plaintiff in a particular negligence case the judge is following an economic theory of adjudication”.<sup>176</sup> In other words, the Hand Formula was not conceived as a tool for designing liability rules based on which party can prevent losses most efficiently, but rather to determine the care required of the party with a pre-existing duty possibly justifiable on non-efficiency grounds.

In recent times, the idea of market deterrence has entered the efficiency debate. Deterrence is a general function of tort law, but economic theorists have conscripted this idea to supplement general efficiency analysis. There are two ways that market deterrence can achieve efficiency: 1) by internalizing “externalities” to the activities that generate them, and 2) by allocating these costs to the parties who can reduce or avoid these costs for the least amount (the “least-cost

<sup>173</sup> John G. Fleming, *The Law of Torts*, 9th ed. (Sydney: LBC Information Services, 1998) at 132.

<sup>174</sup> In the well-known case, *Bolton v. Stone*, [1951] A.C. 850 at 867, [1951] 1 All E.R. 1078 (H.L.), Lord Reid, writing one of the five concurring judgments, remarked upon the relevance of cost in a personal injury claim (the plaintiff was struck by a cricket ball that had been hit out of the park). He held that the probability of injury in these circumstances was so low that the club was not negligent, but noted that “it would not be right to take into account the difficulty of remedial measures”. See also *Law Estate v. Simice* (1994), 21 C.C.L.T. (2d) 228 (B.C.S.C.), aff’d (1995), [1996] 4 W.W.R. 672, 27 C.C.L.T. (2d) 127 (C.A.), a medical malpractice suit, where Spencer J. diminished the importance of the financial cost of a CT scan in the negligence calculus given the potential severity of harm.

<sup>175</sup> See *Watt v. Hertfordshire County Council*, [1954] 1 W.L.R. 835, [1954] 2 All E.R. 368 (C.A.), where a fireman sued the municipal council that employed HIM after he was injured on an emergency call. The Court found that the defendant was not negligent in failing to take greater precautions for his safety given the social utility of the defendant’s activity. Denning L.J., writing one of three concurring opinions, expressly held that a commercial enterprise would not be so justified. See also *Priestman v. Colangelo*, [1959] S.C.R. 615, 19 D.L.R. (2d) 1, involving two pedestrians killed in a police chase where the claim against the police was dismissed. The social utility justification for emergency vehicle accidents may be less effective today in light of changing social attitudes, and policies and legislation which place limits on dangerous driving by police and ambulance drivers.

avoiders”). For instance, forcing motorists to carry liability insurance, as opposed to having insurance paid out of general revenues, will internalize accident costs to the activity and deter some people from driving because they can’t afford insurance. This will produce a more efficient level of accidents than if accident costs were not internalized. After internalizing these costs, tort law can then fashion rules that allocate them to the least-cost avoiders. If, for example, car manufacturers are the least-cost avoiders of accidents caused by defective equipment, i.e., they can prevent more of such accidents at lower cost, then tort law should impose liability on them.<sup>177</sup> As mentioned, the strict liability regime concerning manufacturing defects which is prevalent in the United States reflects this reasoning.

Commonwealth courts have been less influenced by efficiency concerns in choosing liability rules, but they have considered them on occasion. In *Canadian National Railway v. Norsk Pacific Steamship Co.*,<sup>178</sup> the Supreme Court of Canada had to decide whether to recognize a duty of care in a contractual relational economic loss case.<sup>179</sup> Seven judges heard the appeal. McLachlin J., as she then was, wrote for three of the four judges in the majority. She outlined three economic arguments for limiting economic negligence claims: the insurance argument, the loss spreading justification, and the “contractual allocation of risk” argument.<sup>180</sup> These arguments appeared under the heading “Pragmatic Considerations” indicating that she did not believe efficiency and wealth maximization were morally imbued concepts. The insurance argument says that the plaintiff is better able to predict economic loss and obtain cheap insurance. She noted two problems with this argument: one, that the lack of incentives for defendants to take care may increase losses so as to eventually cancel out any initial cost advantage plaintiffs might have in obtaining insurance, and two, it was not clear that plaintiffs were the least-cost avoiders (while some forms of business interruption insurance are available, there is no general loss of profits insurance – self-insurance will often be the only option).<sup>181</sup>

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<sup>176</sup> Coleman, “Efficiency, Utility, and Wealth Maximization”, *supra* note 132 at 550.

<sup>177</sup> See Solomon, Kostal & McInnes, *supra* note 117 at 498-99.

<sup>178</sup> [1992] 1 S.C.R. 1021, 91 D.L.R. (4th) 289 [*Norsk* cited to S.C.R.].

<sup>179</sup> A contractual relational economic loss case is one where the claimant has a contractual relationship with a property owner and suffers economic loss as a result of damage to the property by a third party. This and other categories of economic negligence are described in more detail in Chapter 4.

<sup>180</sup> *Norsk*, *supra* note 178 at 1155-60.

<sup>181</sup> McLachlin J. quoted William Bishop, “Economic Loss in Tort” (1982) 2 Oxford J. Legal Stud. 1 at 2.

The loss spreading argument is that it is better to spread relatively small losses among many victims than to force an individual tortfeasor to pay the full loss. There are many problems with this as an efficiency argument. As with the insurance argument, the lack of incentives on defendants may increase losses. Also, victims' losses will not always be small, and in many cases there will only be one victim or just a few.<sup>182</sup> This is really a fairness argument not an efficiency argument.

The third argument relates more specifically to contractual relational economic loss claims than economic loss claims generally. It posits that the property owner is in the best position to obtain insurance and sue, and that the contractual user of the property can arrange for compensation for its losses from the property owner. This has the effect of internalizing costs by not requiring the contractual user to obtain separate insurance in respect of the property. In McLachlin J.'s opinion, there were problems with this argument too, most notably that it would not always be possible to negotiate an indemnification agreement with the property owner (for instance, in the *Norske* case, the property owner controlled an indispensable bridge and could demand an exorbitant amount in exchange for an indemnification agreement).

The majority in *Norske* rejected these economic arguments as proof that an inefficient allocation of resources would result from imposing a duty of care in the case before them. However, concerns about efficiency may have influenced later decisions, such as *Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.*,<sup>183</sup> where the Court placed clear limits on relational claims.

La Forest J. wrote for the three judges in dissent in *Norske*. He preferred a general exclusionary rule with limited exceptions in this context. His judgment, which has been described as a "veritable *tour de force*",<sup>184</sup> addressed some of the concerns with the economic arguments raised by McLachlin J. For instance, with respect to the possibility of increased losses if no duty were recognized, La Forest J. responded by pointing out that liability to the property owner would deter would-be defendants. This also counters the same concern in relation to the loss spreading argument. La Forest J. also doubted that it would be difficult for plaintiffs to obtain

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<sup>182</sup> McLachlin J. again quoted Bishop, *ibid.*

<sup>183</sup> [1997] 3 S.C.R. 1210, 153 D.L.R. (4th) 385 [*Bow Valley* cited to S.C.R.]

<sup>184</sup> B.S. Markesinis & S.F. Deakin, *Tort Law*, 4th ed. (Oxford: Oxford University Press, 1999) at 34.

insurance in the typical relational economic loss case because the type of loss would be of the business interruption variety which is insurable. However, his conclusion here was tentative because of the lack of evidence on point. He noted that it was important for lawyers “to inform themselves about fundamental matters of insurability in new tort cases and to see to it that courts are also informed”.<sup>185</sup> Aside from general insurability, La Forest J. was of the view that the plaintiff in this case, a railway, was “ideally situated to self-insure”.<sup>186</sup>

Despite the opinions in *Norske*, which are exceptional, Canadian and other Commonwealth courts do not regularly engage in efficiency analyses when deciding “choice of rules” cases.<sup>187</sup> Overall, one has to conclude that in the area of tort law (and negligence law in particular) wealth maximization and efficiency have not been adopted as controlling objectives by the courts at least in Commonwealth jurisdictions.<sup>188</sup>

### 3.3.3 General Functions of Tort Law

As mentioned, there is a certain artificiality in separating normative objectives, such as distributive justice and wealth maximization, from non-normative ones, such as compensation and deterrence, which I refer to as “general” functions.<sup>189</sup> I have maintained this distinction, however, because it reflects a fundamental division between the two sets of objectives.

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<sup>185</sup> *Norske*, *supra* note 178 at 1124. Markesinis & Deakin, *ibid.* at 35, echoed La Forest J. comment bemoaning the lack of empirical interdisciplinary work to assist the courts. See Bruce Feldthusen & John Palmer, “Economic Loss and the Supreme Court of Canada: An Economic Critique of *Norske Steamship* and *Bird Construction*” (1995) 74 Can. Bar Rev. 427 at 444, where the authors state that such insurance is available – their overall conclusion was that the majority position is inefficient, and that economic analysis supports the traditional prohibition against recovery in relational economic loss cases.

<sup>186</sup> *Norske*, *ibid.* Feldthusen & Palmer, *ibid.*, believe that the plaintiff railway in *Norske* probably self-insured because it was more efficient than obtaining private coverage for such a large enterprise (at 444). On this point, see also Norman Siebrasse, “Economic Analysis of Economic Loss in the Supreme Court of Canada: Fault, Deterrence, and Channelling of Losses in *CNR v. Norske Pacific Steamship Co.*” (1994) 20 Queen’s L.J. 1 at 34.

<sup>187</sup> See comment to this effect in Markesinis & Deakin, *supra* note 184 at 35 concerning English judges.

<sup>188</sup> This is largely the case in the United States too, although to the extent that most states have adopted a strict liability regime in the field of products liability economic analysis plays a role. With judges like Posner and Calabresi liability rules may become increasing influenced by economic considerations. It should also be noted that there is more of an inclination in that country to apply the Hand Formula in the standard of care analysis: see the definition of negligence in the *Restatement (Third) of Torts: Liability for Physical Harm (Tentative Draft)* § 3 (2002), and Stephen G. Gilles, “The Invisible Hand Formula” (1994) 80 Va. L. Rev. 1015 and “On Determining Negligence: Hand Formula Balancing, the Reasonable Person Standard, and the Jury” (2001) 54 Vand. L. Rev. 813.

<sup>189</sup> For one thing, not everyone agrees which goals are normative and which are not, as with wealth maximization. Further, some objectives have a dual nature, such as deterrence (e.g., market deterrence as part of a normatively constructed economic theory and ordinary deterrence as a social objective without moral overtones). Another problem is that not all writers even make the distinction between deontological and

More than fifty years ago Glanville Williams identified four general aims of tort law: appeasement, justice, deterrence, and compensation.<sup>190</sup> Mr. Justice Linden has suggested some additional goals, including education, market deterrence, and acting as ombudsman (i.e., as a vehicle for challenging the conduct of powerful defendants).<sup>191</sup> In a report to the American Bar Association, a special committee outlined another role that tort law plays: It acts as a grievance mechanism preventing overt conflict that could break through the crust of civilization if injured victims believed society was not responding to their complaints.<sup>192</sup> In the taxonomy I have adopted, all of these are general functions except Williams' justice and Linden's market deterrence.<sup>193</sup>

Compensation is frequently cited as the most important function of tort law, particularly in negligence.<sup>194</sup> For most claimants, there would be little disagreement on this point. In one sense, compensation is a means of effecting reparatory justice – this was described above in the discussion of corrective justice. It is relatively successful here. In a more general sense, however, if one advocates that tort law should act as an accident compensation mechanism, it is not particularly effective. The current requirements of cause and fault stand in the way of its success as a universal tool for accident compensation. Insurance and government programs fill in the large gaps left by tort law in its compensatory role in this general sense.<sup>195</sup>

Ordinary deterrence (as distinguished from market deterrence) is the next most cited objective for having tort liability. Tort law serves as a specific deterrent, i.e., in relation to future

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instrumentalist theories, lumping corrective justice together with deterrence, for instance, in describing the "functions" or "goals" of tort law: see, for example, Glanville Williams, "The Aims of the Law of Tort" (1951) 4 *Curr. Legal Probs.* 137, and Lewis N. Klar, *Tort Law*, 2nd ed. (Scarborough: Carswell, 1996) c. 1. On one level, it is just a question of semantics, for one certainly can argue that it is a *function* of tort law to enforce a deontological theory of justice. As explained in the introduction to this chapter, I confine the discussion in this section on instrumentalist theory to objectives which extend beyond the particular relationship between injurer and injured.

<sup>190</sup> Williams, *ibid.* Williams was of the opinion that in serving so many masters tort law was a good servant to none.

<sup>191</sup> See Allen M. Linden, *Canadian Tort Law*, 7th ed. (Toronto: Butterworths, 2001) c. 1. See also, Klar, *supra* note 2 c. 1.

<sup>192</sup> See United States, Report to the American Bar Association by a Special Committee on the Tort Liability System, *Towards a Jurisprudence of Injury: the Continuing Creation of a System of Substantive Justice in American Tort Law* (Chicago: American Bar Association, 1984) at 3-18. For a discussion of this report, see Klar, *ibid.* at 17-18.

<sup>193</sup> I have not included the various policy considerations that arise in the context of duty of care analysis, such as the concern about indeterminate liability, because they are specific to negligence and are not general functions of tort law. Some of them are instrumentalist in nature, however. See sections 3.4 and 3.5.

<sup>194</sup> Solomon, Kostal & McInnes, *supra* note 117 at 500.

<sup>195</sup> See Linden, *supra* note 191 at 4-7.



conduct of the particular defendant, and as a general deterrent, deterring the public from engaging in the impugned conduct in the future. Its effectiveness in achieving this objective has limits, particularly in negligence where the conduct is not premeditated. For instance, the reactions of a motor vehicle driver just before an accident typically will not be influenced by the possibility of tort liability. It is in the area of "planned decision-making in business" that potential civil liability likely has its greatest impact.<sup>196</sup>

The other functions, appeasement (Linden calls this the psychological function<sup>197</sup>), education, acting as ombudsman and a grievance mechanism are among those less frequently or openly cited by the courts. As Linden puts it:

Not all the purposes of tort law are expressed openly in the case law. On the contrary, some of them are unrecognized or dimly perceived, or even vehemently denied. Some are achieved only indirectly and some not at all.<sup>198</sup>

None of the social objectives underlying tort law, however one catalogues them, has by itself provided a complete explanation of the various liability rules, and throughout different stages in the development of the law different functions have played more or less prominent roles.<sup>199</sup>

### **3.4 NEGLIGENCE AND DUTY OF CARE**

#### **3.4.1 Proximity and Policy – An Overview**

It is now generally accepted that there are five elements in the modern negligence cause of action: duty of care, breach of the standard of care, factual causation, proximate causation, and damages.<sup>200</sup> Subject to a few exceptions, the onus is on the plaintiff to prove these five elements. The first element determines the existence of an obligation to exercise care – it is the focus of this thesis. Breach of the standard of care is the most litigated of the elements – it

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<sup>196</sup> Solomon, Kostal & McInnes, *supra* note 117 at 498.

<sup>197</sup> See Linden, *supra* note 191 at 16-19. Related to this is retribution or vengeance, which some authors and judges say is not an objective of tort law. Others such as Linden acknowledge that though unexpressed tort law is used for vengeance.

<sup>198</sup> *Ibid.* at 2.

<sup>199</sup> Markesinis & Deakin, *supra* note 184 at 36.

<sup>200</sup> See Linden, *supra* note 191 at 102-03. Linden in fact lists a sixth "element": the absence of one of the defences. Because the onus of proof rests with the defendant to prove the defences, technically, their absence is not an element. If the defendant is silent on the defences, the plaintiff will succeed if he pleads and proves the five elements noted. It should also be pointed out that some authors and judges combine some of these elements in their analysis. It is not uncommon, for instance, for factual and proximate causation to be combined as a single element, "proximate cause": see Fleming, *supra* note 173, for example. Sometimes, the first and second

involves measuring the defendant's conduct against an objective standard of behaviour. To prove cause-in-fact, the plaintiff must show that the defendant's conduct brought about the loss. Proximate causation concerns the extent of the loss (the law only holds a defendant responsible in negligence if there is a reasonable connection between the impugned behaviour and the loss), and the final element requires proof of loss (negligence is not actionable *per se* – the plaintiff must suffer damages).

“Proximity” is a general concept relevant to the establishment of the first element, duty of care. In the law's evolution, it is a relatively recent addition to the panoply of rules, but the *idea* of proximity or “neighbourhood” has been around for a few hundred years. As Professor John Baker writes:

[T]he problem for the substantive law was to settle the cases in which the law imposed a duty to take care in the absence of an undertaking or custom. We have seen that the law sometimes imposed duties independently of any prior relationship between the parties. Yet duties of care cannot be imposed on everyone in every situation. At the beginning of the eighteenth century no one, it seems, could see any pattern emerging; the kinds of cases were ‘almost infinite, daily increasing, and continually receiving new forms’. By the middle of the century, however, a general answer had been formulated in an influential treatise, printed in 1768 from a manuscript supposedly written by Lord Bathurst (1714-94) in the 1750s, which became a standard practitioners’ manual in its subsequent editions by Buller and Onslow. The author suggested for the first time a principle which is now familiar to every English law student: ‘Every man ought to take reasonable care that he does not injure his neighbour; therefore, wherever a man receives hurt through the default of another, though the same were not wilful, yet if it be occasioned by negligence or folly the law gives him an action to recover damages for the injury so sustained... However, it is proper in such cases to prove that the injury was such as would probably follow from the act done.’<sup>201</sup> [footnotes omitted]

Lord Atkin, whose famous judgment in *Donoghue* outlined the concept of proximity, was aware of this search for a common thread in the categories of negligence. He had been thinking about how to formulate a unifying principle, and about the relationship between law, morality and Christian precepts. Some six weeks before the House of Lords decision in *Donoghue*, Lord Atkin gave a lecture at King's College in London in which he said:

It is quite true that law and morality do not cover identical fields. No doubt morality extends beyond the more limited range in which you can lay down the definite prohibitions of the law; but, apart from that, the British law has always necessarily ingrained in it moral teaching in this sense: that it lays down standards of honesty and plain dealing between man and man... He is not to injure his neighbour by acts of negligence; and that certainly covers a very large field of the law. I

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elements are combined, and even more rarely now, the last three elements are combined under the single compendious element, “damages”.

<sup>201</sup> From J.H. Baker, *An Introduction to English Legal History*, 4th ed. (London: Butterworths, 2002) at 414.

doubt whether the whole of the law of tort could not be comprised in the golden maxim to do unto your neighbour as you would that he should do unto you.<sup>202</sup>

In *Donoghue*, Lord Atkin set out his neighbour principle as follows:

[I]n English law there must be, and is, some general conception of relations giving rise to a duty of care, of which the particular cases found in the books are but instances. The liability for negligence, whether you style it such or treat it as in other systems as a species of "culpa," is no doubt based upon a general public sentiment of moral wrongdoing for which the offender must pay. But acts or omissions which any moral code would censure cannot in a practical world be treated so as to give a right to every person injured by them to demand relief. In this way rules of law arise which limit the range of complainants and the extent of their remedy. *The rule that you are to love your neighbour becomes in law, you must not injure your neighbour; and the lawyer's question, Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. 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 acts or omissions which are called in question.*<sup>203</sup> [emphasis added]

Proximity exists where the plaintiff is "closely and directly affected" by the defendant's acts or omissions. Proximity as Lord Atkin conceived it was not confined to physical closeness, and it was clear he intended it to encompass much more than just spatial connection.<sup>204</sup> However, the use of the proximity concept as a tool for recognizing new duties of care encountered difficulties initially. It was rejected as a controlling concept in *Hedley Byrne*, for instance. But in *Home Office Appellants v. Dorset Yacht Co. Ltd.*,<sup>205</sup> there was a breakthrough. The House of Lords had to determine the liability of a public authority for damage caused by some absconding "Borstal" boys under supervision of Borstal officers. Lord Reid, in the majority, referring to the neighbour principle, wrote:

[T]he well-known passage in Lord Atkin's speech should I think be regarded as a statement of principle. It is not to be treated as if it were a statutory definition. It will require qualification in new circumstances. But I think that the time has come when we can and should say that it ought to apply unless there is some justification or valid explanation for its exclusion.<sup>206</sup>

Finally, in *Anns*, the House of Lords set out a clearer framework of analysis. The decision involved the liability of a borough council for negligently passing the inspection of some

<sup>202</sup> This account is from Geoffrey Lewis, *Lord Atkin* (London: Butterworths, 1983) at 57-58 citing "Law as an Education Subject" (1932) *Journal of the Society of Public Teachers of Law* 30, and the video, *The Paisley Snail: Donoghue v. Stevenson* (Vancouver: Law Courts Education Society of British Columbia, 1996).

<sup>203</sup> See *Donoghue*, *supra* note 13 at 579-80.

<sup>204</sup> *Ibid.* at 581. See also W.V.H. Rogers, *Winfield and Jolowicz on Tort*, 15th ed. (London: Sweet & Maxwell, 1998) at 99.

<sup>205</sup> [1970] A.C. 1004, [1970] 2 All E.R. 294 [*Dorset Yacht* cited to A.C.]

<sup>206</sup> *Ibid.* at 1027.

residential dwellings. Lord Wilberforce, for the majority, outlined his well-known two-stage test for determining when a duty of care would arise:

Through the trilogy of cases in this House, *Donoghue v Stevenson*, *Hedley Byrne & Co Ltd v Heller & Partners Ltd* and *Home Office v Dorset Yacht Co Ltd*, the position has now been reached that in order to establish that a duty of care arises in a particular situation, it is not necessary to bring the facts of that situation within those of previous situations in which a duty of care has been held to exist. Rather the question has to be approached in two stages. First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter, in which case a *prima facie* duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise...<sup>207</sup>

It seems likely that Lord Wilberforce intended a simple test for proximity, or neighbourhood, based on the reasonable foreseeability of injury to the plaintiff. He made the assumption that proximity was established on the facts before him<sup>208</sup>, and spent most of his analysis considering the second question. The first question, then, appeared relatively straightforward, but the language left some room for interpretation. Would proximity invariably be established by satisfying the reasonable foreseeability test? The reference was to proximity “such that” injury would be reasonably foreseeable. Some courts interpreted this to mean that establishing proximity might require the consideration of other factors besides foreseeability.<sup>209</sup> From a purely analytical point of view, it did not seem to matter much whether other considerations were brought into the first stage, because the second stage was designed as a limiting mechanism to guard against aggressive expansion of negligence liability<sup>210</sup> – policy could certainly be considered at the second stage.<sup>211</sup>

<sup>207</sup> *Supra* note 22 at 751-52.

<sup>208</sup> *Ibid.* at 753-54.

<sup>209</sup> For example, in *Peabody Donation Fund v. Sir Lindsay Parkinson & Co.*, [1985] 1 A.C. 210, [1984] 3 All E.R. 529 (H.L.) [*Peabody* cited to A.C.], Lord Keith held at 241 that proximity depended on more than just foreseeability and that the plaintiff had to establish why it would be “just and reasonable” for the defendant to owe a duty of care.

<sup>210</sup> Besides setting out a general approach of negligence, including the power to limit liability at stage two, it must be remembered that *Anns* was a public authorities case. It also outlined a specific approach to stage two with respect to claims against public authorities. The Court was concerned about interfering with political discretion, and therefore held that liability would be limited where the complaint related to the exercise of statutory discretion or policy. The complainant had to show that the impugned conduct was “operational” in nature. This aspect of the decision is discussed in more detail in Chapter 4 in section 4.3.1.

<sup>211</sup> With respect to the burden of proof, the plaintiff clearly has the burden at the first stage to prove a *prima facie* duty of care. In *Anns*, Lord Wilberforce held that the plaintiff also had the burden at the second stage: see *supra* note 22 at 755 (i.e., with respect to the policy/operational distinction). However, as Professor Klar

The two-stage approach provided the courts with a powerful new tool in the recognition of new duties of care, and was not confined to municipal inspection cases. It was broad and flexible and could be applied to all sorts of situations: cases involving acts, omissions, words, private parties, public authorities, commercial or non-commercial disputes, physical loss or economic loss.<sup>212</sup> However, this power of expansion, even with the ability to control unruly growth at the second stage, did not sit well with the courts in every jurisdiction. While *Anns* continues to be followed in this country, it has been rejected in the United Kingdom and Australia.<sup>213</sup>

Whether *Anns* is followed or not, it is now clear that the duty issue is essentially one of policy.<sup>214</sup> However, in jurisdictions which still follow *Anns*, such as Canada, the question arises as to how policy relates to each stage. Since the two-stage approach in *Anns* was adopted in *Nielsen v. Kamloops (City)*,<sup>215</sup> the Supreme Court of Canada has consistently followed and refined it.<sup>216</sup> Until recently, Canadian courts analyzed policy primarily at stage two. Stage one dealt with whether a *prima facie* duty of care was owed based on a relationship of proximity. This turned on foreseeability of loss, usually sufficient by itself in physical loss cases, and, in economic loss cases, other policy-based tests such as reliance. In *Bow Valley*, McLachlin J., for the Court on this point, stated:

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points out, to the degree that policy is important at the second stage, the burden of "persuasion" is shifted to the defendant to show why the *prima facie* duty of care should not be recognized or at least be limited: Klar, *supra* note 2 at 143. While the legal burden may technically remain with the plaintiff at stage two, the nature of the debate requires the defendant to respond.

<sup>212</sup> Klar, *ibid.* at 142-43.

<sup>213</sup> See *Murphy v. Brentwood District Council*, [1991] 1 A.C. 398, [1990] 2 All E.R. 908 (H.L.) [*Murphy*] and *Sutherland Shire Council v. Heyman* (1985), 60 A.L.R. 1, 157 C.L.R. 424 (H.C.) [*Sutherland* cited to C.L.R.]. At least one writer in Australia, concerned about the lack of a cohesive framework for analyzing the duty question in that country, advocates a return to *Anns* following the Canadian approach: see Adrian Baron, "The 'Mystery' of Negligence and Economic Loss: When is a Duty of Care Owed?" (2000) 19 Austl. Bar Rev. 167 at 191-98.

<sup>214</sup> See Linden, *supra* note 191 at 271, where he states, "It has now been officially recognized that [the creation of new duties] is a question of public policy which the courts in each jurisdiction will have to decide for themselves in the novel circumstances of the cases that come before them." The word "policy" in this context requires some explanation. It is most often used by itself, but not uncommonly it appears with descriptors such as "public", "social" or "underlying". Occasionally other words and phrases are used including, "theoretical basis", "rationale", "value", and "social purpose". I make no distinction between these various formulations.

<sup>215</sup> [1984] 2 S.C.R. 2, 10 D.L.R. (4th) 641.

<sup>216</sup> In Canada and New Zealand, it provides a general framework of analysis for *all* duties of care in negligence. Some commentators believe it is a Procrustean bed, a straightjacket and Ralph Waldo Emerson's "foolish consistency", all wrapped up in one. At the same time, it must be acknowledged that it brings a formal coherence to a difficult area of the law, while at the same time allowing a controlled measure of flexibility.

[T]he existence of a relationship of "neighbourhood" or "proximity" distinguishes those circumstances in which the defendant owes a *prima facie* duty of care to the plaintiff from those where no such duty exists. The term "proximity" is a label expressing the fact of a relationship of neighbourhood sufficient to attract a *prima facie* legal duty. Whether the duty arises depends on the nature of the case and its facts. *Policy concerns are best dealt with under the second branch of the test.* Criteria that in other cases have been used to define the legal test for the duty of care can now be recognized as policy-based ways by which to curtail indeterminate or inappropriate recovery.<sup>217</sup> [emphasis added]

However, in the recent cases of *Cooper v. Hobar*<sup>218</sup> and *Edwards v. Law Society of Upper Canada*,<sup>219</sup> the Supreme Court of Canada has indicated that broad considerations of policy based on justice and fairness ought to be considered as part of the stage one determination of proximity and the *prima facie* duty of care. In *Edwards*, McLachlin C.J.C. and Major J., writing for the Court, said:

9 At the first stage of the *Anns* test, the question is whether the circumstances disclose reasonably foreseeable harm and proximity sufficient to establish a *prima facie* duty of care. The focus at this stage is on factors arising from the relationship between the plaintiff and the defendant, including broad considerations of policy. The starting point for this analysis is to determine whether there are analogous categories of cases in which proximity has previously been recognized. If no such cases exist, the question then becomes whether a new duty of care should be recognized in the circumstances. Mere foreseeability is not enough to establish a *prima facie* duty of care. The plaintiff must also show proximity – that the defendant was in a close and direct relationship to him or her such that it is just to impose a duty of care in the circumstances.<sup>220</sup>

And in *Cooper*, McLachlin C.J.C. and Major J., again writing for the Court, stated:

34 Defining the relationship may involve looking at expectations, representations, reliance, and the property or other interests involved. Essentially, these are factors that allow us to evaluate the closeness of the relationship between the plaintiff and the defendant and to determine whether it is just and fair having regard to that relationship to impose a duty of care in law upon the defendant.<sup>221</sup>

In practical terms, this greater emphasis on policy at stage one means the plaintiff will likely have a more onerous burden establishing the *prima facie* duty of care outside the established categories. Whether or not this new approach will affect the existing categories of economic negligence in future will depend on whether the Court attaches separate and additional meaning to the "just and fair" requirement over and above the policy-based tests like reliance that already exist.

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<sup>217</sup> *Supra* note 183 at 1244.

<sup>218</sup> [2001] 3 S.C.R. 537, 206 D.L.R. (4th) 193, 2001 SCC 79 [*Cooper*].

<sup>219</sup> [2001] 3 S.C.R. 562, 206 D.L.R. (4th) 211, 2001 SCC 80 [*Edwards*].

<sup>220</sup> *Ibid.* at para. 9.

<sup>221</sup> *Supra* note 218 at para. 34.

In *Cooper* and *Edwards*, the Court held that the second stage of *Anns* involves the consideration of residual policy matters. In *Cooper*, they put it this way:

37 This brings us to the second stage of the *Anns* test...[R]esidual policy considerations fall to be considered here. These are not concerned with the relationship between the parties, but with the effect of recognizing a duty of care on other legal obligations, the legal system and society more generally. Does the law already provide a remedy? Would recognition of the duty of care create the spectre of unlimited liability to an unlimited class? Are there other reasons of broad policy that suggest that the duty of care should not be recognized?...<sup>222</sup>

The Court went on to provide examples of residual policy matters that would arise at stage two, including the economic arguments described in *Norske* and the indeterminacy concern and related factors discussed in *Hercules*.<sup>223</sup> Apart from these types of examples, the second stage of *Anns* will generally be confined to cases where the duty asserted is a new category of negligence.<sup>224</sup>

It is clear that foreseeability is not enough to establish a *prima facie* duty of care.<sup>225</sup> Proximity must also be proven.<sup>226</sup> In *Cooper* and *Edwards*, the Supreme Court of Canada held that proximity characterized the “type” of relationship where a duty of care might arise. The starting point when considering whether a new duty should be recognized is whether it is analogous to an existing category. The reason cited for this was certainty. Beyond that, diverse factors would help the court determine whether the plaintiff was “closely and directly affected” by the defendant’s conduct and whether it was “just and fair” to impose a duty on the defendant. These factors would depend on the circumstances of the case and the Court

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<sup>222</sup> *Ibid.* at para. 37.

<sup>223</sup> *Ibid.* at paras. 37-38.

<sup>224</sup> *Ibid.* at para. 39.

<sup>225</sup> Reasonable foreseeability by itself is considered too encompassing. As one Australian judge remarked, tongue-in-cheek, “If foreseeability of injury were the exhaustive criterion of a duty to act to prevent injury occurring, the “neighbour” of the law would include not only the Biblical Samaritan but also the Priest and Levite who passed by the injured man.” See Brennan J. in *Sutherland*, *supra* note 213 at 478 (H.C.). Both injury and object, the injured, must be foreseeable. However, there are surprisingly few cases where the foreseeability of “unexpected” plaintiffs has been considered. See, for example, the famous American decision of *Palsgraf v. Long Island Railroad Co.*, 284 N.Y. 339 (C.A. 1928), decided a few years before *Donoghue*, and the English decision, *Haley v. London Electricity Board* (1964), [1965] A.C. 778, [1964] 3 All E.R. 185 (H.L.). See also Linden, *supra* note 191 at 274-76 and Margaret Brazier & John Murphy, *Street on Torts*, 10th ed. (London: Butterworths, 1999) at 180-81. The two types of foreseeability are usually combined in one test: “reasonable foreseeability of injury to the plaintiff”.

<sup>226</sup> In Canada, whether foreseeability is now theoretically distinct from proximity or is an aspect of it is not entirely clear. The language in *Cooper* (*supra* note 218 at paras. 30-31) supports both views. Following either interpretation, what the Court is saying is that proximity is a much broader concept than just foreseeability.

was not prepared to comprehensively catalogue them.<sup>227</sup> The emphasis on existing categories signals a return to an earlier time when the courts were more hesitant to recognize new duties. With *Cooper* and *Edwards*, the general approach to the recognition of new duties of care in Canada bears some semblance of the English approach since *Murphy*,<sup>228</sup> in that there is a new emphasis on restraint.<sup>229</sup> And even if a *prima facie* duty of care is established, second stage considerations may operate to limit the duty.

Perhaps unwittingly, the Supreme Court of Canada has brought the two main approaches which dominate general tort law theory into the *Anns* framework of analysis in negligence, each being given its own stage. By focusing on “justice and fairness” at the first stage, the Court may have had in mind a deontological conception of duty and proximity. However, it is not entirely clear how confined the investigation is expected to be at this stage. The Supreme Court of Canada does refer to “broad considerations of policy”, and possibly anticipates the power to consider implications in recognizing a duty not just for the parties themselves, but also for similarly situated parties in the type of relationship involved. And depending on the size of the classes to which the parties belong, the decision on duty could have far-reaching social consequences. However, the more the emphasis is on broader implications the less the

<sup>227</sup> *Ibid.* paras. 31-35 and *Edwards*, *supra* note 219 at paras. 8-10.

<sup>228</sup> *Supra* note 213.

<sup>229</sup> However, the exact position in the United Kingdom is difficult to discern. In the words of one English writer, “[t]he concept of duty has in recent years shown signs of becoming an arcane mystery”. See W.V.H. Rogers, *Winfield and Jolowicz on Tort*, 15th ed. (London: Sweet & Maxwell, 1998) at 91. Since *Anns* was abolished, three possibly four steps make up the duty inquiry (96-108). Besides foreseeability and the still hard-to-define idea of proximity, the courts must address the “fair, just and reasonable” test. Some courts now even recognize a fourth stage of analysis under the heading of “public policy”, although as Rogers mentions, it is hard to see what separates “fair, just and reasonable” from “public policy” – the weight of authority does not make this distinction (107-08). Since Rogers’ text was published a possible fifth, and as yet unnamed, step has emerged based on some kind of inherent concept of liability. In *MacFarlane*, *supra* note 119, a “wrongful birth” case, Lord Steyn reached his decision whether or not to recognize a duty of care by balancing the demands of corrective justice against those of distributive justice. He did not rely on foreseeability or proximity. He also expressly found that he was not basing his decision on the “quicksands” public policy (*MacFarlane*, at 83 – another judge, Lord Clyde, referred to the likeness of public policy to an “unruly horse”, at 99), and only reluctantly allowed that the “fair, just and reasonable” test was relevant, suggesting he had some other level of inquiry in mind. This other conception of liability is apparently relevant to the *Hedley Byrne* liability as well. The *MacFarlane* case was actually argued on the basis of *Hedley Byrne* and voluntary assumption of responsibility. However, Lord Steyn held that it did not matter whether the argument was based on traditional negligence principles or assumption of responsibility; either way his reasoning would be the same. This is unnecessarily “arcane”. Following the Canadian approach, corrective justice concerns could be dealt with under the first stage of *Anns*, and distributional concerns involving society generally, under stage two. And it is all policy. See Rawlins J. in *Y. (M.) v. Boutros* (2002), 313 A.R. 1, [2002] 6 W.W.R. 463, 2002 ABQB 362 at para. 148 [*Boutros*], who made the point that the decision in *MacFarlane* could be seen as rooted in public policy. *MacFarlane* is discussed in more detail below at 3.4.3.



focus is on “proximity” in the particular relationship. In *Cooper*, the examples the Court gave of second stage policies, such as concerns about indeterminate liability and economic efficiency, extend beyond the specific relationship involved.<sup>230</sup> One might assume therefore that the Supreme Court of Canada intends the investigation at stage one to be specific to the relationship between the parties involved despite the reference to “broad” policy considerations. If this assumption is correct, one analytical “flaw” in *Cooper* and *Edwards* is the reference to certainty and the categories approach in relation to proximity. Analogizing to existing relationships *for reasons of certainty* should not influence the decision whether or not a relationship of proximity exists in a particular case – this type of analysis belongs at stage two. Further clarification is needed on this point and the stage one analysis generally. Despite the ambiguity as to the scope of the inquiry at stage one, at the second stage the focus clearly shifts to general instrumentalist considerations, that is, to “the effect of recognizing a duty of care on other legal obligations, the legal system and society more generally”.<sup>231</sup>

As Professor Hepple has observed, negligence law today is engaged in a “search for coherence”.<sup>232</sup> It embodies two conflicting philosophies, one based on “individual responsibility” and the obligation a person at fault has to repair damage she causes (essentially corrective justice), and the other based on “social responsibility” which requires the spreading of losses so as to maximize social welfare (a form of distributive justice). I would add to this conception of social responsibility the need to consider other instrumentalist goals such as deterrence and certainty in the law. The search for coherence therefore involves finding the point of balance between individual responsibility and instrumentalist concerns, which sometimes support but more often weigh against a finding of liability.

In the following subsections of this section, I look at how these ideas inform the duty question in Canada. I look first at proximity and “justice and fairness”, which the courts now consider to be the key elements in the recognition of a *prima facie* duty of care. Next, I consider the instrumentalist policies, which are more clearly *Anns* stage two considerations. I have

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<sup>230</sup> Although, as described below in section 3.4.5.2, indeterminate liability has a dual aspect – it is specific to the relationship *and* concerned with implications beyond the parties.

<sup>231</sup> See *Cooper*, para. 37 (*supra* note 222 and accompanying quote).

<sup>232</sup> See Bob Hepple, “The Search for Coherence” (1997) 50 Curr. Legal Probs. 69. Hepple distinguishes between formal coherence, meaning the internal consistency of rules, and functional coherence, meaning consistency of purpose. He believes both are lacking in negligence law.

separated these instrumentalist policies into two groups, those which support the recognition of a duty of care, and those which do not, i.e., counter policies. The counter policies are further divided into those relating to general negligence and those specific to economic negligence.

One final point should be noted. Policy questions can also arise when considering other elements of the negligence cause of action, such as when determining the appropriate standard of care.<sup>233</sup> However, as Linden points out, broader policy considerations generally influence the duty question in that it is concerned with the "extension or the limits of the law of negligence".<sup>234</sup> Policies which relate to elements other than duty are not discussed here.

### 3.4.2 Closeness, Directness, Justice and Fairness

The linkage between Lord Atkin's "closely and directly affected" test of proximity and "justice and fairness"<sup>235</sup> creates some interpretive problems. Justice and fairness is a vague test,<sup>236</sup> arguably even more so than Lord Atkin's test.<sup>237</sup> Does it expand the conception of duty, limit

<sup>233</sup> See *Ryan v. Victoria (City)*, [1999] 1 S.C.R. 201 at 221, 168 D.L.R. (4th) 513, per Major J.

<sup>234</sup> Linden, *supra* note 191 at 274, quoting J.C. Smith in "Clarification of Duty-Remoteness Problems Through a New Physiology of Negligence: Economic Loss, At Test Case" (1974) U.B.C.L. Rev. 213 at 220.

<sup>235</sup> In *Cooper*, para. 34 (see *supra* note 221 and accompanying quote), and *Edwards*, para. 9 (see *supra* note 220 and accompanying quote), the Supreme Court of Canada referred to need to establish a close and direct relationship such that it is just and fair to impose a duty. Justice and fairness is therefore required in addition to closeness and directness (basic proximity) to establish a *prima facie* duty of care.

<sup>236</sup> There are variations of this phrase, such as "justice, fairness and reasonableness", and the adjectival equivalents, "just and fair" and "just, fair and reasonable". The English courts seem to prefer "fair" before "just", referring to "fair, just and reasonable", etc: see for example, *McFarlane*, *supra* note 119. No particular distinction is made between these expressions. Nor is any made between the individual words. Referring to the "fair, just and reasonable" formulation, the author of *Winfield and Jolowicz on Tort*, *supra* note 229 at 101, notes that the words are not subjected to a "minute disjunctive analysis", and that [a]ll three words convey the same idea of 'judicial policy' in slightly different ways." These expressions have been used in connection with the duty analysis in England since the 1980s (see *Peabody*, *supra* note 209), but their connection to duty and proximity specifically in Canada is more recent (see *Cooper* and *Edwards*, *supra* notes 218 and 219). In *Hercules*, *supra* note 6 at 190-91, the Court used the phrase "simple justice" in connection with proximity, and "basic fairness" in connection with policies extrinsic to the specific relationship which serve to limit liability (under the second stage of *Anns*). Presumably, in light of *Cooper* and *Edwards*, this distinction in terminology from *Hercules* will no longer be followed.

<sup>237</sup> Lord Atkin's test also suffers from ambiguity. For instance, the meaning of being "directly" affected is not clear. The directness test has been applied in various contexts, causation, remoteness and here in duty, and has proven difficult in all of them. As a test for causation, it applies more often in claims based on the intentional torts, which were derived from the old Trespass writ. In negligence, the "but for" and "material contribution" tests are main ones today: see *Athey v. Leonati*, [1996] 3 S.C.R. 458, 140 D.L.R. (4th) 235. In Commonwealth jurisdictions, the directness test for remoteness as applied in *Polemis and Furness, Withy & Co Ltd, Re*, [1921] 3 K.B. 560, 8 Ll. L. Rep. 351 (C.A.) [*Re Polemis*], has been replaced by tests based on reasonable foreseeability: see *Overseas Tankship (U.K.) Ltd. v. Morts Dock & Engineering Co., The Wagon Mound (No. 1)*, [1961] A.C. 388, [1961] 1 All E.R. 404 and *Overseas Tankship (U.K.) Ltd. v. Miller Steamship Co. Pty. Ltd., The Wagon Mound (No. 2)*, [1967] 1 A.C. 617, [1966] 2 All E.R. 709. Lord Atkin was obviously not intending to confine his proximity principle to

it, or do both depending on the circumstances? In England, where the test originated, it is sometimes considered independent of the proximity determination and is used to limit duty of care.<sup>238</sup> Because *Anns* is not followed there, all manner of policies are considered under its banner.<sup>239</sup> In Canada, as a result of *Cooper* and *Edwards*, justice and fairness is clearly part of the proximity determination. As noted in section 3.4.1, there is some ambiguity as to how expansive the investigation is to be at stage one of *Anns*, but the assumption is that the Canadian courts will confine it to the relationship between the specific parties. The broad policy considerations at this stage, I would argue, should be confined to those which relate to the intrinsic nature of individual responsibility, duty or obligation without reference to instrumentalist concerns. The question to ask is whether, as a society, we want one person to be another's keeper in the particular context considering the nature of the activity and the loss. Considerations which reach beyond the parties, although such considerations may be labelled justice or fairness issues, more clearly relate to the second stage of *Anns*. They are discussed below under the headings of supporting and counter policies.

Negligence liability, which is based on proximity, and corrective justice are both founded on relationship, causation and fault.<sup>240</sup> The question at this stage of the analysis is what defines the relationship? A large part of it relates to the nature of the loss. Lord Atkin was primarily concerned with conduct that could lead to physical loss. Engage in conduct that could injure others and you will be in a relationship with them. We now know that mere foreseeability is not enough, and that closeness, directness, justice and fairness are also required. In most cases involving foreseeable physical loss, the circumstances will be such that the additional requirements are also satisfied. As Lord Oliver said in *Murphy*, "The infliction of physical injury to the person or property of another universally requires to be justified."<sup>241</sup> Cases involving pure economic loss are more troubling. The literal meaning of the words "closely and directly affected" can certainly be applied to cases of financial loss, e.g., where a financial

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direct injury in the confined sense of the intentional torts or the *Re Polemis*' causation test. In fact, there is a certain *indirectness* about a manufacturer's relationship to ultimate users (including non-paying ones as in *Donoghue*) – it is the consumer's *own* act of using the product which most immediately causes the injury.

<sup>238</sup> See *Winfield and Jolowicz on Tort*, *supra* note 229.

<sup>239</sup> In England, the "fair, just and reasonable" determination in part serves the same function that the second stage of *Anns* used to.

<sup>240</sup> As discussed in section 3.2, there are competing views as to what amounts to corrective justice – this is one of prevalent views.

<sup>241</sup> *Supra* note 213 at 487.

manager loses all his client's money on bad investments. However, since *Murphy*, the predilection in the United Kingdom has been to deny financial loss claims on the grounds of justice and fairness. This is likely in accordance with Lord Atkin's conception of moral responsibility. Where such claims have been allowed it has generally been on the basis of voluntary assumption of responsibility and the *Hedley Byrne* principle.

In Canada, there has been greater willingness to impose *prima facie* duties of care in financial loss cases, i.e., to accept that closeness, directness, justice and fairness will support a relationship in such circumstances. In *Cooper* the Court held that factors relevant to whether or not a relationship of proximity exists include the "expectations, representations, reliance and the property or other interests" of the parties.<sup>242</sup> These are factors which will frequently be present in economic negligence cases.

One factor that is likely not relevant to proximity is the relative wealth of the parties. In *Jacobi v. Griffiths*,<sup>243</sup> the Supreme Court of Canada had to decide whether a non-profit employer was vicariously liable for an employee's sexual assaults. Binnie J., for the majority, held that in the circumstances of that case the employer was not liable. Binnie J. remarked that "[t]he attribution of vicarious liability is not so much a 'deduction from legalistic premises' as it is a matter of policy", and that "[m]uch as the Court may wish to take advantage of the deeper pockets of the respondent to see the appellants compensated, we have no jurisdiction *ex aequo et bono* to practise distributive justice."<sup>244</sup> A similar conclusion would probably be reached in the context of a proximity determination.

"Justice and fairness" appears to be both a limiting and an expanding concept, depending on the circumstances. The proximity concept was originally based on the rather wide notion of foreseeability. The "closely and directly affected" part of the test was later separated from foreseeability to limit the scope of proximity. In Canada, the practical effect of the recent addition of "justice and fairness" to the mix is still unknown. We know that, so far, negligence liability has expanded well beyond its former limits.<sup>245</sup> But we also know that the Supreme Court of Canada has indicated that restraint is now in order, and that incremental change

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<sup>242</sup> *Cooper*, para. 34 (see *supra* note 221 and accompanying quote).

<sup>243</sup> [1999] 2 S.C.R. 570, 174 D.L.R. (4th) 71 [*Jacobi*].

<sup>244</sup> *Ibid.* at para. 29.

based on analogous categories is the starting place in deciding whether or not to recognize a new duty.

### 3.4.3 Policies Supporting the Imposition of a Duty of Care

Certain policies which are extrinsic to the specific relationship of the parties can, in certain circumstances, support the imposition of a duty of care. They include broad conceptions of distributive justice, and non-normative objectives such as deterrence.

As mentioned in section 3.4.2, the limited relationship-specific form of distributive justice which looks to the relative wealth of the parties was rejected in *Jacobi* as a relevant consideration in determining vicarious liability. Broader conceptions of distributive justice which extend beyond the individual parties are more commonly argued. They are usually based on the deep pockets of defendants as a class (and their ability to spread liability costs) or society generally.<sup>246</sup> The Rawlsian theory of distributive justice based on equality of entitlements has not been accepted as a relevant objective in the duty debate.

Recently, in *McFarlane*,<sup>247</sup> the House of Lords had to consider whether the parents of a healthy but unwanted child had a wrongful birth claim against a health board. The husband had had a vasectomy and was advised by the surgeon afterwards that the husband had been rendered infertile when in fact he had not. Relying on this advice, the couple ceased taking contraceptive precautions and the wife became pregnant. Part of their claim was for the cost of bringing up the child. Lord Steyn, in the majority, stated that:

It is possible to view the case simply from the perspective of corrective justice. It requires somebody who has harmed another without justification to indemnify the other. On this approach the parents' claim for the cost of bringing up [their child] must succeed. But one may also approach

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<sup>245</sup> For example, applying the proximity concept to negligent misrepresentation liability (as in *Hercules*).

<sup>246</sup> In a bold British Columbia decision of short-lived influence, *Inland Feeders Ltd. v. Viridi*, [1980] 5 W.W.R. 346, 12 C.C.L.T. 177 (B.C.S.C.), the Supreme Court allowed a claim by a developer against a municipality for its misinterpretation of a by-law based in part on distributional concerns. The developer relied on the municipality's assurances and suffered economic loss. It should be noted that this was not duty of care case. There was no negligence. Neither was it a case of unjust enrichment or estoppel. The Court allowed the plaintiff's claim for damages based on "innocent" misrepresentation citing, among other reasons, the need to be able to rely on assurances by municipal governments, and that it was preferable that this type of loss be borne by the community as a whole. For a comment on this case, see John Irvine, *Inland Feeders Ltd. v. Viridi*: Annotation (1980), 12 C.C.L.T. 179. On appeal, however, the decision was overturned. The Court of Appeal refused to recognize a new cause of action and was not persuaded by the underlying social reasons of the trial judge: see *Viridi v. Inland Feeders Ltd.* (1981), [1982] 1 W.W.R. 551, 18 C.C.L.T. 292 (C.A.).

<sup>247</sup> *Supra* note 119. See also discussion, *supra* note 229.

the case from the vantage point of distributive justice. It requires a focus on the just distribution of burdens and losses among members of a society.<sup>248</sup>

And later:

The truth is that tort law is a mosaic in which the principles of corrective justice and distributive justice are interwoven. And in situations of uncertainty and difficulty a choice sometimes has to be made between the two approaches.<sup>249</sup>

In the end, however, Lord Steyn concluded that on the facts of this case the principles of distributive justice, and the “fair, just and reasonable” requirement (if it were necessary to decide this point), did not allow the claim. One of the problems with this kind of deep pockets analysis is how do you determine whose deep pockets and when. In *MacFarlane*, Lord Steyn said the answer could be reached by asking commuters or travellers on the Underground.<sup>250</sup> He believed they would resoundingly say no to the question whether or not, in these circumstances, the costs of bringing up a healthy but unwanted child should be born by the medical community as opposed to the parents.

Some Canadian decisions have, since *MacFarlane*, echoed Lord Steyn’s view that distributive justice is a relevant concern in determining the existence of duty, but have similarly found on the facts that no duty was owed.<sup>251</sup> As one author has concluded, distributive justice plays a supplementary role only, and that “[c]ourts do not use the law of tort to correct distributive imbalances, though they may sometimes appeal to considerations of distributive justice to fortify conclusions reached by other routes.”<sup>252</sup>

As described above, tort law serves a number of general functions.<sup>253</sup> The same observations with respect to compensation, deterrence, appeasement, etc. apply generally in the context of the duty analysis. Of these functions, deterrence is a frequently cited justification for imposing a duty. In *Stewart v. Pettie*, a case involving the liability of a commercial host for alcohol-related injuries, Major J. for the Court described the role of deterrence in negligence:

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<sup>248</sup> *Ibid.* at 82.

<sup>249</sup> *Ibid.* at 83.

<sup>250</sup> *Ibid.* at 82. These people are apparently the new representatives of the reasonable person, replacing the “man on the Clapham Omnibus”. Here, however, they are employed to determine the duty question not just the standard of care.

<sup>251</sup> See *Boutros*, *supra* note 229, and *Mummary v. Olsson*, [2001] O.J. No. 226 (Ont. Sup. Ct.), online: QL (OJ). These cases also involved “wrongful birth” claims.

<sup>252</sup> See *Lloyd’s Introduction to Jurisprudence*, *supra* note 27 at 564.

<sup>253</sup> See above 3.3.3.

One of the primary purposes of negligence law is to enforce reasonable standards of conduct so as to prevent the creation of reasonably foreseeable risks. In this way, tort law serves as a disincentive to risk-creating behaviour.<sup>254</sup>

The same point was made in *Winnipeg Condominium Corp. No. 36 v. Bird Construction Co.*, an economic loss case, by La Forest J. delivering the unanimous judgment:

Allowing recovery against contractors in tort for the cost of repair of dangerous defects thus serves an important preventative function by encouraging socially responsible behaviour.<sup>255</sup>

Professor Weinrib argued that the policy analysis at stage two of *Anns* refers only to policy considerations that negative liability, but Mr. Justice Major of the Supreme Court of Canada has countered in a recent paper that this is too narrow a view, considering the relevance of deterrence as a policy that supports the imposition of duty.<sup>256</sup>

Connected to the role of deterrence is the need to afford some measure of protection to members of society. As Lord Pearce said in *Hedley Byrne*:

How wide the sphere of the duty of care in negligence is to be laid depends ultimately upon the courts' assessment of the demands of society for protection from the carelessness of others.<sup>257</sup>

As with distributive justice, however, deterrence and other general functions tend to play a secondary role, helping to justify a conclusion already reached on the proximity issue.

### 3.4.4 Counter Policies and General Negligence

Professor Weinrib may have exaggerated when he suggested that all stage two policies were negative ones, but he was not far off. Most of them are. The counter policies referred to next relate primarily to ordinary negligence claims,<sup>258</sup> although some of them, such as individualism and floodgates, apply to all forms of negligence including pure economic loss claims.<sup>259</sup> To the extent that these policies influence the courts, they prevent the expansion of duties into new

<sup>254</sup> [1995] 1 S.C.R. 131 at 150, 121 D.L.R. (4th) 222.

<sup>255</sup> [1995] 1 S.C.R. 85 at 118, 121 D.L.R. (4th) 193 [*Winnipeg Condominium* cited to S.C.R.].

<sup>256</sup> See Ernest J. Weinrib, "Does Tort Law Have a Future?" (2000) 34 Val. U.L. Rev. 561 at 567, and Justice John C. Major, "Negligence" in *Torts - 2001* (Vancouver: The Continuing Legal Education Society of British Columbia, 2001) c. 1 at 1.1.10. Justice Major cited *Hercules*, where the Supreme Court of Canada reiterated the importance of the deterrent function of tort law. See *infra* note 354 and accompanying quote.

<sup>257</sup> *Supra* note 3 at 536.

<sup>258</sup> I use the term "general" or "ordinary" negligence to mean negligence claims involving personal injury or property damage.

<sup>259</sup> To be more precise, the policies catalogued here are those which are not specific to economic negligence claims.

areas. When Lord Atkin's penned his "neighbour principle", he recognized that in a "practical world" the legal recognition of moral responsibility would have to have limits.<sup>260</sup> He apparently believed that his idea of proximity incorporated the necessary limits. Since *Donoghue*, however, the courts have made it clear policies extrinsic to the relationship need to be accounted for.

As a preliminary point, one potential counter policy should be briefly mentioned for its *lack* of influence in the field of general negligence: distributive justice.<sup>261</sup> The courts have not shown much interest in denying claims involving personal injury or property damage based on distributive concerns. Part of the problem is that the courts lack the power to implement the necessary changes to complement the restriction of liability of particular defendants, i.e., the power to require compensation from another source. No-fault motor vehicle insurance and workers' compensation schemes rely on legislated initiatives and coverage based on mandatory insurance or more general tax-funded sources. And on a theoretical level, negligence liability and other forms of tort liability which concern physical loss are rooted in causation by human agency. Most advocates of distributive justice propose compensation for certain forms of physical loss regardless of how it is caused, i.e., whether through human agency or otherwise.<sup>262</sup>

#### **3.4.4.1 Individualism**

Individualism in this context means self-reliance and self-sufficiency. Given that social and commercial interaction requires some degree of interdependence, any policy which promotes self-sufficiency will involve difficult decisions. The debate comes to this: Where do we and where should we draw the line between relying on others and relying on ourselves? A decision which refuses to recognize a duty on the basis of this policy is inspired by a belief that encouraging individuals to be independent will make them and therefore society stronger. Individualism is a counterweight to individual responsibility (in the sense of being responsibility for the consequences of one's actions).

The law of negligence has always reflected a policy of self-reliance, particularly in relation to certain kinds of claims. For instance, in cases where the court is asked to impose a duty to act,

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<sup>260</sup> *Donoghue*, *supra* note 13 at 580 (see *supra* note 203 and accompanying quote).

<sup>261</sup> As noted below (section 3.4.5.1), it has more weight in the context of economic negligence, and as described above (section 3.4.3), it is sometimes put forward as a supporting policy.



that is, to impose liability for an omission or nonfeasance, there has historically been and still is resistance. The policies supporting the nonfeasance rule include "rugged individualism, self-sufficiency, and the independence of human kind".<sup>263</sup> Accepting that dependence is desirable or necessary in certain situations, a number of exceptions to the nonfeasance rule have been recognized, usually where a prior relationship exists between the parties (e.g., duties to rescue, and duties on commercial and social hosts to control impaired guests in some circumstances).

On a more general level, it has been argued that the expansion of tort obligations in recent times has encouraged a belief by some that if a person is injured it must be the responsibility of someone else.<sup>264</sup> This is a belief the courts are now starting to actively counter. The loss lies where it falls unless there is a good reason to make someone else pay. In *Stovin v. Wise*, Lord Hoffman said:

The trend of authorities has been to discourage the assumption that anyone who suffers loss is *prima facie* entitled to compensation from a person (preferably insured or a public authority) whose act or omission can be said to have caused it. The default position is that he is not.<sup>265</sup>

Individualism, as a counter policy, is most relevant where there are opportunities for self-protection. In commercial settings particularly, there will be such opportunities and therefore the individualism argument will have more weight. Recently, the Supreme Court of Canada refused to recognize a duty to exercise care in conducting commercial negotiations, citing a number of counter policies to justify its conclusion, including the self-sufficiency argument. The Court stated that "[t]he retention of self-vigilance is a necessary ingredient of commerce".<sup>266</sup> Opportunities for self-protection may exist in non-commercial contexts as well, and when they do there is no reason why courts should not consider them. However, in many personal injury cases (e.g., medical malpractice and products liability), there will be fewer such opportunities and this policy will be less of a factor.

While we may work and play in an increasingly interdependent world, there seems to be a renewed belief that the courts should not be promoting a society of dependence, of reliance on others. The starting point is that we must take care of ourselves if possible. Individualism,

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<sup>262</sup> See *Lloyd's Introduction to Jurisprudence*, *supra* note 27 at 564.

<sup>263</sup> *Linden*, *supra* note 191 at 282.

<sup>264</sup> *Street on Torts*, *supra* note 225 at 176.

<sup>265</sup> [1996] A.C. 923 at 949, [1996] 3 All E.R. 801.

<sup>266</sup> See *Martel*, *infra* note 276 at para. 69.

Benthamite liberalism, and *laissez-faire* ideology had their heyday in the nineteenth century, but the ideas which inspired them are not dead and may even be enjoying somewhat of a renaissance.

#### 3.4.4.2 *Change is Bad*

Judicial activism in “creating” new laws has ebbed and flowed over the years. But there have always been arguments against change, whether based on the pretence that judges do not have the power to “make” law and must defer to legislators to implement change, or for other reasons.

Maintaining the *status quo* for its own sake, however, has never been one of the more popular justifications for restraint. In *Donoghue*, Lord Buckmaster, in dissent, made this argument against a products liability principle:

If such a duty exists, it seems to me it must cover the construction of every article, and I cannot see any reason why it should not apply to the construction of a house. If one step, why not fifty? Yet if a house be, as it sometimes is, negligently built, and in consequence of that negligence the ceiling falls and injures the occupier or any one else, no action against the builder exists according to the English law, although I believe such a right did exist according to the laws of Babylon. Were such a principle known and recognized...much of the discussion of the earlier cases would have been waste of time, and the distinction as to articles dangerous in themselves or known to be dangerous to the vendor would be meaningless.<sup>267</sup>

Admittedly, part of his concern was with floodgates (and perhaps going the way of the Babylonians). But his objection that the “earlier cases would have been a waste of time”, if the law were changed, is not one that finds much support if it is the *only* argument against change, especially when there is an otherwise a good reason for expansion.

More recently, in *Junior Books Ltd. v. Veitchi Co.*, in response to the argument that pure economic loss claims for negligent construction should not be allowed, Lord Keith stated:

But in the present case the only suggested reason for limiting the damage (*ex hypothesi* economic or financial only) recoverable for the breach of the duty of care just enunciated is that hitherto the law has not allowed such recovery and therefore ought not in the future to do so. My Lords, with all respect to those who find this a sufficient answer, I do not. I think this is the next logical step forward in the development of this branch of the law.<sup>268</sup>

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<sup>267</sup> *Donoghue*, *supra* note 13 at 577-78.

<sup>268</sup> [1983] 1 A.C. 520 at 546, [1982] 3 All E.R. 201 (H.L.) [*Junior Books* cited to A.C.].

Since *Junior Books*, other objections have been made to expansion in the area of economic negligence, as noted below, but at the time, keeping the *status quo*, as a reason by itself, was not persuasive.

#### **3.4.4.3 Avoidance of Political Interference**

Concern about overstepping judicial authority and entering the political arena operates as a limiting force. It is a legitimate reason for judicial reluctance to “make” law. Judges are not properly situated to make political decisions.

Claims against public authorities, whether based on general or economic negligence, highlight this concern. There is a general policy supporting immunity based on a “pillars of government” idea, i.e., that the courts should not question political decisions. In England, where *Anns* has been rejected, claims against public authorities are effectively barred, unless they can be made to fit under the *Hedley Byrne* principle which requires a finding of voluntary assumption of responsibility. In jurisdictions which follow *Anns*, such as Canada and New Zealand, the same policy exists although it is less rigidly applied. The test from *Anns* requires the court to make a distinction between true policy decisions, which are not reviewable, and the operational component of statutory discretion, which is.<sup>269</sup>

This concern arises in other contexts as well. In the economic sphere, particularly, imposing obligations can amount to a form of consumer protection, which is generally considered political in nature. In *Murphy*, the House of Lords refused to impose a duty on builders (or public authorities) to subsequent owners in respect of loss of resale value because of negligent construction and inspection. Lord Keith has this to say:

There is much to be said for the view that in what is essentially a consumer protection field..., the precise extent and limits of the liabilities which in the public interest should be imposed upon builders and local authorities are best left to the legislature.<sup>270</sup>

#### **3.4.4.4 Certainty**

Certainty and predictability are often cited as desirable goals and as inhibitors of the extension of legal principles.<sup>271</sup> People want to know the bounds of their responsibility not only for general ease of mind, but also so they can plan their affairs, aware of the potential costs of

<sup>269</sup> This aspect of the *Anns* test is discussed in more detail below at 4.3.1.

<sup>270</sup> *Murphy*, *supra* note 213 at 472.

engaging in this or that activity. In the commercial sector, the importance of certainty is more pronounced given that the purpose of commercial activity is to make money. Without knowledge of the financial risks, no rational economic person would engage in business. The same is true to a degree in the non-commercial sector – few rational people would drive a car without some idea of the potential costs.<sup>272</sup> A significant cause of any uncertainty in this area is the broadness of the language of duty and the resulting airiness in the concepts themselves.<sup>273</sup> Of course, the flipside of broad language is adaptability. As McLachlin J. commented in *Norsk*, referring to Canada's relatively open approach to duty of care at the time:

Such uncertainty however is inherent in the common law generally. It is the price the common law pays for flexibility, for the ability to adapt to a changing world. If past experience serves, it is a price we should willingly pay, provided the limits of uncertainty are kept within reasonable bounds.<sup>274</sup>

The desire for predictability, particularly in the economic sector, may have been part of the reason the English courts returned to a category-based approach to expansion (incremental change only in analogous categories).<sup>275</sup> The Supreme Court of Canada cited uncertainty as a reason for failing to recognize a duty of care in the tendering process,<sup>276</sup> and for the return to the categories approach generally in duty of care analysis.<sup>277</sup>

#### **3.4.4.5 Special Considerations**

Sometimes a counter policy is very specific because of the nature of the relationship in question. For instance, in *Dobson v. Dobson*, the Supreme Court of Canada had to decide whether or not to recognize a duty of care on a mother in respect of her unborn child. The majority stated that no such duty should be recognized because it “would result in very

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<sup>271</sup> *Street on Torts*, *supra* note 225 at 177.

<sup>272</sup> Following a law and economics analysis, costs relating to uncertainty would have to be quantified to determine the efficiency of a particular liability rule.

<sup>273</sup> See, for example, Earl A. Cherniak & Elissa How, “Policy and Predictability: Pure Economic Loss in the Supreme Court of Canada” (1999), 31 Can. Bus. L.J. 209 at 231.

<sup>274</sup> *Norsk*, *supra* note 178 at 1150.

<sup>275</sup> Cherniak & How, *supra* note 273 at 233-34.

<sup>276</sup> *Martel Building Ltd. v. Canada*, [2000] 2 S.C.R. 860, 193 D.L.R. (4th) 1, 2000 SCC 60 at para. 119 [*Martel*].

<sup>277</sup> See *Cooper*, *supra* note 218 at para. 31, where McLachlin C.J.C. has apparently stepped back somewhat from her comments in *Norsk*. As noted above in section 3.4.1, analytically, it makes more sense to view the preference for incremental expansion for reasons of certainty as an *Anns* stage two consideration, and not a proximity issue.

extensive and unacceptable intrusions into the bodily integrity, privacy and autonomy rights of women".<sup>278</sup>

#### 3.4.4.6 Floodgates

The floodgates concern is the most frequently cited "administration of justice" policy against expansion into new areas. The spectre of a flood of litigation, as Linden notes, is rarely conclusive, although it does hold more sway in pure economic loss cases.<sup>279</sup>

#### 3.4.5 Counter Policies and Economic Negligence

There are two broad types of economic loss, consequential economic loss and pure economic loss. The former is economic loss that flows from damage to the plaintiff's property (e.g., loss of profits), or from personal injury to the plaintiff (e.g., loss of earning capacity). Pure economic loss is not consequential in that sense and only involves financial loss, such as the loss in value of an investment.<sup>280</sup> Typically, the courts are not any more concerned about consequential economic loss than they are about the physical loss from which it flows. Pure economic loss, on the other hand, is considered a special case. Social values have historically placed greater emphasis on bodily integrity and property, than on economic expectations.<sup>281</sup> It is qualitatively different, it is argued.<sup>282</sup> The following is a look at some other reasons which call for caution in allowing recovery for pure economic loss.

<sup>278</sup> [1999] 2 S.C.R. 753 at 768-69, 174 D.L.R. (4th) 1.

<sup>279</sup> Linden, *supra* note 191 at 271-72. See also *Martel*, *supra* note 276 at para. 71.

<sup>280</sup> The Supreme Court of Canada has recognized five categories of pure economic loss: the liability of statutory authorities, negligent misrepresentation, negligent performance of a service, negligence supply of shoddy goods or structures, and relational economic loss. These categories are discussed in more detail in Chapter 4 (section 4.3.2.4).

<sup>281</sup> See generally, Bruce Feldthusen, *Economic Negligence: The Recovery of Pure Economic Loss*, 4th ed. (Toronto: Carswell, 2000) at 9-15 [*Economic Negligence*], and Linden, *supra* note 191 at 407-08. One writer has described the difference between property damage and pure economic loss in an interesting way. Relying on Hegelian philosophy, he argues that individuals constitute their personalities in part by the property they own, but not by abstract holdings of wealth: see Christian Witting, "Distinguishing Between Property Damage and Pure Economic Loss in Negligence: A Personality Thesis" (2001) 21 L.S. 481.

<sup>282</sup> This view is not universal, however. For instance, some civil law jurisdictions do not draw a distinction between pure financial loss and physical loss: see Daniel Jutras, "Civil Law and Pure Economic Loss: What Are We Missing?" (1986-87) 12 Can. Bus. L.J. 295. Also, most law and economics scholars do not see a substantive distinction between the two forms of loss: see, for example, William Bishop, in "Negligent Misrepresentation Through Economists' Eyes" (1980) 96 Law Q. Rev. 360 at 362, who writes, "Financial costs are costs, too, and there is no fundamental difference between financial and physical costs."

### 3.4.5.1 Loss Spreading

The loss spreading counter argument is that it is preferable to spread numerous small economic losses among potential plaintiffs than require one defendant to bear the burden of the whole loss. In some cases this argument rests on efficiency grounds, but more often it is a question of fairness involving a form of distributive justice.<sup>283</sup> It was argued unsuccessfully in *Norske*, and as McLachlin J. noted this argument rests on some faulty assumptions making it inapplicable in many cases.<sup>284</sup> Not all economic negligence cases involve multiple plaintiffs and not all losses are small.

However, on occasion, a case presents itself where, on fairness grounds, the court chooses to let a class of plaintiffs absorb relatively small losses for the benefit of a particular defendant.<sup>285</sup>

### 3.4.5.2 Indeterminate Liability

The most frequently cited policy reason against recovery for pure economic loss is the spectre of indeterminate liability. Cardozo C.J.'s concern about "liability in an indeterminate amount for an indeterminate time to an indeterminate class" from *Ultramares Corp. v. Touche*,<sup>286</sup> is repeated almost religiously in cases of economic negligence. As the Supreme Court of Canada stated in *Martel*, "The scope of indeterminate liability remains a significant concern underlying any analysis of whether to extend the sphere of recovery for economic loss."<sup>287</sup> This policy has both a fairness component, specific to the particular defendant, and a broader social aspect, which is concerned with the impact on the defendant's profession or a similarly situated group of defendants, and the prospect of unsustainable liability costs.<sup>288</sup>

<sup>283</sup> Cf. distributive justice as a supporting policy: see section 3.4.3. The loss spreading justification in this context could be more accurately described as based on "shallow pockets".

<sup>284</sup> See discussion above at 3.3.2.5.

<sup>285</sup> This was one of five arguments that was put forward by Denning, M.R. in *Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors) Ltd.*, [1973] Q.B. 27, [1972] 3 All E.R. 557 (C.A.) [*Spartan Steel* cited to All E.R.]. A contractor had negligently damaged a power cable and electricity was cut off to the plaintiff's factory. In denying the plaintiff's claim for its lost profits while the factory lay idle, Lord Denning cited the loss spreading idea – it was better that the whole community should suffer comparatively smaller losses, rather than the defendant bear the whole burden. The other arguments were: the equality argument (electricity boards cannot be sued for pure economic loss therefore contractors should be immune too); the common hazard argument (the law should encourage self-sufficiency for this type of loss which is usually small); floodgates; and the rather vague policy that the law should only provide for "deserving" cases.

<sup>286</sup> 255 N.Y. 170, 174 N.E. 441 at 444 (N.Y.C.A. 1931) [*Ultramares* cited to N.E.].

<sup>287</sup> *Martel*, *supra* note 276 at para. 57.

<sup>288</sup> Professor Feldthusen makes the point that indeterminate liability has a "relational" or proximity component to it, i.e., the prospect of indeterminate liability in a particular case may make the relationship too distant to satisfy

In *Bryan v. Maloney*, an Australian High Court decision, the majority juxtaposed the problem of indeterminate liability with considerations relating to social loss (and free market economics):

One policy consideration which may militate against recognition of a relationship of proximity in a category of case involving mere economic loss is the law's concern to avoid the imposition of liability "in an indeterminate amount for an indeterminate time to an indeterminate class". Another consideration is the perception that, in a competitive world where one person's economic gain is commonly another's loss, a duty to take reasonable care to avoid causing mere economic loss to another, as distinct from physical injury to another's person or property, may be inconsistent with community standards in relation to what is ordinarily legitimate in the pursuit of personal advantage. The combined effect of those two distinct policy considerations is that the categories of case in which the requisite relationship of proximity with respect to mere economic loss is to be found are properly to be seen as special. Commonly, but not necessarily, they will involve an identified element of known reliance (or dependence) or the assumption of responsibility or a combination of the two.<sup>289</sup> [footnotes omitted]

While the chance of exposure to indeterminate liability is a significant concern, the absence of such risk does not mean a duty will automatically be imposed. There may be other reasons for negating or limiting the duty.<sup>290</sup>

### 3.4.5.3 Social Loss Neutrality

As the Australian High Court pointed out in *Bryan v. Maloney*, in many economic negligence cases there are transfers of wealth without any net "social loss". Linden explains it this way:

One person's gain becomes another's loss, but nothing is destroyed. Such transfers...are not necessarily objectionable. Unsuccessful investments, for example, are...not, without more, socially objectionable. Indeed, ordinary commerce would grind to a halt were the law to seek to deter transfers of wealth to the same extent it seeks to deter destruction.<sup>291</sup>

In *Martel*,<sup>292</sup> the Supreme Court of Canada relied on this argument in part in refusing to recognize a new duty of care in respect of pure economic loss. The plaintiff owned a building of which a federal Crown agency was a major tenant. The lease expired and the Crown invited

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the neighbour principle: see *Economic Negligence*, *supra* note 281 at 96. I would argue as well that it raises relationship-specific questions of fairness. But there is a broader element to this concern. For example, in discussing indeterminate liability in *Hercules*, *supra* note 6 at 194, La Forest J. referred to the "socially undesirable consequences to which the imposition of indeterminate liability on auditors might lead". Indeterminate liability therefore has a dual aspect nature – it is concerned not only with the particular relationship, but also the impact of finding liability in a broader social sense. It is on solid ground as an *Annex* second stage consideration.

<sup>289</sup> (1995), 128 A.L.R. 163, 182 C.L.R. 609 at 618-19 (H.C.).

<sup>290</sup> For instance, in *Martel*, indeterminate liability was not an issue, but other concerns were present, as described above in section 3.4.4.6 ("Floodgates"), and below in section 3.4.5.3 ("Social Loss Neutrality") and section 3.4.5.4 (under the subheading "Free Competition").

<sup>291</sup> Linden, *supra* note 191 at 408. See also, *Economic Negligence*, *supra* note 281 at 14.

<sup>292</sup> *Supra* note 276.

tenders for the provision of space. The plaintiff sued in negligence when it lost the contract arguing that the Crown owed a duty of care in negotiations and in the tendering process. Both claims were denied. With respect to the duty of care in negotiations, the essence of the claim was that Crown was negligent in not providing the plaintiff with adequate information concerning the Crown's bargaining position, and that it engaged in "hard bargaining", displaying casual contempt toward the plaintiff and its personnel by breaking appointments and generally disregarding the expectation of basic courtesy. The Court applied *Anns* and found proximity under stage one. In negating the *prima facie* duty under stage two, the social loss argument was considered:

63 Perhaps following the traditional view that, at least in some circumstances, economic losses are less worthy of protection than physical or proprietary harm, it has been noted that the absence of net harm on a social scale is a factor weighing against the extension of liability for pure economic loss. That is to say, negotiation merely transfers wealth between parties. Although one party may suffer, another often gains. Thus, as an economic whole, society is not worse off: see Feldthusen, "Liability for Pure Economic Loss: Yes, But Why?" [(1999) 28 U.W.A.L. Rev. 84] at p. 102:

...many pure economic losses are qualitatively different from physical damage. They represent not social loss, as occurs when property is damaged or destroyed, but private loss when wealth is transferred from one party to another with nothing being lost overall. The plaintiff's loss will often be a competitor's gain...<sup>293</sup>

There were other policy considerations in this case, such as the concern that extending a duty of care to pre-contractual commercial negotiations would deter socially and economically useful conduct, and that it would amount to using tort law as "after-the-fact insurance against failures to act with due diligence or to hedge the risk of failed negotiations through the pursuit of alternative strategies or opportunities".<sup>294</sup> The transfer of wealth factor alone will be insufficient in most cases, but added to other policy concerns it can tip the balance against extension of duty of care.<sup>295</sup>

#### **3.4.5.4 *Laissez-Faire***

The authors of one text sum up the relationship between torts, economic interaction and *laissez-faire* in this way:

Much of the law relating to economic transactions is only understood if the implied judicial acceptance of *laissez-faire* is considered. This is merely one facet of the individualism of the law of

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<sup>293</sup> *Ibid.* at para. 63.

<sup>294</sup> *Ibid.* at paras. 64-70.

<sup>295</sup> It would be cold comfort to a plaintiff that the only reason liability was denied was because someone else gained, i.e., that a private economic loss is not worthy of protection where there is no overall social loss.



torts, especially in the nineteenth century, and is an influence which still persists, although less pervasively, in the face of the modern tendency towards collectivism.<sup>296</sup>

*Laissez-faire* and the individualism were manifestations of nineteenth century liberalism. *Laissez-faire* is particularly reflected in free market economics and contractualism, which is the idea that all obligation should arise only through the will of parties contracting freely.<sup>297</sup> To appreciate the influence of free competition and contractualism on economic negligence as counter policies, it is necessary to recognize their current limits. The increasing acceptance during the twentieth century of collectivism, a political ideology opposed to *laissez-faire* which holds that the state is justified in sacrificing a measure of individual freedom to provide benefits to society generally, has meant that some degree of government control over commercial interaction is taken for granted. Collectivism is the ideology behind consumer protection legislation as well as some judge-made law.

#### ▪ Limits

Economic Darwinism has been tempered by enforced conceptions of fairness. A variety of legislation has been enacted impacting on the ability of individuals to compete and contract freely. Trade practices legislation imposes certain standards of conduct in trading, the breach of which can lead to various remedial consequences such as damages and rescission. The effect of this legislation has been to create a legislated tort of fair trading, and it applies whether or not there is fault.<sup>298</sup> Some legislation impacts more specifically on freedom of contract (along with the more general impact of trade practices legislation), prohibiting some

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<sup>296</sup> *Street on Torts*, *supra* note 225 at 13.

<sup>297</sup> See Andrew Robertson, "Situating Equitable Estoppel Within the Law of Obligations" (1997) 19 Sydney L. Rev. 32 at 33, and Morris R. Cohen, "The Basis of Contract" (1933) 46 Harv. L. Rev. 553 at 558. I use the word contractualism in a more moderate sense to refer to the desirability of voluntariness in assuming *economic* obligation – as such it is just a convenient way to group together under one heading the ideas of freedom of contract, *caveat emptor* and contractual overlap, which are all described in this section.

<sup>298</sup> For example, in B.C., the *Trade Practice Act*, R.S.B.C. 1996, c. 457 grants remedies for "deceptive acts or practices" and "unconscionable acts or practices" in the context of "consumer transactions": see ss. 1, 3, 4, and 22. The relatively narrow definition of consumer transaction in the legislation means the Act does not apply to established businesses dealing with each other. Australia and New Zealand have enacted comprehensive fair competition legislation which extends well beyond the unsophisticated consumer and applies to businesses generally. This legislation, because of its breadth (it prohibits almost all forms of misleading or deceptive conduct in almost all commercial contexts), overlaps with and expands upon many economic torts, such as negligent misrepresentation, injurious falsehood and passing off. See Chapter 4 (sections 4.4.2 and 4.4.3) for a brief discussion of the Australian and New Zealand legislation.

kinds of terms or imposing others, generally with the aim of protecting vulnerable parties in various contractual settings.<sup>299</sup>

Judicial attempts to limit *laissez-faire* in the name of collectivism are also varied. While courts in Canada have not recognized a general tort of unfair competition,<sup>300</sup> this belies their apparent willingness to address fairness at other times. A number of common law and equitable claims have grown out of a desire for fairness. Besides the reliance-based economic negligence claims, others include breach of fiduciary duty, breach of confidence, undue influence, duress and unconscionability.<sup>301</sup> However, to the extent that these claims apply in the commercial arena, courts generally exercise caution, recognizing that they are not in the best position to assess the economic or political consequences of their decisions.<sup>302</sup>

#### ▪ Free Competition

Free competition doctrine goes hand in hand with individualism.<sup>303</sup> Free competition, however, is more centred in the economic sphere. Under the influence of collectivism, the doctrine is now more often referred to as free *and fair* competition. The federal Parliament has made “undue” interference with competition a criminal offence.<sup>304</sup> Consonant with legislated policy, the Supreme Court of Canada has affirmed that free and fair competition underpins our economic system.<sup>305</sup>

The belief in free market economics is often called into service to justify certain kinds of intentional behaviour. As Lord Reid said in *Dorset Yacht*:

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<sup>299</sup> In B.C., see for example the *Consumer Protection Act*, R.S.B.C. 1996, c. 69 and *Sale of Goods Act*, R.S.B.C. 1996, c. 410. In the United Kingdom, notable examples include the *Misrepresentation Act 1967* (U.K.), *Unfair Contract Terms Act 1977* (U.K.) and *Contract (Rights of Third Parties) Act 1999* (U.K.).

<sup>300</sup> This broad-based common law tort has been recognized in some states in the United States.

<sup>301</sup> These latter five apply in a wide range of contexts including non-commercial settings. Also, it should be noted, undue influence, duress (including economic duress) and unconscionability are not independent causes of action, but claims which may arise in the context of contractual disputes.

<sup>302</sup> See for example Lord Keith’s comment about consumer protectionism in *Murphy*, quoted above in section 3.4.4.3.

<sup>303</sup> See above section 3.4.4.1.

<sup>304</sup> *Competition Act*, R.S.C. 1985, c. C-34, Part VI.

<sup>305</sup> For example, see *Consumers Distributing Co. v. Seiko*, [1984] 1 S.C.R. 583 at 595-96, 10 D.L.R. (4th) 161, and *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606 at 653, 93 D.L.R. (4th) 36.

[C]ausing economic loss is a different matter; for one thing, it is often caused by deliberate action. Competition involves traders being entitled to damage their rivals' interests by promoting their own...<sup>306</sup>

The authors of *Street on Torts* argue that imposing liability for careless acts, however, does not harm the doctrine of free competition.<sup>307</sup> This is debatable. The example they give is a relational economic loss claim. The gravamen of this claim is that the defendant has negligently damaged or destroyed property (or, less frequently, caused personal injury) and a third party, the plaintiff, has suffered economic loss as a result. Admittedly, in most cases, imposing liability for relational economic loss does not harm free competition. Freedom from constraint in conducting one's business has never meant freedom to injure other people and damage their property. Also, the activity causing the loss in relational claims, while frequently commercial in nature need not be. Relational claims are similar to traditional accident cases. However, the other recognized areas of pure economic loss<sup>308</sup> are different. These complaints relate to activities of an economic nature. Imposing liability in these areas does interfere with the doctrine of free competition. This is easiest to see in cases involving misrepresentations, services and defective buildings and products. For instance, in products liability cases a manufacturers' obligation to correct non-dangerous defects, if such an obligation were found to exist, could be seen as an inappropriate interference with market forces. Risk-averse actors might alter, cease, or move their activities, if they had not accepted the risk. The argument even applies in public authority cases, although the interference is indirect and less clear. The more expensive government becomes, the more difficult it becomes to compete in a free market.

In *Martel*, one of the reasons for not recognizing a duty in commercial negotiations was the concern that it would deter socially and economically useful conduct.<sup>309</sup> In the words of the Court:

It would defeat the essence of negotiation and hobble the marketplace to extend a duty of care to the conduct of negotiations, and to label a party's failure to disclose its bottom line, its motives or its final position as negligent. Such a conclusion would of necessity force the disclosure of privately

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<sup>306</sup> *Supra* note 205 at 1027.

<sup>307</sup> *Street on Torts*, *supra* note 225 at 116.

<sup>308</sup> See *supra* note 280.

<sup>309</sup> See discussion above at 3.4.5.2.

acquired information and the dissipation of any competitive advantage derived from it, all of which is incompatible with the activity of negotiating and bargaining.<sup>310</sup>

The Supreme Court of Canada is clearly of the opinion that liability for careless conduct in this situation would harm free competition. Not every economic negligence claim will do so, however, and there may be other factors, such as the potential for health and safety problems, that override the benefit obtained from promoting competition. The nature of the claim and the context in which it arises must be considered.

#### ▪ Contractualism

Adherents of the view that all economic restraint is objectionable argue in favour of complete freedom in contractual matters. Few theorists support this view today, given the general acceptance of limits based on fairness. Three aspects of contractualism are described next as they relate to economic negligence.

#### *Freedom of Contract*

I refer to freedom of contract here in the sense of allowing parties to agree to bargain as they wish. This policy is not as absolute as it was when Jessel M.R. uttered the words:

[I]f there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred...<sup>311</sup>

There are many statutory and judge-made limitations to this doctrine today,<sup>312</sup> but it still remains the starting place when interpreting commercial contracts. For instance, in *Hunter Engineering Co. Ltd. v. Syncrude Canada Ltd.*, where the Court considered general limits to exclusion clauses in contracts, Wilson J. stated that:

[if] there is no...inequality of bargaining power...the courts should, as a general rule, give effect to the bargain freely negotiated by the parties.<sup>313</sup>

<sup>310</sup> *Supra* note 276 at para. 67.

<sup>311</sup> *Printing & Numerical Registering Co. v. Sampson* (1875), L.R. 19 Eq. 462 at 465.

<sup>312</sup> Of particular note are those relating to the enforceability of exclusion clauses. Some contractual exclusion clauses are regulated by legislation (see for example, in British Columbia, s. 20 of the *Sale of Goods Act*, R.S.B.C. 1996, c. 410, and in the United Kingdom, the *Unfair Contract Terms Act 1977* (U.K.)). Judge-made rules tend to protect vulnerable parties, requiring notice in some situations, and subjecting clauses to scrutiny if they are unconscionable, unfair or unreasonable. See S.M. Waddams, *The Law of Contracts*, 4th ed. (Toronto: Canada Law Book, 1999) at paras. 470-91, G.H.L. Fridman, *The Law of Contract*, 4th ed. (Toronto: Carswell, 1999) at 608-37, and *Cheshire, Fifoot & Furmston's Law of Contract*, *supra* note 1 at 171-215.

<sup>313</sup> [1989] 1 S.C.R. 426 at 515, 57 D.L.R. (4th) 321 [*Hunter Engineering* cited to S.C.R.].

In this somewhat narrow view of freedom of contract, there is no conflict with economic negligence the way there is with free competition. In commercial dealings, parties are generally free to contract out of liability for negligence, economic or otherwise.

### *Caveat Emptor*

*Caveat emptor* or "buyer beware" refers to the idea that buyers must take the property they purchase "as is". To protect themselves they must inspect and test property before purchasing or negotiate warranties with respect to quality and to cover risks of future defects. Consumer protection legislation limits this principle with respect to goods, but it survives largely intact in real property contracts.<sup>314</sup>

Liability for economic negligence can indirectly interfere with the idea of *caveat emptor*. Imposing duties in some situations can amount to imposing non-contractual warranties of quality. In *Winnipeg Condominium*, this argument was made by a builder in resisting a claim that it owed a duty of care to a subsequent owner and was liable for the cost of repairs (no one was injured but the construction defects posed a threat of injury). The Court noted that the *caveat emptor* doctrine stemmed from the *laissez-faire* attitudes of the nineteenth century and was based on the assumption that the buyer was in the best position to discover or bear the risk of defects. Disagreeing with this assumption, the Court concluded:

[A] subsequent purchaser is not the best placed to bear the risk of the emergence of latent defects... For this Court to apply the doctrine of *caveat emptor* to negate [the contractor's] duty in tort would be to apply a rule that has become completely divorced, in this context at least, from its underlying rationale.<sup>315</sup>

How much *caveat emptor* rests on the assumption noted or simply on hard-nosed individualism is arguable. But the decision to impose a duty is a good one given the risk of personal injury. The Court was careful to limit the duty to dangerous defects.<sup>316</sup> In a recent commercial sale of

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<sup>314</sup> See *Winnipeg Condominium*, *supra* note 255 at 122, quoting *Fraser-Reid v. Droumtsekas*, [1980] 1 S.C.R. 720 at 723, 103 D.L.R. (3d) 385.

<sup>315</sup> *Winnipeg Condominium*, *ibid.* at 128.

<sup>316</sup> *Ibid.* at 129. See also the earlier case of *Rivtow Marine Ltd. v. Washington Iron Works*, [1974] S.C.R. 1189, 40 D.L.R. (3d) 530 [*Rivtow Marine*], where a majority of the Supreme Court of Canada denied a claim for the cost of repairs to a defective crane because it was akin to liability under a warranty of fitness. Laskin J., in dissent, argued that the threat of physical harm justified a finding of liability. His position was finally adopted in *Winnipeg Condominium*.

goods case, the British Columbia Court of Appeal refused to impose a duty in respect of non-dangerous defects causing pure economic loss.<sup>317</sup>

### *Contractual Overlap*

The problem of contractual overlap is related to *caveat emptor* but is broader in scope. The argument is that tort duties which are contract-like in nature should not be imposed against the will of the parties. Doing so not only offends the idea of contractualism, but also results in a lack of coherence in approach or purpose.<sup>318</sup>

In imposing a duty in *Winnipeg Condominium*, the Court rejected this argument, in addition to the *caveat emptor* argument. The Court stressed the dangerous nature of the defect:

[T]he duty to construct a building according to reasonable standards and without dangerous defects arises independently of the contractual stipulations between the original owner and the contractor because it arises from a duty to create the building safely and not merely according to contractual standards of quality. It must be remembered that we are speaking here of a duty to construct the building according to reasonable standards of safety in such a manner that it does not contain *dangerous* defects. As this duty arises independently of any contract, there is no logical reason for allowing the contractor to rely upon a contract made with the original owner to shield him or her from liability to subsequent purchasers arising from a dangerously constructed building.<sup>319</sup> [emphasis by the Court]

A duty to avoid dangerous defects is closer to classic tort obligations than contractual ones. It makes sense to class the obligation as tortious.<sup>320</sup> In *Hasegawa*, the contractual overlap argument was successful where the defect was not dangerous. The obligation was closer to a

<sup>317</sup> *M. Hasegawa & Co. v. Pepsi Bottling Group (Canada) Co.* (2002), 213 D.L.R. (4th) 663, [2002] 7 W.W.R. 600, 2002 BCCA 324 [*Hasegawa*].

<sup>318</sup> It should be noted that the question of contractual overlap is not the same thing as the concurrency issue, i.e., whether tort claims can arise in contractual settings (see the Appendix for an overview of the basic concurrency issues). The problem of contractual overlap concerns the appropriateness of tort claims that bear certain similarities to contract claims.

<sup>319</sup> *Winnipeg Condominium*, *supra* note 255 at 123-24.

<sup>320</sup> There is an argument, however, that even considering the risk of injury, the obligation is contractual in nature. Professor Blom argues that the "contractual dimensions of the situation were unduly discounted" in *Winnipeg Condominium*. Purchasing a building is an economic risk and the price should reflect the risk, i.e., contract is an acceptable way to allocate risk in this context. To shift the responsibility to builders when the defect is associated with some vague notion of "dangerousness", exposes builders to uncertain costs making tort liability inappropriate. See Joost Blom, "Tort, Contract and the Allocation of Risk" (2002) 17 Sup. Ct. L. Rev. 289. Professor Feldthusen makes a similar point. He argues that there is no reason to assume a market failure in this context. The builders, sellers, and buyers will have allocated the risk of this kind of loss by contract already, and imposing a duty in tort will have little effect on that allocation, through deterrence or otherwise. The court is in effect giving the plaintiff owner insurance that was not paid for. See *Economic Negligence*, *supra* note 281 at 176-77. These arguments have an efficiency aspect to them, and the courts have not been inclined so far, except in rare instances, to let economics be their guide in duty analysis.

contractual warranty of quality,<sup>321</sup> and therefore Chief Justice Finch, for the Court, refused to impose a duty in tort:

A legal rule which imposed liability for the manufacture or supply of defective, but non-dangerous, goods would create an implied warranty of product quality for the sale of commercial products, in the absence of contract.<sup>322</sup>

It is a primarily a question of functional coherence. If the law treats a type of economic obligation as consensual in one context (i.e., in contract), it should treat a similar type of obligation the same way even though the claim may be framed differently (i.e., in tort), unless there is a justifiable reason to do otherwise. Simply because standards of conduct are *usually* imposed against the will of the defendant in tort is not a justifiable reason.

### 3.4.6 A Note on Efficiency and Duty of Care

As described earlier, the Canadian courts have not enthusiastically adopted the economic analysis of law.<sup>323</sup> In the context of duty analysis, *Norske* is the leading case.<sup>324</sup> If efficiency ever becomes a seriously considered “policy” by the courts in “choice of rules” negligence cases, it could be a supporting policy or a counter policy. It could provide insight into liability for general negligence or for economic negligence. *Norske* was an economic negligence case and the efficiency arguments were raised as counter policies, but law and economics analysis, of course, is not so restricted.

In *Norske*, La Forest J. pointed out, in relation to the insurance arguments, that lawyers will have to become conversant with “fundamental matters of insurability” in new tort cases and inform the courts of their research if efficiency is to become a significant policy consideration.<sup>325</sup> In fact, they will have to become educated in economics generally, and not just in matters of insurability, to do the cost-benefit analyses required. The costs of various forms of risk avoidance besides insurance, of different liability rules, of uncertainty, etc. will all factor into the calculus of wealth maximization.

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<sup>321</sup> It should be noted that tort obligations in these circumstance are not identical to typical contractual warranties. A duty in negligence would only result in liability if there were a breach of the standard of care; liability for breach of warranty is strict. However, in many cases it would amount to the same thing. Its purely economic nature and relation to quality is what makes the obligation contract-like.

<sup>322</sup> *Hasegawa*, *supra* note 317 at para. 57.

<sup>323</sup> See generally above section 3.3.2.5.

<sup>324</sup> See *supra* note 178 and accompanying discussion.

<sup>325</sup> *Ibid.*

Efficiency arguments are considered below in relation to negligent misrepresentation to see if they support one form of liability over another.<sup>326</sup>

### **3.5 IMPLICATIONS FOR A THEORY OF LIABILITY IN NEGLIGENT MISREPRESENTATION**

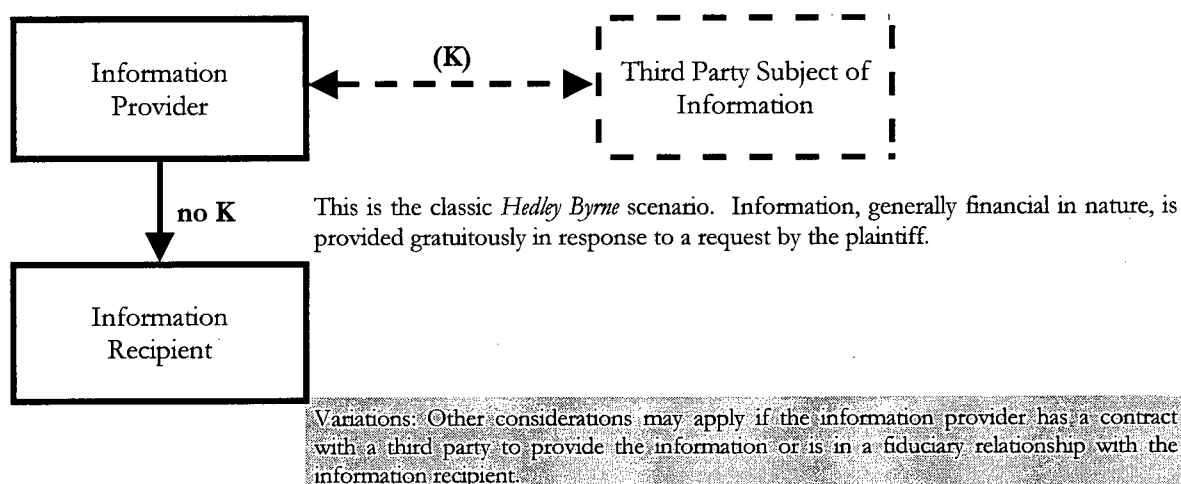
In this section, I look first at the foregoing deontic and instrumentalist approaches to tort law, as they have been absorbed into the duty of care analysis, to see if they point to a particular model of liability for negligent misrepresentation. The economist's goal, the efficient attainment of maximum wealth, is considered next. The question is asked: Does law and economics analysis favour one theory of liability over another? Its separate heading reflects its interdisciplinary status. Lastly, certain problems specific to the reliance and consent models of liability are examined.

As a preliminary matter, I diagram and describe the various contexts in which negligent misrepresentation claims arise in the following three figures. The failure to distinguish between them is responsible, I believe, for some of the confusion that exists in the analysis of *Hedley Byrne* liability. I have isolated three main contexts, although, as I mention, there are variations on these themes and in some cases a certain degree of overlap. The names I use to describe them, "direct advice", "basic contract", and "free rider", are my own and not generally accepted nomenclature. In the figures, "K" refers to contract.

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<sup>326</sup> See section 3.5.2.



**Figure 3.5-1 Direct Advice Gratuitously Provided**

*Explanation.* The direct advice scenario is the first context in which the tort of negligent misrepresentation was held applicable. The information is provided directly (or through an agent) to the information recipient and without consideration (i.e., without contractual obligation). Both *Hedley Byrne* and *Micron Construction* are examples.

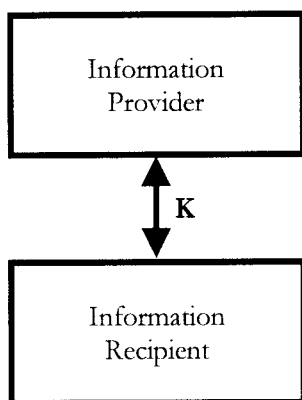
Professor Bishop refers to this as three-party negligent misrepresentation, apparently because the information typically relates to a third party (usually a client with whom the information provider has a contractual relationship).<sup>327</sup> Such was the case also in both *Hedley Byrne* and *Micron Construction*. However, neither the House of Lords nor the British Columbia Court of Appeal predicated their decisions on the existence of such a third party relationship. Analytically, it is not necessary, although it should be noted that when such a relationship does exist, the lack of consideration is less significant, because there will likely be an “indirect” financial benefit in providing the information. Further, if one could establish that the banking or other contract with the third party authorized or even required the provision of relevant financial information concerning the third party’s business, this situation becomes a variant of the “free rider” scenario illustrated in Fig. 3.5-3.<sup>328</sup>

Besides the third party contract variation, other considerations apply where the information provider has a fiduciary relationship with the information recipient – besides a duty of care, a duty of loyalty will also exist in such a case.

<sup>327</sup> Bishop, “Negligent Misrepresentation Through Economists’ Eyes”, *supra* note 282 at 373-77.

<sup>328</sup> It is also potentially raises issues relating to third party beneficiaries under contracts (the third party here would be the information recipient or intended information recipient), which are described below in section 3.5.1.3 under “*Laissez-Faire*”.

**Figure 3.5-2 Negligent Misrepresentation in Basic Contract Settings**



A little more than a decade after *Hedley Byrne* was decided it was established that negligent misrepresentation claims could arise in contractual settings (it had long been established that actions in deceit could arise in this context). As explained below, the negligent misrepresentation can either be pre-contractual (during negotiation) or post-contractual (after agreement is reached). Most cases involve pre-contractual misrepresentations, as evidenced by the greater number of decisions in this category.

Variations: Other considerations may apply if the information provider is in a fiduciary relationship with the information recipient.

*Explanation.* In the basic contract setting, the information provider and information recipient have a contract with one another. Generally, the information will be specific to their relationship and have little value to anyone else. The negligent misrepresentations can occur either before or after agreement. Misrepresentations occurring during negotiations may be classed as “mere” misrepresentations (i.e., without contractual force), or may also be terms of the contract (sometimes referred to as collateral contracts) based on the parties’ intention objectively determined.<sup>329</sup> In the former case, besides an action in tort for damages, the equitable remedy of rescission may also be available (for an innocent but negligent misrepresentation). In the latter case, an alternative claim for contract damages is available. Misrepresentations occurring after agreement, in most cases, will be connected with performance of a contractual obligation,<sup>330</sup> and therefore an alternative claim for contract damages will be available here too. If the misrepresentation follows completion, however, a tort claim will be the only option.<sup>331</sup>

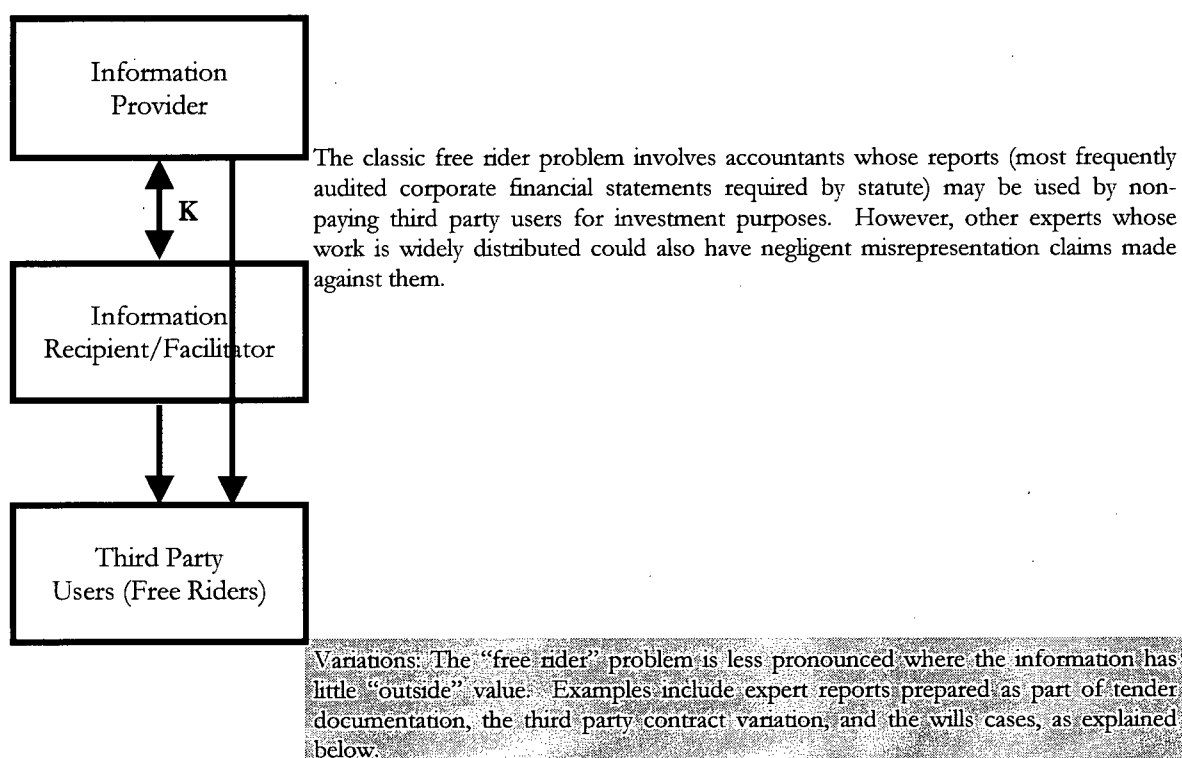
As in the direct advice setting, where the information provider has a fiduciary relationship with the information recipient, besides a duty of care, a duty of loyalty will also exist.

<sup>329</sup> *Esso Petroleum Co. Ltd. v. Mardon*, [1976] Q.B. 801, [1976] 2 All E.R. 5 (C.A.) [*Esso Petroleum*] was the first case to clearly establish that *Hedley Byrne* could apply to pre-contractual misrepresentations. The majority of the Court of Appeal found that the misrepresentation was also a warranty, but Lord Denning was prepared to allow the claim whether it was or not. See also *Williams*, *supra* note 5. In Canada, *Hedley Byrne* is firmly entrenched in this context too: see *Sodd Corp. v. Tessis* (1977), 17 O.R. (2d) 158, 79 D.L.R. (3d) 632 (C.A.) [*Sodd Corp.*], *Cognos*, *supra* note 49, and *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12, 99 D.L.R. (4th) 577 [*BG Checo* cited to S.C.R.].

<sup>330</sup> *J. Nunes Diamonds Ltd. v. Dominion Electric Protection Co.*, [1972] S.C.R. 769, 26 D.L.R. (3d) 699 [*Nunes Diamonds* cited to S.C.R.] is an example of such a case, although the Court’s approach to concurrent liability in that case is no longer followed. See also *Henderson v. Merrett Syndicates Ltd.* (1994), [1995] 2 A.C. 145, [1994] 3 All E.R. 506 (H.L.) [*Henderson* cited to A.C.].

<sup>331</sup> See the Appendix for an overview of the issues relating to concurrent liability in negligent misrepresentation and contract.

**Figure 3.5-3 Negligent Misrepresentation and the Free Rider**



*Explanation.* As in the basic contract situation, the information here is generated in a contractual setting, but the difference is that the information has value to others outside the contractual relationship. Oftentimes, the information recipient is more of a facilitator, having the information prepared so that certain third parties can use it. It may be, however, that others than the intended users have access to it and/or that it is used for unintended purposes. As noted above, the dispute commonly involves corporate financial reports prepared by accountants. Shareholders of the corporation or other investors, who have access to the report, then rely on it in making investment decisions.<sup>332</sup> I refer to these third party users or consumers as free riders, to borrow an economics expression, because they have not paid for the information, at least not directly. Part of the problem with this secondary market is that the information producers cannot readily benefit from this usage. There is a danger in imposing liability in this situation that, because of the potential liability costs, the information will stop being produced or become very expensive and therefore under produced. Traditional duty analysis deals with this problem by applying rules to limit indeterminate liability, for

<sup>332</sup> Some notable cases include *Ultramares*, *supra* note 286, *Candler v. Crane Christmas & Co.* (1950), [1951] 1 All E.R. 426, [1951] 2 K.B. 164 (C.A.) [*Candler* cited to K.B.], *Haig v. Bamford*, [1977] 1 S.C.R. 466, 72 D.L.R. (3d) 68 [Haig], *Scott Group Ltd. v. McFarlane*, [1978] 1 N.Z.L.R. 553 (C.A.) [*Scott Group*], *Caparo Industries Plc. v. Dickman*, [1990] 2 A.C. 605, [1990] 1 All E.R. 568 (H.L.) [*Caparo* cited to A.C.], *Esanda Finance Corporation Ltd. v. Peat Marwick Hungerfords (Reg)* (1997), 142 A.L.R. 750 (H.C.) [*Esanda*] and *Hercules*, *supra* note 6. Accountants are not the only advice givers that need to worry about the possibility of wide-ranging liability, however. Newspaper columnists dispensing financial advice, valuers, surveyors, cartographers, marine hydrographers (Lord Denning's example referred to in *Candler*, at 183), and generally all experts whose work is widely available need to be concerned.

instance, the “end and aim” rule.<sup>333</sup> Economists look at the problem from an efficiency standpoint. This problem does not generally arise in the previous two contexts.

In some free rider cases, the indeterminacy problem is minimal because of the particularized nature of the information. In construction cases, for example, engineering or architectural reports prepared for tender purposes are generally only seen by a limited number of contractors.<sup>334</sup> The third party contract variation described under Fig. 3.5-1 is another example of this – a bank whose client contractually provides for the release of information to specified parties is not likely to be confronted with an indeterminate liability problem.

A somewhat special situation is the case of the disgruntled beneficiary under a will who loses his bequest because of negligent draftsmanship or execution of the will by the lawyer.<sup>335</sup> There is no concern about unlimited liability. These cases do, however, stretch the reliance concept (whether at the duty stage or the causation stage) – the reliance is passive at best. They are really service cases not misrepresentation cases.<sup>336</sup>

As indicated, these categories are not watertight and there can be a degree of overlap. For instance, misrepresentations by real estate agents to purchasers concerning the property have generated much litigation. When the real estate agent acts for the vendor, there can be elements of all three scenarios. If the information provided is outside the scope of the agency agreement, it resembles the direct advice scenario. If the information is authorized by the agency arrangement, it is part basic contract (pre-contractual misrepresentation in negotiations between the vendor and purchaser – it is as if the vendor supplied the information) and part free rider. To further complicate matters, if there is a joint agency arrangement (i.e., the real estate agent represents both the vendor and purchaser), the agent’s obligation may also be fiduciary in nature. If the agent only represents the purchaser, however, the same degree of overlap does not arise – this would be an example of the basic contract scenario.

One final point should be mentioned: Regardless of which scenario is involved, if the information provider is a public authority, other considerations, particularly from an efficiency standpoint, may be relevant.<sup>337</sup>

### 3.5.1 Duty of Care and Negligent Misrepresentation

In Canada, since *Hercules*, traditional duty of care analysis has been applied to negligent misrepresentation. It is no longer a separate “pocket” of negligence with its own special rules

<sup>333</sup> The “end and aim” rule requires the information provider to know who will be using the information and for what purpose as a condition of liability. This rule is described below in section 3.5.1.3 (under the subheading “Indeterminate Liability and the ‘End and Aim Rule’”).

<sup>334</sup> See *Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd.*, [1993] 3 S.C.R. 206, 107 D.L.R. (4th) 169 [*Edgeworth Construction* cited to S.C.R.].

<sup>335</sup> See *Whittingham v. Crease & Co.* (1978), 88 D.L.R. (3d) 353, [1978] 5 W.W.R. 45 (B.C.S.C.) [*Whittingham*] and *Ross v. Caunters* (1979), [1980] Ch. 297, [1979] 3 All E.R. 580 (Ch.) [*Ross*], for example.

<sup>336</sup> Negligent performance of a service is another one of the five categories of economic negligence recognized by the Supreme Court of Canada. The five categories are described below in section 4.3.2.4.

<sup>337</sup> Cases in this category include *Windsor Motors Ltd. v. Powell River (District)* (1969), 4 D.L.R. (3d) 155, 68 W.W.R. 173 (B.C.C.A.) [*Windsor Motors*] and *Porkey Packers Ltd. v. The Pas (Town)* (1976), [1977] 1 S.C.R. 51, [1976] 3 W.W.R. 138 [*Porkey Packers*], both involving a misrepresentation (direct advice) by a municipal official. The action succeeded in *Windsor Motors* but failed in *Porkey Packers* because of lack of actual reliance. See section 3.5.2.4 for a brief note on the efficiency aspect of public authority liability for negligent misrepresentation.

for determining duty of care.<sup>338</sup> In England, liability for careless words is not exactly a pocket of negligence, however, but one of two main branches of negligence, the first based on *Donoghue* and proximity (and other considerations), and the second based on an extended *Hedley Byrne* principle (which applies to services cases too) and voluntary assumption of responsibility. In abandoning the consent model in negligent misrepresentation cases, Canada has parted company with England, and apparently the rest of the Commonwealth. The Supreme Court of Canada may have been motivated by a desire for formal coherence in duty analysis, but this unified approach has come at the expense of functional coherence. Section 3.4 was an overview of duty analysis. The following is an examination of those aspects of the analysis which have particular relevance to negligent misrepresentation together with any considerations which are unique to this area.<sup>339</sup>

### ***3.5.1.1 Closeness, Directness, Justice and Fairness***

Proximity bears some similarity to the more general conception of corrective justice, which is also concerned with liability based on a specific relationship. As described earlier, the idea of corrective justice has been expanded upon since Aristotle first expressed it, but it remains open-textured.<sup>340</sup> It most clearly applies in the field of accident compensation. Corrective justice has so far not been clearly associated with careless words, reliance-based forms of causation and pure economic loss. And there does not appear to be any compelling reason why it should be. The tools of proximity and policy are adequate to the task of forming a theory of liability in this area.

In *Cooper* and *Edwards*, the Supreme Court of Canada held that proximity characterizes the type of relationship where a duty of care might arise, that the starting point is existing categories, and that various factors such as expectations, representations, and reliance will help the court determine whether the plaintiff is closely and directly affected by the defendant's conduct and whether it is just and fair to impose a duty on the defendant.

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<sup>338</sup> The expression, "pocket" of negligence, is Professor Stapleton's and was quoted with approval by the Supreme Court of Canada in *Hercules*, along with the idea that negligent misrepresentation should not be treated differently from other negligence cases. See Jane Stapleton "Duty of Care and Economic Loss: A Wider Agenda" (1991) 107 L.Q. Rev. 249, and *Hercules*, *supra* note 6 at 186.

<sup>339</sup> For a general discussion of many of the following elements of the duty of care analysis, see the corresponding subheading in section 3.4.

<sup>340</sup> See section 3.2 above.

In Canada, it is now clear that the type of relationship can include one that is based on "words". This is more than Lord Atkin intended when he originally conceived his neighbour principle. In his King's College lecture just before the *Donoghue* decision,<sup>341</sup> he not only talked about injury by act, but also about injury by word. He said:

The idea of law is that the obligations of a man are to keep his word. If he swears to his neighbour, he is not to disappoint him. In other words, he is to keep his contracts. He is not to injure his neighbour by word. That is to say, he is not to libel or slander him. He is not to commit perjury in respect of him, and he is not to defraud him into acting to his detriment by telling him lies.<sup>342</sup>

Liability for words included contractual liability, and certain forms of imposed liability for injury by word (defamation, the crime of perjury, and intentional deception or fraud). Imposed liability for careless words was not in his thinking. In *Hedley Byrne*, the House of Lords also considered negligent words to be outside the purview of *Donoghue* and an imposed duty of care.<sup>343</sup> Moral responsibility did not require a person to use care with words the same way it required care when engaging in other kinds of conduct.

Another aspect of negligent misrepresentation which distinguishes it from most ordinary negligence cases is the nature of the causation – it requires reliance by the plaintiff.<sup>344</sup> However, the need for reliance is not and probably never has been *by itself* a significant objection to the application of the proximity concept. In *Norske, La Forest J.* considered the relevance of causation in defining the nature of the obligation in contractual relational economic loss cases (it was part of a comparative analysis of civil law systems and their treatment of economic negligence):

Although some scholars argue that the common law should change its focus entirely to a concern with causation as the limiting factor (see Tetley, "Damages and Economic Loss in Marine Collision: Controlling the Floodgates" (1991), 22 J. Mar. Law & Com. 539, at p. 584), this does not appear to me to be an advisable option. Our current causality test of foreseeability is clearly insufficient to

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<sup>341</sup> See *supra* note 202 and accompanying quote.

<sup>342</sup> Lewis, *supra* note 202 at 58.

<sup>343</sup> For example, see Lord Reid in *Hedley Byrne*, *supra* note 3 at 482-83. But note also Lord Devlin's opinion at 530-31 that proximity was a flexible concept capable of evolving, and that in the future cases may arise where a broader theory of liability might be appropriate, apparently alluding to the "free rider" scenario.

<sup>344</sup> Professor Blom describes two forms of reliance or causation that frequently occur in economic negligence cases: coincidental dependence and voluntary reliance. See Joost Blom, "The Evolving Relationship Between Contract and Tort" (1985) 10 Can. Bus. L.J. 257 at 285-87. Coincidental dependence is a kind of implied reliance on others to conduct themselves with due care. Voluntary reliance, on the other hand, involves a deliberate decision on the part of the plaintiff to rely on the defendant, which is typically the case in negligent misrepresentation cases. The suggestion is not so much that proximity is an inappropriate concept in this area, but that where the reliance is on the skill of the defendant the specific criteria for liability should approximate that of contract, i.e., there should be some form of assumed responsibility by the defendant close to a contractual intention to be bound (292-95 and 304).

control liability. The directness criterion was rejected in *Overseas Tankship (U.K.) Ltd. v. Morts Dock & Engineering Co. (The Wagon Mound)*, [1961] A.C. 388, for determinations as to remoteness and does not seem to me to provide much predictive value...<sup>345</sup>

Directness is a difficult test and was rejected in *Norske* as a limiting factor.<sup>346</sup> In *Hercules*, the need for directness was also implicitly rejected in negligent misrepresentation cases by the adoption of the reliance model of liability. However, the Supreme Court of Canada was not stretching the proximity concept too much, in recognizing a relationship based on reliance. Despite Lord Atkin's test requiring the plaintiff to be "directly affected" by the defendant's conduct, in *Donoghue* itself there was a certain indirectness and even reliance in the causation.<sup>347</sup>

More troubling than the nature of the causation is the nature of the loss. It is almost certain that Lord Atkin did not have financial relationships in mind when he conceived his neighbour principle – there was no reference to them in his judgment. Nonetheless, the Supreme Court of Canada has now applied the proximity principle to five categories of pure economic loss, of which negligent misrepresentation is just one.<sup>348</sup> We may conclude that while the proximity concept may not have been overly strained in its application to reliance-based relationships, its application to relationships based on words and money extends it well beyond its original reach.

Besides concerns about the nature of the conduct, causation and the type of loss involved, there is also a fairness argument for limiting liability that stems from the fact that the claimant in a negligent misrepresentation action has not paid for the information (except possibly in the basic contract scenario). There are efficiency issues that flow from this which are described below,<sup>349</sup> but as Professor Bishop writes:

It is also possible to phrase the effect [that inefficient levels of information production could result if non-paying users are allowed to sue in negligence] as one of fairness – only those who have paid should be allowed to recover if they lose. We can say to the man who complains of a loss: you were not required to use the information and you intentionally used it to benefit yourself. This is unlike an accident case where the victim would have behaved in the way he did if the injurer had

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<sup>345</sup> *Norske*, *supra* note 178 at 1079.

<sup>346</sup> Whether La Forest J. was considering causation as a means of limiting proximity or duty generally (e.g., as an *Ann's* second stage consideration) is not entirely clear from his judgment. Using causation to control floodgates (a concern in economic loss cases in France and Quebec, he noted) suggests a second stage analysis, but controlling liability by reference to the nature of the causation in the particular relationship suggests proximity.

<sup>347</sup> *Supra* note 237. The nature of the reliance is relevant to other considerations, however. See discussion of individualism below in section 3.5.1.3.

<sup>348</sup> See section 4.3.2.4 below for a discussion of the other categories.

<sup>349</sup> See section 3.5.2.

been entirely absent. There is a possible moral objection in the case of statements, as there is not in the case of accidents, to someone taking a free ride on another's efforts.<sup>350</sup>

Bishop is likely basing his fairness argument on a regime that permitted a wide-open form of liability, such as one based on simple foreseeability. It would be somewhat like a thief stealing something, and then having a claim against the owner because it doesn't work right. The requirement of foreseeability *and* reasonable reliance under *Hercules* minimizes this unfairness, but the argument still has some merit even under this rule. Of course, La Forest J.'s counter position is that "simple justice"<sup>351</sup> requires a person to stand behind his word when reliance by others is reasonable and foreseeable.

There are also more general fairness considerations, such as those based on loss spreading and distributive justice, but they are broader in scope and concern consequences beyond the specific relationship in question. As noted above, they are more clearly *Anns* second stage considerations<sup>352</sup> and should not be part of the proximity question.<sup>353</sup>

### ***3.5.1.2 Policies Supporting the Imposition of a Duty of Care***

The same policies in support of other duties of care apply generally to the duty to use words with care.<sup>354</sup> The general deterrence function, in particular, has been cited as a consideration in deciding whether or not to impose a duty. In *Hercules*, La Forest J. acknowledged the relevance of this policy:

Certain authors have argued that imposing broad duties of care on auditors would give rise to significant economic and social benefits in so far as the spectre of tort liability would act as an incentive to auditors to produce accurate (i.e., non-negligent) reports... I would agree that deterrence of negligent conduct is an important policy consideration with respect to auditors' liability.<sup>355</sup>

Ultimately, however, on the facts of *Hercules*, deterrence was outweighed by a counter policy, the concern over indeterminate liability, discussed below.

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<sup>350</sup> See Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 377.

<sup>351</sup> *Hercules*, *supra* note 6 at 190.

<sup>352</sup> See section 3.4.1.

<sup>353</sup> A very localized form of distributive justice which just looks to the deep pockets of the particular defendant could be considered a proximity issue, but the Supreme Court of Canada (in *Jacobi*) has indicated that this is not a factor the courts would consider: see *supra* note 243 and accompanying text.

<sup>354</sup> Here, as in other areas, the deep pockets of the particular class of defendants involved (such as banks), or their ability to spread losses, have not been accepted as a reason for imposing a duty on the grounds of fairness or distributive justice. However, the ability to spread losses may trigger efficiencies which support one liability position over another (see below section 3.5.2).

<sup>355</sup> *Supra* note 6 at 194.



### 3.5.1.3 Counter Policies

#### ▪ Loss Spreading and Distributive Justice

Concerning the relevance of distributive justice to negligent misrepresentation, Professor Feldthusen, arguing that a limited form of liability is required in this area, writes:

What is required is a more precise delineation of the circumstances under which one owes another a duty of care. This cannot be based on foreseeability alone, but also on consideration of commercial mores, business efficacy, fair dealing, *distributive justice*, and consumer protection. These, it is suggested, will justify a much narrower basis of liability.<sup>356</sup> [emphasis added]

This passage has been adopted in a few lower court Canadian decisions,<sup>357</sup> but unfortunately neither Feldthusen nor the courts have explained what they mean by distributive justice. It seems clear they do not mean the promotion of equality in a Rawlsian sense. The primary context in which negligent misrepresentation claims arise is commercial and, as Feldthusen points out, our economic system is based on competition and the intentional “besting” of others financially.<sup>358</sup> It would be somewhat absurd to have a claim for negligent misrepresentation (or any form of economic negligence for that matter) swimming in the opposite direction of the free market current. Perhaps it was the idea of loss spreading that was intended (i.e., it is preferable to have many plaintiffs suffering comparatively small losses than one defendant suffering a large loss), but this is not a strong argument either. In the direct advice and basic contract situations there is usually just one plaintiff suffering what is frequently a substantial loss; and even in the free rider context, there may not be that many plaintiffs and the losses may not be that small. A convincing case for distributive justice in this area has not been advanced so far, and, despite Feldthusen’s comment above and passing comments in a few decisions, there is little evidence the courts have been influenced by it in fashioning a rule for negligent misrepresentation. There are arguments for limiting liability in this area but this is not one of them.

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<sup>356</sup> *Economic Negligence*, *supra* note 281 at 33.

<sup>357</sup> See *Alvin's Auto Service Ltd. v. Clew Holdings Ltd.* [1997] 9 W.W.R. 5 at 16, 157 Sask. R. 278 (Q.B.) [*Alvin's Auto Service* cited to W.W.R.] and *Wind Power Inc. v. Saskatchewan Power Corp.* (1999), 179 Sask. R. 95 at 114, 46 B.L.R. (2d) 116 (Q.B.) [*Wind Power* cited to Sask. R.].

<sup>358</sup> *Economic Negligence*, *supra* note 281 at 33.

### ■ Individualism

Limiting liability in careless words cases finds some justification in the policy of encouraging self-reliance, particularly in business settings. The causation question reappears. As Linden states in discussing why the duty is limited in negligent misrepresentation:

[M]isrepresentations do not injure anyone directly. The plaintiff must take some action in reliance on the statement before any harm occurs. This gives the plaintiff opportunities for self-protection not available in most physical injury situations.<sup>359</sup>

Arguably, any form of imposed liability runs counter to the spirit of individualism, given the nature of the causation in this area which requires voluntary participation by the plaintiff.

### ■ Certainty

Certainty is as important in this area as it is in other areas of economic negligence. Commenting on the need for certainty in negligent misrepresentation cases, Professor Feldthusen writes:

Professional advisors ought to be able to convey information and opinions to others without operating in fear of liability every time they speak...[They] should be able to predict with relative certainty when their speaking entails legal duties of care and when it does not...[D]uties should only be recognized in situations where the reasonable defendant ought to have known that legal consequences might attach to the advice if tendered negligently.<sup>360</sup>

One specific certainty issue relates to the use of disclaimers. Given the conclusive effect that was accorded standard disclaimers in *Hedley Byrne* and the resulting commercial expectations that have become associated with their use, a legal rule which diminishes their effectiveness creates uncertainty.<sup>361</sup> This has been the combined effect of *Hercules* and *Micron Construction*, particularly in light of the British Columbia Court of Appeal's interpretation of the reasonable reliance test from *Hercules*,<sup>362</sup> and it runs counter to the expressed desire for certainty in *Cooper* and *Edwards*. The use of disclaimers is discussed in more detail in Chapter 4.<sup>363</sup>

<sup>359</sup> Linden, *supra* note 191 at 411. Feldthusen makes the same point: *ibid.* at 34.

<sup>360</sup> *Economic Negligence*, *supra* note 281 at 33-34.

<sup>361</sup> Feldthusen argues that there will be many occasions where a plaintiff will reasonably rely on a defendant's advice or information (even in the face of a disclaimer) without any expectation of liability on the part of the defendant, i.e., the plaintiff will have taken calculated risk: *ibid.* at 46-47.

<sup>362</sup> On the uncertainty generally created by these decisions, see Griffin, *supra* note 30 at 2.1.22-23.

<sup>363</sup> See section 4.3.4.

■ Indeterminate Liability and the “End and Aim Rule”

The concern about indeterminate liability, though not unique to negligent misrepresentation (it is a concern in economic negligence generally), was first brought to prominence in this context.<sup>364</sup> It is especially relevant in this setting because, as Lord Pearce said in *Hedley Byrne*:

Negligence in word creates problems different from those of negligence in act. Words are more volatile than deeds. They travel fast and far afield.<sup>365</sup>

This concern arises most frequently in the free rider context – rarely will it be an issue in the direct advice or basic contract situations. In *Hercules*, the Court held that the problem of indeterminacy could be countered by requiring proof of two limiting factors: knowledge by the defendant of the plaintiff or limited class of plaintiffs using the information, and use of the information by the plaintiff for the intended purpose.<sup>366</sup> Requiring these limiting factors as pre-conditions to liability is sometimes referred to as the “end and aim” rule.<sup>367</sup> While there are conceptual differences between Canada’s approach to negligent misrepresentation and the approaches in other jurisdictions, the “end and aim” limitations are recognized in most of them as a requirement of liability.<sup>368</sup> However, as Professor Feldthusen notes, in most cases

<sup>364</sup> Cardozo C.J.’s famous admonition against “liability in an indeterminate amount for an indeterminate time to an indeterminate class” from *Ultramares*, *supra* note 286 at 444, arose in a claim against auditors for negligence in the certification of a company’s “balance sheet”. On the faith of certificate, the plaintiff loaned money to the company which was not repaid. See also above section 3.4.5.2.

<sup>365</sup> *Hedley Byrne*, *supra* note 3 at 534.

<sup>366</sup> *Hercules*, *supra* note 6 at 192. The earlier Supreme Court of Canada decision in *Haig*, *supra* note 332, had imposed the same limitations on liability for negligent misrepresentation, although not within the *Anns* framework of analysis.

<sup>367</sup> The name of this rule comes from the aphoristically inclined Cardozo J. in *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (C.A. 1922) [*Glanzer* cited to N.Y.]. In this case, a weigher negligently prepared a weight certificate for a third party with the knowledge that it would be given to the plaintiff and used for the very purpose for which it was prepared. The plaintiff relied on it and lost money. The Court found the defendant liable in damages. In reaching his decision, Cardozo J. stressed the fact that the certificate was used for the very “end and aim of the transaction” and not for any “indirect or collateral” purpose (at 238-39).

<sup>368</sup> In *Caparo*, *supra* note 332, the exact basis of negligent misrepresentation liability was not clearly defined by the Law Lords, but they were all of the opinion that these limitations were relevant to the duty question (for example, see Lord Roskill at 622-23 and Lord Oliver at 638). In *Williams*, *supra* note 5, where voluntary assumption of responsibility was clearly established as the basis of liability, the “end and aim” rule was not mentioned, but on the facts indeterminate liability was not a concern, given that the case was a variant of the basic contract scenario. Where liability is based on an express or implied assumption of responsibility, it is difficult to imagine a case where these limiting factors would not be present. They would certainly be relevant to the question whether or not responsibility had been *impliedly* assumed. The Australian position based on *Esanda*, *supra* note 332, is not entirely clear (there were six judges and five judgments emphasizing different points) but at least half the Court adopted the “end and aim” rule (see Brennan C.J. at 757 and Toohey and Gaudron JJ. at 768). The U.S. position as reflected in the *Restatement (Second) of Torts* § 552 (1977), expressly incorporates the “end and aim” rule (see § 552(2)) – § 552 is set out below in section 4.4.4. The New Zealand position bears some resemblance to Canada’s in that the *Anns* framework of analysis is applied to negligent misrepresentation liability, but the similarity ends there. The New Zealand approach is otherwise exceptional.

the result would be the same with just the purpose of use limitation – requiring knowledge of the limited class is not necessary.<sup>369</sup>

#### ▪ Social Loss Neutrality

Almost all negligent misrepresentation cases involve transfers of wealth, but there still may be social costs involved. Consider the situation where investors rely on financial statements in deciding whether or not to supply venture capital for a project, such as occurred in *Haig and Candler*.<sup>370</sup> If the financial information inaccurately represented a venture that was doomed to fail, the market value of the investment could not be properly assessed. In a particular case, there may be simply a transfer of wealth, but where assets are repeatedly traded at more or less than market value, this could lead to a market failure over time. In other words, if the information is not protected by *some form of liability*, investors will stop investing, developments will not occur and net social wealth will diminish with time.<sup>371</sup> This leads into efficiency analysis and complicated calculations of the present value of future costs. Without factoring in these future costs, however, money is simply changing hands in most careless words cases without any *apparent* loss of overall social wealth. Even assuming a net social loss, the most that can be said is that there ought to be some form of liability. What that form of liability should be is more easily determined by reference to other considerations.

#### ▪ Laissez-Faire

The doctrine of free competition supports restraint in imposing obligations to use words with care.<sup>372</sup> However, freedom of contract is not directly affected by such duties. A defendant has the option of “contracting out” of these obligations with those with whom she deals directly, but to the degree that non-contractual disclaimers are trumped by tort duties (as in *Micron Construction*) there is in effect an interference with the liberty to *not* contract. This leads to

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Two of the three judges in *Scott Group*, *supra* note 332, appeared to apply what Feldthusen refers to as a profession-specific approach, basing accountants’ liability for audited financial statements of public companies on the statutory framework and nature of the accounts that had to be prepared rather than dealing with indeterminate liability concern head-on. See Feldthusen’s detailed discussion of this case in *Economic Negligence*, *supra* note 281 at 100-05.

<sup>369</sup> *Economic Negligence*, *ibid.* at 100.

<sup>370</sup> *Supra* note 332.

<sup>371</sup> See Bishop, “Economic Loss in Tort”, *supra* note 181 at 28-29. As Bishop points out, this type of analysis also applies to contracts generally.

<sup>372</sup> See above section 3.4.5.4.

problems of contractual overlap, which feature prominently in negligent misrepresentation cases.

As earlier described, imposing a duty of care in economic negligence can be like implying a warranty of fitness or quality in the absence of a contract. Contractualism and functional coherence require such an obligation to be consensual.<sup>373</sup> In negligent misrepresentation cases specifically, imposing a duty of care is similar to the implication of a warranty as to the accuracy of the information in the absence of a contract.<sup>374</sup> Before assessing the substance of this concern, it may be helpful to consider some related developments in contract law which challenge traditional ideas, such as the doctrine of consideration and bargain theory. Two developments in particular are examined, those relating to promissory estoppel and to the rights of third party beneficiaries.

In the Commonwealth, the doctrine of promissory or equitable estoppel<sup>375</sup> was revived in *Central London Property Trust Ltd. v. High Trees House Ltd.*<sup>376</sup> in the 1940s. In its traditional guise, this form of estoppel arises when one party to a contract promises the other that he will not enforce his strict rights under the contract. The promise therefore is usually of future inaction. Generally, the courts require the promise to be clear and unequivocal. Mere indulgences in allowing technical breaches will not suffice,<sup>377</sup> and the promise must be given freely and without intimidation.<sup>378</sup> Provided the promisee has relied on the promise,<sup>379</sup> the promise

<sup>373</sup> See above section 3.4.5.4 under "Contractualism".

<sup>374</sup> Of the three scenarios outlined above in the three figures at the beginning of this section, the implied warranty argument is most relevant in the free rider and direct advice scenarios.

<sup>375</sup> No attempt is made here to distinguish between promissory estoppel and the related doctrine of waiver.

<sup>376</sup> (1947), [1947] K.B. 130, [1956] 1 All E.R. 256 (Note) [*High Trees*]

<sup>377</sup> See for example *John Burrows Ltd. v. Subsurface Surveys Ltd.*, [1968] S.C.R. 607, 68 D.L.R. (2d) 354 and *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490, 115 D.L.R. (4th) 478 [*Saskatchewan River Bungalows*]. Sometimes, however, the courts question how "unequivocal" the promise or conduct must be: see *Revell v. Litwin Construction (1973) Ltd.* (1991), 86 D.L.R. (4th) 169 at 178 (B.C.C.A.) [*Revell*].

<sup>378</sup> See *D. & C. Builders Ltd. v. Rees* (1965), [1966] 2 Q.B. 617, [1965] 3 All E.R. 837 (C.A.), where a promise to partially release a debt was held not binding because it was extracted from a creditor in financial difficulty under a threat of nonpayment.

<sup>379</sup> The exact nature of the required reliance has never been clearly established. In some cases, acting differently is all that is necessary (see *High Trees* and Lord Denning in *W.J. Alan & Co. Ltd. v. El Nasr Export & Import Co.*, [1972] 2 Q.B. 189, [1972] 2 All E.R. 127 (C.A.), for example); some courts require reliance such that it will be inequitable if the promisor resiles (see *Société Italo-Belge Pour le Commerce et L'Industrie S.A. (Antwerp) v. Palm and Vegetable Oils (Malaysia) Sdn. Bhd. (The Post Chaser)* (1981), [1982] 1 All E.R. 19, [1981] 2 Lloyd's Rep. 695 (Q.B.)); and others require detrimental reliance (see *Edwards v. Harris-Intertype (Canada) Ltd.* (1983), 40 O.R. (2d)

becomes binding and the promisor is estopped from returning to his original position.<sup>380</sup> In the usual case, the promise modifies an existing relationship.<sup>381</sup> However, a few courts have taken the doctrine a step further recently, and allowed a promise to be enforced in the absence of a pre-existing relationship.<sup>382</sup> In these cases, something more than mere reliance, detrimental or otherwise,<sup>383</sup> is required. That something extra may be unconscionability based on inducement or encouragement by the promisor that the promisee act on the assumption the promise was binding,<sup>384</sup> or “unfairness or injustice” in all the circumstances in not enforcing the agreement.<sup>385</sup>

In the United States, there was an earlier recognition that justice might require the direct enforcement of gratuitous voluntary promises. The *Restatement (Second) of Contracts* § 90(1) (1981), under the heading “Contracts Without Consideration”, provides:

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

The U.S. common law as reflected in § 90(1) may have been initially concerned with protecting detrimental reliance, but some commentators believe the modern approach, based on more

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558 (S.C.), aff'd (1984), 46 O.R. (2d) 286, 9 D.L.R. (4th) 319 (C.A.) and *Robichaud c. Caisse populaire de Pokemouche Ltée* (1990), 69 D.L.R. (4th) 589, 105 N.B.R. (2d) 227 (C.A.).

<sup>380</sup> In some cases, the promisor is entitled to resile upon giving reasonable notice: see *Saskatchewan River Bungalows*, *supra* note 377.

<sup>381</sup> Sometimes it is said that promissory estoppel operates as a shield not a sword. But as Lord Denning more accurately explained it, the promise can be sued upon provided it plays a supplementary role, i.e., “[i]t may be part of a cause of action, but not a cause of action in itself”: see *Combe v. Combe*, [1951] 2 K.B. 215 at 220, [1951] 1 All E.R. 767 (C.A.). Perhaps, this is just another way of saying that the promise must modify an existing relationship.

<sup>382</sup> For instance, see *Waltons Stores (Interstate) Pty. Ltd. v. Maher* (1988), 76 A.L.R. 513, 164 C.L.R. 387 (H.C.) [*Maher* cited to C.L.R.], *Commonwealth v. Verwayen* (1990), 95 A.L.R. 321, 170 C.L.R. 394 (H.C.) [*Verwayen* cited to C.L.R.], *Litwin Construction (1973) Ltd. v. Pan* (1988), 52 D.L.R. (4th) 459 (B.C.C.A.) [*Pan*] and *Revell*, *supra* note 377.

<sup>383</sup> The Australian position seems to be that detrimental reliance while not sufficient is necessary: see *Verwayen* at 413 per Mason C.J., 429 per Brennan J., 444 per Deane J., 455 per Dawson J. and 500 per McHugh J. (also *Maher*, *ibid.*) The B.C. position is that detrimental reliance is not necessary: see *Pan*, *ibid.* at 468 (also *Revell*, *ibid.* and *Vic Van Isle Construction Ltd. v. Central Okanagan School District No. 23* (1997), 33 C.L.R. (2d) 75 (B.C.C.A.) – although it should be noted that there was evidence of detriment in all these cases.

<sup>384</sup> *Ibid.*, *Maher* at 406-08 per Mason C.J. and Wilson J., 428-29 per Brennan J., 453 per Deane J. and 458 per Gaudron J.

<sup>385</sup> *Pan*, *supra* note 382 at 468 (see also *Revell*, *supra* note 377).

recent case law, is less concerned with reliance and more with giving effect to promises according to the seriousness of the commitment with which they are made.<sup>386</sup>

Whether one argues that these developments spell the “death of contract”,<sup>387</sup> or that promissory estoppel no longer belongs to the law of contract and is either part of tort law or some other anomalous category,<sup>388</sup> it is clear that promissory estoppel is based in part on the voluntariness of the promise.<sup>389</sup>

Another challenge to the classical boundaries of contract law comes from the developing rights of third party beneficiaries under contracts. As with promissory estoppel, liability to a third party beneficiary is based in part on the existence of a voluntary promise. A distinguishing feature, however, is that reliance is rarely a factor. In the Commonwealth, the development of third party rights has lagged behind the United States, where such rights have long been recognized.<sup>390</sup> The general common law rule in the Commonwealth, which developed early in the nineteenth century in England, is that lack of privity<sup>391</sup> prevents third parties from enforcing benefits intended for them under contracts.<sup>392</sup> While only limited common law exceptions have been recognized,<sup>393</sup> increasingly, jurisdictions are enacting

<sup>386</sup> See Edward Yorio & Steve Thel, “The Promissory Basis of Section 90” (1991) 101 Yale L.J. 111.

<sup>387</sup> See discussion in Donal Nolan, “The Classical Legacy and Modern English Contract Law” (1996) 59 Mod. L. Rev. 603.

<sup>388</sup> For an overview of this debate, see Robertson, *supra* note 297 at 40-63.

<sup>389</sup> In Robertson, *ibid.*, the author outlines three theories to explain modern promissory estoppel: promise theory, conscience theory and reliance theory. Despite their different emphases, all three require a *voluntary* promise as a precondition of liability.

<sup>390</sup> See the *Restatement (Second) of Contracts* § 304 (1981), under the heading “Creation of Duty to Beneficiary”, which provides: “A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.”

<sup>391</sup> There is a debate over whether lack of privity simply means lack of consideration, or more precisely whether “the privity rule is just another way of saying that ‘consideration must move from the promisee’”: Christine Boyle & David R. Percy, eds., *Contracts: Cases & Commentaries*, 6th ed. (Toronto: Carswell, 1999) at 301.

<sup>392</sup> See Waddams, *supra* note 312 at paras. 281-84, Fridman, *supra* note 312 at 197, and *Cheshire, Fifoot & Furmston’s Law of Contract*, *supra* note 1 at 499-502.

<sup>393</sup> For instance, the Supreme Court of Canada has recognized an “employee” exception whereby a clause excluding negligence in a contract between two parties can be extended to employees of the party protected if they were intended to be covered by the clause and they were doing the work contemplated by the contract when the loss occurred: *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299, 97 D.L.R. (4th) 261. Professor Siebrasse has argued that *London Drugs* and *Edgeworth Construction*, *supra* note 334 (concerning a similar issue raised in that case) are best explained in efficiency terms, as attempts to fill gaps left in the contracts by the parties in a way that is profit maximizing: see Norman Siebrasse, “Third-party Beneficiaries in the Supreme Court: Categorization and the Interpretation of Ambiguous Contracts” (1995) 45 U.T.L.J. 47. The Supreme Court has also recognized a “waiver of subrogation” exception whereby insurers who waive the right to subrogate against certain third parties named in an insurance contract will be held to that promise should they pursue the third party: *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3

legislation granting a general right to third party beneficiaries to enforce contractual obligations intended to benefit them.<sup>394</sup> All these exceptions, common law and statutory, are premised on the intention of the promisor to confer the benefit on the third party, i.e., on a voluntarily assumed responsibility.

In light of basic contract principles and these developments, is there a problem of overlap in imposing a duty of care in tort when using words? And if there is, what should the approach to liability be? The argument that there is *no* overlap seems to rest on three main points. First, negligent misrepresentation liability is concerned with representations of fact, not promises.<sup>395</sup> It is true that the paradigmatic contract is the bilateral executory contract (promises of future action), which is an indispensable tool for planning and providing certainty, especially in business. However, representations and warranties also play an important role in commercial contracts. Representations of a financial nature are closer to contract than tort – the closest connection to tort is the action in deceit.<sup>396</sup> Second, a duty of care is not the same as strict liability in contract; the exercise of reasonable care is generally no excuse for breach of contract. This is not a significant difference. As a practical matter of proof once the inaccuracy of the information is established, it is a short step to want of care. Further, while many contractual obligations are strict, implied and express terms frequently require only the exercise of reasonable care.<sup>397</sup> A third distinction relates to how damages are calculated in

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S.C.R. 108, 176 D.L.R. (4th) 257. Both the employee and subrogation exceptions are limited in the sense that third parties can only raise the contractual stipulation “as a shield” to defend actions against them. There are a number of other “exceptions”, some of which are not true exceptions because the privity rule by definition does not apply in the particular circumstances (e.g., the agency and trust exceptions). For an overview of the exceptions, see Waddams, *ibid.* at paras. 287-98 and Fridman, *ibid.* at 206-17.

<sup>394</sup> For example, in Australia, see the *Property Law Act 1969* (W.A.), s. 11 and the *Property Law Act 1974* (Qld.), s. 55; in New Zealand, see the *Contracts (Privity) Act 1982* (N.Z.); and in the United Kingdom, there is now the *Contract (Rights of Third Parties) Act 1999* (U.K.). In Canada, see the New Brunswick provision, *Law Reform Act*, S.N.B. 1993, c. L-1.2, s. 4. The other provinces rely on piecemeal alterations to the privity doctrine: e.g., B.C.’s *Insurance Act*, R.S.B.C. 1996, c. 226, ss. 53 and 159, which allow, respectively, beneficiaries of life insurance contracts and claimants with judgments against persons covered by motor vehicle policies to sue the insurance companies directly.

<sup>395</sup> While there is some doubt as to whether omissions and representations of future factual occurrences are covered by the tort of negligent misrepresentation (see discussion, *infra* note 636), it is clear that promises to act are not (see, for example, *Soursos v. Canadian Imperial Bank of Commerce*, [1983] 3 W.W.R. 716, 44 B.C.L.R. 66 (S.C.), where the Court held that gratuitous undertaking by a bank was different than a misrepresentation of fact and would not support a cause of action).

<sup>396</sup> See *Derry v. Peek* (1889), 14 App. Cas. 337, 5 T.L.R. 625 (H.L.) [*Derry v. Peek* cited to App. Cas.] – this case is outlined in Chapter 4 (section 4.1).

<sup>397</sup> For example, as noted in *Nocton v. Lord Ashburton*, [1914] A.C. 932 at 956, [1914-15] All E.R. Rep. 45 (H.L.) [*Nocton* cited to A.C.], per Viscount Haldane L.C., a solicitor has a contractual obligation of care with her client.



contract and tort. Damages in contract are generally forward looking, attempting to place the plaintiff in the position she would have been had the contract been properly performed, whereas damages in tort are backward looking, attempting to place the plaintiff in the position she would have been had the tort not occurred. In many cases, however, the calculation of damages for misrepresentation in contract and tort will lead to similar amounts, particularly after consequential losses are accounted for. All in all, it has to be said that the obligation to use care in making representations of a financial nature looks more like a contractual obligation than a tortious one.

Accepting then that there is some contractual overlap, the courts in choosing the appropriate form of liability should strive for functional coherence based on the nature of the activity regulated and the purpose of regulation. Both contract law and negligent misrepresentation are concerned for the most part with the regulation of economic activities in a free and fair competitive environment. They are generally concerned with transactions and transfers of a purely financial nature, and with the organization and reorganization of wealth. Voluntarism is a cornerstone of free enterprise and contractualism and should be sacrificed only with good reason. Reliance, an important component of contractual ordering and causally essential in negligent misrepresentation, is based on the voluntary action of the plaintiff; voluntarism should similarly be reflected in the responsibility for the consequences of that reliance.

Two “contractual” arguments against using a consent model in negligent misrepresentation present themselves. First, the actionability of gratuitously assumed responsibilities in respect of factual representations erodes the doctrine of consideration. This argument is weak. For one thing, the same can be said of the reliance model (in that a contract-like obligation is being enforced without consideration). More importantly, as I attempted to show in the discussion of promissory estoppel and developments relating to third party beneficiaries, the law already recognizes that certain voluntary promises may be enforced in contract-like settings without consideration. In other contexts, the same is true of gratuitous representations of *fact*.<sup>398</sup> There

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Typically, such an obligation would be implied, but as a general rule there is nothing preventing these or other parties from expressly limiting their liability to losses flowing from careless performance.

<sup>398</sup> Gratuitous representations of fact may have legal consequences in a number of different contexts. Common law estoppel and estoppel by representation afford defences in certain circumstances. Provided certain conditions are satisfied, innocent and fraudulent misrepresentations will support actions for rescission. Fraudulent misrepresentations will also support a claim for damages in deceit (see *Derry v. Peek*, *supra* note 396). Under trade practices legislation such as the *Trade Practice Act*, R.S.B.C. 1996, c. 457 (see *supra* note 298 for

does not appear to be any forceful objection to recognizing tortious liability for careless misrepresentations simply because they are gratuitously made.<sup>399</sup> Further, any erosion of the doctrine of consideration is minimal because proof of detrimental reliance, required to establish factual causation, provides an analogue to consideration.<sup>400</sup> The second argument is that the consent model blurs the traditional line between tort law and contract in terms of the basis of liability, i.e., tort is primarily based on imposed duties, and contract law is primarily based on obligations arising by consent. This is also a weak point. Maintaining distinctions simply based on historical development is not an appealing justification.<sup>401</sup> Further, the line was never that clear in the first place. Not all contractual relationships are completely consensual. Not only do some statutes impose contractual obligations against the will of the parties,<sup>402</sup> but the courts do so on occasion as well.<sup>403</sup> Similarly, not all tortious relationships need be completely imposed without consent.

*Hedley Byrne* liability was conceived as a hybrid form of liability for good reason. It does not make sense to require consent *and* consideration in contract (subject to the limited exceptions mentioned), but in tort to require neither when regulating essentially the same activity. In contract law, the consideration and privity doctrines may be weakened, but voluntarism remains strong. It should also be part of this closely related tort. In *Williams*, Lord Steyn phrased it this way:

[T]he restricted conception of contract in English law, resulting from the combined effect of the principles of consideration and privity of contract, was the backcloth against which *Hedley Byrne* was decided and the principle developed in *Henderson [v. Merrett Syndicates Ltd.]* (1994), [1995] 2 A.C. 145]...It may become necessary for the House of Lords to re-examine the principles of consideration and privity of contract. But while the present structure of English contract law remains intact the law of tort, as the general law, has to fulfil an essential gap-filling role. In these

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other examples), and specialized legislation such as the *Misrepresentation Act 1967* (U.K.), claims for damages for gratuitous representations, whether innocent, negligent or fraudulent, are also possible.

<sup>399</sup> Negligent misrepresentations are gratuitous in the free rider and direct advice scenarios, but not necessarily in the basic contract scenario.

<sup>400</sup> It is not true consideration because the reliance is not at the "request" of the representor. Often, however, there is an expectation of reliance which could be evidence of an implied request.

<sup>401</sup> The argument has been made in connection with distinctions between actions at law and in equity: see P.B.H. Birks, "Civil Wrongs: A New World" in *Butterworth Lectures 1990-91* (London: Butterworths, 1992) 55 at 110, where he stated "[T]he divisions which make thinking and teaching manageable must not be based on the accidents of jurisdictional history." The same applies to distinctions between tort and contract.

<sup>402</sup> See above section 3.4.5.4 under "Limits".

<sup>403</sup> See *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986, 91 D.L.R. (4th) 491, where the Court describes the rules for implying terms, including terms implied in law based on "necessity" and not the parties' intentions. It should be noted that the overall relationship is consensual and not imposed against the will of the parties.

circumstances there was, and is, no better rationalisation for the relevant head of tort liability than assumption of responsibility.<sup>404</sup>

#### ■ Free Speech

This policy consideration is unique to negligent misrepresentation among the categories of pure economic loss. It stems, of course, from the nature of the conduct in question: the use of words. The Supreme Court of Canada has defined freedom of expression under s. 2(b) of the *Canadian Charter of Rights and Freedoms*<sup>405</sup> very broadly and it clearly includes, but extends beyond, speech or words.<sup>406</sup> The reasons for protecting freedom of expression are (1) to attain truth, (2) to encourage political and social activity and (3) to foster individual self-fulfilment.<sup>407</sup> An activity is expressive “if it attempts to convey meaning”.<sup>408</sup> Most statements that form the basis of negligent misrepresentation claims attempt to convey meaning, and it has been established that commercial expression is covered.<sup>409</sup> However, even if *Hedley Byrne* or *Hercules* could be interpreted as interfering with freedom of expression, the *Charter* does not apply to the common law,<sup>410</sup> so there is no “direct” constitutional argument. But the Supreme Court of Canada has held that while the common law is not subject to the *Charter*, the courts in Canada should develop the common law in accordance with *Charter* values.<sup>411</sup> Justice Linden writes:

[F]reedom of speech is an important social value in a constitutional democracy. A requirement to exercise reasonable care in speech restricts free speech. Such an inhibition must be imposed thoughtfully, and only in circumstances that justify infringing the defendant’s right of expression.<sup>412</sup>

Despite this call for caution, it is unlikely a court would find that careless words liability conflicts with *Charter* values, given the longstanding and widespread acceptance of consumer protection legislation which prohibits deceptive and misleading conduct including speech (not only in Canada but elsewhere), and the absence of successful constitutional challenges to such

<sup>404</sup> *Williams*, *supra* note 5 at 584.

<sup>405</sup> Canadian Charter of Rights and Freedoms, Part 1 of the Constitution Act, 1982, being Schedule B to the Canada Act 1982 (U.K.), c. 11. For a detailed overview, see Peter W. Hogg, *Constitutional Law of Canada*, loose-leaf ed. (Scarborough: Carswell, 1966) c. 40.

<sup>406</sup> See *Irvin Toy Ltd. v. Quebec (Attorney General)*, [1989] 1 S.C.R. 927, 58 D.L.R. (4th) 577 [cited to S.C.R.]

<sup>407</sup> *Ibid.* at 976.

<sup>408</sup> *Ibid.* at 968.

<sup>409</sup> See *Ford v. Québec (Procureur général)*, [1988] 2 S.C.R. 712, (*sub nom. Ford v. Québec (Attorney General)*) 54 D.L.R. (4th) 577.

<sup>410</sup> See *R.W.D.S.U. v. Dolphin Delivery Ltd.*, [1986] 2 S.C.R. 573, (*sub nom. R.W.D.S.U., Local 580 v. Dolphin Delivery Ltd.*) 33 D.L.R. (4th) 174.

<sup>411</sup> See *Pepsi-Cola Canada Beverages (West) Ltd. v. R.W.D.S.U., Local 558*, [2002] 1 S.C.R. 156, 208 D.L.R. (4th) 385, 2002 SCC 8.

legislation (in Canada, whether the legislation would run afoul of s. 2(b) or be “justified” under s. 1 of the *Charter* is not important). But if weight were to be given to this fundamental freedom, in a contest between the reliance and consent models of liability, it would be much harder for a defendant to make a “*Charter* values” argument if the basis of liability were voluntary assumption of responsibility.<sup>413</sup>

### 3.5.2 Efficiency and Negligent Misrepresentation

In section 3.3.2.5, efficiency was examined in relation to tort law with the emphasis on negligence generally. The following considers law and economics theory in relation to negligent misrepresentation specifically.

The three figures at the beginning of this section illustrate the main contexts in which negligent misrepresentation claims can arise. Professor Bishop, one of the few authors to examine tortious liability for careless words and efficiency in detail, has concluded “that some very different economic conditions underlie different contexts in which statements are made”.<sup>414</sup> Before considering these different conditions, the uniqueness of information as an economic good should be noted. Compared with tangible goods, information is often difficult to value and exploit.<sup>415</sup> Part of the reason for this is that it is easily reproduced. Much of law and economics analysis concerns the internalization of externalities in the products liability context to arrive at optimal production and price levels. A quite different problem can arise with information production. The market may fail to achieve the social optimum not because of a failure to internalize external costs but because of a failure to reward the producer with the external benefits (bootlegged copies of musical works and software programs come to mind). The producer may be required to absorb the full cost of information production but be unable to gather the full benefit. This could result in information being under produced from an efficiency standpoint (copyright laws and the success of Bill Gates notwithstanding). As

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<sup>412</sup> Linden, *supra* note 191 at 410.

<sup>413</sup> Professor Feldthusen believes the reliance model in *Hercules* constitutes a “drastic interference” with a defendant’s freedom of speech: *Economic Negligence*, *supra* note 281 at 46.

<sup>414</sup> Bishop, “Negligent Misrepresentation Through Economists’ Eyes”, *supra* note 282 at 360.

<sup>415</sup> *Ibid.* at 364-65.

Bishop puts it, with information “the market failure is not on the supply side but on the demand side”.<sup>416</sup>

### 3.5.2.1 Direct Advice

It is in the context of direct advice provided without formal consideration that negligent misrepresentation liability has had its longest affiliation (see Fig. 3.5-1 above). Bishop refers to the classic *Hedley Byrne* scenario as three-party negligent misrepresentation<sup>417</sup> fitting somewhere between what I have classed the basic contract and secondary market situations. However, it is a little misleading to refer to this situation as three-party misrepresentation – in some cases it will resemble the basic contract scenario with just two parties, in others the secondary market scenario,<sup>418</sup> the difference being that the information in this situation is gratuitously produced.<sup>419</sup>

As mentioned, a rule of liability based on foreseeable and reasonable reliance is a less limited form of liability than assumption of responsibility.<sup>420</sup> Because consent is not an element (and disclaimers are not necessarily conclusive of responsibility), it introduces costs that are uncertain and difficult to measure. For instance, if advisors adopt the say-nothing option to avoid liability costs, how will that affect their business? Clients and customers may be unhappy with such a response and take their business elsewhere. Lord Devlin alluded to this possibility in *Hedley Byrne*:

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<sup>416</sup> *Ibid.* at 366.

<sup>417</sup> *Ibid.* at 373-74.

<sup>418</sup> As noted in the explanation to Fig. 3.5-1, the presence of a third party was not made a requirement of liability in *Hedley Byrne*. The assumption of responsibility and reliance arguments in *Hedley Byrne* could just as easily have been made with respect to information that did not relate to a customer or any other specific third party. However, in cases like *Hedley Byrne* and *Micron Construction* where the advice does involve a customer, there is a resemblance to the secondary market situation.

<sup>419</sup> The absence of consideration in this situation should not be stressed, however. In most cases there will be an indirect financial benefit to the information provider, such as good will, an expectation of future reciprocity, etc. Where a customer is involved, there would be a general expectation that relevant information would be passed on to other parties if it were in the best interests of the customer. Technically, the service may be gratuitous, but there is at least an argument that it would be part of a package of services *purchased* by the customer: see comments to this effect by Bishop in “Negligent Misrepresentation Through Economists’ Eyes”, *supra* note 282 at 375.

<sup>420</sup> This is so even recognizing the limitations in *Hercules* concerning knowledge of the users and usage, which are more relevant to the secondary market scenario than the context considered here.

The service that a bank performs in giving a reference is not done simply out of a desire to assist commerce. It would discourage the customers of the bank if their deals fell through because the bank had refused to testify to their credit when it was good.<sup>421</sup>

As well, expectations of reciprocity and cooperation from other businesses (in *Hedley Byrne* the information was actually passed between two banks, and not directly to the user) would become unclear. On the other hand, if advisors continue giving advice but redraft disclaimers and employ new methods of communicating them in an attempt to control liability costs (by removing all "reasonableness" from the reliance), there will be unknown costs associated with implementing these new procedures and with the litigation that will inevitably be required to test their effectiveness. These costs associated with controlling liability (through silence, redrafting disclaimers, or other means), which may be referred to collectively as "Uncertainty Costs", militate in favour of a liability rule based on consent allowing advisors the opportunity to more clearly define their responsibility to others.

Despite these Uncertainty Costs, if one applies the Hand Formula and the Kaldor-Hicks approach to efficiency, there is a possibility that the reliance model might prove a more efficient rule for gratuitous direct advice, even though the banks may lose.<sup>422</sup> Banks and other information providers can generally remove the risk of inaccuracy at a lower cost than the information recipient can protect itself from error.<sup>423</sup> If they decide to continue giving advice under the reliance rule (eliminating the Uncertainty Costs associated with the silence option), they could minimize costs in other ways than designing new disclaimers. They could, for instance, implement information review protocols or, in the case of banks particularly, self-insure against misinformation liability costs (spreading the "premium" over a large customer base). Both of these options would likely be at little cost to themselves. As pointed out above, even some law and economics theorists who see contract law and voluntarism as the preferred means of achieving efficiency in the commercial context concede that imposing liability of

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<sup>421</sup> *Hedley Byrne*, *supra* note 3 at 529.

<sup>422</sup> Posner has written an article on gratuitous *promises to act* and efficiency, but specifically omits from his analysis a discussion of gratuitous promises backed by detrimental reliance, which are generally enforceable in the United States, and which are most analogous to the situation we are concerned with here, i.e., gratuitous *information or advice*. Interestingly, he does reach the conclusion that liability for most gratuitous promises is supportable on efficiency grounds, largely because the promisor is the least-cost avoider. See Richard A. Posner, "Gratuitous Promises in Economics and Law" (1977) 6 J. Legal Stud. 411.

<sup>423</sup> See discussion to this effect next under "Basic Contract" (section 3.5.2.2).

some form on the information provider would promote efficiency through lower bargaining costs and improved reliability of exchanged information.<sup>424</sup>

However, having made the case for the reliance model, there is another argument (besides Uncertainty Costs) that supports the more restrictive assumption of responsibility model. As with the secondary market scenario, there is problem with non-appropriability of benefits, although here it is not as strong. The information in a case like *Hedley Byrne* or *Micron Construction* will usually be more particularized and not published in a public or semi-public document such as a financial report. But Professor Bishop believes the non-appropriability argument is still relevant in this context, and limited liability based on "special relationship" is an efficient rule. He apparently equates "special relationship" with assumed responsibility by the defendant. He writes:

Without the special relationship limitation many banks might decline to give any information at all. *The special relationship allows them to give it and disclaim liability effectively.* Without it the bank might be unable to give the valuable information without incurring unacceptable costs to itself. The requirement of a "special relationship" allows the bank to perform a cost-benefit analysis of information giving – and to avoid liability if its customers are not willing to pay for the costs to the bank of compensating those who lose because of information error.<sup>425</sup> [emphasis added]

As described next in connection with basic contract scenario, a model based on consent is more consistent with the preference for private ordering in neo-classical economics as a means of achieving Pareto-superior transactions. This is true in the direct advice setting too where the parties are best able to assess costs and benefits, and where externalities are not a significant concern. They will not proceed with a transaction that they believe will make either of them worse off.<sup>426</sup>

### 3.5.2.2 Basic Contract

Where two parties are negotiating a contract, in most cases, the information produced is of value only to the plaintiff, so the non-appropriability problem does not arise. Because transaction costs are generally low in this context, the Coase Theorem dictates that the

<sup>424</sup> See *infra* notes 436 and 437, and accompanying text.

<sup>425</sup> Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 374.

<sup>426</sup> This is the case regardless of which rule of liability applies. If the consent rule applies and responsibility is not assumed, the information recipient can pay for a warranty; without a warranty, the information recipient will have to assess the risk of relying on the information without a claim against the information provider. If the reliance rule applies and the information provider is not prepared to take the risk of liability (factoring in the costs of silence, etc.), he can seek a contractual exclusion and refuse to provide the information without one.

particular liability rule is not that important from an efficiency standpoint.<sup>427</sup> But transaction costs while low are not zero (negotiating responsibility for carelessly provided information is not costless) therefore the *prima facie* assignment of liability should attempt to minimize the sum of all costs.<sup>428</sup>

Generally, the cost of care to the information provider is less than the cost of error to the information recipient, therefore liability for misinformation should reside with the information provider (the precise model of liability, voluntary assumption of responsibility, reliance or even basic foreseeability, is not significant). For example, in *Esso Petroleum Co. Ltd. v. Mardon*<sup>429</sup> a pre-contractual misrepresentation by Esso concerning projected sales induced the Mardon to enter into a three-year lease. Sales turned out to be much less than expected the lease was eventually given up. Assuming loss avoidance on the part of Esso was less than the resulting loss to Mardon, efficiency dictates that liability for negligent misrepresentation should be assigned to Esso, as it was.<sup>430</sup> This will *likely* reduce transaction costs as well (although it is not certain that it will, because the party making the representation might attempt to negotiate an exclusion of liability).

There will be some cases where the cost of care to the information provider exceeds the cost of error, however. In *Nunes Diamonds*<sup>431</sup> a post-contractual misrepresentation (i.e., one made in the course of performance of contractual obligations) by a security company led the plaintiff to

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A form of consent, therefore, determines the nature of the relationship under either rule. Why then not start from this position?

<sup>427</sup> Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 370. Bishop uses the standard Coase analysis, assuming first that one party, e.g., the information provider, is liable for the default, and then assuming the information recipient is responsible (i.e., there is no liability rule). In the former case, if the information provider is not willing to enter the contract with the risk of liability for inaccuracies, she can exclude liability under the contract. The information recipient will then have to decide if the risk of inaccuracy is worth taking or protecting against. In the latter case, if the information recipient is unprepared to contract without a warranty of the accuracy of the information, the information provider must decide whether it will be to her benefit to give a warranty or assume the risk of liability in tort. In either case the contract will not be entered into until the parties have negotiated a Pareto-superior solution. What Bishop does not do is consider different forms of limited liability for the information provider, e.g., the reliance versus the consent models. However, the same conclusion is reached when these two approaches are considered. Just as in the direct advice setting (as explained in the previous note), it doesn't matter which rules applies. In either case the information will only be provided or used in circumstances where both parties believe the benefits are outweighed by the risks.

<sup>428</sup> *Ibid.* at 371.

<sup>429</sup> *Esso Petroleum*, *supra* note 329.

<sup>430</sup> The Court of Appeal also found that the representation was a warranty and that Esso was in breach of contract.

<sup>431</sup> *Nunes Diamonds*, *supra* note 330.



believe a security system was safer than it was. A theft occurred. There was a question about causation in this case because Nunes Diamonds was insured – in fact, it was so well insured it actually profited from the incident. But the majority of the Court did not base its decision that the security company was not liable in tort for misrepresentation on an absence of reliance. They based their decision on a concurrent liability rule, holding that liability under *Hedley Byrne* was inapplicable where the relationship between the parties was governed by contract unless the tort was an “independent tort”.<sup>432</sup> An exclusion clause precluded an action in contract. This concurrent liability rule is no longer followed, but there is an economic justification for the decision. Nunes Diamonds, the information recipient, was “the least-cost avoider of, or least-cost insurer against, theft”.<sup>433</sup>

This kind of efficiency argument can be seen as an application of the Hand Formula: if  $B < PL$  there is liability. More specifically, the reasoning is that the party whose cost of risk avoidance (B) is the least should be responsible, assuming this cost is also less than the risk itself (PL).<sup>434</sup> Given that the *Nunes Diamonds* situation (i.e., where the information recipient is the least-cost avoider) is probably the exception, *overall* efficiency (in the Kaldor-Hicks sense) would be served by a rule fixing liability on information providers in the basic contractual setting.

However, it should be remembered that there is an objection to the use of the Hand Formula (and Kaldor-Hicks reasoning) at all in this context. The formula assumes the actors are not risk averse, which in the commercial context is clearly not the case.<sup>435</sup> Some law and economics scholars believe that Pareto-superior transactions are best achieved by voluntarism and contractual allocation of risk where it is possible, the Coase Theorem and transaction costs aside.<sup>436</sup> This suggests a no-liability rule or at most one based on assumption of responsibility.

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<sup>432</sup> See the Appendix for a more detailed discussion of concurrent liability in contract and tort.

<sup>433</sup> Bishop, “Negligent Misrepresentation Through Economists’ Eyes”, *supra* note 282 at 372.

<sup>434</sup> Two points relating to the Hand Formula should be noted here. First, the way most law and economics scholars use the formula is slightly different than its application as originally conceived. They use it to determine whether a tort obligation ought to exist at all and, if so, what it should be, not simply to determine whether an existing obligation supported on other grounds has been breached. See *supra* note 176 and accompanying text. Second, Posner’s “marginal” modification must be applied in order for it to be truly accurate (probability is affected by the avoidance measures taken): see Fig. 3.3-1 and accompanying text. There is no reason to believe that this modification would not apply equally in cases of indirect causation based on reliance.

<sup>435</sup> See discussion to this effect above in section 3.3.2.5.

<sup>436</sup> See Trebilcock, *supra* note 122 at 368.

Others, however, acknowledge that liability rules have some role to play in reducing transaction costs and discouraging carelessness in the exchange process.<sup>437</sup>

Unfortunately, the economic arguments in favour of a liability rule based on either the Hand Formula or a contract analysis do not *clearly* point to any particular form of liability. In the final analysis, even if an expansive liability rule were imposed, it is questionable how significant its impact would be given that bargaining costs are generally low in this context and the information provider can control liability through contractual exclusions, or decline to contract should the other party fail to agree to them.<sup>438</sup>

### 3.5.2.3 Free Rider

The secondary markets scenario best highlights the problem of non-appropriability of the benefits of information. There are many examples of information, usually created by experts and under contract with their clients, which has value to persons other than those for whom it is created. Based on the litigation generated, one the largest categories involves accountants and financial reports prepared for corporate clients where investors, shareholders and others rely on the information, usually for investment and related purposes: see *Ultramares*, *Candler*, *Haig*, *Caparo* and *Hercules*,<sup>439</sup> for example. Reports by engineers,<sup>440</sup> surveyors, appraisers,<sup>441</sup> and mapmakers<sup>442</sup> are just a few of the other types of information that may have value in secondary markets. Sometimes the information is prepared with knowledge of the identity of the third party users and the purposes for which they will apply the information, sometimes not.

In an ideal market (from the economist's perspective), information producers would be able to fully exploit the value of the information by charging a fee to all users, and would similarly be responsible for losses caused if the information was negligently produced.<sup>443</sup> The debate would likely focus on how expansive negligence liability should be in order to achieve the

<sup>437</sup> *Ibid.* at 369, and Bishop, "Economic Loss in Tort", *supra* note 181 at 28-29, who talks in broader terms about how failing to recognize a liability rule could have a negative effect on the market for information.

<sup>438</sup> See *supra* note 427. The different types of contractual exclusion clauses that may be used are discussed in Chapter 4 (sections 4.3.4.1 and 4.3.4.3).

<sup>439</sup> See *supra* notes 286, 332, and 6.

<sup>440</sup> For example, *Edgeworth Construction*, *supra* note 334.

<sup>441</sup> For example, *Senger v. Kennedy* (1989), 6 R.P.R. (2d) 274 (B.C. Co. Ct.) and *Smith v. Eric S. Bush*, [1990] 1 A.C. 831, [1989] 2 All E.R. 514 (H.L.) [*Smith* cited to A.C.].

<sup>442</sup> For example, *Sea Farm Canada Inc. v. Denton* (1991), 7 C.C.L.T. (2d) 209 (B.C.S.C.). Also note Lord Denning's marine hydrographer example in *Candler*, *supra* note 332 at 183.

optimum level of information production. Perhaps the question of strict liability would arise, along the lines of the products liability debate in the United States. In the real market, however, it is not practically possible to collect payment from all users. If information producers were required to pay for losses under an expansive liability rule, substantial costs would be added without a corresponding revenue gain.<sup>443</sup> Quality would rise but likely with a sizeable decrease in production because fewer paying consumers would be able to afford the increased price required to cover liability costs.

It is not possible for information producers to negotiate with every user to reach an efficient solution to the non-appropriability problem – transaction costs are too high in this context and the Coase Theorem therefore does not apply. According to law and economics theory, this is where the law can make a difference. The question arises: If a court were to choose a liability rule based on efficiency, what would that rule be? Broadly speaking, the three options are expansive liability, no liability, or some form of limited liability. The courts in most jurisdictions have adopted a middle position recognizing a liability rule for *some* losses caused by misinformation. Bishop thinks that by doing so they have intuitively reached an efficient solution.<sup>445</sup> A limited form of liability ensures an optimum balance between quality and level of production. Both the reliance and voluntary assumption of responsibility models are forms of limited liability. Unfortunately, as with the basic contract scenario, economics analysis does

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<sup>443</sup> See Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 367.

<sup>444</sup> Bruce Chapman, in "Limited Auditors' Liability: Economic Analysis and the Theory of Tort Law" (1992) 20 Can. Bus. L.J. 180 at 192-93, questions Bishop's assumption, at least in the auditors' liability context, that information providers would have any problem in appropriating benefits from reasonably foreseeable users of the information. While agreeing with Bishop that directly charging investors would not be practically possible, auditors could charge their client corporations more. Auditors could in this fashion appropriate benefits indirectly and so absorb higher liability costs. There are problems with this analysis. While large accounting firms servicing large corporations requiring audits by law may be relatively unaffected, the many smaller accounting firms servicing smaller corporations may see their businesses diminish possibly resulting in an inefficient underproduction of information. Smaller businesses might not be able to absorb the increased accounting fees and the demand for accounting services would decline: see John A. Siliciano, "Negligent Accounting and the Limits of Instrumental Tort Reform" (1988) 86 Mich. L. Rev. 1929 at 1971. And to the extent that corporations could absorb the increased accounting fees it would likely be by passing those costs on to the public through its shareholders or consumers. Under a broad liability regime, investors would thus be provided with a "society-assisted free ride": see Brian R. Cheffins, "Auditors' Liability in the House of Lords: A Signal Canadian Courts Should Follow" (1991) 18 Can. Bus. L.J. 118 at 127.

<sup>445</sup> Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 369.

not clearly point to any particular rule.<sup>446</sup> To determine precisely which form of limited liability is the best one would require difficult and expensive experimentation with different rules.<sup>447</sup>

#### 3.5.2.4 A Note on Public Authorities

Regardless of which category is involved, direct advice, basic contract or free rider, if the information provider is a public authority, different efficiencies may, though not necessarily, be present. For instance, with respect to building inspections, the *possibility* exists for relatively inexpensive error avoidance aided by the incentive of imposing liability on the government for careless errors (an expansive liability rule may even be supportable). On the other hand, if purchasers were required to absorb losses (no liability or limited liability on the part of government), there is the potential for a high degree of "private waste" along with the uncertainty associated with not being able to rely on government. This makes for an inefficient alternative.<sup>448</sup>

#### 3.5.3 Choosing the Right Rule

The Supreme Court of Canada in *Hercules*, in adopting the reliance model of liability, did not provide a clear rationale for abandoning *Hedley Byrne* and the consent model. Apparently, the main reason for moving from special relationship to proximity was formal coherence, but why voluntary assumption of responsibility was not incorporated into the *Anns* framework is unclear.<sup>449</sup> It is in fact even unclear whether the Court intended to discard the requirement of consent – the absence of a disclaimer in *Hercules* meant the Court did not have to confront the issue. That was left for the later decision in *Micron Construction*. Of the duty and efficiency arguments just canvassed some support reliance, some voluntary assumption of responsibility,

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<sup>446</sup> With respect to the reliance model of liability, part of the difficulty in measurement would result from the Uncertainty Costs described under the direct advice scenario (which would also arise here). For instance, if non-contractual disclaimers were ineffective against free riders there would be unknown costs associated with controlling liability. Although, difficulty of measurement is arguably not by itself a sufficient justification to jettison the rule.

<sup>447</sup> Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 369. The point has been made that in the auditors' liability cases, regardless of whether accountants are subject to an expansive liability rule or not, the public will end paying something for the risk of loss. Whether it is the accountants who charge more for their services or investors for their credit (investors will charge more as their risk increases. i.e., as accountants' liability diminishes), corporations will pass on their costs to the buying public: see Siliciano, *supra* note 444 at 1972-73. The factual question which has not yet been resolved is, who is the more efficient absorber of the losses?

<sup>448</sup> Bishop, *ibid.* at 377-78.

<sup>449</sup> This transition from special relationship to proximity is discussed in more detail in Chapter 4.

and others are neutral. Before choosing a winner, a few of the problems relating specifically to the application of these two models are considered.

### 3.5.3.1 *The Reliance Model*

The reliance model for establishing a *prima facie* duty of care focuses on the plaintiff's response to the defendant's behaviour. It should be noted that not all reliance is bad – a plaintiff may not be prejudiced by the reliance or may even profit from it – but because negligence requires the proof of damage, generally only detrimental reliance will be significant in establishing a claim. Besides being either detrimental or non-detrimental, reliance can be specific or general. Specific reliance has three elements to it: voluntary conduct by the defendant, reliance by the plaintiff, and a “connection between the two such that the latter can be identified as a product of the former”.<sup>450</sup> Professor Barker believes specific reliance suggests a relationship of power and dependence, and is a composite model of liability combining reliance with voluntary conduct (which is the third and weakest method of proving voluntary assumption of responsibility, discussed next). It has some qualified parallels in contract law, such as claims of misrepresentation (innocent and fraudulent) and estoppel (promissory and proprietary). Barker criticizes the specific reliance approach mainly because he believes it has been overtaken by negligence law generally: he cites *Anns*,<sup>451</sup> negligent misrepresentation cases<sup>452</sup> and other economic loss cases<sup>453</sup> where reliance is not significant. This criticism is questionable. Just because specific reliance fails to explain *all* negligence cases is no reason to reject its application in *some* cases. In his opinion, specific reliance is too narrow a principle to apply to negligence law including negligent misrepresentation and other economic loss cases. I would argue, however, that specific reliance as defined above does not necessarily connote a power-dependency relationship<sup>454</sup> and is too broad. If it were adopted without qualification and just in the context of economic negligence or even just negligent misrepresentation, it would fundamentally change commercial interaction creating responsibilities unheard of to this point.

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<sup>450</sup> Barker, *supra* note 7 at 477-78.

<sup>451</sup> Barker notes that while *Anns* has been overruled in the United Kingdom [and Australia], it is still good law in some Commonwealth jurisdictions [e.g., Canada and New Zealand].

<sup>452</sup> For example the *Ross* case, *supra* note 335. As discussed in the text accompanying this note, *Ross* is not really a negligent misrepresentation case.

<sup>453</sup> For example, the relational economic loss cases, such as *Norsk*, *supra* note 178.

<sup>454</sup> Generally, power-dependency relationships transcend the particular transaction in question. If each instance of specific reliance were seen as creating a power-dependency relationship it would have wide ranging implications for tort, contract and fiduciary law.

The general reliance approach, Barker argues, has “reasonable reliance” as the “touchstone of liability”.<sup>455</sup> And in contrast with specific reliance cases, where typically the parties will have communicated with each other, the concept of general reliance is characterized by “remoter relations in which the plaintiff is dependent on the defendant for other reasons [i.e., other than the act or default upon which the plaintiff’s claim is based]”.<sup>456</sup> The duty of care arises because the defendant has some “special power” over the plaintiff’s welfare and the plaintiff expects the defendant to use reasonable care in the exercise of that power; the reliance is therefore diffuse.<sup>457</sup> The general reliance concept has not been received enthusiastically by the courts, but it has found limited acceptance in cases involving public authorities and building inspection obligations.<sup>458</sup> If this approach were applied to negligent misrepresentation (and assuming power-dependency in a broad sense is a requirement), it would mark a return to the days before *Hedley Byrne* when liability was predicated on a fiduciary relationship.

In *Hercules*, the Supreme Court of Canada adopted a reliance model that has aspects of both specific and general reliance, as defined above. “Reasonable reliance” on the statement<sup>459</sup> is an essential component of the proximity test, but the *indicia* of reasonable reliance adopted by the court are suggestive of both forms of reliance.<sup>460</sup> For instance, one *indiciu*m is the special skill and knowledge of the defendant (suggestive of general reliance), and another is the provision of information in response to a specific inquiry or request (suggestive of specific reliance). Also, actual reliance is apparently not required at the duty stage which is indicative of general

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<sup>455</sup> Barker, *supra* note 7 at 476.

<sup>456</sup> *Ibid.* Barker notes that normative basis of general reliance resides in the idea that “power invites responsibility”.

<sup>457</sup> Barber argues that under this approach while reasonable reliance is a “touchstone” of liability it is not a necessary precondition of liability. The key requirement is power-dependency. I would add that reasonable reliance just like specific reliance does not necessarily imply power-dependency: see *supra* note 454.

<sup>458</sup> Most of the cases are from New Zealand and the United States. I discuss them briefly in Chapter 4 in the comparative survey (section 4.4).

<sup>459</sup> Feldthusen argues that the reasonable reliance test is inherently ambiguous because it is not clear what it is the plaintiff is to have relied on. For instance, is the plaintiff relying on the defendant just to look at the information, or to subject it to “careful professional analysis”? See *Economic Negligence*, *supra* note 281 at 46. In *Williams*, *supra* note 5 at 583-84, when describing the necessary *causal* reliance, Lord Steyn referred to reliance by the plaintiff on the defendant’s assumption of responsibility. La Forest J.’s view of what constitutes reasonable reliance seems more straightforward. The question is simply whether or not it would be reasonable, in all the circumstances, to rely *on the statement* in making a financial decision: *Hercules*, *supra* note 6 at 188.

<sup>460</sup> The *indicia* of reasonable reliance recognized by the Supreme Court of Canada in *Hercules* are set out in Chapter 4 (section 4.3.3.2).

reliance.<sup>461</sup> However, La Forest J., for the Court, did not hold that a power-dependency relationship was a necessary prerequisite of liability. The main attractiveness of this approach to liability rests on morality and the idea that one ought to stand behind one's word, just as one ought to stand behind one's actions. La Forest J. referred to "simple justice" as underpinning his rule.<sup>462</sup>

### 3.5.3.2 *The Consent Model*

Turning now to the consent model of liability: One clear distinction between the two models is that voluntary assumption of responsibility focuses on the defendant's conduct and not the plaintiff's expected response to it. The question arises, however, how exactly is such an assumed responsibility to be established? The answer is far from clear. As Barker notes, "[t]he courts have been free with the language of voluntariness and have not given it any set form".<sup>463</sup> He identifies three means of proof used by the courts. From strongest to weakest, they are the promise, choice and voluntary action methods.<sup>464</sup> The promise method requires proof that the information provider has promised care. Rarely will there be an express warranty or undertaking to this effect.<sup>465</sup> The difficulty is where the promise must be inferred from a course of conduct.<sup>466</sup> No clear guidelines have been established to assist the courts, but the exercise is not an unfamiliar one. In contract law, the intention to make offers and acceptances may be inferred not only from the words used and surrounding circumstances but also from conduct.<sup>467</sup> One objection to this approach is that it looks, at first blush, like it infringes the longstanding principle against the enforcement of gratuitous promises. As noted earlier, however, the lack of consideration should not be a bar. The law already attaches legal consequences to certain gratuitous promises of future action and representations of fact. There is no reason why there should be an absolute bar in relation to gratuitous undertakings of care in making factual statements. Further, detrimental reliance is required (in response to

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<sup>461</sup> The question at the duty stage is whether the reliance *would be* reasonable if it were to occur: see *Hercules*, *supra* note 6 at 188. *Actual* reasonable reliance is required to prove causation, however. Because actual reasonable reliance is causally necessary there is a danger that the duty question will become a mere formality. The reasonableness of the actual reliance is also relevant to the question of contributory negligence.

<sup>462</sup> See *supra* note 351 and accompanying text.

<sup>463</sup> Barker, *supra* note 7 at 465.

<sup>464</sup> *Ibid.* at 463 and following discussion (464-75).

<sup>465</sup> See *Economic Negligence*, *supra* note 281 at 50.

<sup>466</sup> This is pointed out clearly by Lord Devlin in *Hedley Byrne*, *supra* note 3 at 528-29.

<sup>467</sup> See for example *Saint John Tug Boat Co. v. Irving Refinery Ltd.*, [1964] S.C.R. 614, 46 D.L.R. (2d) 1.

the promise) which approximates the consideration requirement in contracts.<sup>468</sup> Another problem with this approach is that it becomes strained when applied to the “free rider” category of case, because there is no direct communication between the parties.<sup>469</sup> Express promises may be made to the world at large,<sup>470</sup> but inferring promises to those who may use the information, but with whom there has been no communication (the defendant may not even know the plaintiff) is somewhat artificial.

The choice method is an easier way to establish consent and is an attractive alternative to the promise method where the parties are not in direct communication. However, Barker points out that there are problems with this approach, because “judges at not wholly clear what it is that the defendant is supposed to have ‘chosen’”.<sup>471</sup> He notes four possibilities: choosing to act, choosing a legal obligation, choosing a relationship of reliance/dependence, and choosing to put the plaintiff at a specific risk of harm.<sup>472</sup> Choosing to act is really a form of the voluntary action method of proof.

Choosing a legal obligation, the second variation of the choice method, suffers from circularity in Barker’s opinion.<sup>473</sup> The question is, when is there a legal obligation? Answering, when you know it, requires the question to be asked again. Another way of saying the same thing is that this approach does not address the underlying reason for liability. I disagree that these are necessarily flaws, however. In contract law, the intention of the parties to be bound is a requirement of liability. If tortious liability is borrowing from contract law here, establishing choice of legal obligation as the basis of liability could be justified for reasons similar to those that support the intention rule in contracts: certainty, ability to plan, etc. Another more

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<sup>468</sup> See discussion above of negligent misrepresentation and contractual overlap in section 3.5.1.3 under “*Laissez-Faire*”. Barker makes the observation that the requirement of reliance even with the consent model makes it a “composite model”: Barker, *supra* note 7 at 465. This is not completely accurate, however. Reliance under the consent model is simply the means of proofing causation and not a constituent element of the duty.

<sup>469</sup> Barker, *ibid.* at 468-69.

<sup>470</sup> *Carlill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256 (C.A.).

<sup>471</sup> Barker, *supra* note 7 at 470.

<sup>472</sup> *Ibid.* at 469-74.

<sup>473</sup> *Ibid.* at 470-71.



substantial objection is that if choosing (or promising for that matter) a legal obligation is really the test, how often would the facts truly support such a finding?<sup>474</sup>

The next possibility, choosing a relationship of reliance/dependence, occurs where the information provider induces a relationship of reliance.<sup>475</sup> This approach differs from a pure reliance model only if it is accepted that inducement, or more precisely, the likelihood of inducement, is not enough by itself. There must be a voluntary "choice" in taking on such a relationship and the ability to disclaim responsibility. Otherwise, this is just a repackaging of the specific reliance approach described above.

The final possibility, choosing to put the plaintiff at a specific risk of harm,<sup>476</sup> is hard to justify as the basis of an assumption of responsibility model. For one thing, it has not been emphasized in the case law. More importantly, it is not really a choice approach at all. As Barker puts it, with this approach, "[l]iability is imposed not because the defendant has *exercised any significant decision*, but simply because he *was particularly at fault* in failing to avert the plaintiff's damage, given his advertence to the risks generated by his conduct".<sup>477</sup> As with the previous approach, unless the information provider can disclaim responsibility for creating the risk, it is another reworking of the specific reliance approach.

The voluntary action method is the third and weakest means of establishing voluntary assumption of responsibility. One view of this method is that "[l]iability is imposed not because the defendant has promised or chosen anything, but simply because he has 'acted' in circumstances in which he was free from...constraints".<sup>478</sup> The main criticism of this method is that it says nothing about why voluntary action should carry with it responsibility for care in ensuring the accuracy of the statement.<sup>479</sup> Why should voluntariness, which is a *precondition* to tortious liability generally, also be the *basis* of liability in this situation? I agree with this

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<sup>474</sup> See D.M. Gordon, "*Hedley Byrne v. Heller* in the House of Lords" (1964) 2 U.B.C. L. Rev. 113 at 149. See also, Brian Coote, "The Effect of *Hedley Byrne*" (1966-67) N.Z.U.L. Rev. 263 at 271, who put it forcefully: "No-one in their right minds would make such an undertaking."

<sup>475</sup> This form of the choice method was suggested in *Caparo*, *supra* note 332 at 620-21 (per Lord Bridge), and 638 (per Lord Oliver).

<sup>476</sup> *Ibid.*

<sup>477</sup> Barker, *supra* note 7 at 473.

<sup>478</sup> *Ibid.* at 474. Barker states that the defendant doesn't choose anything under this method, but, as mentioned, the "choosing to act" variation of the choice method is a form of the voluntary action method.

<sup>479</sup> See Barker, *supra* note 7 at 474 and the comments of Lord Oliver in *Caparo*, *supra* note 332 at 637.

criticism. The voluntary provision of information ought not to be enough by itself to found liability. But the courts which have adopted this method are not simply basing their decision on the voluntariness of the action as the above quote suggests. What is really occurring is that the courts are considering the voluntariness *in the particular circumstances* as evidence that responsibility is being assumed, in effect, finding an implied undertaking. Those circumstances usually include knowledge by the defendant that the plaintiff is trusting and relying on him.<sup>480</sup>

It is not necessary for the law to be overly pedantic and to articulate whether the promise, choice or voluntary action methods are being applied in determining whether or not a defendant has voluntarily assumed responsibility in a particular case. The question, I believe, should be simply whether or not the defendant has assumed or undertaken an obligation to use care in making the statement. It is, after all, a duty of care. In most cases the undertaking would be inferred based on an objective assessment of the surrounding circumstances.<sup>481</sup> It should not be necessary to find an undertaking to be *legally* responsible for damages in the event the information is inaccurate and there is detrimental reliance. There is little evidence the courts are looking for evidence of such a specific undertaking when applying the consent model, and few defendants would willingly make such an undertaking.<sup>482</sup> To be strictly accurate, what appears to happen is the courts imply or *impose* such an obligation in law when the defendant undertakes to use care in fact.<sup>483</sup> If the defendant issues a standard “without responsibility” disclaimer, that has traditionally been sufficient not only to qualify the undertaking of care, but also to negative the *legal* responsibility flowing from it.

### 3.5.3.3 *And the Winner Is?*

Barker concludes that both the reliance and consent (or voluntary assumption of responsibility) models of liability are so flawed they should be abandoned altogether as the bases of duties of care in negligence, whatever the area.<sup>484</sup> He does not suggest an alternative. Feldthusen argues that the assumption of responsibility model is preferable to the reliance

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<sup>480</sup> Lord Reid applied this approach in *Hedley Byrne*. He said that if a defendant who has the option of saying nothing provides information *knowing he is being trusted and relied on*, he must be taken to have accepted responsibility for exercising care (so long as he does not disclaim responsibility): *Hedley Byrne*, *supra* note 3 at 486.

<sup>481</sup> *Ibid.* In *Williams*, *supra* note 5 at 582, Lord Steyn phrased it this way: “An objective test means that the primary focus must be on things said or done by the defendant or on his behalf in dealings with the plaintiff.”

<sup>482</sup> See *supra* note 474 and accompanying text.

<sup>483</sup> See comments of Professor Feldthusen to this effect in *Economic Negligence*, *supra* note 281 at 50-51.

model. The main reasons he gives are: 1) that information is a commercial product (and so is the care that goes into ensuring its accuracy) and expectations are that such products be transferred by consent; 2) that the consent model “seems to direct attention more naturally to what duty precisely ought the defendant to owe to the plaintiff”, i.e., to the obligation to use care in making the statement; and 3) that this model has application beyond misrepresentation cases and can be extended to services cases where the injury is direct (i.e., reliance is not necessary).<sup>485</sup>

I agree with Professor Feldthusen. I would add to the points he makes. Basic fairness requires some form of consent as the basis of a duty of care with respect to information gratuitously provided (particularly in the direct advice and free rider contexts). Functional coherence dictates that like areas of regulation be treated similarly – negligent misrepresentation and commercial contracts concern economic ordering where obligations are generally expected to be consensual. Further, a number of the policies expressly recognized by the Supreme Court of Canada as relevant to duty of care analysis run counter to the approach taken in *Hercules* and justify a rethinking of the reliance model of liability. These include the encouragement of individualism, certainty, and the value of free speech in a free and democratic society. A number of other policies, if not directly supportive of the consent model, are at least consistent with it, such as those relating to social loss neutrality and indeterminate liability. Efficiency analysis does not yield any firm conclusions on an appropriate model of liability for all contexts. However, in the direct advice and basic contract scenarios the weight of the arguments seems to support the consent model. The most that can be said of the free rider context is that some form of limited liability is required.

In the following chapter I examine in more detail how the courts have applied the theory described in this chapter. In Chapter 5, I review and expand upon the conclusions just reached offering some suggestions how the consent model could be implemented in duty analysis. I also offer some suggestions for dealing with the uncertainty created by *Hercules* until such time, if ever, the approach in *Hedley Byrne* is reinstated.

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<sup>484</sup> Barker, *supra* note 7 at 462, 474-75, 479.

<sup>485</sup> *Economic Negligence*, *supra* note 281 at 52-54. Regarding Feldthusen’s last point, the United Kingdom already applies an “extended *Hedley Byrne* principle” to both misrepresentation and services cases: see *Williams*, *supra* note 5 at 581.

## Chapter 4

### IN PRACTICE – NEGLIGENT MISREPRESENTATION IN CANADA

In Canada, the tort of negligent misrepresentation grew out of the English approach, but in a number of decisions leading up to and culminating in *Hercules*, Canada has developed a homegrown position, unique in the Commonwealth.

#### **4.1 A TORT IS BORN**

The closest common law analogue to negligent misrepresentation prior to *Hedley Byrne* was the tort of deceit (i.e., fraudulent misrepresentation).<sup>486</sup> *Derry v. Peek*, still the leading case on deceit, established the means of proving fraud, the core element in the cause of action. Lord Hershel held:

First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.<sup>487</sup>

The plaintiff had purchased shares on the faith of false information in a prospectus and when he lost his investment he brought an action in deceit against the directors of the company. The most the evidence proved was that the directors were careless. This decision established that if the maker of a statement had an honest belief in its truth, a person relying on the statement had no cause of action, even if the statement was carelessly made.

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<sup>486</sup> See Arthur L. Goodhart, "Liability for Innocent but Negligent Misrepresentations" (1964) 74 Yale L.J. 286, for a detailed discussion of the development of the law of misrepresentation from *Derry v. Peek* to *Hedley Byrne*.

<sup>487</sup> *Supra* note 396 at 374.

Equity wrote the next chapter in this story. In 1914, the House Lords heard *Nocton*,<sup>488</sup> which was decided on the basis of breach of fiduciary duty. A solicitor had placed himself in a conflict of interest with his client and personally profited from his advice to the client. The client held a first mortgage on property on which the solicitor held an interest in a second mortgage. The solicitor advised his client to release a portion of the property from the first mortgage security (the second mortgage then became the first mortgage with respect to that portion), and when the property development failed the plaintiff lost money because of the insufficiency of the remaining portion of the property. The evidence was inadequate to establish fraud but the House of Lords held that there was negligence. Negligence in word without more would not have been actionable, but in finding that the solicitor was in the position of a fiduciary, the House of Lords allowed the claim. The duty to be careful arose by virtue of the fiduciary relationship.

*Nocton* breathed new life into fiduciary doctrine, but an independent common law action for negligent misrepresentation had to wait for almost another fifty years. It would have been longer if it had not been for *McAlister (Donoghue) v. Stevenson*. It is ironic that *Donoghue*, arguably the most significant common law decision ever, is in fact a civil law case, arising on appeal from the Scottish courts on a pre-trial motion to strike the pleadings as disclosing no cause of action.<sup>489</sup> The alleged facts are too well known to bear recounting in detail. Suffice it to say that the House of Lords was prepared to assume for the purposes of the application that a decomposed snail was in the opaque ginger beer bottle and that May Donoghue, the plaintiff, did get sick from drinking the ginger beer. They held that a manufacturer does owe a duty of care to an ultimate consumer in the absence of a contractual relationship, subject to certain limits. The case never did make it to trial and was settled out of court.

What is most significant about the case is, of course, Lord Atkin's formulation of a general principle of liability in negligence. Part of the difficulty with Lord Atkin's formulation, besides the broadness of the language, is that it refers to so many of the elements of the cause of action, and they are not neatly delineated. This was left for later judges and commentators to

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<sup>488</sup> *Supra* note 397.

<sup>489</sup> Nothing turned on the fact that it was a civil law case, however, because as Lord Atkin said, "the principles of the law of Scotland on [the question were] identical with those of English law": *supra* note 13 at 579. The decision was thoroughly British with a half-Irish, half-Welsh judge writing the leading judgment for England's highest court deciding a Scottish case.

do. And while the neighbour principle was strictly speaking *obiter dictum*, when it was eventually clarified and adopted in *Anns*, it became a powerful new guide to behaviour in many forms of social interaction.<sup>490</sup>

Prior to *Anns*, however, *Donoghue* still had an effect. It gave judges the courage at least to attempt to forge new rules where they felt it was appropriate. The first try at recognizing a common law duty of care in word was *Candler*.<sup>491</sup> It failed but Lord Denning's wrote a forceful dissent. The defendant accountants had prepared financial statements for a company at its request with knowledge that the plaintiff would be looking at the statements in making his decision whether or not to invest in the company. The accounts were carelessly prepared and the plaintiff suffered losses on the investment. The majority believed *Derry v. Peek* and other authority bound them to dismiss the action. However, Denning L.J. argued that *Nocton* and *Donoghue* entitled him to reconsider the law relating to negligent misrepresentation. He was prepared to recognize a limited duty of care owed by the defendants not only to their client but to a third party they knew would be relying on their report for a specified purpose and transaction. It was perhaps Lord Denning's judgment that gave the House of Lords the necessary impetus for their decision in *Hedley Byrne*.

In 1963, the House of Lords finally recognized that a common law duty of care in word could exist. The facts of *Hedley Byrne* were that a bank, Heller & Partners, provided a banking reference relating to one of their customers, Easipower, to Hedley Byrne, an advertising company that was considering doing business with Easipower. Hedley Byrne was concerned about the creditworthiness of Easipower because they would be extending business of high value on credit. Communicating through their own bank, Hedley Byrne wrote Heller & Partners twice requesting a reference. The first letter was qualified by the phrase "in confidence and without responsibility" on the part of Heller & Partners, and the second by the phrase "private and confidential". Heller & Partners replied:

CONFIDENTIAL

For your private use and without responsibility on the part of this bank or its officials.

Dear Sir, In reply to your inquiring letter of 7th instant we beg to advise:

Re E..... Ltd.

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<sup>490</sup> See the detailed discussion the neighbour principle and duty of care in Chapter 3 (section 3.4).

<sup>491</sup> *Supra* note 332.

Respectably constituted company, considered good for its ordinary business engagements. Your figures are larger than we are accustomed to see.

Yours faithfully,  
Per pro. Heller & Partners Ltd.

On the faith of this letter Hedley Byrne extended credit and ended up losing money when Easipower was unable to keep its commitments. The Law Lords rejected the direct application of *Donoghue* in this context. Liability for careless words (resulting in pure economic loss) could exist outside of contractual or fiduciary relationships, they held, but would depend on the existence of a "special relationship" between the parties.<sup>492</sup> The judgments have to be reviewed more closely to determine what their Lordships meant by that phrase.

Lord Reid stated that "the law must treat negligent words differently from negligent acts".<sup>493</sup> He was of the view that any rule should not extend to social or informal occasions, and that indeterminate liability concerns be addressed noting that "words can be broadcast with or without the consent or the foresight of the speaker or writer".<sup>494</sup> Lord Reid concluded that a special relationship was one based on a reasonable expectation of trust and reliance by the plaintiff, and where the defendant had assumed responsibility for exercising care in giving the advice or information. This assumption of responsibility for being careful could be inferred, for example, where the defendant knew he was being relied on and chose not to disclaim responsibility. He phrased it this way:

A reasonable man, knowing that he was being trusted or that his skill and judgment were being relied on, would, I think, have three courses open to him. He could keep silent or decline to give the information or advice sought: or he could give an answer with a clear qualification that he accepted no responsibility for it or that it was given without that reflection or inquiry which a careful answer would require: or he could simply answer without any such qualification. If he chooses to adopt the last course he must, I think, be held to have accepted some responsibility for his answer being given carelessly, or to have accepted a relationship with the inquirer which requires him to exercise such care as the circumstances require.<sup>495</sup>

On the facts of this case, however, the defendants did disclaim responsibility. Lord Reid also emphasized the fact that the request itself had been qualified by the words "in confidence and

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<sup>492</sup> All five Law Lords referred to the need to prove a "special relationship" before a duty would exist: see *Hedley Byrne*, *supra* note 3 at 482, 486, 491, 492 (per Lord Reid); at 502-03 (per Morris); at 511, 512 (per Lord Hodson); at 523, 525, 526, 528-29 (per Lord Devlin); and at 536, 539, 540 (per Lord Pearce).

<sup>493</sup> *Ibid.* at 482.

<sup>494</sup> *Ibid.* at 482-83.

without responsibility” on the part of Heller & Partners.<sup>496</sup> No duty was undertaken on the facts.

Lord Morris talked about a relationship arising as a result of the defendant undertaking to apply his “special skill” for the benefit of another and that the person relied on such skill.<sup>497</sup> Lord Morris was apparently of the view, unlike Lord Reid, that an assumption of responsibility would not occur in these circumstances simply by virtue of choosing to give the advice without disclaimer. He said, “if a banker gives a reference in the form of a brief expression of opinion in regard to credit-worthiness, he does not accept, and there is not expected of him, any higher duty than that of giving an honest answer.”<sup>498</sup> In any event, there was a disclaimer and he concluded that it effectively precluded any assumption of a duty of care.<sup>499</sup>

Lord Hodson appeared to agree with Lord Morris that the giving of advice by a bank in the ordinary course of business would not without more create a special relationship. Yet of all the Law Lords, Lord Hodson came the closest to the reasonable reliance model of liability. He refused to catalogue the “special features” that would give rise to a duty of care, but concluded by saying:

[I]f in a sphere where a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful inquiry such person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows, or should know, will place reliance upon it, then a duty of care will arise.<sup>500</sup>

Somewhat inconsistently, he had earlier noted that the disclaimer in this case made it clear that the bank was not responsible, suggesting an assumption of responsibility model.<sup>501</sup>

Lord Devlin described relationships giving rise to a duty as follows:

[T]he categories of special relationships which may give rise to a duty to take care in word as well as in deed are not limited to contractual relationships or to relationships of fiduciary duty, but include also relationships which in the words of Lord Shaw in *Nocton v. Lord Ashburton*...are “equivalent to

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<sup>495</sup> *Ibid.*, at 486. In Barker, *supra* note 7 at 470, the author notes how Lord Reid used the language of “choice”. If the defendant had chosen to act without disclaiming in the circumstances a duty could be inferred. See above Chapter 3 (section 3.5.3.2).

<sup>496</sup> *Hedley Byrne*, *ibid.* at 492.

<sup>497</sup> *Ibid.*, at 502-03.

<sup>498</sup> *Ibid.* at 504. Lord Morris did not explain what he would consider sufficient evidence of an undertaking to use care.

<sup>499</sup> *Ibid.*

<sup>500</sup> *Ibid.* at 514.

<sup>501</sup> *Ibid.* at 511.



contract," that is, where there is an assumption of responsibility in circumstances in which, but for the absence of consideration, there would be a contract. Where there is an express undertaking, an express warranty as distinct from mere representation, there can be little difficulty. The difficulty arises in discerning those cases in which the undertaking is to be implied.<sup>502</sup> [footnote omitted]

Implied undertakings would require an examination of the particular facts of the case. Lord Devlin in an earlier passage also clearly expressed the view that just because the loss was purely financial was no objection to liability.<sup>503</sup> And he went so far as to suggest the possibility that in the future a wider notion of liability might be required, anticipating the "free rider" cases.<sup>504</sup> However, on these facts, there was no liability – the disclaimer was conclusive that no duty had been assumed.<sup>505</sup>

Lord Pearce also found that any duty would have to be based on an assumption of responsibility. He wrote:

To import such a duty the representation must normally, I think, concern a business or professional transaction whose nature makes clear the gravity of the inquiry and the importance and influence attached to the answer... A most important circumstance is the form of the inquiry and of the answer. Both were here plainly stated to be without liability... [The words used] clearly prevent a special relationship from arising. They are part of the material from which one deduces whether a duty of care and a liability for negligence was assumed. If both parties say expressly (in a case where neither is deliberately taking advantage of the other) that there shall be no liability, I do not find it possible to say that a liability was assumed.<sup>506</sup>

He stressed therefore not only the disclaimer but also the form of the request.

*Hedley Byrne* established that negligent misrepresentation claims are not restricted to claims based on contractual or fiduciary relationships. But at the same time, it established that ordinary negligence principles were not appropriate. What was required was a "special relationship", which Lords Reid, Morris, Devlin and Pearce held was based on voluntary assumption of responsibility.<sup>507</sup> The undertaking required was an undertaking to exercise care; from that a duty of care would arise. It was clear that it was no objection that the loss was

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<sup>502</sup> *Ibid.* at 528-29. Barker argues that Lord Devlin's model of liability depends on a "promise" to undertake responsibility given the "equivalent to contract" reference: *supra* note 7 at 464. Whether this is an accurate interpretation of Lord Devlin's judgment or not, arguably it makes no real difference whether there is a "promise" to use care or a "choice" to exercise care, as I noted earlier. Generally, it is a question of implying a voluntary undertaking of care based on all the circumstances, whether by promise, choice, or otherwise. See concluding comments above section 3.5.3.2.

<sup>503</sup> *Hedley Byrne*, *ibid.* at 517.

<sup>504</sup> *Ibid.*, at 530-31.

<sup>505</sup> *Ibid.* at 533.

<sup>506</sup> *Ibid.* at 539-40.

<sup>507</sup> Lord Hodson was less clear on this point.

purely economic. Nor was there a problem that the information was gratuitously provided. This was a key reason why the decision was necessary – if Heller & Partners had charged for the information the case could have proceeded as a contractual dispute. What was most uncertain, however, was not the test that the House of Lords applied, but the precise circumstances which would afford evidence of an *implied* or *inferred* assumption of responsibility. This was because in the usual case the undertaking would not be express.

## **4.2 CONSENTING PARENTS**

As Lord Devlin said, “[T]he categories of special relationships which may give rise to a duty to take care in word as well as in deed are not limited to contractual relationships or to relationships of fiduciary duty”. There is no doubt who the parents are, but whose features did the newly born tort inherit?

The idea of “special relationship” owes much to fiduciary doctrine and particularly the *Nocton* case. How that relationship was defined in *Hedley Byrne*, however, arguably owes more to contract law, given the emphasis on voluntary assumption of responsibility. This is particularly apparent in Lord Devlin’s “equivalent of contract” test. But assumption of responsibility may also be important in relation to fiduciary obligations, more so than is sometimes acknowledged. The following considers the extent to which contractual *and* fiduciary relationships are based on consent.

### **4.2.1 Contractual Relationships**

The role of consent in contractual relationships and its influence on duties of care in negligence was considered in Chapter 3. As noted, the sanctity of contracts freely and voluntarily entered into was generally accepted philosophically and legally in the nineteenth century and early twentieth century. Since then, collectivism has taken away some of the freedom formerly enjoyed, but only in limited contexts typically involving the potential for abuse.<sup>508</sup> Recent developments in contract law such as those relating to promissory estoppel

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<sup>508</sup> Concerns about inequality of bargaining power, the use of standard form contracts and the need for consumer protection most notably find expression in rules restricting the use of exclusion clauses. See *Cheshire, Fifoot & Furmston’s Law of Contract*, *supra* note 1 at 20-24.

and the rights of third party beneficiaries have called into question the doctrines of consideration and privity of contract.<sup>509</sup> Professor Waddams writes:

In recent years, after a period in which little was written on contract theory, there has been a revival of interest in the theoretical and philosophical aspects of the subject. Does contractual obligation rest primarily on principles of morality, or on grounds of social utility? Is the fundamental purpose of contract law to give effect to the will of the promisor, or to protect the reliance or expectation of the promisee? Is it better to think in terms of promises or of bargains? Is contract law primarily in search of justice between individuals, or of the enlargement of social welfare?...All the approaches mentioned contain valuable insights. But no single theory accounts for all of the existing law, nor does any single theory command such general acceptance as to operate as an external criterion for evaluating the merits of legal doctrines and rules. This is hardly surprising. It is not to be expected that a complex and basic legal institution will be amenable to explanation by a single theory, nor that, in a pluralistic society, there is likely to be a consensus on fundamental moral and social problems.<sup>510</sup>

But despite all these unanswered, and perhaps unanswerable, questions, and through all the recent developments in contract law, consent has remained the basis of the *relationship*. Relationships not based on consent are not contractual relationships.

#### 4.2.2 Fiduciary Relationships

The phrase "fiduciary relationship" can be misleading because it suggests that a definable relationship must exist before a fiduciary obligation will arise. It is true that certain relationships are properly characterized as fiduciary *per se* and do give rise to fiduciary obligations. But fiduciary obligations can also arise because of the existence of certain factors in the context of a relationship which is itself not fiduciary in nature. Some writers believe it is more accurate just to refer to fiduciary obligations.<sup>511</sup> But the phrase is well entrenched in the case law and so the title stands. Context should reveal the intended meaning.

The relevance of consent in fiduciary law is less easily seen than in contract law. But there is a strong argument that consent or undertaking is important, if not essential, in the establishment of fact-based fiduciary obligations. A brief review of the development of fiduciary doctrine in Canada will show the influence of consent in this area.

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<sup>509</sup> See discussion of consent in contract law in sections 3.4.5.4 (under "Contractualism") and 3.5.1.3 (under "*Laissez-Faire*").

<sup>510</sup> Waddams, *supra* note 312 at para. 4.

<sup>511</sup> See P.D. Finn, *Fiduciary Obligations* (Sydney: Law Book Company, 1977) at para. 3.

Most writers agree that the precise origin of fiduciary doctrine, a branch of the law of equity, is impossible to determine. However, there is a consensus that *Keech v. Sandford*<sup>512</sup> is the first significant English case,<sup>513</sup> although by the time it was decided fiduciary obligations had been well entrenched in Roman civil law.<sup>514</sup>

The decision of the House of Lords in *Nocton*<sup>515</sup> not only planted the seeds for the future tort of negligent misrepresentation, it also breathed new life into fiduciary doctrine generally. The parameters of the doctrine, however, were left relatively undefined in *Nocton*.

In the past three decades, fiduciary claims have proliferated and the Supreme Court of Canada has been called on to examine the doctrine in many widely varied contexts: director/senior officer and corporation,<sup>516</sup> federal government and Indian Band,<sup>517</sup> custodial parent and non-custodial parent,<sup>518</sup> two companies discussing a joint-venture,<sup>519</sup> solicitor and client,<sup>520</sup> doctor and patient,<sup>521</sup> father and daughter,<sup>522</sup> financial advisor and client,<sup>523</sup> and others. Overall it may be concluded that the Supreme Court of Canada has aggressively expanded the scope of fiduciary duties compared with other Commonwealth jurisdictions.<sup>524</sup> Unfortunately, the law remains unclear. As the following brief review of these cases shows there is some uncertainty surrounding the threshold question of when a duty arises.<sup>525</sup>

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<sup>512</sup> (1726), 25 E.R. 223 (Ch.).

<sup>513</sup> Interestingly, *Keech v. Sandford* is a classic trust case involving a trustee who held a lease of a property in trust for a beneficiary and who later, when the lease expired, personally leased the property. The landlord had been unwilling to renew to the beneficiary. Why this case is considered a fiduciary obligation case as opposed to an ordinary trust case is not entirely clear.

<sup>514</sup> See generally, Mark R. Gillen & Faye Woodman, eds., *The Law of Trusts: A Contextual Approach* (Toronto: Emond Montgomery, 2000) at 739-40.

<sup>515</sup> See *supra* note 397 (see also the discussion of this case above section 4.1).

<sup>516</sup> *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592, 40 D.L.R. (3d) 371 [*Canaero*].

<sup>517</sup> *Guerin v. R.*, [1984] 2 S.C.R. 335, (*sub nom. Guerin v. Canada*) 13 D.L.R. (4th) 321 [*Guerin* cited to S.C.R.].

<sup>518</sup> *Frame v. Smith*, [1987] 2 S.C.R. 99, 42 D.L.R. (4th) 81 [*Frame* cited to S.C.R.].

<sup>519</sup> *LAC Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, 61 D.L.R. (4th) 14 [*LAC Minerals* cited to S.C.R.].

<sup>520</sup> *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534, 85 D.L.R. (4th) 129 [*Canson*].

<sup>521</sup> *McInerney v. MacDonald*, [1992] 2 S.C.R. 138, 93 D.L.R. (4th) 415 [*McInerney*] and *Norberg v. Wynrib*, [1992] 2 S.C.R. 226, 92 D.L.R. (4th) 449 [*Norberg*].

<sup>522</sup> *M. (K.) v. M. (H.)*, [1992] 3 S.C.R. 6, 96 D.L.R. (4th) 289 [*M. (K.)*].

<sup>523</sup> *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377, 117 D.L.R. (4th) 161 [*Hodgkinson* cited to S.C.R.].

<sup>524</sup> See *infra* note 551.

<sup>525</sup> Related questions relating to the extent of the duty, assuming one arises, and the remedies available for breach are not considered.

*Canaero*<sup>526</sup> was one of the first cases to consider the doctrine in any detail. It was a corporate opportunities case and when it was decided the fiduciary nature of the relationship between directors and corporations was long established, both in equity and by legislation. The Court was therefore not dealing with uncharted territory and had itself dealt with the issue previously.<sup>527</sup> What made *Canaero* somewhat novel was that the defendants were senior *officers* of the plaintiff corporation (it was unclear whether they had been properly appointed as directors). In imposing a fiduciary obligation on the defendants, who had put themselves in a conflict of interest, the Court demonstrated that it was more concerned with the substantive nature of the relationship, rather than its prior classification as *director*-corporation.

In *Guerin*,<sup>528</sup> the Crown was held liable for negotiating a lease on behalf of an Indian Band in respect of surrendered lands on terms less favourable than the Band had agreed to. In this split decision, Dickson J., writing for four of the eight judges on the panel, was the only one to base his decision on breach of fiduciary duty. His judgment is important because it represents one of the early judicial attempts at formulating a general theory or principle. He wrote:

...where by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another, and that obligation carries with it a discretionary power, the party thus empowered becomes a fiduciary. Equity will then supervise the relationship by holding him to the fiduciary's strict standard of conduct.<sup>529</sup> [emphasis added]

Later in his judgment he drew an analogy between the Crown's fiduciary obligation and promissory estoppel:

In the present case the relevant aspect of the required standard of conduct is defined by a principle analogous to that which underlies the doctrine of promissory or equitable estoppel. The Crown cannot promise the Band that it will obtain a lease of the latter's land on certain stated terms, thereby inducing the Band to alter its legal position by surrendering the land, and then simply ignore that promise to the Bands detriment.<sup>530</sup>

In determining whether a fiduciary relationship exists, Dickson J. emphasized two characteristics: a legal obligation to act for the benefit of another, and discretion. His "principle" is noteworthy because, excepting statutory obligation, it contemplates an

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<sup>526</sup> *Supra* note 516.

<sup>527</sup> See for example, *Peso Silver Mines Ltd. (N.P.L.) v. Cropper*, [1966] S.C.R. 673, 58 D.L.R. (2d) 1.

<sup>528</sup> *Supra* note 517.

<sup>529</sup> *Ibid.* at 384.

<sup>530</sup> *Ibid.* at 389.

agreement or undertaking by the fiduciary as the basis of the obligation. This idea was further developed in *Hodgkinson*, discussed below.

In *Frame*,<sup>531</sup> the Canada's highest Court was confronted with a claim, based in part on breach of fiduciary duty, in circumstances far removed from the commercial context. A father was suing his former wife because of her efforts to prevent his access to the children, who were in her custody. La Forest J., writing for the majority, was concerned with the uncertainty that would result if a claim were recognized in this area and held that no civil remedy was available. Wilson J., who wrote the lone dissent, found the wife liable to the husband based on breach of fiduciary duty. She noted that the courts had resisted developing a general fiduciary principle, but believed it was time to look for commonality in the earlier cases. She stated:

[T]here are common features discernible in the contexts in which fiduciary duties have been found to exist and these common features do provide a rough and ready guide to whether or not the imposition of a fiduciary obligation on a new relationship would be appropriate and consistent.

Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:

- (1) The fiduciary has scope for the exercise of some discretion or power.
- (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
- (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.<sup>532</sup>

In stressing vulnerability, she made it clear that her "rough and ready guide" would generally exclude the imposition of fiduciary obligations in commercial contexts where experienced parties of similar bargaining power deal at arm's length.<sup>533</sup> Wilson J. did not incorporate Dickson J.'s concepts of agreement or unilateral undertaking from *Guerin*, above. Her judgment is significant because it has been adopted in part in subsequent judgements.

The next case, *LAC Minerals*,<sup>534</sup> has proven to be the most controversial. In that case, a small mining company, Corona, had staked some claims. It possessed confidential drilling information that indicated claims adjacent to its own could be valuable. It disclosed this information to a larger mining company, LAC Minerals, with which it hoped to develop the adjacent claims. LAC Minerals used that information to the detriment of Corona. The

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<sup>531</sup> *Supra* note 518.

<sup>532</sup> *Ibid.* at 136.

<sup>533</sup> *Ibid.* at 137-38.

<sup>534</sup> *Supra* note 519.

judgment is difficult to interpret because four of the five-judge panel wrote separate judgments. Sopinka J. led the majority on the issue of the appropriate cause of action, but was in the dissent on the question of the appropriate remedy. He held that there was no fiduciary relationship because of the absence of dependency or vulnerability, and based his decision on breach of confidence. La Forest J. was in the dissent on the fiduciary duty issue but in the majority on the question of remedy, holding that a constructive trust was the appropriate remedy not damages. La Forest J.'s analysis of fiduciary doctrine is nonetheless important because he continued to develop his approach in *Hodgkinson*, the most recent judgment of the Supreme Court of Canada to consider fiduciary doctrine in detail and where he wrote the main judgment.

In *LAC Minerals* he observed that the term "fiduciary" is used in three different ways. Only the first two are described here.<sup>535</sup> The first use is as a descriptor of "relationships" which are *per se* fiduciary in nature, either because they belong to an established class (i.e., traditional or classic fiduciary relationships such as director-corporation, solicitor-client, trustee-beneficiary, and agent-principal), or because they are analogous to them. Determining whether or not a relationship is analogous to a classic one requires a consideration of Wilson J.'s three-pronged test from *Frame*, set out above. If a relationship is *per se* fiduciary there is a strong but rebuttable presumption that the relationship is attended by a duty of loyalty (the exact nature of which will vary with the circumstances).<sup>536</sup> La Forest J. did not dwell on this line of analysis, however, because it was clear that the relationship in the case before him was not a classic or analogous fiduciary relationship.

With respect to the second use, he wrote:

This brings me to the second usage of fiduciary, one I think more apt to the present case. The imposition of fiduciary obligations is not limited to those relationships in which a presumption of such an obligation arises. Rather, a fiduciary obligation can arise as a matter of fact out of the specific circumstances of a relationship. As such it can arise between parties in a relationship in which fiduciary obligations would not normally be expected.<sup>537</sup>

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<sup>535</sup> The third use, in La Forest J.'s opinion, was in fact a misuse. It concerned cases where courts employed the term to justify the granting of equitable remedies, but where the relationships or obligations were not truly fiduciary: *ibid.* at 649-52.

<sup>536</sup> See discussion, *ibid.* at 646-47.

<sup>537</sup> *Ibid.* at 648.

This second use of the term therefore describes “obligations” arising in the context of relationships which are not *per se* fiduciary. Whether one of these fact-based obligations exists has to be determined by considering the specific facts and circumstances surrounding the relationship. In the case before him, he looked at factors under three headings – trust and confidence, industry practice and vulnerability – and concluded that all three supported the finding that a fiduciary obligation existed and had been breached. In finding vulnerability on the facts before him, he recognized that this was an unusual case and generally in commercial settings there would be no vulnerability. More importantly, however, he was of the view that vulnerability was not essential to the existence of a fiduciary obligation. He was unpersuaded by the argument that great uncertainty would result from what amounted to the enforcement of morality in business dealings.<sup>538</sup> The requirement of an undertaking to sacrifice self-interest was not part of the analysis until *Hodgkinson*, described next.

In four cases following *LAC Minerals – Canson, McInerney, Norberg, and M. (K.)*<sup>539</sup> – the Supreme Court of Canada was again confronted with fiduciary doctrine but failed to resolve the general debate about when a duty does or should arise.<sup>540</sup> Then came *Hodgkinson*<sup>541</sup> the most recent decision of the Supreme Court of Canada to deal with fiduciary doctrine in detail. This time the Court had to analyze the doctrine in the professional advisor context. The plaintiff, Hodgkinson, a successful stockbroker, went to the defendant, Simms, for investment and tax-planning advice. On Simms advice, Hodgkinson invested in some tax-sheltered real estate investments, but unfortunately soon after parting with his money the real estate market crashed and he lost nearly everything. Hodgkinson then learned that Simms had made a secret profit on the investments. There was a quorum of seven and La Forest J. wrote for three of the four judges in the majority (Iacobucci J. wrote a brief concurring judgment). In what may be described as “complexly structured” judgment, La Forest J. concluded that Simms owed

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<sup>538</sup> *Ibid.* at 666-68. He also made it clear that fiduciary obligations could arise in pre-contractual negotiations.

<sup>539</sup> *Supra* notes 520, 521 and 522.

<sup>540</sup> *Canson* dealt with the fiduciary obligation of a lawyer to a client. The *existence* of the obligation was assumed, and the concern was with the *extent* of liability. In *Norberg*, a case in which a doctor traded drugs for sexual contact, the majority was content to resolve the dispute on tortious grounds. The dissent believed that the reposing of trust was at the heart of the fiduciary relationship, and that tort and contract were inadequate to deal with abuses of that trust. *M. (K.)* was a case of incest by a father against his daughter. La Forest J., writing for the majority, held that the father committed both a battery and a breach of his fiduciary duty. In his discussion of the latter he held that the relationship between parent and child is a fiduciary one. He was careful to note that his use of the word fiduciary was in the first sense per his analysis in *LAC Minerals*, i.e., it described a relationship where a fiduciary obligation is presumed to exist.



Hodgkinson a fiduciary duty, that it was breached, and that Simms was liable for the full extent of his loss (he also found that the same damages would have been available for breach of contract). With respect to the question of when a duty arises, he affirmed his analysis in *LAC Minerals*, where he identified three uses of the term fiduciary, the first two only being accurate usages.<sup>542</sup> Like *LAC Minerals*, professional advisor cases such as this one fell in the second category, i.e., those involving fact-based fiduciary obligations in the context of relationships not considered *per se* fiduciary.<sup>543</sup> Wilson J.'s guidelines do not work as well in this context, according to La Forest J., and a different approach is required. He stated:

As I noted in *Lac Minerals*, however, the three-step analysis proposed by Wilson J. encounters difficulties in identifying relationships described by a slightly different use of the term "fiduciary", viz., situations in which fiduciary obligations, though not innate to a given relationship, arise as a matter of fact out of the specific circumstances of that particular relationship... *In these cases, the question to ask is whether, given all the surrounding circumstances, one party could reasonably have expected that the other party would act in the former's best interests with respect to the subject matter at issue. Discretion, influence, vulnerability and trust were mentioned as non-exhaustive examples of evidential factors to be considered in making this determination.*

Thus, outside the established categories, *what is required is evidence of a mutual understanding that one party has relinquished its own self-interest and agreed to act solely on behalf of the other party*...<sup>544</sup> [emphasis added]

La Forest J. therefore advocated that while discretion, influence, vulnerability and trust are evidential factors, a mutual understanding or agreement that one will act exclusively in the best interests of the other is *required* in order to found a fiduciary obligation in this context.<sup>545</sup> He went on to mention other relevant "evidential" factors. In referring to a number of advisor cases where a fiduciary duty was imposed, he concluded that the common thread was confidence, trust and reliance.<sup>546</sup> He also referred again to the "coincidence of business and accepted morality", which in this case was evidenced by an accountants' code of ethics requiring disclosure of all fees and other remuneration.<sup>547</sup> On these facts, he concluded that Simms owed Hodgkinson a fiduciary duty. There was trust, an agreement to act in Hodgkinson's best interests, and reliance. La Forest J., in dealing with the alleged absence of

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<sup>541</sup> *Supra* note 523.

<sup>542</sup> *Ibid.* at 409.

<sup>543</sup> This assumes that the relationship is not also principal-agent or lawyer-client, relationships which are usually classed as fiduciary *per se*.

<sup>544</sup> *Hodgkinson*, *supra* note 523 at 409-10.

<sup>545</sup> The reference to reasonable expectations in the first paragraph of the above quote does not seem to detract seriously from the clear requirement of consent set out in the second paragraph.

<sup>546</sup> *Ibid.* at 418-19.

<sup>547</sup> *Ibid.* at 422-23. See also, Keith Farquhar, "Hodgkinson v. Simms: The Latest on the Fiduciary Principle" (1995) 29 U.B.C. L. Rev. 383 at 394, where the author states that "it is hard to resist the conclusion that the majority views the fiduciary principle as an attractive way of enforcing business morality".

vulnerability, wrote that vulnerability just meant “*susceptibility* to harm”,<sup>548</sup> and that it was undesirable to overemphasize the vulnerability in deciding whether a duty was owed. He was affirming his position in *LAC Minerals* here. He held that the approach of the majority in *LAC Minerals* (i.e., Sopinka J.’s holding on the fiduciary issue) was confined to commercial interactions between parties at arm’s length whose relationships are normally based on self-interest. It did not apply to other relationships, such as professional advisory relationships, which may be commercial in nature, but which are characterized by trust and confidence.<sup>549</sup> The three dissenting judges in *Hodgkinson* believed that *LAC Minerals* was not limited to commercial arm’s length dealings and that it bound them to the position that the absence of vulnerability meant no fiduciary relationship existed and hence no obligation existed. Iacobucci J., in his brief concurring judgment, agreed generally with La Forest J.’s reasons, but concerning *LAC Minerals* preferred to simply distinguish that case from this one.<sup>550</sup> It is hard to know exactly what Iacobucci J. meant by this – if he agreed with La Forest J.’s analysis and the de-emphasis of vulnerability, *how* is *LAC Minerals* distinguishable? Restricting its application, as La Forest J. did, seems the only option.

As it now stands, La Forest J.’s analysis of fiduciary obligations is apparently the position of the Supreme Court of Canada. However, there seems to be considerable tension in the highest Court as to the underlying policies and appropriate principles that should guide us in this area. Add to this the difficulty lower courts are having trying to extract the governing principles,<sup>551</sup> and it is a safe prediction that we haven’t heard the last pronouncement from the Supreme Court of Canada on the law of fiduciaries.<sup>552</sup>

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<sup>548</sup> *Hodgkinson*, *ibid.* at 430.

<sup>549</sup> *Ibid.* at 414-15.

<sup>550</sup> *Ibid.* at 480.

<sup>551</sup> For example, in *A. (C.) v. Critchley* (1998), 166 D.L.R. (4th) 475 at 498 (B.C.C.A.) [*Critchley*], McEachern C.J.B.C. summarized *LAC Minerals* as a case where the defendant breached a fiduciary obligation to the plaintiff, when in fact the majority in *LAC Minerals* found no such obligation existed and based their decision on breach of confidence. Chief Justice McEachern, who wrote for the majority, had some general comments about the state of the law (at 496):

Our Supreme Court of Canada has led the way in the common law world in extending fiduciary responsibilities and remedies but it has not provided as much guidance as it usually does in emerging areas of law. The law in this respect has been extended by our highest court not predictably or incrementally but in quantum leaps so that judges, lawyers and citizens alike are often unable to know whether a given situation is governed by the usual laws of contract, negligence or other torts, or by fiduciary obligations whose limits are difficult to discern. Many lawyers plead cases in the alternative not knowing where the line should be drawn. This case, and a number of other recent trial judgments seem to suggest that Crown liability, and indeed the liability of all citizens, may be absolute in many circumstances even in the absence of personal fault.

While the underlying policy objectives may be unclear we have had *some* guidance from the courts. In *Hodgkinson*, La Forest J. described the most frequently cited policy consideration animating the fiduciary principle:

By enforcing a duty of honesty and good faith, the courts are able to regulate an activity that is of great value to commerce and society generally.<sup>553</sup>

He continued:

The desire to protect and reinforce the integrity of social institutions and enterprises is prevalent throughout fiduciary law. The reason for this desire is that the law has recognized the importance of instilling in our social institutions and enterprises some recognition that not all relationships are characterized by a dynamic of mutual autonomy, and that the marketplace cannot always set the rules. By instilling this kind of flexibility into our regulation of social institutions and enterprises, the law therefore helps to strengthen them.<sup>554</sup>

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At issue in *Critchley* was the liability of the provincial Crown for sexual and physical assaults that occurred at a group home operated by a foster parent. The Court of Appeal dismissed claims in negligence and for breach of fiduciary duty, but allowed the claim based on vicarious liability. Having expressed the view that the fiduciary principle had become too unwieldy, McEachern C.J.B.C. attempted to narrow its scope to cases where the defendant had personally benefited from the breach of duty (at 500):

...I conclude that *it would be a principled approach to confine recovery based upon fiduciary duties to cases of the kind where, in addition to other usual requirements such as vulnerability and the exercise of a discretion, the defendant personally takes advantage of a relationship of trust or confidence for his or her direct or indirect personal advantage.* This excludes from the reach of fiduciary duties many cases that can be resolved upon a tort or contract analysis, has the advantage of greater certainty, and also protects honest persons doing their best in difficult circumstances from the shame and stigma of disloyalty or dishonesty. In effect, this redirects fiduciary law back towards where it was before this experiment began but with much broader remedies, such as damages, when fiduciary duties are actually breached. [emphasis added]

Limiting recovery to situations where the defendant has personally benefited would certainly have the effect of limiting the scope of fiduciary claims. It is also somewhat "revolutionary" because, at least in the context of true trusts, it goes against hundreds of years of authority, where trustees have been held responsible for breaching trust obligations in situations where they have not personally benefited. As one of many possible illustrations, trustees have long been held responsible for retaining unauthorized investments in the trust regardless of any personal benefit to themselves: see, for example, *Fry v. Fry* (1859), 27 Beav. 144 (Ch.D.), and Jill E. Martin, *Hanbury & Martin, Modern Equity*, 16th ed. (London: Sweet & Maxwell, 2001) at 655.

<sup>552</sup> There have been a few Supreme Court of Canada cases since *Hodgkinson* involving fiduciary obligations but none have added much to the law. For instance, *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 involved the fiduciary obligation owed by a real estate agent to his principal to disclose any conflicts of interest. *Non-Marine Underwriters, Lloyd's of London v. Scalera*, [2000] 1 S.C.R. 551, 2000 SCC 24 and *Sansalone v. Wawanese Mutual Insurance Co.*, [2000] 1 S.C.R. 627, 2000 SCC 25 were decided one after the other and dealt with insurance claims. In *R. v. Neil*, 2002 SCC 70, the Court dealt with the established fiduciary relationship between a lawyer and client, and in particular the duty of loyalty and the duty to avoid conflicts of interest. The theoretical basis of fiduciary doctrine was not discussed in these cases.

<sup>553</sup> *Hodgkinson*, *supra* note 523 at 420.

<sup>554</sup> *Ibid.* at 422. See also P.D. Finn, "The Fiduciary Principle" in T.G. Youdan, ed., *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) at 26 and Leonard I. Rotman, "Fiduciary Doctrine: A Concept in Need of Understanding" (1996) 34 Alta. L. Rev. 821 at 826. Related to this policy is deterrence. As La Forest J. stated, *ibid.* at 453, "The law of fiduciaries has always contained within it an element of deterrence." It should also be noted that the courts have recognized counter policies in fiduciary law, just as they have in connection with the proximity analysis in negligence. In fact, many of them are the same. Besides free competition and freedom of contract, already alluded to, others include certainty, individualism (responsibility for one's own economic losses), and the avoidance of paternalism. Obligations should not be imposed and freedoms interfered with

While the combined effect of *LAC Minerals* and *Hodgkinson* may be that commercial interactions between arm's length parties of similar bargaining strength are not subject to fiduciary obligations, other commercial interactions are. Arguably, one of the most important roles of fiduciary law is protecting the integrity of certain commercial interactions.<sup>555</sup> But, as is clear from the foregoing review of cases, fiduciary obligations can exist in non-commercial settings. As Professor Blom has observed, fiduciary doctrine has never been a "unitary concept", and that three functions can be identified: to protect property, to protect unequal relationships, and to protect certain commercial relationships where one has broad discretion over another.<sup>556</sup>

There is some debate about whether a unifying theory or principle can be extracted from the cases. A number of theories have been put forward as the basis of fiduciary doctrine: property theory, reliance theory, inequality theory, contract theory, unjust enrichment theory, utility theory, power and discretion theory, and rule or dualistic theories are the main ones.<sup>557</sup> Various criticisms and weaknesses have been noted with respect to these theories, and one writer, J.C. Shepherd, proposed a new theory. It is a modified version of contract theory, which he believes is the strongest because it is analytic and not merely descriptive and, in more practical terms, can be applied in specific fact situations. Professor Rotman has criticized contract theory because of what he considers are its obvious flaws.<sup>558</sup> For example, many fiduciary obligations arise in circumstances where there is no offer and acceptance, such as where a fiduciary unilaterally undertakes an obligation. Further, contract theory is based on the morals of the marketplace, whereas fiduciary doctrine is premised on higher moral standards. The world of contract assumes in most cases that the parties will act in their own interest, but fiduciaries must put the beneficiary's best interests before their own. Shepherd's theory addresses these concerns, at least in part. He described his "transfer of encumbered power" theory this way:

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without clear justification. For an overview of these and other policies, see J.C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981) c. 5-6.

<sup>555</sup> See for example, Ernest [J.] Weinrib, "The Fiduciary Obligation" (1975) 25 U.T.L.J. 1 at 11.

<sup>556</sup> Joost Blom, "Equitable Torts: Breach of Confidence and Breach of Fiduciary Obligations" in *Torts - 2001* (Vancouver: The Continuing Legal Education Society of British Columbia, 2001) c. 3 at 3.2.09-10.

<sup>557</sup> See Gillen & Woodman, *supra* note 514 at 744, and for a more detailed exposition of these theories, Shepherd, *supra* note 554 at 51-91 (c. 5), and Rotman, *supra* note 554 at 837-50.

<sup>558</sup> Rotman, *ibid.* at 845-47.

*A fiduciary duty exists whenever any person acquires a power of any type on condition that he also receive with it a duty to utilize that power in the best interests of another, and the recipient of the power uses that power.*<sup>559</sup>

In *Hodgkinson*, La Forest J. cited Shepherd's theory with approval without adopting it as *the* theory.<sup>560</sup> This theory is consistent with policies of free and fair competition and freedom of contract because it recognizes that there must be a form of assent by the "fiduciary" through the use of the transferred power. The idea of assumption of responsibility or voluntarism as the playing a role in this area is not new. Dickson J. alluded to it in *Guerin*.<sup>561</sup> However, the approach of Wilson J. in *Frame*, which was adopted by both Sopinka J. and La Forest J. in *LAC Minerals*, in connection with the recognition of new *per se* fiduciary relationships, seemed to move away from the idea of undertaking, introducing a new principle based on power, discretion and vulnerability. An approach based on voluntarism factors in choice and assumed responsibility by the defendant, while Wilson J.'s approach is more plaintiff-centred, looking at the potential for victimization. Professor McCamus advocates voluntarism and the "centrality of undertaking" in the recognition of fiduciary duties, and believes that La Forest J. in *Hodgkinson* has shifted the focus back to a position where undertaking or agreement is essential to the finding of fiduciary responsibility.<sup>562</sup>

If La Forest J.'s analysis in *LAC Minerals*, as developed in *Hodgkinson*, is considered authoritative, the following conclusions may be drawn about when fiduciary duties are owed in Canada:

- *Per se fiduciary relationships*.<sup>563</sup> A particular fiduciary duty may be owed in the context of an underlying fiduciary relationship. A fiduciary relationship exists where the parties belong

<sup>559</sup> Shepherd, *supra* note 554 at 96.

<sup>560</sup> *Hodgkinson*, *supra*, at 411, 413.

<sup>561</sup> See *supra* note 529 and accompanying quote.

<sup>562</sup> John D. McCamus, "Prometheus Unbound: Fiduciary Obligations in the Supreme Court of Canada" (1997) 28 Can. Bus. L.J. 107 at 118-22. I agree with McCamus' analysis of the cases in part. I believe La Forest J. has made agreement, mutual understanding or undertaking essential in the context of fact-based fiduciary obligations. But La Forest J. affirmed the approach of Wilson J. in determining the existence of *per se* fiduciary relationships analogous to the classic ones. Here undertaking or agreement is apparently not essential. In many if not most of these cases there will be agreement but he does not require it. The requirement of vulnerability and the presumption of a duty of loyalty are what distinguish this area of fiduciary responsibility from fact-based obligations. Professor Hadfield even disputes whether La Forest J. intended that undertakings are essential for fact-based obligations given that he referred to the "reasonable expectations" of the parties immediately before setting out the "requirement" of understanding or agreement (see *supra* note 544 and accompanying quote); Gillian K. Hadfield, "An Incomplete Contracting Perspective on Fiduciary Duty" (1997) 28 Can. Bus. L.J. 141 at 143-45. The language is clear and this argument is hard to defend.

<sup>563</sup> This is the first use of the term "fiduciary" as La Forest J. described it in *LAC Minerals* (see *supra* note 519 at 646-47, and discussion above accompanying note 536), and as he confirmed it in *Hodgkinson* (see *supra* note 523 at 409, and discussion above accompanying note 542).

to one of the traditional or classic categories of director-corporation, solicitor-client, trustee-beneficiary, and agent-principal. Other *per se* fiduciary relationships will be recognized by analogy to these traditional categories applying the “rough and ready guide” of Wilson J. (i.e., her test of power or discretion, unilateralism, and vulnerability). Finding that a traditional or analogous fiduciary relationship exists carries with it a strong but rebuttable presumption that the general fiduciary obligation of loyalty also exists, but the exact nature of the obligation can vary according to the specific circumstances of the case.

- *Fact-based fiduciary obligations.*<sup>564</sup> Where a *per se* fiduciary relationship does not exist, a judge may still find that a person owes a fiduciary obligation to another based on the surrounding circumstances. The court will consider various evidential factors such as discretion, influence, vulnerability and trust in making that determination,<sup>565</sup> but the final decision must rest on a finding that there is a “mutual understanding that one party has relinquished its own self-interest and agreed to act solely on behalf of the other party”.<sup>566</sup>
- *A “business” exception?* By requiring some form of consent to act solely in the interests of another concerning fact-based fiduciary obligations, La Forest J. was in effect endorsing Sopinka J.’s ruling in *LAC Minerals* on the fiduciary duty issue *in the context of commercial interactions between parties at arm’s length pursuing self-interest and who are able to protect themselves by contract*. Sopinka J. did not recognize fact-based fiduciary obligations. For him, fiduciary obligations only existed in connection with underlying fiduciary relationships, and new relationships could only be recognized by applying Wilson J.’s three-factor test (with vulnerability being an indispensable element). Because vulnerability will rarely be present in such business dealings, Sopinka J.’s approach effectively precludes the operation of fiduciary duties in this area based on *per se* fiduciary relationships. La Forest J.’s fact-based fiduciary obligations are also effectively excluded in this setting because they turn on the voluntary sacrifice of self-interest, which similarly will rarely be present. La Forest J. was perhaps capitulating to the argument he rejected in *LAC Minerals* concerning the uncertainty that would result if fiduciary obligations were imposed in such business dealings.<sup>567</sup> However, in other contexts, such as professional advisory relationships, where the pursuit of self-interest is not necessarily expected, it is more likely a fact-based

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<sup>564</sup> This is the second use of “fiduciary” per La Forest J.’s analysis in *LAC Minerals* (see *supra* note 519 at 648, and above quote accompanying note 537) and as developed in *Hodgkinson* (see *supra* note 523 at 409-10, and above quote accompanying note 544).

<sup>565</sup> As mentioned, other factors may be relevant depending on the context – for instance, in the professional advisory context, besides trust, *confidentiality* and *reliance* were important factors: see *Hodgkinson*, *supra* note 523 at 418-19, and discussion above accompanying note 546. According to La Forest J. the vulnerability factor alone is neither a necessary nor a sufficient indicator of the existence of a fact-based fiduciary obligation. It is nonetheless an important factor. Early in his judgment in *Hodgkinson* at 405, he put it this way:

From a conceptual standpoint, the fiduciary duty may properly be understood as but one of a species of a more generalized duty by which the law seeks to protect vulnerable people in transactions with others. I wish to emphasize from the outset, then, that the concept of *vulnerability* is not the hallmark of fiduciary relationship though it is an important indicium of its existence.

<sup>566</sup> *Ibid.* at 409-10, and discussion, *supra* note 562.

<sup>567</sup> See discussion above accompanying note 538.

obligation will be recognized. Here, Sopinka J.'s approach, which requires of vulnerability, does not apply.<sup>568</sup>

La Forest J. is therefore advocating a composite model of liability for fiduciary duties. For *per se* fiduciary relationships, a duty is presumed to exist – a form of imposed liability designed to protect socially valuable and necessary relationships which are inherently fragile, primarily because of the vulnerability of one of the parties. With respect to other relationships, also worthy of protection but not necessarily marked by such a power imbalance, some form of assent by the fiduciary is required; liability here is based on voluntary assumption of responsibility.<sup>569</sup> This composite model of liability is an appropriate way to balance the competing policies in this area.<sup>570</sup> Unfortunately, there is some doubt whether La Forest J.'s analysis will be followed, and we await clarification from the Supreme Court of Canada.<sup>571</sup>

#### 4.2.3 The Special Relationship Extension

The expression “special relationship”, like “proximity”, has no clear meaning. Until it is referenced to a test it has little substance. If so defined, the special relationship concept could

<sup>568</sup> See *Hodgkinson*, *supra* note 523 at 414-15, where La Forest J. attempts to confine Sopinka J.'s approach in *LAC Minerals*, and discussion above accompanying note 549.

<sup>569</sup> The precise form of consent required is not entirely clear. La Forest J. refers to “mutual understanding” and the defendant having “agreed” to act solely in the plaintiff's interests. It is unlikely that La Forest J. intended that a binding contract is required. And if he means to exclude *unilateral* undertakings, why that should be the case is not apparent. Dickson J. in *Guerin*, it will be recalled, was apparently of the view that a unilateral undertaking would be sufficient: see *supra* note 529 and accompanying quote.

<sup>570</sup> For a brief listing of some of these policies, see *supra* notes 553 and 554, and accompanying quotes and text.

<sup>571</sup> In the lower courts across Canada, there does not appear to be any eagerness to follow the framework of analysis articulated by La Forest J. In B.C., for example, the Court of Appeal has gone in its own direction. In the *Critchley* decision, *supra* note 551, the Court was content to analyze the situation without considering the existence of an underlying fiduciary relationship, which is consistent with La Forest J.'s notion of fact-based fiduciary obligations. But it emphasized vulnerability and added a new and required factor: direct or indirect personal advantage by the defendant. See also *B. (K.L.) v. British Columbia* (2001), 197 D.L.R. (4th) 431 (B.C.C.A.), *G. (E.D.) v. Hammer* (2001), 197 D.L.R. (4th) 454 (B.C.C.A.) and *B. (M.) v. British Columbia* (2001), 197 D.L.R. (4th) 385 (B.C.C.A.), where the personal benefit requirement from *Critchley* was reiterated. Despite the analysis of La Forest J. and his fact-based obligation, some commentators still assume that an underlying fiduciary relationship is required before an attendant obligation will exist, along the lines of Sopinka J.'s approach in *LAC Minerals*. For example, see Gillen & Woodman, eds., *supra* note 514 at c. 11, and Rotman, *supra* note 554 – these works were all written after *Hodgkinson*. Rotman advocates a “functional” approach and a theory of categorical open-endedness. By this he means that various criteria such as trust, dependence and reliance ought to be considered, in light of the guiding policy of preserving and protecting socially valuable or necessary relationships, before recognizing new fiduciary relationships. It is a necessarily broad and adaptable doctrine. Does anything significant turn on which approach is applied, La Forest J.'s, Sopinka J.'s, the British Columbia Court of Appeal's or Rotman's? As stated above, I believe La Forest J.'s composite model of liability for fiduciary duties, which imposes duties (subject to a rebuttable presumption) in cases of power imbalance, and which bases duties on voluntarism in other contexts, is an effective way to balance the competing policies in this area.

refer to relationships based on voluntary assumption of responsibility, reasonable reliance,<sup>572</sup> the presence of various factors such as trust, vulnerability, etc., or something else altogether. However, considering the case law so far, the test has “collapse[d] into the either the reliance or assumption of responsibility approaches”, to borrow Professor Feldthusen’s phrasing.<sup>573</sup>

The nexus between fiduciary doctrine, contract law and their progeny, negligent misrepresentation, may lie in voluntarism as a grounding principle of liability. Initially, at least, the conception of “special relationship” relied heavily on consent.<sup>574</sup> The difference is the nature of the consent. In fiduciary law, any required consent relates to a duty of loyalty. In contract law, the consent can relate to any number of obligations but is typically more formal in nature requiring an exchange. The undertaking in negligent misrepresentation is to take care.

With respect to the connection between fiduciary duties and negligent misrepresentation, La Forest J. apparently does not consider consent to be a common element. He had this to say in *Hodgkinson*:

Vulnerability is common to many relationships in which the law will intervene to protect one of the parties. It is, in fact, the “golden thread” that unites such related causes of action as breach of fiduciary duty, undue influence, unconscionability and negligent misrepresentation.

At the same time, however, it is only by having regard to the often subtle differences between these causes of action that civil liability will be commensurate with civil responsibility. For instance, the fiduciary duty is different in important respects from the ordinary duty of care. In *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534, at pp. 571-73, I traced the history of the common law claim of negligent misrepresentation from its origin in the equitable doctrine of fiduciary responsibility; see also *Nocton v. Lord Ashburton*, [1914] A.C. 932, at pp. 968-71, per Lord Shaw of Dunfermline. However, while both negligent misrepresentation and breach of fiduciary duty arise in reliance-based relationships, the presence of loyalty, trust, and confidence distinguishes the fiduciary relationship from a relationship that simply gives rise to tortious liability. Thus, while a fiduciary obligation carries with it a duty of skill and competence, the special elements of trust, loyalty, and confidentiality that obtain in a fiduciary relationship give rise to a corresponding duty of loyalty.<sup>575</sup>

La Forest J. stresses “vulnerability” and “reliance” as common elements which is consistent with his decision in *Hercules*, and the reliance theory of liability. However, it is somewhat anomalous that he makes consent essential to the recognition of fact-based fiduciary

<sup>572</sup> In adopting the reasonable reliance test for “proximity” in *Hercules*, La Forest J. stated that whenever the test is satisfied it could be said that the parties are in a “special relationship”: *Hercules*, *supra* note 6 at 188.

<sup>573</sup> *Economic Negligence*, *supra* note 281 at 37.

<sup>574</sup> *Hedley Byrne* is the best example of this.

<sup>575</sup> *Hodgkinson*, *supra* note 523 at 405.



obligations, but seemingly not with duties to use words with care. If anything, the argument for voluntarism in negligent misrepresentation, an economic tort, is stronger.

The journey to *Hercules* and beyond is described next. While voluntarism may be a key component of contract law and to a lesser degree fiduciary law, the Supreme Court of Canada is apparently no longer wedded to the idea in connection with negligent misrepresentation, even though it is a derivative form of liability. This, I believe, is a mistake.

### **4.3 NEGLIGENT MISREPRESENTATION TODAY**

*Hedley Byrne* reignited interest in Lord Atkin's neighbour principle and was instrumental in the push to expand negligence liability into new areas in the 1970s and 1980s. With the *Anns* decision in 1978 came a framework of analysis for that expansion. *Anns* has since been rejected in the United Kingdom, largely because it was seen as *too* expansionary, but it is still followed in Canada where it has been modified and restrained. In *Hercules*, *Hedley Byrne* liability was absorbed into the *Anns* approach leaving behind voluntary assumption of responsibility as a grounding principle.

#### **4.3.1 The Approach to Negligence Law Generally**

After *Hedley Byrne*, there were a number of attempts to apply the neighbour principle, even though it had been rejected in *Hedley Byrne*. In *Dorset Yacht*, described in Chapter 3,<sup>576</sup> the House of Lords extended liability into the public authorities context. In a Court of Appeal decision the next year, *Dutton v. Bognor Regis United Building Company Ltd.*,<sup>577</sup> the Court held that a municipal authority and its building inspectors owed a duty to prospective purchasers of houses to inspect with care. The house in this case had been built on a "rubbish tip". The foundations were not sufficient for the conditions and the house began to subside. The defendant local government was found liable for the economic loss<sup>578</sup> caused by the negligent inspection (the builder settled out of court).

In *Anns* the House of Lords was faced with a municipal inspection case, similar to *Dutton*, this time involving poorly constructed "maisonettes". The builders constructed the foundations

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<sup>576</sup> See section 3.4.1.

<sup>577</sup> (1971), [1972] 1 Q.B. 373, [1972] 1 All E.R. 462 (C.A.) [*Dutton*].

only two feet six inches deep instead of the three feet or deeper required by the deposited plans. The flats developed cracks in the walls and sloping floors, and the plaintiffs, long-term lessees, sued the borough council for negligently passing the inspection. Lord Wilberforce's well-known two-stage test for determining when a duty of care arises and its adoption and development in Canada is described in Chapter 3.<sup>579</sup> In the particular circumstances of the case before him, the concern was that because this was a statutory authority he did not want the imposition of a private law duty to interfere with the exercise of *bona fide* discretion under the legislation. He held that in the exercise of statutory powers and, to a lesser degree, duties, there was an element of discretion where policy decisions had to be made based on the allocation of resources.<sup>580</sup> These kinds of decisions were political in nature and not properly the subject of claims in negligence. However, the implementation of policy decisions, what he referred to as the "operational" area of statutory discretion,<sup>581</sup> was not subject to the same objection. He recognized that the distinction between policy and operational areas was not a neat one, because the operational side might include an element of discretion. However, he concluded that it was a question of degree, and that the more operational the duty or power, the easier it would be to superimpose a duty of care. Simply put, if the defendant was just doing what it was required to do or had decided to do, it was more likely the court would impose a duty to do it with care.

Two important contributions, then, flow from the *Anns* decision: first, the two-stage approach to the imposition of new duties of care generally, and, second, a framework for analyzing negligence liability of public authorities.

### 4.3.2 The Special Case of Economic Negligence

#### 4.3.2.1 General

As earlier described, a pure economic loss is a financial loss which is not consequent upon damage to the property or person of the plaintiff. In many cases, the nature of the loss is clear, for example, when the plaintiff loses money on an investment made in reliance on bad advice. In cases where tangible property is involved, however, it is not always so clear. For instance, if

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<sup>578</sup> The majority (Denning M.R. and Sachs L.J.) were of the view there was damage "to" the house, as well as a threat of personal injury. In their view this was, therefore, not a "pure" economic loss case.

<sup>579</sup> See section 3.4.1.

<sup>580</sup> *Supra* note 22 at 754.

<sup>581</sup> *Ibid.*

the plaintiff's house starts to sag because it was negligently built, but no one is hurt, has the plaintiff suffered property damage or pure economic loss? The English approach, based on the decision in *Murphy*,<sup>582</sup> is that unless there is personal injury or damage to property other than the house itself, the damage is pure economic loss. This is contrary to the earlier decisions in *Dutton* and *Anns* where the House of Lords characterized similar damage as property damage.

The approach in *Anns* and *Dutton* is consistent with what has been referred to as the "complex structure theory", which holds that if an internal defect causes damage to other parts of a complex structure, such as a house, the damage is property damage. The purpose of this characterization is to avoid the typical concerns over awarding damages for pure economic loss, such as the problem of indeterminate liability. The complex structure theory was rejected in *Murphy*, and is not followed in the US.<sup>583</sup> It has also been rejected in Canada. In *Winnipeg Condominium*, La Forest J. stated:

I am in full agreement with Lord Bridge's criticisms [in *Murphy*, *supra* note 213 at 476] of the "complex structure" theory. In cases involving the recoverability of economic loss in tort, it is preferable for the courts to weigh the relevant policy issues openly. Since the use of this theory serves mainly to circumvent and obscure the underlying policy questions, I reject the use of the "complex structure" theory in cases involving the liability of contractors for the cost of repairing defective buildings.<sup>584</sup>

La Forest, J. rejected the plaintiff's argument in *Winnipeg Condominium* that the defective exterior cladding which collapsed should be considered as a localized defect which caused damage to the rest of the structure. Damage to property caused by internal defects is therefore considered pure economic loss.

More important than what *is* pure economic loss, however, are the reasons *why* economic loss should be considered qualitatively different from physical loss. These reasons, which include concerns about indeterminate liability, the nature of social loss and interfering with the domain of contract, are canvassed above in section 3.4.5.

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<sup>582</sup> *Supra* note 213.

<sup>583</sup> See *East River Steamship Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 90 L. Ed. 2d 865 (1986).

<sup>584</sup> *Supra* note 255 at 100.

#### 4.3.2.2 Duty or Remoteness?

Those who argue that recovery for pure economic loss should not be treated differently than physical loss cases are generally of the view that where there is a real concern about the extent of liability it should be dealt with as a remoteness issue. This makes sense if the “no-difference” argument is accepted. However, if one accepts that a qualitative difference exists between physical loss and economic loss cases, then, as Professor Feldthusen argues, it is more appropriate to deal with liability primarily at the duty stage.<sup>585</sup> A duty analysis allows the court to openly examine the policy issues – remoteness or proximate cause issues are generally decided on the simpler test of foreseeability alone.<sup>586</sup>

#### 4.3.2.3 Comparison with Intentionally Caused Economic Loss

The English and Canadian courts have refused to recognize a general tort based on the intentional, but otherwise lawful, interference with economic interests.<sup>587</sup>

A general question of policy arises: If intentionally caused economic loss is not actionable, why should negligently caused economic loss be? The authors of *Street on Torts* offer this two-part explanation.<sup>588</sup> Firstly, the doctrine of free competition supports deliberate interferences with trade (provided they are “legal”). Free competition encourages the best person to win, so long as that person does not cross the line by engaging in unlawful behaviour. Free competition, however, is indifferent to careless behaviour. As earlier mentioned, this last assumption is questionable.<sup>589</sup> Secondly, negligence can be thought of as a species of unlawfulness. If a duty of care based on proximity is breached the defendant has engaged in unlawful behaviour. However, the authors point out that limits must be recognized in light of two policy concerns: firstly, concerns over indeterminate liability; and secondly, concerns over blurring the line between contract and tort (i.e., the contractual overlap argument). This second argument is a good one, but the real debate is on *how* duty should be limited in view of the two policy considerations referred to as well as others.

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<sup>585</sup> See *Economic Negligence*, *supra*, note 30, at 11-12.

<sup>586</sup> Although, as Lord Denning stated in *Spartan Steel*, *supra* note 285 at 561-63, economic loss cases, whether characterized as raising duty or remoteness issues, are policy-driven.

<sup>587</sup> *Allen v. Flood*, [1898] A.C. 1. See also *Street on Torts*, *supra* note 225 at 115-117, and Klar, *supra* note 2 at 522-24 (in Canada, the few cases considering a general theory of intentional interference with economic interests have all required unlawfulness as an element).

<sup>588</sup> *Street on Torts*, *ibid.*

<sup>589</sup> See discussion above section 3.4.5.4 under “Free Competition”.

#### 4.3.2.4 Professor Feldthusen's Taxonomy

In *Cooper and Edwards*,<sup>590</sup> the Supreme Court of Canada dealt with the tension between using an open-ended approach to duty of care (providing flexibility at the expense of certainty), and a categories-based approach (providing greater certainty at the expense of flexibility), by adopting a combination of the two. The Court has acknowledged that new categories of negligence may be established using the *Anns* test, but has stated that the preference will be for incremental expansion by analogy to existing categories.<sup>591</sup> In the field of economic negligence, the categories approach goes back even further, and there is now, in effect, a presumption against the recognition of new categories.<sup>592</sup> The Supreme Court of Canada has held that recovery for pure economic loss is possible in five specific categories, adopting a taxonomy based on the work of Professor Feldthusen.<sup>593</sup> The five categories are:

1. Negligent Misrepresentation,
2. Negligent Performance of a Service,
3. Negligent Supply of Shoddy Goods or Structures,
4. Relational Economic Loss, and
5. The Independent Liability of Statutory Public Authorities.<sup>594</sup>

Before considering the development of negligent misrepresentation, the *other* four categories are described briefly here.

##### ▪ Negligent Performance of a Service

Liability for negligent performance of a service can arise in at least three different contexts.<sup>595</sup> The first and least contentious is where the defendant directly undertakes to perform a specific service for the plaintiff. The liability is either based in contract, tort or both. If the undertaking is gratuitous, tort will be the only option. Tort starts from the general position

<sup>590</sup> *Supra* notes 218 and 219.

<sup>591</sup> See above section 3.4.1.

<sup>592</sup> For example, see *Martel*, *supra* note 276, where the Supreme Court of Canada refused to recognize new categories relating to conduct in negotiating commercial contracts and the drafting of tender specifications. The Court also refused to recognize new categories in *Cooper and Edwards*, as described below in this section under "Public Authorities".

<sup>593</sup> For example, see Bruce Feldthusen, "Economic Loss in the Supreme Court of Canada: Yesterday and Tomorrow" (1991) 17 Can. Bus. L.J. 356, and *Economic Negligence*, *supra* note 281.

<sup>594</sup> See *Winnipeg Condominium*, *supra* note 255 at 96-97, *D'Amato v. Badger*, [1996] 2 S.C.R. 1071 at 1082-83 [*D'Amato*], and *Martel Building*, *supra* note 276 at para. 38, where the Supreme Court of Canada expressly recognized these five categories. I've listed them in the order in which Feldthusen covers them in *Economic Negligence*, *ibid*. The Supreme Court of Canada listed them in a same order but placed statutory authorities first instead of last.

<sup>595</sup> For a detailed analysis, see *Economic Negligence*, *supra* note 281 c. 3.

that there is no liability for failing to perform gratuitous undertakings – to adopt such a position generally would seriously erode the doctrines of privity and consideration. However, the action here is not to enforce the undertaking, but to recover for damages flowing from its negligent performance. As Lord Devlin stated in *Hedley Byrne*:

A promise given without consideration to perform a service cannot be enforced as a contract by the promisee; but if the service is in fact performed and done negligently, the promisee can recover in an action in tort.<sup>596</sup>

Cases of this type are now analyzed under *Anns*, but borrow heavily from the traditional *indicia* of liability under the *Hedley Byrne* principle, such as reliance and voluntary assumption of responsibility (along with the mandatory foreseeability).<sup>597</sup>

The second situation is where the defendant is under a contract with another party, and as part of that contract undertakes to perform some service that will benefit the plaintiff (as a third party beneficiary under the contract). Cases before *Anns* used *Hedley Byrne* as the basis of liability,<sup>598</sup> but again, even following *Anns* now, the concepts of reliance and assumption of responsibility (along with the mandatory foreseeability) still dominate this area.<sup>599</sup>

A third situation is where the defendant breaches a contract with the other party, and besides affecting that party and perhaps a third party beneficiary, *as well* injures the plaintiff who is not a direct beneficiary under the contract. In a possible fourth context, there are also a few cases where duties of affirmative action are imposed either on the basis of a prior business relationship or on “efficiency or distributional” grounds.<sup>600</sup>

#### ▪ Negligent Supply of Shoddy Goods or Structures

In the recent British Columbia Court of Appeal decision in *Hasegawa*,<sup>601</sup> the Court had to consider the claim of the purchaser of a large quantity of bottled water against the bottler with respect to the financial losses the purchaser suffered when the bottled water was destroyed by

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<sup>596</sup> *Hedley Byrne*, *supra* note 3 at 526.

<sup>597</sup> See *Tracy v. Atkins* (1979), 105 D.L.R. (3d) 632, 16 B.C.L.R. 223 (B.C.C.A.), where a lawyer representing a purchaser in a real estate transaction had assumed responsibility for looking after the vendor's interests, and was therefore found to owe a duty of care to the vendor.

<sup>598</sup> For example, see *Whittingham*, *supra* note 335.

<sup>599</sup> See, for example, *B.D.C. Ltd. v. Hofstrand Farms Ltd.*, [1986] 1 S.C.R. 228.

<sup>600</sup> As explained in *Economic Negligence*, *supra* note 281 at 120, the third and fourth areas, and particularly the fourth, are less developed in the case law, and the actual bases of liability are harder to determine.

<sup>601</sup> *Supra* note 317.

the Japanese government as being unfit for human consumption. About three per cent of the water had been contaminated with mould flocs. No one had suffered personal injury, no property was damaged and, despite the government order, the water did not pose a real and substantial danger to the health of potential consumers. The Court of Appeal held that no duty in tort existed between the manufacturer and the purchaser in these circumstances. Finch C.J.B.C., for the Court, held that valid policy reasons negated the *prima facie* duty of care:

57 The plaintiff contends that, under the second part of the *Anns* test, there is no valid policy reason why liability for pure economic loss should be denied in this case. With respect, I disagree. A legal rule which imposed liability for the manufacture or supply of defective, but non-dangerous, goods would create an implied warranty of product quality for the sale of commercial products, in the absence of contract. Such a rule would be an enormous change in the law, and would indeed create "liability in an indeterminate amount for an indeterminate time to an indeterminate class": per Cardozo C.J. in *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y.C.A. 1931) at p. 444.<sup>602</sup>

Chief Justice Finch seems to blend the contractual overlap and indeterminate liability counter policies, but they are distinct reasons for limiting duty of care.

It was argued in *Hasegawa* that *Junior Books*<sup>603</sup> applied to these facts. In that case, the House of Lords held a subcontractor liable to a building owner for non-dangerous building defects despite the absence of a contract. According to Linden, the question whether *Junior Books* applies in Canada is unresolved.<sup>604</sup> Finch C.J.B.C. expressly declined to follow the result and the reasoning in *Junior Books*.<sup>605</sup>

Related to the issue of pure economic loss for shoddy goods, is the claim for pure economic loss based on a failure to warn. It is clear that if a manufacturer learns that its product is dangerous after distribution it has an obligation to warn consumers. Pure economic losses that flow from a failure to warn in a timely fashion, such as increased loss of profits, may be recovered.<sup>606</sup>

*Winnipeg Condominium*<sup>607</sup> is the leading case in Canada on building defects. A subsequent owner of an apartment building sued the original contractor for structural defects, some dangerous and some not. In a unanimous decision, the Supreme Court of Canada held that contractors

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<sup>602</sup> *Ibid.* at para. 57. See also *supra* note 322 and accompanying quote and text.

<sup>603</sup> *Supra* note 268.

<sup>604</sup> See Linden, *supra* note 191 at 601.

<sup>605</sup> *Hasegawa*, *supra* note 317 at para. 68. *Junior Books* is discussed in more detail below in section 4.4.1.

<sup>606</sup> See *Rivtow Marine*, *supra* note 316.

(as well as subcontractors, architects and engineers) who take part in the design and construction of a building will owe a duty in tort to subsequent purchasers of the building if it can be shown that it was foreseeable that a failure to take reasonable care in constructing the building would create defects that pose a substantial danger to the health and safety of the occupants. Where negligence is established and such defects manifest themselves before any damage to persons or property occurs, they can be held liable for the reasonable cost of repairing the defects and putting the building back into a non-dangerous state. La Forest J., for the Court, declined to follow recent House of Lords decisions which held that there would be no duty of care in these circumstances. He held that a *prima facie* existed on the facts:

Given the clear presence of a real and substantial danger in this case, I do not find it necessary to consider whether contractors should also in principle be held to owe a duty to subsequent purchasers for the cost of repairing non-dangerous defects in buildings. It was not raised by the parties. I note that appellate courts in New Zealand..., Australia...and in numerous American states...have all recognized some form of general duty of builders and contractors to subsequent purchasers with regard to the reasonable fitness and habitability of a building. In Quebec, it is also now well-established that contractors, subcontractors, engineers and architects owe a duty to successors in title in immovable property for economic loss suffered as a result of faulty construction, design and workmanship (see arts. 1442, 2118-2120 of the *Civil Code of Quebec*, S.Q. 1991, c. 64...<sup>608</sup>

While noting that some jurisdictions, including Quebec, also allowed claims for non-dangerous defects he expressly left that question open. He went on to hold that certain *Anns* second stage considerations – indeterminate liability, contractual overlap, and interference with the *caveat emptor* doctrine – were not sufficient to negate the duty here involving dangerous defects.<sup>609</sup> Builders were better positioned than subsequent purchasers to bear the risks of dangerous latent defects.<sup>610</sup>

#### ▪ Relational Economic Loss

Relational economic loss refers to economic loss suffered by the plaintiff as a result of property damage or personal injury to a third party caused by the defendant's negligence. Usually there is a relationship, contractual or otherwise, between the plaintiff and the third party. As Feldthusen says, this category of case has "a longstanding and independent

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<sup>607</sup> *Supra* note 255.

<sup>608</sup> *Ibid.* at 119-20.

<sup>609</sup> See Arnie Herschorn, "Damages for Economic Loss in Tort: *Winnipeg Condominium Corp. No. 36 v. Bird Construction Co. Ltd.*" [Case Comment] (1996), 18 *Advocates' Q.* 109 for a detailed discussion of this decision.

<sup>610</sup> See above section 3.4.5.4 under "Contractualism" for more discussion of *Winnipeg Condominium* concerning the *caveat emptor* and contractual overlap arguments.



pedigree".<sup>611</sup> In England, a general exclusionary rule has applied to claims of this nature since 1875.<sup>612</sup>

The Supreme Court of Canada first considered this area in depth in *Norsk*.<sup>613</sup> A barge being towed by a tug owned by Norsk collided with a railway bridge causing extensive damage which closed the bridge for several weeks. Norsk admitted liability for negligence as to the collision, but disputed liability to Canadian National Railway ("CN") for its economic losses. The bridge was owned by Public Works Canada ("PWC") and was used by four railways, including CN. CN was the primary user, and the bridge formed part of CN's main line connecting with tracks and land owned by CN on either side of the bridge. CN's use of the bridge was governed by a contract which explicitly reserved full ownership of the bridge to PWC. The seven-judge panel of the Supreme Court of Canada was split, and there was no clear majority on the applicable principle. McLachlin J, writing one of the majority judgments on behalf of herself and two other judges, proposed a flexible approach whereby pure economic loss caused by negligence would be *prima facie* recoverable. In addition to requiring foreseeability of loss, proximity would be used as a controlling concept to avoid unlimited and unreasonable liability. In determining whether liability should be extended to a new situation, the courts would consider the factors relevant to proximity such as the relationship between the parties, physical propinquity, assumed or imposed obligations and close causal connection. McLachlin J. allowed recovery for CN's losses. Stevenson J. agreed in the result but applied a narrower principle borrowed from Australian case law, the "known plaintiff" test, as a means of circumscribing liability in this area.

La Forest J., in dissent, preferred a "bright line" rule excluding recovery for contractual relational economic loss. He felt that the policy concerns over floodgates, indeterminate liability, deterrence and cost internalization (such that only one party would have to carry insurance coverage for the property) were best met by confining the tortfeasor's primary liability to the property owner. He did recognize that there were exceptions to this

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<sup>611</sup> *Economic Negligence*, *supra* note 281 at 193.

<sup>612</sup> *Cattle v. Stockton Waterworks Co.* (1875), L.R. 10 Q.B. 453, [1874-80] All E.R. Rep. 492 (Q.B.) [*Cattle*].

<sup>613</sup> *Supra* note 178. See accompanying discussion of the economic arguments that were held not determinative, by the majority, in that case.

exclusionary rule, such as cases of joint ventures, general average contributions, and possessory and proprietary interests, which had already been reasonably well defined and limited.

Most commentators preferred the well-reasoned and almost encyclopedic judgment of La Forest J., and the Supreme Court of Canada decided to adopt his approach in two subsequent decisions, *D'Amato* and *Bow Valley*, both involving contractual relational economic loss. *D'Amato*<sup>614</sup> was a personal injury case and included a claim by a company co-owned and operated by the injured person for its economic losses flowing from the injury. In denying the claim, the Court applied both La Forest J.'s exclusionary rule and McLachlin J.'s slightly broader test, to reach the same result. *Bow Valley*<sup>615</sup> involved property damage, as in *Norske*, this time damage to an oil-drilling rig caused by fire. The relational claims were by oil exploration companies that controlled a majority of the shares in the rig owner. In denying their claims, McLachlin J., who wrote for the majority, in effect rejected her earlier open-ended approach *Norske*. She held:

Despite [the differences in our approaches], La Forest J. and I agreed on several important propositions: (1) relational economic loss is recoverable only in special circumstances where the appropriate conditions are met; (2) these circumstances can be defined by reference to categories, which will make the law generally predictable; (3) the categories are not closed. La Forest J. identified the categories of recovery of relational economic loss defined to date as: (1) cases where the claimant has a possessory or proprietary interest in the damaged property; (2) general average cases; and (3) cases where the relationship between the claimant and property owner constitutes a joint venture.<sup>616</sup>

*Anns* is still the test, and while the categories are not closed, she made it clear the Court would not "assiduously seek new categories".<sup>617</sup> In relational claims, then, the Court is applying a categories-within-a-category approach – the force of expansion is meeting resistance.

#### ▪ Public Authorities

Public authorities are creatures of statute exercising their powers or duties in the public interest. Most commonly, the defendants in this category are municipalities, but other authorities are also included in this category.

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<sup>614</sup> *Supra* note 594.

<sup>615</sup> *Supra* note 183.

<sup>616</sup> *Ibid.* at 1241-42.

<sup>617</sup> *Ibid.* at 1243.

*Anns*, while having a broad impact on the law of negligence generally, was a public authorities case. In 1980, in *Barratt v. North Vancouver (District)*,<sup>618</sup> the Supreme Court of Canada adopted the *Anns* analysis in relation to public authorities and particularly the distinction drawn between policy and operational areas of discretion. The complaint in *Barratt* was with the frequency of highway inspections undertaken not the way in which they were carried out. The Court held that this was a matter of policy and was not subject to a duty of care in negligence. In *Nielsen v. Kamloops (City)*,<sup>619</sup> a negligent house inspection case, the Supreme Court of Canada again applied *Anns*. This time the municipality was found liable. Stop work orders had been issued because of deficiencies in the construction, but the stop work orders were not enforced and the builder continued the construction without correcting the deficiencies. The house was eventually completed and the owner went into occupation without a final permit. A subsequent purchaser who was unaware of this construction history sued the municipality when structural problems became apparent. The Court held that the complaint here related to the "operational" end of the spectrum of discretion, and therefore the municipality was not immune from liability. No policy decision had been made to end the inspection process.

*Just v. British Columbia*,<sup>620</sup> a highway inspections case, is currently the leading case in this area. The plaintiff was injured, and his daughter killed, by falling rock. The Court found that the manner and quality of a highway inspection system, once the decision had been made to inspect, was part of the operational aspect of a governmental activity, and therefore not immune from review by the courts. With respect to the standard of care issue, all the surrounding circumstances had to be assessed including budgetary restraints and the availability of qualified personnel and equipment. Because these findings were not made at trial, a new trial was ordered. This case has been criticized as narrowing the scope of public authority immunity in Canada.<sup>621</sup> As Sopinka J. remarked in dissent,<sup>622</sup> in terms of immunity, "[a]ll that is left is the decision to inspect." Lower level discretion will be harder to characterize as true policy. However, in two subsequent decisions the Supreme Court of

<sup>618</sup> [1980] 2 S.C.R. 418, 114 D.L.R. (3d) 577 [*Barratt*]. *Barratt* was a personal injury case (the plaintiff was injured when he hit a pothole riding his bicycle), but the principles applied are relevant to economic loss cases.

<sup>619</sup> *Supra* note 215.

<sup>620</sup> [1989] 2 S.C.R. 1228, 64 D.L.R. (4th) 689 [*Just* cited to S.C.R.]. Like *Barratt*, this is a personal injury case, but the principles, although they may be more difficult to apply, are the same in economic loss cases.

<sup>621</sup> See Bruce Feldthusen, "Failure to Confer Discretionary Public Benefits: The Case for Complete Negligence Immunity" (1997) 5 Tort Law Rev. 17.

Canada may have signalled a return to a broader form of immunity. Both involved cases where a decision to inspect had been made, but the Court nevertheless held that the method and means of inspection involved policy and could not be questioned.<sup>623</sup>

In the *Cooper*,<sup>624</sup> the Supreme Court of Canada considered whether the Registrar of Mortgage Brokers in British Columbia owed a duty of care to investors who lost money through the questionable practices of a particular broker. The investors argued that if the Registrar had acted sooner to suspend the broker's licence, their losses would have been avoided or diminished. The Court applied the new approach to duty of care described in Chapter 3<sup>625</sup> and found no analogous categories. After reviewing the legislative scheme, the Court concluded that the legislation was designed to protect the public generally and not just investors.<sup>626</sup> Further, there were no broad policy reasons to recognize a *prima facie* duty of care in this context. The Court went on to find that even if a *prima facie* duty of care were established, the decision to suspend a broker involved both policy and quasi-judicial interests and therefore was immune from review. The policy/operational analysis still falls to be decided under the second stage of *Anns*.

The approach taken here indicates that the Supreme Court of Canada is starting to pull back on the reins of negligence liability. Even recognized categories are going to be considered in a specific, narrow sense.<sup>627</sup> Arguably, a few years earlier, the Court would have treated this as a simple public authorities case, and proceeded directly to the second stage of *Anns*.

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<sup>622</sup> *Just*, *supra* note 620 at 1254.

<sup>623</sup> See *Swinamer v. Nova Scotia (Attorney General)*, [1994] 1 S.C.R. 445, 112 D.L.R. (4th) 18 and *Brown v. British Columbia (Minister of Transportation & Highways)*, [1994] 1 S.C.R. 420, 112 D.L.R. (4th) 1.

<sup>624</sup> *Supra* note 218.

<sup>625</sup> See sections 3.4.1 and 3.4.2.

<sup>626</sup> The emphasis the Court placed on whether the legislation was directed at protecting investors as opposed to the public as a whole came very close to suggesting the legislation must create, recognize or imply a duty (see *Cooper*, *supra* note 218 at paras. 43-50). This is arguably contrary to *Saskatchewan Wheat Pool v. Canada*, [1983] 1 S.C.R. 205, 143 D.L.R. (3d) 9, where the Court abolished the implied statutory cause of action in negligence. Legislation may be evidence of a duty, but the fact that it is not should not be the end of the inquiry. There may be other evidence of proximity. In any event, it was stretching credulity in this case to suggest that the mortgage broker's job under the legislation was to protect the public generally but not investors!

<sup>627</sup> See also *Edwards*, *supra* note 219, where the Court took a similar approach to *Cooper*. *Edwards* was a companion case to *Cooper* and the Court adopted the framework of analysis and much of the reasoning from *Cooper*. The plaintiffs in *Edwards* sued the Law Society of Upper Canada. They had lost money that had been deposited in a lawyer's trust account as part of a gold delivery fraud. The lawyer had notified the Law Society when he suspected his account was being used improperly, and an investigation was launched. The plaintiffs argued

### 4.3.3 Negligent Misrepresentation – A Short History

#### 4.3.3.1 The Early Years

*Hedley Byrne* was adopted and applied in Canada soon after it was decided, but initially the test for duty of care was not clear.<sup>628</sup> In *Carman Construction Ltd. v. Canadian Pacific Railway*,<sup>629</sup> the Supreme Court of Canada seemed to settle on the assumption of responsibility model of liability. Carman Construction (“Carman”) bid on and was awarded a contract with Canadian Pacific Railway (“CPR”) to excavate some rock to widen a railway siding beside a stretch of railway. Prior to the submission of the bid an employee of CPR allegedly misrepresented the volume of rock to be removed which Carman relied on in preparing its bid. The bid documents included a clause (also included in the final contract) that provided that Carman did not rely on any information given or statement made to it by CPR in relation to the work. Carman was aware of this provision prior to the misrepresentation and the submission of the bid. Martland J., for the Court, quoted passages from four of the five judgments in *Hedley Byrne* which referred to accepting, assuming or undertaking a duty of care as the basis of liability, and concluded on the facts before him:

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that the Law Society owed them a duty and could have done more to prevent the losses. Again, the Court found that no *prima facie* duty of care was owed because the legislation did not expressly or impliedly impose a private law duty on the Law Society (para. 13). The Court held that while the relevant legislation was designed to protect clients and the public that did not mean as duty was owed to these investors. In any event, the Court held even if a *prima facie* duty was owed, it was negated under the second stage of *Anns* based on broad policy considerations as in *Cooper*. Like *Cooper*, *Edwards* should have been analyzed primarily under the second stage of *Anns*. In considering the legislative objectives at stage one, the Court was engaging in a policy analysis that was outside the specific relationship in question. As I argue in Chapter 3 (section 3.4.2), the analysis at stage one should be confined to the particular relationship in question if the inquiry is to have a clear focus.

<sup>628</sup> One early writer interpreted *Hedley Byrne* as establishing a foreseeable and reasonable reliance test for careless words: see R. Atkey, “Negligent Words: A Look at *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*” (1964) 3 West. L.R. 104 at 114. In *Windsor Motors*, *supra* note 337, a case involving a misrepresentation by a municipal official, the B.C. Court of Appeal appeared to apply a reasonable reliance test of liability, although some passages from *Hedley Byrne* were quoted where assumption of responsibility was mentioned. In two Supreme Court of Canada decisions from 1971, *Cominco Ltd. v. Bilton* (1970), [1971] S.C.R. 413, 15 D.L.R. (3d) 60 and *Welbridge Holdings Ltd. v. Winnipeg (Greater)* (1970), [1971] S.C.R. 957, 22 D.L.R. (3d) 470, *Hedley Byrne* was only mentioned in passing and there was no analysis of the basis of the duty. In *Nunes Diamonds*, *supra* note 330, Pigeon J., for the majority, seemed to accept the consent model, but he based his decision on the “independent tort” rule (which is no longer followed as he framed it – see discussion on concurrency in the Appendix). In *Porkey Packers*, *supra* note 337, another case involving a misrepresentation by a municipal official, the Supreme Court of Canada again seemed to accept the consent model, but dismissed the case principally because there was no reliance in fact. Finally, in *Haig*, *supra* note 332, the Court was primarily concerned with the problem of indeterminate liability – accountants were being sued by a seed capital investor for negligence in the preparation of financial statements specifically prepared for the purpose of raising seed capital. The Court limited liability by requiring knowledge of the limited class (at 476-77), referred to the assumption of responsibility test as “an interesting one” (at 479-80), and in the end seemed to adopt the U.S. “justifiable reliance” test (at 483).

<sup>629</sup> [1982] 1 S.C.R. 958, 136 D.L.R. (3d) 193 [*Carman Construction* cited to S.C.R.].

In the *Hedley Byrne* case the decision was that the disclaimer of responsibility for the persons alleged to be liable for negligent misrepresentation, communicated to the other party, excluded the assumption of a duty of care. I regard the wording of clause 3.1 [the non-reliance clause] of the agreement as having the like effect. The judgment at trial dealt with the situation on the basis that negligent misrepresentation had been established, but that clause 3.1 was an exemption clause which exempted C.P.R. from liability. In the circumstances of this case, I would prefer to regard the clause as establishing that C.P.R. did not assume any duty of care, and a claim in negligence will not arise in the absence of a duty of care.<sup>630</sup>

Martland J. did not consider *Anns* or the concept of proximity in reaching his conclusion.

Just over ten years later, in *Cognos*,<sup>631</sup> reaffirmed the concurrency rule that just because the parties are in a contractual relationship, or negotiating toward one, when the misrepresentation occurs is no bar to the action.<sup>632</sup> The misrepresentation in this case was made in the context of pre-contractual negotiations leading to an employment contract. The employer misrepresented the security of the funding for the project for which the position had been created.<sup>633</sup> The plaintiff brought this action when his position was terminated after approximately 1½ years due to lack of funding. The judgment was significant for both what it did establish and what it did not establish. Iacobucci J. clearly set out the elements of the claim:

The required elements for a successful *Hedley Byrne* claim have been stated in many authorities, sometimes in varying forms. The decisions of this Court cited above suggest five general requirements: (1) there must be a duty of care based on a "special relationship" between the representor and the representee; (2) the representation in question must be untrue, inaccurate, or misleading; (3) the representor must have acted negligently in making said misrepresentation; (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and (5) the reliance must have been detrimental to the representee in the sense that damages resulted.<sup>634</sup>

In dealing with the first element, however, Iacobucci J. left some doubt as to the applicable test. He stated:

There is some debate in academic circles, fuelled by various judicial pronouncements, about the proper test that should be applied to determine when a "special relationship" exists between the representor and the representee which will give rise to a duty of care. Some have suggested that "foreseeable and reasonable reliance" on the representations is the key element to the analysis, while others speak of "voluntary assumption of responsibility" on the part of the representor. Recently, in *Caparo Industries plc v. Dickman*, [1990] 1 All E.R. 568 (H.L.), a case unlike the present

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<sup>630</sup> *Ibid.* at 972.

<sup>631</sup> *Supra* note 49.

<sup>632</sup> See Fig. 3.5-2 and accompanying explanation, and the Appendix.

<sup>633</sup> In the interview it was implied but not expressly stated that secure funding was in place. Iacobucci J., who wrote the main judgment concerning the constituent elements of the claim, held that an implied misrepresentation could support a claim for negligent misrepresentation: *Cognos*, *supra* note 49 at 128-31.

<sup>634</sup> *Ibid.* at 110.

one in that there the whole issue revolved around the existence of a duty of care, the House of Lords suggested that three criteria determine the imposition of a duty of care: foreseeability of damage, proximity of relationship, and the reasonableness or otherwise of imposing a duty.<sup>635</sup>

He declined to choose between the tests because on the facts before him it was unnecessary – all the tests were satisfied. *Cognos* gave us a clear list of the elements of the claim, but left the duty question unresolved.<sup>636</sup>

In a decision handed down later that same year (1993), *Edgeworth Construction*,<sup>637</sup> Canada's highest court continued to equivocate on the basis of liability. Edgeworth successfully bid on a road-building contract with the Province of British Columbia. It alleged that there were errors in drawings prepared by N.D. Lea, an engineering firm, and that in relying on the drawings it lost money on the project. In the contract between Edgeworth and the Province, the Province was absolved of responsibility for errors in the drawings. Edgeworth had no contractual relationship with N.D. Lea, however, and its claim against the engineering firm for negligent misrepresentation was successful. McLachlin J., who wrote for six of the seven

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<sup>635</sup> *Ibid.* at 116.

<sup>636</sup> Some uncertainty with respect to the other elements remains, however. The second and third elements could be grouped together as one under the heading "Standard of Care and Breach". Iacobucci J. analyzed them under the heading "The Breach of the Duty of Care" (*ibid.* at 118). The "legal" question concerning the level of care required would be included here as well – for instance, if the defendant is possessed of special skill and knowledge, presumably the test would require care measured against a reasonable person with similar skill and knowledge. The cases so far have spent little energy on the question of breach. Once a duty is found to exist, if the statement is untrue negligence is almost presumed. While it is clear that representations of existing facts and implied misrepresentations are covered (*supra* note 633), there is doubt whether representations of future occurrences and omissions might also be covered. Some courts have interpreted *Cognos* as establishing that omissions may be covered (for example, see *Spinks v. Canada*, [1996] 2 F.C. 563, 134 D.L.R. (4th) 223 at 230, 236 per Linden J.A., *Alvin's Auto Service*, *supra* note 357 at 16 and *Wind Power*, *supra* note 357 at 114, apparently also adopting this interpretation), but it is arguable whether Iacobucci J. intended to go that far. The causation element, actual reasonable reliance, seems relatively straightforward. One writer has criticized this causation test because if a third party's reliance causes the plaintiff's loss the plaintiff would be not be able to recover. For example, if a negligently prepared audit caused a depreciation in share value because of *market reliance*, an individual shareholder who did not personally rely on the report would have no recourse: see Barker, *supra* note 7 at 481. There is merit to that argument. Also, one element that is conspicuously absent from the roster is *proximate* cause or remoteness. Perhaps, the reasoning behind this omission is that remoteness concerns are adequately dealt with in the duty analysis and the built-in indeterminate liability limitations. Lastly, there is some doubt about the application of the defence of contributory negligence, not an element as such: see discussion in Linden, *supra* note 191 at 432-33 and *Economic Negligence*, *supra* note 281 at 113-15. How can there be reasonable reliance required at the causation stage (and the duty stage under *Hercules*), but at the same time be unreasonable reliance required to prove contributory negligence? These issues are not considered further in this thesis.

<sup>637</sup> *Supra* note 334. For a discussion of this decision from a construction law perspective, see Robert W. Eden & Kerry R. Powell "The Legal Edge" (1994), 12 C.L.R. (2d) 183 and Lawlor Rochester, "Can We Afford *Edgeworth*?" (2000), 50 C.L.R. (2d) 277.

judges on the panel, appeared to bring the *Hedley Byrne* duty question under the *Anns* framework of analysis. Concerning the test for duty, she stated:

Liability for negligent misrepresentation arises where a person makes a representation knowing that another may rely on it, and the plaintiff in fact relies on the representation to its detriment: *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465 and *Haig v. Bamford*, [1977] 1 S.C.R. 466.<sup>638</sup>

This calls into question the assumption of responsibility theory, but later on she wrote:

The responsibility of the engineering firm arises from its own misrepresentation, coupled with the knowledge that contractors will be relying on it and acting on it without practical opportunity for independent inquiry, *in the absence of any disclaimer of responsibility*. While the possibility of being sued in tort may inhibit the willingness of design professionals to enter into limited retainers, it does not follow that by assuming duties toward third parties the engineering firm would be performing work for which it is not paid. Many professionals in a wide variety of callings and circumstances assume duties toward persons other than those with whom they have contracted, and are held liable in tort for their proper discharge: see, for example, *Haig v. Bamford*, *supra*. Typically, the additional risks are reflected in the price of the contract. *Alternatively, disclaimers of responsibility to third parties may be issued.*<sup>639</sup> [emphasis added]

While she apparently rejected the economist's argument about the non-appropriability of the benefits of information discussed in Chapter 3,<sup>640</sup> she nevertheless recognized a power to limit liability on the part of the representor. Unfortunately for N.D. Lea, it had not disclaimed responsibility to third parties in its report. For McLachlin J., then, assumption of responsibility *was* part of the duty question. Exactly how it fit in with the *Anns* approach was not clear, however.

La Forest J. wrote a concurring judgment, but added some passing comments in which he kept his options open on the duty issue. He remarked:

The appellant here [Edgeworth] was quite reasonably relying on the skills of the engineering firm and the firm in turn must be taken to have recognized that persons in the position of the respondents [*sic*] would rely on their work and act accordingly. I have cast the relationship in terms of reliance but it may also be seen as a matter of voluntary assumption of risk.<sup>641</sup>

#### 4.3.3.2 *Hercules and Reliance*

Four years after *Edgeworth Construction*, La Forest J., writing for the Court in *Hercules*,<sup>642</sup> set the record straight. The recurring question of the extent of accountants' liability arose again. An annual auditors' report required by statute was relied on by shareholders in making decisions to

<sup>638</sup> *Edgeworth Construction*, *supra* note 334 at 214.

<sup>639</sup> *Ibid.* at 219-20.

<sup>640</sup> See section 3.5.2.

<sup>641</sup> *Edgeworth Construction*, *supra* note 334 at 212.

<sup>642</sup> *Supra* note 6.



keep their existing shares and to purchase more shares. A significant part of the decision related to folding *Hedley Byrne* liability into the *Anns* two-stage test. The Court found that the law was not well served by having a separate "pocket" of negligence with separate rules of liability.<sup>643</sup> Establishing the first of the *Cognos* elements, then, became a question of first proving a *prima facie* duty of care, followed by a consideration of whether there were policy reasons for negating or limiting liability. La Forest J., in discussing the *prima facie* duty of care issue, stated:

[P]roximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable. To use the term employed by my colleague, Iacobucci J., in *Cognos*, *supra*, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere.<sup>644</sup>

With respect to the foreseeability portion of the test, the question of degrees of foreseeability has not been an issue in negligent misrepresentation the way it has been in general negligence in the context of the remoteness issue.<sup>645</sup> Part of the reason for this may be that limitations of liability under the second stage of *Anns* effectively control the "extent" of liability.

In determining what constitutes reasonable reliance, the second of the two criteria, La Forest J. referred to Professor Feldthusen's five general *indicia* of reasonable reliance:

Professor Feldthusen (at pp. 62-63 [in Bruce Feldthusen, *Economic Negligence*, 3rd ed. (Scarborough: Carswell, 1994)]) sets out five general *indicia* of reasonable reliance; namely:

- "(1) The defendant had a direct or indirect financial interest in the transaction in respect of which the representation was made.
- (2) The defendant was a professional or someone who possessed special skill, judgment, or knowledge.
- (3) The advice or information was provided in the course of the defendant's business.
- (4) The information or advice was given deliberately, and not on a social occasion.
- (5) The information or advice was given in response to a specific enquiry or request."

While these *indicia* should not be understood to be a strict "test" of reasonableness, they do help to distinguish those situations where reliance on a statement is reasonable from those where it is not.<sup>646</sup>

<sup>643</sup> See discussion section 3.5.1.

<sup>644</sup> *Hercules*, *supra* note 6 at 188.

<sup>645</sup> See the *Overseas Tankship (U.K.) Ltd. v. Morts Dock & Engineering Co., The Wagon Mound (No. 1)*, [1961] A.C. 388, [1961] 1 All E.R. 404 (P.C.) and *Overseas Tankship (U.K.) Ltd. v. Miller Steamship Co. Pty. Ltd., The Wagon Mound (No. 2)*, [1967] 1 A.C. 617, [1966] 2 All E.R. 709 (P.C.).

<sup>646</sup> *Hercules*, *supra* note 6 at 201-02.

It will be recalled that reasonable reliance is also the fourth element in the *Cognos* list of five. The difference between reasonable reliance in relation to the two elements appears to be that at the duty stage the question is objective and concerned with what might occur (would a reasonable person rely on the information in the circumstances?), whereas in establishing the fourth element the test is subjective and concerned with what has occurred (i.e., the plaintiff must have actually relied on the information causing the loss).<sup>647</sup>

On the facts of this case, the Court held that a *prima facie* duty of care was established: It was foreseeable that the plaintiffs would rely on the audited statements, and that reliance was reasonable (the first four of Feldthusen's *indicia* were present).

The second stage of the inquiry required a look at considerations which might obviate concerns over indeterminate liability. Two such considerations were knowledge by the defendant of the plaintiff (or limited class of plaintiffs) who would use the information, and use of the information by the plaintiff for the purpose for which the information was prepared.<sup>648</sup> Here, La Forest J. brought the "end and aim" rule<sup>649</sup> into the *Anns* framework. The Court held that the statements had been prepared to assist the collectivity of shareholders make decisions in overseeing management, not to assist shareholders make personal investment decisions. The duty was therefore negated on these facts – the policy concern over indeterminate liability was not obviated.

La Forest J. did not incorporate the concept of voluntary assumption of responsibility into his analysis. The absence of a disclaimer made it easy for him to dispense with the consent model. Had there been a disclaimer, it is not clear how he would have approached it. In discussing

<sup>647</sup> See Linden, *supra* note 191 at 431-32.

<sup>648</sup> In *Ultramares*, *supra* note 286 at 444, Cardozo J. referred to the concern about "liability in an indeterminate amount for an indeterminate time to an indeterminate class". The first consideration, i.e., knowledge of the users, relates to indeterminacy of class and possibly amount. La Forest J. did not make it clear which indeterminacy concern the second consideration was designed to neutralize, amount, time, or, as one writer has put it, the "nature" of potential liability: see Michael E. Deturbide, "Liability of Auditors – *Hercules Managements Ltd. v. Ernst & Young*" [Case Comment] (1998) 77 Can. Bar Rev. 260 at 263. It is interesting to note that Canadian legislators are apparently less concerned about the indeterminate liability of auditors (and other experts) with respect to misrepresentations in prospectuses and other disclosure documents than the courts are. Civil liability under Canadian securities legislation is not restricted to a "limited class", for instance, but usually extends to "any person" who purchases a security covered by the document: as one example, see s. 131 of the *Securities Act*, R.S.B.C. 1996, c. 418. See also Deturbide, at 263, who notes the more expansive liability of auditors under securities legislation.

<sup>649</sup> See above 3.5.1.3 under "Indeterminate Liability and the 'End and Aim Rule'".

indeterminate liability as an *Anns* second stage consideration, La Forest J. mentions that this was not a concern in *Hedley Byrne* and that “[t]he House of Lords found that but for the presence of a disclaimer, the defendants would have been liable to the plaintiffs in negligence”.<sup>650</sup> He did not question the effectiveness of the disclaimer.<sup>651</sup> The relationship between the new approach to duty and disclaimers was confronted head-on in *Micron Construction*.

#### 4.3.3.3 *Micron Construction Revisited*

The facts and appeal history of *Micron Construction* are recounted in detail in Chapter 2. The fraud claim was dismissed as unsupported by the evidence. This case fell to be decided on the basis of negligent misrepresentation. It was much like *Hedley Byrne* in that it involved a negligent banking reference. Esson J.A. noted certain factual similarities. In both cases, the creditworthiness of a customer of the bank was uncertain, heavy advance costs were to be incurred by the plaintiff, there were no alternative sources of information, and standard banking disclaimers (unclear to those not versed in banking practice) were used. The finding in *Micron Construction* that there was no alternative source of information was debatable on the facts. So was the conclusion that disclaimers in both cases were unclear. Even accepting these findings, however, they don’t support the result under either model of liability. Certain factual distinctions were also noted. They were: the communications in *Hedley Byrne* were through an intermediary (the plaintiff’s own bank), whereas in *Micron Construction* they were initially through the general contractor as agent and later were direct; in *Hedley Byrne* the request and the response were qualified, but in *Micron Construction* only the response was stated to be “without responsibility”; *Hedley Byrne* involved an error in judgment, whereas *Micron Construction* involved clear negligence; and finally, *Hedley Byrne* there was just one reference, but in *Micron Construction* there were two. These distinctions also do not support the result. The brief discussion of the reasons in Chapter 2 is amplified in this section.

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<sup>650</sup> *Hercules*, *supra* note 6 at 199.

<sup>651</sup> At 190, *ibid.*, La Forest J. said he would not question the conclusion in *Hedley Byrne*. Susan Griffin argues that the Supreme Court of Canada in *Hercules* seems to have assumed that disclaimers would continue to be effective: Susan A. Griffin, “Hedley Byrne Revisited” in *Torts – 2001* (Vancouver: The Continuing Legal Education Society of British Columbia, 2001) at 2.1.18.

▪ Interpretation of the Law

Esson J.A. interpreted *Hercules* to mean that the voluntary assumption of responsibility theory from *Hedley Byrne* no longer applied.<sup>652</sup> The question of the foreseeability of the reliance, the first part of the proximity test, was not analyzed, presumably because it was clear in the circumstances. In determining whether or not the reliance was reasonable, the Court followed *Hercules* in considering Professor Feldthusen's five general (though not conclusive) *indicia* of reasonable reliance.

One consequence of a theory of liability based on voluntary assumption of responsibility is arguably that a disclaimer is determinative of the duty question. How can a person be assuming a duty of care if she is disclaiming responsibility when providing the information? There is some debate whether even under the consent model the existence of a disclaimer invariably leads to the result that there is no duty. However, Esson J.A. sidestepped this line of argument; *Hercules* had made it moot. A test based on reasonable reliance or, to use another term he preferred, "justifiable reliance",<sup>653</sup> is more consonant with traditional tort/negligence doctrine. The existence of a disclaimer is simply one circumstance the court will consider in determining whether or not there was reasonable or justifiable reliance. It is certainly not conclusive of the duty issue.

▪ Application of the Law

Esson J.A. found that Professor Feldthusen's five *indicia* were all met on the facts. *Indicia* two through five were clear. With respect to the first, Esson J.A. concluded that the bank had a direct financial interest in the project. He was prepared to assume, absent the disclaimer, that the reliance was reasonable. But was it still reasonable to rely on the information in the face of the disclaimer? Stressing two of the facts mentioned above, that there was no alternative source of information and that the wording of the disclaimer was unclear (these were factual

<sup>652</sup> *Micron Construction*, *supra* note 28 at paras. 82-83.

<sup>653</sup> Esson J.A. cited with approval a passage from Professor Joost Blom, "Economic Loss: Curbs on the Way Ahead?" (1986-87) 12 Can. Bus. L.J. 275 at 283, where Professor Blom defined justifiable reliance as follows:

The defendant owes the plaintiff no duty of care unless a reasonably prudent and sceptical person, in the plaintiff's position, would have been led by the defendant's words or conduct to believe that he had an assurance of the defendant's taking reasonable care, equivalent in weight to the defendant's promise...Only in such a case can the plaintiff truly be said to have placed justifiable reliance on the defendant.

Somewhat confusingly, while Professor Blom clearly contemplated an aspect of assumed responsibility in his test, Esson J.A. rejected this idea but at the same time approved the notion of justifiable reliance. See *Micron*

similarities with *Hedley Byrne*), Esson J.A. concluded that the reliance was still reasonable. Further, to support his conclusion that Micron's reliance was reasonable (and justifiable), there were the later direct communications (the November conversations) which were not qualified by the disclaimer. But whether or not these oral communications were covered by the disclaimer was academic he said, as it would still have been reasonable and justifiable for Micron to rely on the Bank's representations even if they were.<sup>654</sup> As the reliance was foreseeable too, Esson J.A. found that the plaintiff had established a *prima facie* duty.<sup>655</sup> Also, he found that there were no policy concerns over indeterminate liability in this case requiring the court to limit or negate the duty – i.e., the second stage of the duty analysis under *Anns* and *Hercules* was not invoked.<sup>656</sup> Therefore, the Bank owed Micron a duty of care, the first element of the claim for negligent misrepresentation, despite the disclaimer.

Esson J.A. had said earlier in his judgment that elements two, three and five had been established and were not impacted by the disclaimer. The disclaimer only had a bearing, although a significant one, on the first *and fourth* elements of the claim, both of which involved the test of reasonable reliance.<sup>657</sup> However, he concluded his analysis having only analyzed duty of care. In a passing comment, though, he may have had the fourth element in mind: he stated that the November conversations were “important in establishing actual reliance”.<sup>658</sup> In the result, the Court of Appeal set aside the dismissal of the action by the trial judge and remitted the case to the trial court to assess damages.

#### ▪ Dissent

Ryan J.A., in dissent, agreed with the majority that the fraud claim should be dismissed. The trial judge's finding that there was no intent to deceive involved an issue of credibility and, as such, it was not open to the Court of Appeal to disturb it. However, she disagreed with the

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*Construction*, *ibid.* at paras. 103, 107. It is also part of the U.S. test under the *Restatement (Second) of Torts* § 552 (1977), which is discussed below section 4.4.4.

<sup>654</sup> *Micron Construction*, *ibid.* at para. 106. If the conclusion that the two factual inferences which Esson J.A. emphasized were not supportable on the evidence is correct, then the most convincing reason for finding liability would be that the disclaimer did not cover the November conversations. It follows, therefore, that Esson J.A.'s statement that this point was academic is inaccurate – that the disclaimer did not cover these conversations would be essential.

<sup>655</sup> *Ibid.* at para. 107.

<sup>656</sup> *Ibid.*

<sup>657</sup> *Ibid.* at para. 59.

<sup>658</sup> *Ibid.* at para. 106.

resolution of the negligent misrepresentation claim, which she would have dismissed. She was of the opinion that that claim turned on the disclaimer, and that the disclaimer precluded a finding that the Bank owed Micron a duty of care.

Ryan disagreed with the majority's assessment of the facts relating to the disclaimer in three respects. In her opinion, the disclaimer was clear, the disclaimer covered the November conversations, and the Bank was not the only source of information (Micron could have contacted the owner directly).<sup>659</sup>

With respect to the law, she agreed that the test for whether a *prima facie* duty of care would arise was "foreseeable and reasonable reliance", per *Hercules*. In applying this test she held that the foreseeability of the reliance was established, but given her assessment of the facts, particularly her finding that the disclaimer was clear and that it covered the telephone calls, the reliance was not reasonable.

She concluded her judgment with a couple of general comments about liability in this area. Firstly, she stated:

129 It is important not to lose sight of the nature of the inquiry in cases such as this. The disclaimer in question was not made in a contract binding the two parties. As Lord Reid pointed out in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465 at 489 [*sic*] (H.L.), in contract very specific words are required to exclude liability for negligence. Here, however, we are looking to see if we can *assume* a relationship upon which liability might be *imposed*. Where one party specifically advised the other that he takes no responsibility for his words, the other, in the normal course of things, must be taken to understand that he should not expect any more than a duty to be honest from the speaker.<sup>660</sup> [emphasis added]

In the passage from *Hedley Byrne* to which she apparently referred,<sup>661</sup> Lord Reid stated that generally clear words are required to exclude liability for negligence where the parties have a contract, but in this type of situation the question is whether an undertaking of a duty of care can be inferred. Ryan J.A.'s choice of words was interesting. She seemed to suggest that it is the court (her reference is to "we") which must assume the duty not the defendant. This is contrary to *Hedley Byrne* and does not make sense. Also, in the same sentence she refers to the

<sup>659</sup> *Ibid.* at paras. 124, 128 and 132, respectively.

<sup>660</sup> *Ibid.* at para. 129.

<sup>661</sup> The passage concerning the requirement of clear words to exclude liability for negligence in contract is at 492-93 not 489 of the A.C. report.

court imposing liability. This confusion in terminology highlights the nub of the issue. Should liability for negligent misrepresentation be based on consent or reliance?

In a second comment Ryan J.A. stated:

131 With respect for those who hold a contrary view, I am of the opinion it would be wrong to conclude, for policy reasons, a person may reasonably rely on information that he has been specifically told he cannot rely upon.<sup>662</sup>

This statement seems to confuse the two stages of the inquiry, at least as currently framed. The first part requires a determination whether there is *prima facie* duty, and the second whether there are any policy reasons to limit or negate the duty. If the reliance is not reasonable as Ryan J.A. held then that is the end of it, there is no duty. The second stage of the analysis does not arise. Perhaps, however, Ryan J.A. was alluding to other second stage policies that the courts might consider in the future. For example, even if it is reasonable to rely on information in the face of a disclaimer, the promotion of certainty in business dealings and the ability to control financial risk *using disclaimers* may justify negating the duty of care.

▪ Bad Law?

As I conclude in Chapter 5, for a number of reasons, the reliance model of liability should be rejected in favour of a model based on consent. Given *Hercules*, however, Ryan J.A.'s approach to the reliance model is preferable to Esson J.A.'s. When she referred to Micron's ability to contact the owner for financing information (disagreeing with the majority's assessment of the facts), she said:

132 ...The appellant had in hand a letter from the bank that disclaimed responsibility. The bank was reluctant to vouch for the creditworthiness of its client without disclaiming responsibility. Knowing that, Micron could have demanded further express information from Newport City [the owner] about its financing scheme, or, assessed the risk of going ahead without it accordingly.<sup>663</sup>

I would go even further. Even if Micron could not obtain information from the owner, it would still need to assess the risk in going ahead. Admittedly, it would be sizeable risk if neither the Bank nor the owner were prepared or able to give unqualified information about the financing. But it was Micron's risk to take. If the risk were too great, Micron still had other options to pursue before refusing to proceed. It could have 1) required a rapid payment

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<sup>662</sup> *Micron Construction*, *supra* note 28 at para. 131.

<sup>663</sup> *Ibid.* at 132.

schedule to minimize exposure; 2) required a binding assurance from bank, 3) required payment in advance by the owners, or 4) required a direct payment arrangement whereby Micron's obligations were to be met directly by the Bank or the owner. If none of these options were possible in the circumstances and Micron was not prepared to take the risk, it could have refused to continue with the venture. The majority of the Court of Appeal did not adequately consider how risk had been allocated by way of the disclaimer. The effect of the decision was to give Micron a guarantee of financing that was not bargained for.<sup>664</sup> Also, as Ryan J.A. alludes to in her judgment, the decision came at the expense of uncertainty. However, although the factual inferences of the majority in *Micron Construction* and its application of the law may have been questionable, it cannot be said that *Micron Construction* has created bad law. The real problem is with the *Hercules* test.

#### 4.3.4 Negligent Misrepresentation and Disclaimers

##### 4.3.4.1 General

The disclaimer in *Micron Construction* was not effective to prevent a duty of care from arising. The disclaimer in *Hedley Byrne* was. Does this mean disclaimers are generally no longer effective under the reliance model of liability? Are they relevant in the free rider context (*Hedley Byrne* and *Micron Construction* were direct advice scenarios)? Does it make a difference if the disclaimer is contractual? These questions are considered in this section. As a preliminary point, it should be noted that the word "disclaimer" is not a term of art. In the contractual context, different words are often used without distinction to describe clauses limiting liability, e.g., "disclaimer", "exclusion", "exclusionary", "exculpatory", "exemption", "exempting", "limitation", "limiting", etc. Generally, it might be said that limitation or limiting clauses merely limit liability (for example, to a certain dollar amount), whereas the others exclude some form of liability altogether, but even this difference is not universally recognized. The House of Lords has suggested that clauses which exclude liability altogether ought to be controlled more rigorously than clauses which mere limit liability.<sup>665</sup> However, Wilson J., in *Hunter Engineering* held that "any categorical distinction between clauses limiting and clauses excluding

<sup>664</sup> See Joost Blom, "Tort, Contract and the Allocation of Risk" (2002) 17 Sup. Ct. L. Rev. 289 at 298-303 on allocation of risk in negligent misrepresentation generally.

<sup>665</sup> *Ailsa Craig Fishing Co. v. Malvern Fishing Co.* (1981), [1983] 1 All E.R. 101 at 102-03, [1983] 1 W.L.R. 964 (H.L.).



liability is inherently unreliable”.<sup>666</sup> There is a large body of jurisprudence concerning the interpretation of contractual exclusion and limitation clauses, which is not considered in any detail here.

In the context of non-contractual disclaimers of liability for negligent misrepresentations, the word “disclaimer” is usually used by itself. Non-contractual disclaimers are typically not considered to be subject to the same strict rules of construction that apply to contractual clauses. Contractual exclusions frequently (though not always) qualify obligations already agreed to, whereas non-contractual disclaimers go to whether a duty has been assumed in the first place.<sup>667</sup>

#### **4.3.4.2 Non-Contractual Disclaimers**

In the “direct advice” context, the parties, by definition, are not in a contractual relationship – disclaimers in this context, therefore, do not have contractual force. Banks have been using non-contractual disclaimers of responsibility when providing credit references at least since the early 1900s.<sup>668</sup> Absent fraud, they did so with the knowledge that they were secure from liability with respect to the information provided. In *Hedley Byrne* itself, it was the existence of the disclaimer that led the House of Lords to conclude that no duty had been cast upon the defendant bank. The bank’s disclaimer in *Hedley Byrne* provided:

For your private use and without responsibility on the part of the bank or its officials.

The disclaimer at the end of the reference in *Micron Construction* provided:

This bank reference is given at the request of the captioned and without any responsibility on the Bank and its signing officers.

How then could such similarly worded “standard” disclaimers lead to opposite results? In *Micron Construction*, Esson J.A. acknowledged that the reasonable reliance rule increases the possibility of recovery in the face of a disclaimer and that in a “few” cases that would a reasonable result. However, “[i]n the vast majority of cases in which there is a clear disclaimer,

<sup>666</sup> *Supra* note 313 at 518. Madame Justice Wilson cited with approval the argument made by Professor Waddams that “exclusions can be perfectly fair and limitations very unfair”: see Waddams, *supra* note 312 at para. 474.

<sup>667</sup> Lord Reid made this point in *Hedley Byrne*, *supra* note 3 at 492-93, as did Lord Pearce, at 540. See also, *supra* note 661 and accompanying text.

<sup>668</sup> See, for example, *Robinson v. National Bank of Scotland*, [1916] S.C. 154. See also *Micron Construction*, *supra* note 28 at paras. 67, 77 and Robert Stevens, “*Hedley Byrne v. Heller*: Judicial Creativity and Doctrinal Possibility” (1964) 27 Mod. L. Rev. 121 at 151.

that should continue to preclude recovery".<sup>669</sup> *Micron Construction* was one of the "few" cases. Esson J.A. emphasis on the lack of clarity of the disclaimer in finding liability is difficult to reconcile with the fact that standard banking disclaimers had been clear enough for almost a century. If anything, the disclaimer in *Micron Construction* is clearer than the one in *Hedley Byrne*. The phrase in *Micron Construction* is "without any responsibility". This strict construction placed on a non-contractual disclaimer goes against authority,<sup>670</sup> even accepting the reliance model of liability.

As similar analysis applies in the "free rider" situation. The information may have been generated pursuant to a contractual obligation, but given that there is no privity with the third party user, disclaimers, whether in the contract or elsewhere, must operate comparably to disclaimers in the "direct advice" context. In *Edgeworth Construction*,<sup>671</sup> McLachlin J., writing for the majority of the Court, was ambivalent about the exact nature of the duty of care,<sup>672</sup> but she still assumed that a disclaimer by the engineering firm would be effective to preclude liability to third party contractors relying on the report the engineering firm had prepared. However, because the engineering firm did not disclaim liability to third parties, the Court found that a duty of care was owed to the third party contractor. Presumably, to be effective, the disclaimer must be included with the information relied upon. If there is a contract and a separate report containing the information, a disclaimer just in the contract might not come to the attention of the third party. In *Wolverine Tube (Canada) Inc. v. Noranda Metal Industries Ltd.*,<sup>673</sup> the Ontario Court of Appeal, relying on *Carman Construction*, *Edgeworth Construction*, and *Hedley Byrne*, held that the following disclaimer in an environmental consultant's report directed at third parties effectively precluded a duty of care from arising:

This report was prepared by Arthur D. Little of Canada, Limited for the account of Noranda, Inc. The material in it reflects Arthur D. Little's best judgment in light of the information available to it at the time of preparation. *Any use which a third party makes of this report, or any reliance on or decisions to be made based on it, are the responsibility of such third parties. Arthur D. Little accepts no responsibility for damages, if any, suffered by any third party as a result of decisions made or actions based on this report.*<sup>674</sup> [emphasis by the Court]

Both *Edgeworth Construction* and *Wolverine Tube* were decided before *Hercules*.

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<sup>669</sup> *Micron Construction*, *ibid.* at para. 88.

<sup>670</sup> *Supra* note 667 and accompanying text.

<sup>671</sup> *Supra* note 334.

<sup>672</sup> See discussion of this case above section 4.3.3.1.

The conclusion one must draw is that the effectiveness of non-contractual disclaimers has been diminished somewhat as a result of the adoption of the reliance model of liability. Under the consent model, the disclaimer refutes an inference of the assumption of responsibility at the outset (as long as it is communicated at the same time as or before the information is given). Under the reliance model, the disclaimer becomes one of many factors the court will consider in determining reasonable reliance. However, a basic “without responsibility” disclaimer clearly communicated in a business setting should almost invariably lead to a finding that the reliance was *not* reasonable. It might be otherwise if there is evidence the disclaimer was not clearly communicated, that there were special reasons why it was not understood, or that the defendant had led the plaintiff to believe the disclaimer was not to be taken seriously.

Professor Feldthusen is of the view that the adoption of the reasonable reliance test means that the defendant will now “bear the onus of proving by way of affirmative defence that the simple words ‘without responsibility’ were sufficient to exculpate her from a pre-existing duty of care”.<sup>675</sup> This is not strictly accurate – at least it was not the approach the Court of Appeal took in *Micron Construction*. The defendant may have the burden of persuasion, but the onus is still on the plaintiff to prove reasonable reliance, and the existence of the disclaimer will be a hurdle the plaintiff will have to overcome. As mentioned, while there are fundamental problems with the reliance rule, the particular result in *Micron Construction* might be more a function of the rule’s incorrect application than the rule itself.

#### 4.3.4.3 Contractual Exclusions of Liability

Non-contractual disclaimers of the “without responsibility” variety occur most frequently in the “direct advice” and “free rider” contexts. In the “basic contract” situation, because the information is generated in the context of a contract between the representor and representee, it is more likely that attempts to limit liability will take the form of limiting provisions in the contract itself.<sup>676</sup>

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<sup>673</sup> (1995), 26 O.R. (3d) 577, 18 C.E.L.R. (N.S.) 219 (C.A.) [*Wolverine Tube* cited to O.R.].

<sup>674</sup> See *ibid.* at 579.

<sup>675</sup> *Economic Negligence*, *supra* note 281 at 56-57.

<sup>676</sup> This is not to say that non-contractual disclaimers will be ineffective to exclude tortious liability where the parties are in a contractual relationship. In *Carman Construction*, *supra* note 629 at 972, the Court held that a non-reliance clause in a “proposed” contract seen by the representee prior to the representation (the clause was also part of the contract finally agreed to) prevented the assumption of a duty in the first place, as in *Hedley*

There are a number of different techniques for controlling tortious liability in the "basic contract" context. If the negligent misrepresentation were pre-contractual, the representor could purchase a release from the representee. Or, along the same lines, the representor could bargain for a clause expressly excluding liability for negligent misrepresentation or limiting the quantum of liability for negligent misrepresentation.<sup>677</sup>

Another more indirect method is to include a "whole contract" clause whereby the representee agrees that the contract is wholly contained within the written document.<sup>678</sup> However, depending on the precise wording of such a clause, this technique may only have the effect of reducing what might have been a warranty to the status of a mere misrepresentation – tort liability for negligent misrepresentation would not necessarily be excluded.<sup>679</sup> The following clause, for example, may be insufficient to prevent a negligent misrepresentation claim:

This written contract contains the entire agreement between the parties and neither party shall be bound by any representation not contained herein.

The reference to being bound could be interpreted to mean "contractually" bound and not apply to tort liability. But if the wording is clear enough, it can be effective to exclude tort liability. For example, in *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.*,<sup>680</sup> the following clause

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*Byrne*, i.e., it was not a case of contractually negating a pre-existing duty. The reasoning is sound on these particular facts, and assuming a consent model of liability. If the disclaimer had not been communicated prior to the representation, however, the reasoning would have been suspect. If a disclaimer is to prevent the assumption of a duty, it follows that it should be communicated at the time of or before the representation. Further, if the reliance model of liability per *Hercules* had been applied, the Court may have found that a pre-contractual duty had arisen. The approach in *Carman Construction* is somewhat atypical and most cases involving contracting parties turn on the effectiveness of a contractual exclusion clause. In *Carman Construction* itself the trial judge, after finding that negligent misrepresentation had been established, had treated the same clause as an effective contractual exemption of liability (as noted in the Supreme Court of Canada judgment at 972). Generally, the use of a contractual exclusion clause has benefits over a non-contractual one – provided the contractual clause is clearly worded and otherwise enforceable – because the timing of the representation is not as important and neither is the model of liability for negligent misrepresentation. See generally, John Swan & Barry J. Reiter, "The Effectiveness of Contractual Allocations of Risk: *Carman Construction Ltd. v. Canadian Pacific Railway, Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.*" (1982) 6 Can. Bus. L.J. 219.

<sup>677</sup> See the general discussion of such clauses above in section 4.3.4.1.

<sup>678</sup> Such clauses are also referred to as "complete agreement", "entire agreement", "four corners", "integration", or "merger" clauses.

<sup>679</sup> With respect to the parol evidence rule, when it applies, it prevents the proof of oral terms, but it does not preclude the claims based on mere misrepresentation. Therefore, if damages for negligent (or fraudulent) misrepresentation only are sought and not for breach of contract, the parol evidence rule would not bar the claim. The equitable remedy of rescission for mere misrepresentation might also be available. See D.W. McLauchlan, *The Parol Evidence Rule* (1976) at 29, cited in Christine Boyle & David R. Percy, eds., *Contracts: Cases & Commentaries*, 5th ed. (Scarborough: Carswell, 1994) at 624-25.

<sup>680</sup> (1978), 19 O.R. (2d) 380, 25 O.R. (2d) 155n [erratum], 85 D.L.R. (3d) 321 (H.C.), rev'd on other grounds (1979), 27 O.R. (2d) 168, 105 D.L.R. (3d) 684 (C.A.), aff'd [1982] 1 S.C.R. 726, 135 D.L.R. (3d) 1.

was held to preclude tortious liability for a pre-contractual misrepresentation which induced the contract:

...except as herein expressly stated, no representation, statement, understanding or agreement has been made or exists, either oral or in writing...which relates to the subject matter hereof or which imposes any liability...<sup>681</sup>

One other technique for controlling exposure to negligent misrepresentation liability is to negotiate a "non-reliance" provision. In *Carman Construction*,<sup>682</sup> the Supreme Court of Canada held that the following provision prevented a duty of care from arising:

It is hereby declared and agreed...that...the Contractor does not rely upon any information given or statement made to him in relation to the work...<sup>683</sup>

As noted, the Court concluded that this was not a case of excluding a pre-existing duty as the trial judge had held.<sup>684</sup> One of the consequences of this was that the clause was not subject to the same strict rules of interpretation.<sup>685</sup> However, there is no reason to think that had the clause been introduced into the contract after the representation was made, it would not have been effective as a contractual exclusion of liability per the analysis of the trial judge.

With respect to post-contractual misstatements, they would be most effectively covered by clauses expressly limiting or excluding liability for negligent misrepresentation. "Whole contract" and "non-reliance" clauses are more clearly directed at statements made during negotiations.

#### 4.3.5 The Position in Quebec

In Quebec and France, there is no absolute rule against recovery for pure economic loss, based on negligent misrepresentation (which is not a separate, recognized form of delict) or otherwise.<sup>686</sup> Civil law judges, however, restrict recovery not as a matter of legal principle but on factual grounds and on the basis of causal connection.

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<sup>681</sup> Set out *ibid.* 85 D.L.R. (3d) 321 at 330 (H.C.) and [1982] 1 S.C.R. 726 at 740.

<sup>682</sup> See *supra* note 629 and accompanying text.

<sup>683</sup> Set out *Carman Construction*, *supra* note 629 at 961.

<sup>684</sup> See *supra* note 676.

<sup>685</sup> *Carman Construction*, *supra* note 629 at 973. See also above section 4.3.4.1.

<sup>686</sup> See Jutras, *supra* note 282. Jutras notes, however, that not all civil law jurisdictions are the same. For instance, Germany's approach to economic loss is close to the common law approach (at 295).

Two principal articles of the *Civil Code of Quebec*, S.Q. 1991, c. 64, in Book V on Obligations, are relevant to liability for careless words:

**1457.** Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another.

Where he is endowed with reason and fails in this duty, he is responsible for any injury he causes to another person by such fault and is liable to reparation for the injury, whether it be bodily, moral or material in nature...

**1458.** Every person has a duty to honour his contractual undertakings.

Where he fails in this duty, he is liable for any bodily, moral or material injury he causes to the other contracting party and is liable to reparation for the injury; neither he nor the other party may in such a case avoid the rules governing contractual liability by opting for rules that would be more favourable to them.

Art. 1457 deals with delictual or tortious liability and art. 1458 with contractual liability. "Fault" is the basis of civil liability in Quebec.<sup>687</sup> Contractual and delictual fault are seen as examples of the same concept: that one must live up one's obligations. Contractual fault is based on voluntarily assumed obligations, and tortious fault on general standards of good behaviour.<sup>688</sup> However, the two forms of fault are not interchangeable. The courts "clearly distinguish between those duties that should reasonably be qualified as duties implicitly resulting from the contract and those duties said to derive from the general duty imposed by law..."<sup>689</sup>

The civil law approach to contracts is different from the common law in a number of respects including its treatment of consideration. The promisor's intention to contract is the central question, and elements like "consideration, moral obligation or writing are relevant as evidence of that intention".<sup>690</sup> Consideration is therefore not required in civil law contracts. Another important concept is the idea of the "cause of the contract" (which is not the same thing as

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<sup>687</sup> Linden, *supra* note 191 at 739. Chapter 20 of Linden's text is based on a book and monograph prepared by Justice Jean-Louis Baudouin of the Quebec Court of Appeal. The language of "new" art 1457 does not use the word fault, although the main predecessor article on delictual liability from the original Civil Code of Quebec of 1866, art. 1053, did. Article 1457 uses a distinctly common law word, "duty".

<sup>688</sup> Linden, *ibid.* at 739-40.

<sup>689</sup> *Ibid.* at 740.

<sup>690</sup> Boyle & Percy, *supra* note 391 at 262.

factual causation of damages).<sup>691</sup> The cause of the contract has been described as the requirement of “a valid purpose, a reason for, an end to be pursued in the contract”.<sup>692</sup>

In the “direct advice” and “basic contract” settings where the common law finds a tortious duty to use care, the civil law would find a contractual obligation if the requirements of intention and cause were there. The absence of consideration would not be problem as it was in cases like *Hedley Byrne* and *Micron Construction*. As Lord Devlin stated in *Hedley Byrne*, the duty problem in that case was “a by-product of the doctrine of consideration”, and that if the bank “had made a nominal charge for the reference” it would have been a contract issue.<sup>693</sup> However, in cases of direct dealing where the requirements of civil law contracts are not met, the “injured” party can base his claim on the delictual form of fault.<sup>694</sup>

In the “free rider” context, delict will generally be the only route to follow.<sup>695</sup> One writer has described the “duty” of accountants in Quebec as follows:

In Québec, the common law notion of duty of care does not exist. Rather, Article 1457 of the *Civil Code of Québec* states that any person who is endowed with reason and who fails in his duty to abide by the rules of conduct which rest with him is responsible for any injury he causes to another person and is liable to reparation for the injury. In other words, if a plaintiff can prove fault, damage and a causal link between the two, that is sufficient grounds for a court to find liability on the part of the accountant without the plaintiff being obliged to prove that the accountant owed him a duty of care. For instance, in the case of *Garnet Retallack & Sons Ltd. v. Hall and Henshaw Ltd.*, [1990] R.R.A. 303 (Qué. C.A.), Jacques, J.A. of the Court of Appeal stated that the common law notions of “substantial reliance” and “reasonable reliance”, relied upon by the trial judge in dismissing the appellant’s action, are not part of Québec law. In a second judgment rendered by the Court of Appeal that same year, *Caisse Populaire de Charlesbourg v. Michaud*, [1990] R.R.A. 531 (Qué. C.A.), Baudoin, J.A. further commented that common law jurisprudence is of no use in determining whether an accountant is liable for damages under Québec law. He added that when an accountant agrees to provide professional services, he must at the same time accept the

<sup>691</sup> See *Civil Code of Québec*, S.Q. 1991, c. 64, art. 1410.

<sup>692</sup> Boyle & Percy, *supra* note 391 at 178, citing Pollard, *Sourcebook on French Law*, (1993) at 193.

<sup>693</sup> *Hedley Byrne*, *supra* note 3 at 525-26.

<sup>694</sup> See, for example, *Cordia Ltd. v. Montréal (Ville)*, [2000] Q.J. No. 2709 (S.C.), online: QL (QJ), where the plaintiff recovered economic losses suffered as a result of relying on statements by City employees. The plaintiff tore down its legal but non-conforming gas station having been led to believe it could rebuild. However, it was only permitted to repair and maintain and therefore lost its right to operate the gas station when it was torn down.

<sup>695</sup> It may be possible in some cases to establish a “contractual” claim in this setting. Third party beneficiaries of contractual obligations have rights under the Code. Also, economic loss caused by the negligent performance of a contractual undertaking may be actionable under the concept of *action directe* – this concept was developed to cover situations involving a chain of contracts or legal relationships. However, *action directe* has little application outside of products liability. See Jutras, *supra* note 282 at 299-302.

consequences of his written representations regardless of the initial purpose of the document he prepared.<sup>696</sup>

As she noted the common law concept of “reasonable reliance” is not relevant in Quebec. Nor is the “end and aim” rule directly addressed. It seems relatively clear that the “fault” required for the delictual claim can be established by reference to the non-performance or improper performance of the contractual obligation, as opposed to having to prove fault independent of the contract.<sup>697</sup> The problems of floodgates and indeterminate liability in economic loss cases are controlled principally through factual causation which must be the “direct, logical and immediate consequence of the fault”.<sup>698</sup> The courts take a practical approach to causation relying on concepts like “adequate causation” and “reasonable expectation” to place limits on recoverability, and refuse to engage in “doctrinal controversies” about the nature of causation.<sup>699</sup>

#### **4.4 A COMPARISON WITH OTHER JURISDICTIONS**

Canada is the only jurisdiction of those compared to have clearly adopted such an expansive form of liability for careless words at common law. However, the *Anns* second stage limitations imposed in *Hercules* may mean that the exposure to negligent misrepresentation liability in Canada in the “free rider” context is not significantly greater than elsewhere.

##### **4.4.1 United Kingdom**

In the United Kingdom today, there are two parallel forms of negligence liability: “traditional” negligence claims based on *Donoghue* as modified since *Murphy*,<sup>700</sup> and claims based on an expanded *Hedley Byrne* principle and voluntary assumption of responsibility.<sup>701</sup> The following recounts the rise and fall of the *Anns* principle and the settling into the current position.

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<sup>696</sup> Hélène Lefebvre, “Professional Liability: Recent Developments of Importance” (2001) LEXD/2001, online: QL (LEXD).

<sup>697</sup> See Jutras, *supra* note 282 at 303-04. The accounting firm’s negligent performance of its contractual obligation to the corporation would be the “fault” upon which the investors who relied on the report would base their claim.

<sup>698</sup> Linden, *supra* note 191 at 746. See also La Forest J.’s criticism in *Norsk* of this method of controlling the extent of liability, *supra* note 345 and accompanying text.

<sup>699</sup> Linden, *ibid.*

<sup>700</sup> *Supra* note 213.

<sup>701</sup> See above section 3.4 generally, which also includes a discussion of the development of the English position.



Initially, *Anns* was seen as a positive force for expansion particularly in the area of pure economic loss.<sup>702</sup> *Junior Books*<sup>703</sup> was the most significant example of the early expansive power of *Anns*. In this case, the plaintiff factory owners sued a flooring subcontractor in negligence for the cost of repairs to the floor. There was no contract between them, and there was no danger to person or property because of the defective flooring. A majority of the Law Lords seemed to equate proximity with foreseeability, and given the closeness of the relationship between the parties held that a *prima facie* duty of care had been established. The majority were not concerned about blurring the lines between contract and tort. Lord Roskill, who wrote one of the concurring judgments in the majority, in analyzing the second stage of *Anns*, concluded that there were no good policy reasons for distinguishing between consequential economic loss and "damage to the pocket" simpliciter. Although it was not necessary to decide this, he stated that a well-drafted exclusion clause might have been effective to protect the subcontractor, in the same fashion as the disclaimer in *Hedley Byrne*. He also said that "proximity" must always involve some degree of reliance. These comments suggest a possible connection between the assumption of responsibility theory that was the basis of *Hedley Byrne* and other situations involving pure economic loss.<sup>704</sup>

*Junior Books* was the high-water mark in the U.K. for allowing recovery for pure economic loss. In *Street on Torts*, the authors commented on the implications of *Junior Books*, "[T]he tort of negligence looked set to undermine the very boundaries of contract and tort long established in the English law of obligations and, in particular, the undermine to doctrines of consideration and privity of contract."<sup>705</sup>

In *Peabody*,<sup>706</sup> the House of Lords started to retreat from the expansive approach taken in *Junior Books*. *Peabody* was a public authorities case, much like *Anns*. A developer sued a local

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<sup>702</sup> In *Anns* itself, the House of Lords had actually avoided confronting the issue of recovery for pure economic loss by classifying the damage as physical or property damage, as described in section 4.3.2.1 above. It should be noted that claims for pure economic loss, other than *Hedley Byrne* claims, were not unheard of before *Anns*. For instance, the "general average" exception to the exclusionary rule for relational economic loss was affirmed by the House of Lords in 1947: *Morrison Steamship Co. v. "Greystoke Castle" (The)*, [1947] A.C. 265, [1946] 1 All E.R. 696 (H.L.) [*Greystoke Castle*]. Under maritime law rules, cargo owners are required to share losses to cargo and certain consequential losses pro rata. This exception allows cargo owners whose cargo is not damaged to claim their contribution from a third party who negligently caused the losses.

<sup>703</sup> *Supra* note 268.

<sup>704</sup> *Ibid.* at 546-47.

<sup>705</sup> *Street on Torts*, *supra* note 225 at 175-76.

<sup>706</sup> *Supra* note 209.

authority for passing an inspection of a drainage system. Lord Keith held that proximity depended on more than foreseeability and that the plaintiff had to establish why it would be “just and reasonable” for the defendant to owe a duty of care.<sup>707</sup> The effect was to place a more onerous burden on the plaintiff in proving a *prima facie* duty of care. Was it just and reasonable to impose a duty of care on the defendant here? Lord Keith held that it was not: Peabody, as developer, had the primary responsibility to ensure compliance with the drainage byelaws, and was relying on its architects, engineers and contractors, not the local authority, to be in compliance.<sup>708</sup> The public authority’s mandate was to safeguard occupiers of the houses and the public from dangers to their health, and not to protect developers from economic losses flowing from a failure to comply with building plans.

In another public authorities case, *Yuen Kun-yeu v. A.G. Hong Kong*,<sup>709</sup> the Privy Council reached a similar result. In deciding that the Hong Kong Commissioner of Deposit-taking Companies was not responsible to investors who lost money deposited with a registered company under the Deposit-taking Ordinance, Lord Keith for the Court affirmed the position in *Peabody* that foreseeability alone was not enough to establish proximity. In addition to foreseeability, proximity required a “close and direct relationship” recalling the language of Lord Atkin in *Donoghue*. Lord Keith stated: “[F]or the future it should be recognised that the two-stage test in *Anns* is not to be regarded as in all circumstances a suitable guide to the existence of a duty of care.”<sup>710</sup> He went on to explain that in cases where financial loss had been recoverable such as in *Junior Books*, there had been a voluntary assumption of responsibility by the defendant creating a “special relationship” as in *Hedley Byrne*. He concluded that since the commissioner had no control over the day-to-day management of Deposit-taking companies and also had to consider the position of existing depositors in deciding whether to deregister a company, there was no special relationship between the commissioner and the company or depositors capable of giving rise to a duty of care.

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<sup>707</sup> *Ibid.* at 241.

<sup>708</sup> *Ibid.*

<sup>709</sup> [1988] 1 A.C. 175, [1987] 2 All E.R. 705 (P.C.) [*Yuen* cited to A.C.].

<sup>710</sup> *Ibid.* at 194.

*Caparo*,<sup>711</sup> decided two years after *Yuen*, was a negligent misrepresentation case, and very similar to the later Canadian case of *Hercules*. The plaintiff in *Caparo* took over another company, and when its profits turned out to be less than anticipated sued the auditors for misstatements in the annual financial reports. The Court recognized that policy was involved in the duty question, but making determinations based on what the court considers to be "fair, just and reasonable" was vague – practical tests had to be applied to give meaning to those words.<sup>712</sup> They held that because the information was prepared for the purpose of enabling shareholders to exercise their class rights at the general meeting and not to assist shareholders or non-shareholders in making future investment decisions in the company, there was no reason in policy for finding a special relationship between the plaintiff and the defendant auditors, and therefore no duty of care was owed. The Court suggested a move back toward incremental change by analogy to existing categories of claims.<sup>713</sup>

Then came *Murphy*,<sup>714</sup> yet another public authorities case. *Anns* was expressly overruled. The facts in *Murphy* were that a local authority passed certain building plans relying on the negligent advice of an independent contractor. The defective design of the foundation led to extensive damage. Did the local authority owe a duty of care to a subsequent owner for economic loss (loss of market value) upon resale? The Court was unanimous in holding that it did not, even where there was a possible threat of physical danger. What was proposed was a return to the days before *Anns* where physical loss was required when suing public authorities, unless a claimant could bring himself within the *Hedley Byrne* principle based on reliance by the plaintiff

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<sup>711</sup> *Supra* note 332.

<sup>712</sup> In effect, the Law Lords were recognizing the negligent misrepresentation claim as a "pocket" of liability with its own rules. For example, Lord Oliver, *ibid.* at 638, listed four elements, neither conclusive nor exclusive, which were common to *Hedley Byrne* claims:

(1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given; (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose; (3) it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry, and (4) it is so acted upon by the advisee to his detriment.

Lord Bridge referred to the importance of assumption of responsibility, but the Court as a whole was non-committal on this point. The later House of Lords decision in *Williams*, *supra* note 5, discussed below, made it clear that assumption of responsibility is the basis of duty in negligent misrepresentation.

<sup>713</sup> See, for example, Lord Bridge, in *Caparo*, *ibid.* at 618.

<sup>714</sup> *Supra* note 213.

and the assumption of responsibility by the defendant.<sup>715</sup> Lord Bridge, writing one of the five separate concurring judgments, reasoned that there may be cogent reasons of social policy for imposing liability for financial losses on local authorities because they are publicly funded and can spread the losses, but that it was for Parliament to decide this not the courts.<sup>716</sup> Lord Keith reiterated a preference for restraint generally, with expansion in increments by analogy to existing categories.<sup>717</sup> While it was not necessary to decide the question, the Law Lords also made it clear that builders would not be liable to first or subsequent owners for pure economic loss.<sup>718</sup>

In two cases following *Murphy, Henderson*<sup>719</sup> and *Spring v. Guardian Assurance plc*,<sup>720</sup> the House of Lords has shown a willingness to allow economic loss claims using *Hedley Byrne*. In *Henderson*, underwriting agents were held liable to underwriting members at Lloyd's (known as "Names") who suffered great losses after certain catastrophic events led to an unprecedented level of claims against the Lloyd's underwriters. The agents had been negligent in arranging various insurance contracts. The Court concluded that in applying the *Hedley Byrne* principle, based as it is on voluntary assumption of responsibility, there is no need to embark on an inquiry whether it is "fair, just and reasonable" to impose liability for economic loss.<sup>721</sup> It was clear from the contracts between the agents and underwriters that the agents had undertaken a duty of care. The Court also concluded that the claims in contract and tort were concurrent.<sup>722</sup>

In *Spring*, an insurance representative was dismissed from his job with the defendant insurance company because he did not get along with a new chief executive. When he applied for work at other insurance companies, he was unsuccessful because the references provided by the defendant were unfavourable, describing him as dishonest and having little or no integrity. The regulatory body for insurance companies required representatives to be of good character and competence. The trial judge found that while the references had not been made

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<sup>715</sup> The extent of potential liability under general negligence principles in the event of actual physical injury resulting from the defective condition of the building was not clearly decided: see, for example, the judgment of Lord MacKay in *Murphy*, *ibid.* at 457.

<sup>716</sup> *Ibid.* at 482.

<sup>717</sup> *Ibid.* at 461.

<sup>718</sup> *Ibid.* at 475-79 (per Lord Bridge), 488-489 (per Lord Oliver), 498 (per Lord Jauncey).

<sup>719</sup> *Supra* note 330.

<sup>720</sup> (1994), [1995] 2 A.C. 296, [1994] 3 All E.R. 129 (H.L.) [*Spring*].

<sup>721</sup> *Henderson*, *supra* note 330 at 181, per Lord Goff, for the majority.

maliciously, they were untrue and the exercise of care would have revealed them to be untrue. There were two grounds for finding liability: the *Hedley Byrne* principle and the neighbour principle. *Hedley Byrne* required reliance and assumption of responsibility, which were established here. Unlike in *Henderson*, the Court here also considered liability on the basis of ordinary negligence. A majority found that based on the employment relationship, economic loss in the form of failure to obtain employment was clearly foreseeable if a careless reference were given, and there was an obvious proximity of relationship. As such, it was fair, just and reasonable that the law should impose a duty of care on the employer not to act unreasonably and carelessly in providing a reference about his employee or ex-employee.

The Court of Appeal decision, *Welton v. North Cornwall District Council*,<sup>723</sup> illustrates how the *Hedley Byrne* principle can apply when suing a public authority for pure economic loss. The plaintiffs owned a guest house. A health officer employed by the local food authority inspected their premises, and in the course of the inspection he told the plaintiffs that significant building modifications were required to be in compliance, and that they would be closed down if the requirements were not met. Despite repeated requests, and in contravention of the authority's policy, the requirements were never confirmed in writing, but over the following months the officer visited the premises several times to inspect and approve the works carried out. When the plaintiffs discovered the changes ordered were substantially more than could be required under the regulations, the plaintiffs brought an action against the authority claiming damages for the unnecessary expenditures incurred. At trial, the judge found that the plaintiffs had undertaken the work as a result of the threat of closure and that ninety per cent of the work which the officer had required to be undertaken was unnecessary to comply with the regulations. He held that the officer had given the advice for the purpose of securing compliance with the regulations knowing that the plaintiffs were likely to act on it without independent inquiry. The plaintiffs had acted to their detriment and were awarded substantial damages. The Court of Appeal affirmed the decision at trial. By purporting to impose detailed requirements, enforced by threat of closure and close supervision, the officer had *assumed a responsibility* to take care in the statements he made to the plaintiffs. Two of the three judges agreed that since the officer had been acting outside his statutory powers and

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<sup>722</sup> *Ibid.*, at 184-94.

<sup>723</sup> [1997] 1 W.L.R. 570 (C.A.) [*Welton*].

duties it was unnecessary for the court to consider whether the imposition of a duty of care was in the circumstances fair, just or reasonable, or contrary to public policy. But, in any event, they all agreed that the officer's conduct had been such that it was fair, just and reasonable and in accordance with public policy that a duty of care should be imposed. The general policy against finding public authorities responsible for financial losses, because it might deter inspections, for example, or deplete limited resources, did not outweigh the "special circumstances" of the case.<sup>724</sup>

*Williams*<sup>725</sup> is currently the leading case on the extended *Hedley Byrne* principle in United Kingdom. This case involved the personal liability of the defendant managing director and principal shareholder of a company set up to franchise retail health food shops. The plaintiffs had no personal dealings with the defendant but had been provided with detailed financial projections, to which the defendant had made a substantial contribution and which allegedly had been negligently prepared. The plaintiffs invested in the business relying on the financial projections. They suffered substantial losses when the turnover proved much less than predicted, and they sued the defendant for negligent misrepresentation. They won in the lower courts and the defendant appealed to the House of Lords. Lord Steyn, writing the unanimous judgment, held that liability under the extended *Hedley Byrne* principle, which also covered the negligent services cases, was based on voluntary assumption of responsibility.<sup>726</sup> Whether or not the defendant had assumed responsibility was to be determined objectively by reference to things said or done by the defendant or on his behalf in dealing with the plaintiff.<sup>727</sup> On the facts of this case there were no personal dealings which could have conveyed to the plaintiffs that the defendant had assumed personal liability toward them and therefore their claim was dismissed.

The *MacFarlane* case, described above,<sup>728</sup> was in fact framed as a *Hedley Byrne* case, although Lord Steyn analyzed it in terms of the interplay between corrective justice and distributive

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<sup>724</sup> See, for example, Ward L.J. in *Welton*, *ibid.* at 585-86.

<sup>725</sup> *Supra* note 5.

<sup>726</sup> Reliance by the plaintiff on the assumption of responsibility by the defendant is also required, but not to prove duty. It is required to prove causation: see *supra* note 459. The reliance element is not the usual form of reliance in negligent misrepresentation cases, whether in relation to proving duty *or* causation – the usual form is reliance *on the statement*.

<sup>727</sup> See *supra* note 481.

<sup>728</sup> *Supra* note 119. See discussion of this case section 3.4.3.

justice. The House of Lords collectively did not add anything new in this case to the concept of voluntary assumption of responsibility.

As mentioned, the English courts are now considering negligence liability using two approaches, either separately or together: 1) the extended *Hedley Byrne* principle, or 2) the neighbour principle, as modified since *Murphy*.

*Hedley Byrne* liability is based on voluntary assumption of responsibility and reliance.<sup>729</sup> In the ordinary case, apparently, policy does not need to be considered. Lord Goff in *Henderson*, stated:

“It follows that, once the case is identified as falling within the *Hedley Byrne* principle, there should be no need to embark upon any further inquiry whether it is ‘fair, just and reasonable’ to impose liability for economic loss...”<sup>730</sup>

The reasoning seems to be that because the responsibility is based on choice it is inherently fair. Other policy considerations, such as the worry over indeterminate liability, are dealt with by carefully defining the rules of liability<sup>731</sup> or by looking closely at the *extent* of the assumed liability. Presumably a person could assume liability to a large ascertainable class of individuals, if done so clearly.

Does policy need to be considered where the defendant in a *Hedley Byrne* claim is a public authority, as in *Welton*? As described, the approach of the court in *Welton* was that it does, but only if the public authority is acting within its jurisdiction.

It is now clear that *Hedley Byrne* liability is not limited to traditional “advice or information” cases, and that it also applies in services cases.<sup>732</sup> The implications of this are significant,

<sup>729</sup> There was an earlier suggestion that the court might have the power to *deem* assumption of responsibility (i.e., where it was not voluntary). See, for example, Lord Griffiths, in *Smith*, *supra* note 441 at 862, who believed that voluntariness was not required in all cases and that there might be “circumstances in which the law [would] deem the maker of the statement to have assumed responsibility to the person who acts upon the advice.” In *Smith*, the plaintiff relied on a negligently prepared valuation; Lord Griffiths felt that regardless whether or not the surveyor had “voluntarily” assumed responsibility, it was just and reasonable in all the circumstances that there be liability. This apparently flexibility in deeming assumption of responsibility was not emphasized in the later cases of *Henderson*, *Spring*, *Welton* or *Williams*.

<sup>730</sup> *Henderson*, *supra* note 330 at 181.

<sup>731</sup> See *supra* note 332, per Lord Oliver in *Caparo*. The Canadian approach to indeterminate liability, of course, is different. In *Hercules*, La Forest J. incorporated the “end and aim” rule in stage two of the *Anns* analysis: see above section 4.3.3.2.

<sup>732</sup> See Lord Goff in *Henderson*, *supra* note 330 at 180, and Lord Steyn in *Williams*, *supra* note 5 at 581.

because most economic loss cases, except perhaps relational claims, could fit under the rubric of assumption of responsibility and reliance. Viewed in this light, the *Junior Books* case, vilified as extreme, seems very reasonable. In that case, there was both reliance and, at least an implied, assumption of responsibility.<sup>733</sup>

In cases where *Hedley Byrne* does not apply, the neighbour principle must be called into action. Negligence liability will be extended in appropriate cases, but only incrementally and by analogy to existing duties of care.<sup>734</sup> As described in Chapter 3, the duty of care analysis in England is in danger of becoming an “arcane mystery”. Since *Anns* was abolished in *Murphy*, three or four stages in the analysis have emerged (foreseeability, proximity, the “fair, just and reasonable” test, and possibly a separate public policy stage). And with *MacFarlane*, Lord Steyn has intimated that a distinct consideration of “corrective justice versus distributive justice” may be necessary.<sup>735</sup> Theoretically this general duty analysis applies whether the loss is purely economic or physical.<sup>736</sup>

The authors of *Street on Torts* have concluded that while pure economic loss is recoverable in England the recent trend is that it should be the exception not the rule.<sup>737</sup> This is, of course, assuming that the extended *Hedley Byrne* principle does not apply. In terms of the categories of economic loss recognized in Canada, the English approach to the general duty of care has made it relatively difficult to prove three of the categories: defective goods or structures, relational economic loss<sup>738</sup>, and public authorities cases.

The question is whether the current English approach is better suited to address the concerns over unpredictability and uncontrolled expansion that led to the rejection of *Anns* in *Murphy*. I would argue that the wholesale rejection of *Anns* was unnecessary. Two stages have been replaced by three, four or five, all of which could be analyzed within the *Anns* framework

<sup>733</sup> See Lord Roskill in *Junior Books*, *supra* note 268 at 540-41.

<sup>734</sup> See *supra* notes 713 and 717 and accompanying text.

<sup>735</sup> See discussion *supra* note 229.

<sup>736</sup> The House of Lords has stated that extension will be less problematic in physical loss cases: see, for example, Lord Oliver in *Caparo*, *supra* note 332 at 632, and also in *Murphy*, *supra* note 213 at 487. However, the Court has also made it clear that the general approach to duty applies regardless of whether the loss is physical or purely economic: *Marc Rich & Co. A.G. v. Bishop Rock Marine Co. Ltd.*, [1996] 1 A.C. 211, [1995] 3 All E.R. 307 (H.L.).

<sup>737</sup> *Street on Torts*, *supra* note 225 at 117.



which survives in Canada. The evolving Canadian position since *Cooper* and *Edwards*, based on relationship-specific policy analysis at stage one and extrinsic policy analysis at stage two, promotes a degree of clarity that is missing in England. Both jurisdictions have signalled a new era of restraint within their respective frameworks, but the House of Lords has done so at the expense of analytical coherence.

#### 4.4.2 Australia

In Australia, the torts of negligent misrepresentation and deceit (as well as passing off, defamation and others) have diminished in importance as a result of s. 52 of the *Trade Practices Act 1974* (Austl.), which provides:

Misleading or deceptive conduct

(1) A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

(2) Nothing in the succeeding provisions of this Division shall be taken as limiting by implication the generality of subsection (1).

Three primary factors required for its operation are: 1) a corporation, 2) conduct that is misleading or deceptive or is likely to mislead or deceive, and 3) conduct in trade in commerce. The remedial provisions, including s. 82 (the damages provision), provide for a private right of action. Section 52 has been extended by s. 6 to include natural persons. As a result, doctors, dentists, architects, engineers, accountants, lawyers, and other professionals engaging in trade or commerce are caught by the legislation.<sup>739</sup> The attractiveness of proceeding under this legislation is that there is no need to prove want of care or intention to deceive just that the conduct is misleading or deceptive. In the words of one Australian judge, "So far as general conclusions are possible, it seems that the simplicity and strength of the prohibition contained in s. 52 of the *Trade Practices Act* will displace the existing torts in the area of its operation."<sup>740</sup>

However, common law actions for negligent misrepresentation are still possible, and in 1997 the Australian High Court handed down the decision in *Esanda*.<sup>741</sup> The facts in *Esanda* were similar to *Hercules* and the result was the same; the action was dismissed. *Esanda* was a

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<sup>738</sup> The general exclusionary rule for relational claims was established in *Cattle*, *supra* note 612. Concerning the general average exception, see *supra* note 702.

<sup>739</sup> Russell V. Miller, *Miller's Annotated Trade Practices Act 1974*, 2002 ed. (Sydney: Lawbook, 2002) at 388.

<sup>740</sup> Justice R.S. French, "The Law of Torts and Part V of the Trade Practices Act" in P.D. Finn, ed., *Essays on Torts* (Sydney: Law Book Company, 1989) 183 at 202.

<sup>741</sup> *Supra* note 332.

financier who relied on the audited accounts of a company in making the decision to lend money to various associated companies and in taking a guarantee from the audited company. Esanda claimed that the defendant accounting firm which prepared the audit was negligent and that Esanda lost money by relying on the accounts. Esanda sued the defendant for damages in negligence. There were six judges on the panel and five judgments. No clear rule was settled upon by the Court as a whole. The foreseeability, reasonable reliance, voluntary assumption of responsibility, and intention to induce tests were all canvassed. The concerns about indeterminate liability in the "free rider" context, the fact that the receipt of reciprocal value from third parties is often not possible (i.e., the non-appropriability problem) and efficiency generally were also considered. Foreseeability was clearly rejected, but the Court was split on whether reasonable reliance or voluntary assumption of responsibility should govern liability.<sup>742</sup> In a more recent case, *Perre v. Apand Pty. Ltd.*,<sup>743</sup> which was a relational economic loss case not a negligent misrepresentation case, the High Court attempted to formulate a general approach to all pure economic loss cases, where duty of care would be based in part on the vulnerability of the claimant, and where reliance and assumption of responsibility would be indicators.<sup>744</sup>

In general terms, the approach of the courts in Australia to pure economic loss (at common law) is similar to the U.K. in that *Anns* has been rejected and there is a reluctance to recognize new categories of recovery. However, two notable distinctions are their willingness to consider relational economic loss claims, and claims concerning non-dangerous housing defects.

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<sup>742</sup> Brennan C.J. and Dawson J. wrote separate judgments but both appeared to adopt a foreseeable and reasonable reliance test with the "end and aim" rule built in. Toohey and Gaudron JJ. held that either the reasonable reliance or assumption of responsibility tests would support a duty of care as long as additional requirements were met such as proof that the defendant had special expertise or knowledge and that the "end and aim" rule was not offended. McHugh J. allowed for a duty of care if the defendant had voluntarily assumed one or had intended to induce reliance (at 780). Besides referring to the doubtfulness whether corrective justice required auditors to absorb the losses of sophisticated investors in these circumstances (at 785), he was also wary about imposing liability without information as to whether auditors would be more efficient absorbers of these kinds of losses (at 784). Finally, Gummow J. adopted the voluntary assumption of responsibility test (at 803).

<sup>743</sup> (1999), 164 A.L.R. 606, 198 C.L.R. 180 (H.C.) [*Perre*]. See *infra* note 748 for a more detailed discussion of this case.

<sup>744</sup> See comments about this case in *Economic Negligence*, *supra* note 281 at 37.

In the area of defective housing construction, Australia has an approach based on “consumer protection”, perhaps reflecting a society that accepts the wide-ranging protection afforded by the *Trade Practices Act*. Economic loss from non-dangerous construction defects is recoverable based on the decision in *Bryan v. Maloney*,<sup>745</sup> exceeding the reach of the Canadian decision in *Winnipeg Condominium*.<sup>746</sup>

The Australian approach to relational economic loss is based on the two decisions of *Caltex Oil (Australia) Pty. Ltd. v. The Dredge Willemstad*,<sup>747</sup> and *Perre*,<sup>748</sup> and seems to favour the “known plaintiff test”, but *Perre* has left the matter in considerable doubt.

With respect to public authorities, recovery is generally limited. The leading case is still *Sutherland*,<sup>749</sup> where the Australian High Court rejected the *Anns* approach to duty of care, and

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<sup>745</sup> *Supra* note 289. The facts were that a builder had who contracted with the original owner to build a house was liable to a subsequent purchaser when cracks began to develop in the walls caused by inadequate footings. A sufficient degree of proximity existed between the builder and the subsequent owner, a relationship the majority analogized to the builder and first owner. The policy concerns of indeterminate liability and interference with a competitive market were not significant in this case, and there was a degree of assumed responsibility by the builder to the subsequent purchaser, and “likely” reliance by that purchaser. The Court noted that there was no relevant disclaimer in the contract to construct the house, suggesting that if there were, that might be a way the builder could limit its liability if so desired. The Court also emphasized that the decision turned in part on the fact that claim involved a house (implying a desire for some measure of protection with respect to this important investment for the average person) and was only for diminution of value. The Court expressly stated that they were not offering an opinion about the liability of a manufacturer of goods in parallel circumstances. Lord Buckmaster’s fear expressed in his dissent in *Donoghue* had materialized in Australia, and it was even worse than he had expected (see above section 3.4.4.2). Not only were builders liable for physical injury but also for pure economic loss.

<sup>746</sup> *Supra* note 255. See also above section 3.4.5.4 under “Contractualism”.

<sup>747</sup> (1976), 11 A.L.R. 227, 136 C.L.R. 529 (H.C.) [*The Willemstad*]. In this case, a dredge negligently damaged an underwater pipe which transported oil to the plaintiff’s depot. The plaintiff did not own the pipeline and suffered economic loss because of the interrupted flow of oil. The Court apparently rejected the exclusionary rule, and allowed recovery applying the “known plaintiff” rule.

<sup>748</sup> *Supra* note 743. In *Perre*, the High Court made it clear that in Australia there was no exclusionary rule, but at the same time the Court did not recognize a separate category of relational loss. In this case, the defendant negligently allowed a farmer’s crop to become infected with a disease. As a result, a neighbouring farmer who was unaffected by the disease, and other relational plaintiffs, suffered economic losses because of restrictions on the sale of adjoining crops. As in *The Willemstad*, the Court applied a form of “known plaintiff or class of plaintiffs” rule, but it was far from clear whether this was intended as a general rule to be applied in similar claims. As mentioned above, the Court attempted to formulate a general approach to pure economic loss cases, with duty of care based in part on the vulnerability of the claimant, and where reliance and assumption of responsibility would be indicators. However, this judgment was lengthy, complex and seven of the eight-judge quorum wrote their own reasons, so it is still too early to see where this fiduciary-like vulnerability principle will lead. See J.L.R. Davis, “Liability for Careless Acts or Omissions Causing Purely Economic Loss: *Perre v. Apand Pty. Ltd.*” (2000) 8 Torts Law Journal 123, for a criticism of the High Court for missing an opportunity to bring some clarity to the law. Similarly, see Jane Swanton & Barbara McDonald, “Liability in Negligence for Pure Economic Loss” (2000) 73 Austl. L.J. 904 and Joseph Tesvic, “*Perre v. Apand Pty. Ltd.* – Coherent Negligence Law for the New Millennium” [Case comment] (2000) 22 Sydney L. Rev. 297.

<sup>749</sup> *Supra* note 213.

held that, as a general rule, the ordinary principles of the law of negligence apply to public authorities.<sup>750</sup> In considering the alternative to *Anns* when deciding whether to recognize a new duty of care, Brennan J. stated:

It is preferable, in my view, that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care restrained only by indefinable "considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed". The proper role of the "second stage"...embraces no more than "those further elements [in addition to the neighbour principle] which are appropriate to the particular category of negligence and which confine the duty of care within narrower limits than those which would be defined by an unqualified application of the neighbour principle".<sup>751</sup>

The more recent public authorities decision in *Pyrenees Shire Council v. Day*<sup>752</sup> is important for its rejection of the "general reliance" principle, which allows for reliance based on the idea that members of society sometimes generally rely on government to look after their interests. However, beyond that no clear principle emerged from the decision.<sup>753</sup> One author suggests

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<sup>750</sup> In *Sutherland*, the plaintiffs argued that local authority inspectors negligently passed the inspection of a house during its construction by failing to inspect the footings. The plaintiffs were not the original owners and when they purchased the house they did not obtain a certificate of compliance under the relevant legislation or make any other inquiries of the local authority about the house. Soon after they purchased the house, structural defects appeared which were caused by the subsidence of inadequate footings. The Court was unanimous that the local authority did not owe the plaintiff a duty of care. There were five judges, all concurring in the result. However, with four slightly differing opinions as to the law, no clear rule replacing *Anns* comes out of the case. In finding that the local authority did not owe the plaintiffs a duty of care, three of the judges (particularly, Mason J.) discussed the importance of reliance in founding a duty of care in addition to foreseeability of injury. There was no evidence of reliance in this case. Brennan J. felt that the reliance had to be in response to the undertaking to perform a task, and what was involved here was an omission to perform a discretionary inspection.

<sup>751</sup> *Sutherland*, *supra* note 213 at 481.

<sup>752</sup> (1998), 151 A.L.R. 147, 192 C.L.R. 330 (H.C.) [*Pyrenees*].

<sup>753</sup> In *Pyrenees*, tenants of a residence lit a fire in their fireplace, which spread due to a defect in the chimney destroying the entire premises comprising a shop and the residence. The local authority was aware of the defect based on an earlier inspection and had written a letter to the former occupants of the residence stating that the fireplace should not be used unless repaired. This information was not passed on to the tenants. The Council had not exercised its power to ensure compliance. A majority of the Court held that a duty of care was owed to both the tenants and the shop owner. There were five judges and five judgments, again, with differing analyses of the law. Three of the five rejected the concept of general reliance which was argued as founding the duty of care. The general reliance here referred to the idea that there was a general expectation that municipal authorities would look after housing interests. No clear principle emerges, although three of the judges seemed to recognize the delict here as "operational" negligence, along the lines of the Canadian (and former English) approach. In general terms, this case signals a relaxing of the requirement of reliance per *Sutherland* to found liability on the part of local authorities. But it is not clear how much the fact that this was a clear physical loss case influenced the decision.

the Australian position with respect to public authorities is not that far removed from the English position.<sup>754</sup>

#### 4.4.3 New Zealand

New Zealand enacted similar trade practices legislation soon after Australia passed the *Trade Practices Act 1974*. Section 9 of the *Fair Trading Act 1986* (N.Z.) applies with the same breadth as Australia's s. 52. The result is that in New Zealand the significance of the tort of negligent misrepresentation has diminished as well.

New Zealand's common law approach to pure economic loss is perhaps the most generous of the Commonwealth jurisdictions. Like Canada, New Zealand has adopted and kept the *Anns* analysis for recognizing new duties of care. It is also similar to Canada in that it has incorporated negligent misrepresentation claims into the *Anns* framework, doing so twenty years before *Hercules*, in *Scott Group*.<sup>755</sup> This case also involved auditors' negligence. The plaintiffs had relied on the audited financial statements of a company in successfully pursuing a takeover bid. Like *Hercules*, the action failed. Cooke and Woodhouse JJ. of the three-member panel of the New Zealand Court of Appeal recognized that a *prima facie* duty existed. However, the basis of the duty is difficult to extract from the reasons. As Professor Feldthusen puts it, they developed a "profession-specific" approach based on the statutory framework and the nature of the audit.<sup>756</sup> Cooke J., however, negated the duty at the second stage, because of the nature of the damages (the plaintiff wanted to be put in the position he would have been if the statements were accurate, not the position he would have been if the statement were not made). The third judge, Richmond P. applied the assumption of responsibility test. He said:

[I]t does not seem reasonable to attribute an assumption of responsibility unless the maker of the statement ought in all the circumstances, both in preparing himself for what he said and in saying it, to have directed his mind, and to have been able to direct his mind, to some particular and

<sup>754</sup> See Ken Warner, "Assumption of Responsibility and Economic Loss in Negligence" (1999) 73 Austl. L.J. 904, where the author posits, after reviewing the *Welton* case, *supra* note 723, that the English and Australian approaches to recovery for pure economic loss against public authorities are getting closer together. The English Court of Appeal was prepared to extend *Hedley Byrne* into the public authority context finding an assumption of responsibility based on conduct together with the requisite reliance – this he believes broadly conforms to the views of the High Court in *Sutherland*.

<sup>755</sup> *Supra* note 332.

<sup>756</sup> See *supra* note 368. Although, there is language in the two judgments that suggests the *prima facie* duty was simply based on reasonable foreseeability: *Scott Group*, *supra* note 332 at 573 (per Woodhouse J.) and at 583 (per Cooke J.).

specific purpose for which he was aware that his advice or information would be relied on. In many situations that purpose will be obvious. But the annual accounts of a company can be relied on in all sorts of ways and for many purposes.<sup>757</sup>

This conflates the “end and aim” rule into the assumption of responsibility test which is not by itself a problem. However, there are no other indicators of assent giving the assumption of responsibility test no independent meaning. Richmond P.’s approach was followed in a subsequent New Zealand High Court decision.<sup>758</sup>

The Court of Appeal recently revisited the question of auditors’ liability in *Boyd Knight v. Purdue*.<sup>759</sup> The defendant was the auditor of a failed finance company, whose business consisted of borrowing money from the public and lending it at margin. It was a lender of last resort. The defendant prepared a prospectus and certified financial statements without detecting the frauds perpetrated by the finance company. The defendant admitted that reasonable care on its part would have led to the discovery of the frauds, and that if they had been discovered the audit report would not have been given and the prospectus would not have been issued. The frauds were only detected after the trustee had appointed receivers. The plaintiffs were investors and their claim was based on “a general reliance by investors” on the audit report. In a unanimous judgment, the Court of Appeal approved the passage from Richmond P.’s judgment quoted above,<sup>760</sup> but went on to find that a *prima facie* duty existed based on foreseeability – the auditor’s knew that their accounts would be given to potential investors.<sup>761</sup> However, the Court rejected the idea of general reliance on the integrity of the market. Because the investors could not prove actual reliance, their claims failed. This case is problematical. Indeterminate liability was not addressed adequately. Richmond P.’s approach, which includes an end and aim limitation, was cited with approval but ignored in the Court’s finding of proximity based on foreseeability. There was no clear analysis of what should be considered at the second stage of *Anns*. This case in the end is just about causation.

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<sup>757</sup> *Scott Group*, *ibid.* at 566.

<sup>758</sup> See *Jagwar Holdings v. Julian* (1992), 6 N.Z.C.L.C. 68,040 at 68,058-68,060 (H.C.).

<sup>759</sup> [1999] 2 NZLR 278 (C.A.).

<sup>760</sup> *Ibid.* at para. 45.

<sup>761</sup> *Ibid.* at paras. 51-52.

With respect to services and relational economic loss cases, there have not yet been any Court of Appeal decisions.<sup>762</sup> New Zealand's approach to housing defects is similar to Australia's in that recovery for non-dangerous defects is recoverable.<sup>763</sup> New Zealand has a unique approach with respect to public authorities. Invoking a theory of "general reliance" or community expectations, the New Zealand courts can in effect judge the exercise of political discretion by local authorities.<sup>764</sup>

#### 4.4.4 United States

In the United States, there is inconsistent state authority as to breadth of the negligent misrepresentation action and even as to its existence. When it is recognized, it is often considered a species of fraud. *Corpus Juris Secundum*, vol. 37 (Brooklyn, N.Y.: The American Law Book Co., 1936-) "Fraud", at § 59 concludes:

<sup>762</sup> Concerning relational claims, two High Court decisions, *Mainguard Packaging Ltd. v. Hilton Haulage Ltd.*, [1990] 1 N.Z.L.R. 360 and *New Zealand Forest Products Ltd v. A.G.*, [1986] 1 N.Z.L.R. 14, have allowed claims based on negligent damage to hydro poles causing loss of electricity to the plaintiffs. Feldthusen believes that it is likely New Zealand would adopt the Canadian or Australian approaches over the English position if the issue arises on appeal: *Economic Negligence*, *supra* note 281 at 199.

<sup>763</sup> In this area, the leading case appears to be *Riddell v. Porteous*, [1999] 1 N.Z.L.R. 1 (C.A.) [*Riddell*]. The facts were somewhat unusual in that the original owners were suing the contractor and local authority for negligence not the subsequent purchasers who owned the house when the defect became apparent. Again, there was a negligent builder not following plans, and a local authority negligently passing the inspection. The original owners were suing because they had been required to indemnify the subsequent owners for the loss based on a warranty in the sale contract. They were suing the builders and local authority for the amount they had to pay out. The Court of Appeal held that nothing turned on this unusual twist and treated the case as if it had been a claim by the subsequent owners against the builders and local authority. The Court simply applied *Anns* and found no policy reasons for limiting the duty of the builder or the local authority to the owners. The Court considered that most purchasers do not have construction expertise whereas builders and local authorities do. As well, it would be easier for the builders and local authorities to obtain insurance. As in the *Bryan* case, *supra* notes 289 and 745, the half-stated policy is consumer protection.

<sup>764</sup> This approach was expressly rejected in Australia in the *Pyrenees* case, *supra* note 752. In *Invercargill City Council v. Hamlin*, [1996] A.C. 624, [1996] 1 N.Z.L.R. 513 (P.C.), the Privy Council upheld this approach citing the community standards and expectations unique to New Zealand as the basis for their decision. Interestingly, some of the same judges in this case were on the *Murphy* appeal to the House of Lords. *Invercargill* was another case involving negligent approval of defective foundations. The loss was characterized as purely economic (there had been no collapse or personal injury), and the damages were based on the cost of repairs (in cases where repair was not possible, the Court stated that depreciation in market value was the measure).

In the *Riddell* case, *ibid.*, the Court of Appeal also found the local authority liable for economic loss, based in part on this idea of general reliance, which was incorporated into the second stage of the *Anns* analysis. After referring to the New Zealand practice and experience concerning the reliance by owners on their local authority, the Court made an interesting comment at 12:

The position may be different where the home in question is less modest or where the work is being carried out on a commercial or industrial building, for it may be expected that an architect or an engineer will be employed by the owner, but we are not concerned with such a case.

This only confirms that the underlying policy is "protection of the little guy". Rich people and businesses may not be able to make the same reliance argument. When the duties of builders and municipal authorities are debated in contexts outside housing, they will likely turn out to be more limited.

There is authority, under which, no tort of negligent misrepresentation is recognized. Other authority fails to recognize negligent misrepresentation in a commercial setting, in the educational context, or outside of the context of an employment or professional relationship. [footnotes omitted]

The *Restatement (Second) of Torts* § 552 (1977) summarizes the position<sup>765</sup> this way:

- (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
- (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
  - (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
  - (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
- (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

The emphasis in § 552(1) and the case law seems to be on the “pecuniary interest” requirement and less so on the idea of “justifiable reliance”.<sup>766</sup> Requiring a pecuniary interest on the part of the advice-giver results in a potentially narrower scope of liability than in the Commonwealth, where it is a relevant factor but not a requirement. This position is at least consistent with pre-Restatement U.S. cases which had emphasized the idea of “indirect” financial interest.<sup>767</sup> In most cases the pecuniary interest requirement will confine liability to defendants who have a contractual obligation with another party to provide advice to the plaintiff (or a contract with the plaintiff). This excludes indirect and inferred forms of assumed responsibility that would be sufficient in the Commonwealth.

Even if the pecuniary interest hurdle is overcome, the further “end and aim” limitations, first given voice in *Glanzer* and set out in § 552(2), must be met.<sup>768</sup>

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<sup>765</sup> U.S. Restatements, it should be noted, are not necessarily accurate reflections of the current legal position in any given state. Until a particular Restatement provision is legislated or adopted by a court as authority, it is just a secondary source, influential though it may be. Note also that the American Law Institute is in the process of adopting the *Restatement (Third) of Torts*. § 552 has not been replaced yet.

<sup>766</sup> *Economic Negligence*, *supra* note 281 at 67-70. See also discussion of *Micron Construction*, above section 4.3.3.3, and *Esson J.A.*’s preference for justifiable reliance over reasonable reliance.

<sup>767</sup> See *Glanzer*, *supra* note 367, and *Ultramares*, *supra* note 286.

<sup>768</sup> See discussion above section 3.5.1.3 under “Indeterminate Liability and ‘End and Aim’ Rule”.



Despite the general acceptance of § 552 in U.S. case law, in the area of auditors' liability three positions have developed, which are based only "in varying degrees on" the Restatement.<sup>769</sup> The first denies recovery by third parties for auditors' negligence in the absence of a third party relationship to the auditor that is "akin to privity". For the relationship to exist: 1) the auditor must have been aware that the financial reports were to be used for a particular purpose; 2) in the furtherance of which a known party or parties was intended to rely; and 3) there must have been some conduct on the part of the auditor linking the auditor to that party, which demonstrates an understanding by the auditor of that party or parties' reliance.<sup>770</sup> The second approach is the least followed and bases auditors' liability to third persons on foreseeable risk of harm. However, it is partially limited, restricting liability to "recipients from the company of the statements for its proper business purposes provided that the recipients rely on the statements pursuant to those business purposes".<sup>771</sup> The third approach is the most popular – it is based on the principle that all persons who supply information owe a duty of care when they intended "to supply the information for the benefit of one or more third parties in a specific transaction or type of transaction identified to the supplier."<sup>772</sup> This position is very similar to the approach in *Hercules* without the two-stage analysis. The "end and aim" rule is part and parcel of the definition of the duty.

The U.S. position is also difficult to pin down in other areas of economic loss because of the diversity of opinion among state courts. Liability for negligent performance of a gratuitous service of the first variety, a direct undertaking to provide a service,<sup>773</sup> is usually analyzed in the U.S. applying a long established contract doctrine called "detrimental reliance".<sup>774</sup> Concerning liability in the second context, beneficiaries of contractual obligations base their claims on another well-established contract doctrine in the U.S., the third party beneficiary rule (this rule

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<sup>769</sup> These three positions were reviewed in *Bihy v. Arthur Young and Co.*, 834 P.2d 745 at 752-9, 3 Cal. 4th 370 (Sup. Ct. App. Div. 1992) [*Bihy* cited to P.2d].

<sup>770</sup> *Ibid.* at 752-55 – only nine states follow this rule.

<sup>771</sup> *Ibid.* at 755-57 citing *Rosenblum v. Adler*, 461 A.2d 138 at 153, 93 N.J. 324 (Sup. Ct. App. Div. 1983). See also Howard B. Wiener, in "Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation" (1983) 20 San Diego L. Rev. 233, who advocates the foreseeability standard as a means of achieving fair compensation for investors and deterring negligent conduct by accountants.

<sup>772</sup> *Bihy*, *ibid.* at 758.

<sup>773</sup> The different varieties are canvassed above in section 4.3.2.4 under "Negligent Performance of a Service".

<sup>774</sup> *Economic Negligence*, *supra* note 281 at 122-23.

has not been generally adopted in Commonwealth jurisdictions, although in limited situations third party beneficiaries have some rights under Commonwealth jurisprudence).<sup>775</sup>

In the area of negligent manufacture of products and construction of buildings, the position on recovery for pure economic loss in most states is governed by economic loss doctrine (assuming there are no claims for misrepresentation or negligent performance of a service<sup>776</sup>). *Corpus Juris Secundum*, vol. 65 (Brooklyn, N.Y.: The American Law Book Co., 1936-) "Negligence", at § 58 defines the economic loss doctrine:

The economic loss doctrine prevents a plaintiff who is not in privity of contract with a defendant from maintaining an action for negligence based on purely economic losses.<sup>777</sup>

Generally, even where there is a threat of personal injury or damage to property the loss is classed as economic. To impose tort liability for pure economic loss is seen as being tantamount to imposing contractual warranties of fitness, and this runs contrary to the fundamental policies of free competition and freedom of contract. However, not all states follow this approach.<sup>778</sup> And as was discussed in *Winnipeg Condominium*,<sup>779</sup> some states have even recognized duties in respect of non-dangerous defects:

[C]ourts...in numerous [or at least some] American states (e.g., *Lempke v. Dagenais*, 547 A.2d 290 (N.H. Sup. Ct. 1988); *Richards v. Powercraft Homes, Inc.*, 678 P.2d 427 (Ariz. Sup. Ct. 1984) (en banc);

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<sup>775</sup> *Ibid.* at 127. Note, however, that increasingly legislation is being enacted to grant rights to third party beneficiaries: see discussion above in section 3.5.1.3 under "*Laissez-Faire*".

<sup>776</sup> To the extent that claims based on negligent misrepresentation and negligent performance of a service are recognized, they may be thought of as exceptions to the economic loss doctrine. For a discussion of negligent misrepresentation as an "exception" to the economic loss doctrine, see R. Joseph Barton, "Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims" (2000) 41 Wm. & Mary L. Rev. 1789.

<sup>777</sup> The notes to this section provide:

Under the "economic loss rule," when a defendant interferes with a contract or economic opportunity due to negligence and causes no harm to either the person or property of the plaintiff, the plaintiff may not recover for purely economic losses...

The economic loss rule prevents a plaintiff who is not in privity of contract with a defendant from maintaining an action for negligence based on purely economic losses.

"Economic loss" is damages for inadequate value, costs of repair and replacement of defective product, or consequent loss of profits without any claim of personal injury or damage to other property, as well as diminution in value of product because it is inferior in quality and does not work for general purposes for which it was manufactured and sold.

Where failure to exercise due care only creates a risk of economic loss, an "intimate nexus" between the parties is generally required. When parties to a negligence action share an intimate nexus, satisfied by privity of contract or its equivalent, recovery in negligence may be had for economic loss, despite the absence of any risk that personal injury will result. In addition, purely economic loss is recoverable, even if there is no privity of contract between parties, where a "special duty" or "special relationship" is found to exist. [footnotes omitted]

<sup>778</sup> *Economic Negligence*, *supra* note 281 at 161. As Feldthusen points out, however, there are more deviations from this position in the area of defective construction on real property.

<sup>779</sup> *Supra* note 255 at 120.

*Terlinde, supra*) have...recognized some form of general duty of builders and contractors to subsequent purchasers with regard to the reasonable fitness and habitability of a building...

Relational claims are also difficult to establish in the U.S. Most jurisdictions follow a long established exclusionary rule that pre-dates the English exclusionary rule.<sup>780</sup> There are a few recognized exceptions, including the general loss averaging rule from maritime law.<sup>781</sup>

Finally, with respect to the liability of public authorities, the *Restatement (Second) of Torts* § 895C (1979) describes local government immunity from tort liability as follows:

- (1) Except as stated in Subsection (2), a local government entity is not immune from tort liability.
- (2) A local governmental entity is immune from tort liability for acts and omissions constituting
  - (a) the exercise of a legislative or judicial function, and
  - (b) the exercise of an administrative function involving the determination of fundamental governmental policy.
- (3) Repudiation of general tort immunity does not establish liability for an act or omission that is otherwise privileged or is not tortious.

The immunity described in section (2)(b) is aligned closely with the immunity under *Anns* (as interpreted and applied in Canada) with respect to "true policy" decisions.<sup>782</sup> The liability of local government and other regulatory agencies in respect of the negligent exercise of statutory powers generally requires reliance.<sup>783</sup>

<sup>780</sup> The first U.S. case was apparently *Anthony v. Slaid*, 52 Mass. 290 (1846). The U.S. Supreme Court applied the rule in *Robins Dry Dock & Repair Co. v. Flint*, 272 U.S. 303, 48 S.Ct. 134 (1927). The first English case to set out the rule was *Cattle, supra* note 612, decided in 1875.

<sup>781</sup> See *Re The Sucarseco*, 294 U.S. 394, 55 S.Ct. 467 (1935). The leading English case concerning this exception is *Greystoke Castle, supra* note 702.

<sup>782</sup> See above section 4.3.2.4 under "Public Authorities".

<sup>783</sup> Mason J. in the *Sutherland, supra* note 213 at 462-63 reviewed the U.S. position:

Likewise, in the United States reliance has been a critical element in liability for negligent failure to exercise a power, especially when it is a power of inspection. Where the plaintiff alleged negligent failure by federal inspectors to inspect machinery involving safety hazards, it was held that the plaintiff must so choose to look to federal inspectors for protection that as a result of the government's inducements he or his employer had purposely come to rely specifically and principally on the government for their safety: *Blessing v. United States* [447 F.Supp. 1160 at 1197-1200 (1978)]. But it was acknowledged that reliance might be established if the authority supplanted, rather than supplemented, the employer's inspections [447 F.Supp. at 1194 (1978)]. Similarly, the liability of coastguards for negligent inspections has been denied on the ground that the plaintiffs had not shown that they knew that the coastguards conducted safety inspections and that they were thereby induced to forego their own safety efforts: *Patentas v. United States* [687 F. (2d) 707 at 717 (1982)]. On the other hand, it has been recognized that where the government has supplanted private responsibility, as in the case of air traffic controllers, general, rather than specific, reliance may be sufficient to generate liability: *Clemente v. United States* [567 F. (2d) 1140 at 1147-1148 (1977)]. This approach was adopted in relation to the inspection and certification of civil aircraft: *S.A. Empresa De Viacao Aerea Rio Grandense (Varig Airlines) v. United States* [692 F. (2d) 1205 (1982)] and *United Scottish Insurance v. United States* [692 F. (2d) 1209 (1982)], where the court pointed out that the public generally depends on the government properly to inspect aircraft and that this justifies the imposition of a duty of care [692 F. (2d) at 1211 (1982)]. These decisions were overruled by the Supreme Court in *United States v. Varig Airlines* [104 S. Ct 2755, 81 Law.Ed. (2d) 660 (1984)] but only on the ground that they fell within the discretionary function exception in the *Federal Tort Claims Act* 1946.

#### 4.4.5 Summary

The Canadian, English, Australian, New Zealand and American common law approaches to negligent misrepresentation are all slightly different, but end up in similar positions, particularly with respect to the “free rider” context and the liability of accountants. Generally all recognize that special treatment is required in this area to counter the possibility of indeterminate liability (New Zealand is the Commonwealth exception), and to a degree there is an agreed concern (not always expressed) with efficiency and the ability of advisors to absorb costs associated with any extensive form of liability. Cardozo J.’s “end and aim” rule is usually incorporated into the analysis, either in the formulation of the duty principle or as a limitation on a *prima facie* duty (the approach in Canada). There are exceptions, however. A minority position in the United States has a relatively open-ended form of liability, and the approach in New Zealand, the only other Commonwealth jurisdiction to follow *Anns*, does not clearly address the problem of indeterminate liability which could result in an expanded form of liability. The new “vulnerability” approach in Australia could expand or diminish the scope of liability depending on how the concept of vulnerability is developed.

As mentioned, the trade practices statutes in Australia and New Zealand have the potential to subsume careless words liability within a much wider statutory cause of action based on deceptive or misleading conduct.<sup>784</sup>

The services cases are difficult to synthesize. England uses a modified *Hedley Byrne* principle based on voluntary assumption of responsibility and reliance. The United States has at its disposal contract doctrines as well as tort principles.

In the shoddy structures cases involving non-dangerous defects, courts in Australia, New Zealand and some U.S. states, have adopted a “consumer protection” policy that has clearly been rejected in the United Kingdom. Canada sits on the sidelines, imposing a duty only where the defects are dangerous. All jurisdictions refuse to allow tort claims based on non-dangerous products defects.

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As mentioned in this survey, the idea of “general” reliance has been accepted in certain contexts, as in New Zealand, but unlike the other Commonwealth jurisdictions.

<sup>784</sup> Provincial trade practices legislation in Canada is not nearly as far-reaching. For instance the B.C. *Trade Practice Act*, R.S.B.C. 1996, c. 457 also covers deceptive or misleading conduct but only applies to consumer

Relational economic loss claims are difficult to establish in most jurisdictions. The United States and United Kingdom recognize general exclusionary rules with exceptions. Canada's position is essentially the same. New Zealand has yet to decide the matter at the appeal level, and Australia, while not recognizing an exclusionary rule, has apparently taken a restrictive approach based on the "known plaintiff" test or the concept of "vulnerability".

The United Kingdom is the most restrictive in the area of public authority liability, although it has shown a willingness to expand liability somewhat since *Murphy*, using the principles of assumption of responsibility and reliance in an expanded form of *Hedley Byrne* liability. Australia's approach is similar, as is the approach of a number of U.S. states. New Zealand and Canada both follow *Anns*, but New Zealand's theory of general reliance in the housing context is unique in the Commonwealth.

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transactions. "Consumer transaction" is defined narrowly in s. 1 and only includes transactions involving personal property or services in relation to personal or first-time business use. See also *supra* note 298.

## Chapter 5

### CONCLUSIONS

In the Commonwealth, *Hedley Byrne* has let the careless words genie out of the bottle and there is little chance she will be put back in. Two theories of liability have emerged as front-runners: reliance and voluntary assumption of responsibility. The question posed in Chapter 1 was which of these two ought to be the test for duty of care. The consent model has been criticized as “often resting on a fiction used to justify a conclusion that a duty of care exists”.<sup>785</sup> The main criticism of the reliance model is that it is vague and unpredictable. Of the two models, for the reasons set out below, liability based on consent is the better one.

#### 5.1 SUMMARY AND ARGUMENT

In a passing comment in *Norske*, La Forest J. wrote that “[n]o one is suggesting... that we modify the rules adopted in *Hedley Byrne* for an undifferentiated *Donoghue* test in economic loss cases”.<sup>786</sup> In the later case of *Hercules*, he came close to doing just that, however, with his foreseeable and reasonable reliance test. Admittedly, he limits that test by incorporating the “end and aim” rule, but this only has significance in the “free rider” cases. The “direct advice” and “basic contract” situations, which commonly arise, are now governed by a rule which is not that different from the “undifferentiated *Donoghue* test” to which La Forest J. referred.

The proximity concept is generally neutral on the question of whether consent should be preferred to reliance, but it is clear that Lord Atkin’s neighbour principle has been stretched in its application to words and money cases.<sup>787</sup> Where the plaintiff has not paid for the information (i.e., in the direct advice and free rider scenarios) there is an element of unfairness in allowing a claim when the information turns out to be inaccurate. Of course, the counter argument is that “simple justice” requires a person to exercise care in a close and direct

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<sup>785</sup> See Lord Steyn in *Williams*, *supra* note 5 at 854, citing Barker, *supra* note 7 and Hepple, *supra* note 224. General criticisms of the consent model were reviewed in section 3.5.3.2 above.

<sup>786</sup> *Norske*, *supra* note 178 at 1085.

<sup>787</sup> See generally section 3.5.1.1 above.

relationship. The wealth (or deep pockets) of the particular defendant is not a relevant proximity consideration.

In Canada, what are now classed as *Anns* second stage considerations dominate the analysis.<sup>788</sup> Of these instrumentalist policies, those which support the recognition of a duty of care, like deterrence, tend to be outweighed by counter policies. Some of these counter policies have more bearing on the choice of rules question than others. For instance, broad conceptions of distributive justice have little or no influence in this area, nor should they unless one is prepared to rethink the free market system. The oft-repeated fear of indeterminate liability does not point in one direction or the other – adequate means of controlling open-ended liability are available whichever route is taken. But the promotion of individualism (that is, self-reliance where self-protection is possible) and the general uncertainty created by the reliance model of liability are strong arguments favouring the consent model. There is also the desire for functional coherence. Imposing a duty in tort for careless words suffers from a confusion of purposes. It is akin to imposing a contract between the parties in the form of a warranty as to the accuracy of information. If a type of economic obligation is consensual in contract so it should be in tort. And as described, there are parallels to promissory estoppel and the developing rights of third party beneficiaries which are based on obligations undertaken by the defendant. These areas regulate contract-like obligations of a similar nature and there is no justification for singling out negligent misrepresentation as a non-consensual form of liability. Finally, the *Charter* value of freedom of expression would be interfered with less if the consent model were adopted.

Of these arguments the two most significant are the desire for general certainty and for functional coherence with contract law (and free market doctrine generally). The Supreme Court of Canada in *Cooper* and *Edwards* has made it clear that the preference for a categories approach to duty is justified by the need for certainty. I agree with this approach, which also promotes, intentionally or not, a neo-liberal economic philosophy. Most of the physical injury duties are well established. Arguments about the extension of duty of care tend to arise in financial loss settings, e.g., *Martel*, *Cooper* and *Edwards*. In none of these cases was a new duty

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<sup>788</sup> See sections 3.5.1.2 and 3.5.1.3 above for a more detailed discussion.

recognized. The *effect* of restraint and the categories approach is to foreclose or seriously restrict expansion in the economic area, leaving the parties to arrange their own affairs.

Does it not make more sense that the tort of negligent misrepresentation, which frequently involves some form of voluntary "exchange" of information for a direct or indirect benefit, should also be consensual? And where a business person provides information without formal consideration, i.e., in the direct advice and free rider settings, should she not be able to control her exposure to liability by disclaiming responsibility just as contracting parties can through exclusion clauses? Ultimately, the determination of the metes and bounds of choice in the economic arena is ideological. If we subscribe to a system of free and fair competition, where does free end and fair begin? My own sense is that being careless with words in business does not cross the line into unfair competition. In other words, imposing liability for negligent misrepresentation against a party without reference to that party's consent is an undue fetter on the ability of the representor to deal in a free and fair market.

The economic analysis of law and the goal of wealth maximization through efficient regulation is not a generally accepted part of duty analysis (or any part of legal analysis for that matter). If it were to be accepted in Canada, following *Cooper* and *Edwards*, its objectives would likely become part of the analysis at the second stage of *Anns*. Given that the power to "reason" the most efficient approach to duty in negligent misrepresentation is limited without empirical study, what broad conclusions can be drawn?

Concerning the basic contract and direct advice scenarios, there are arguments supporting both the consent and reliance approaches.<sup>789</sup> To recapitulate, the main arguments in favour of the reliance model, which may impose liability against the will of the information provider in some cases, are: 1) generally the information provider will be the least-cost avoider; 2) transaction costs *may* be reduced by starting from this default position; and 3) carelessness in the provision or exchange of information will be discouraged. The following arguments support the consent model: 1) voluntarism is the best means of achieving Pareto-superior interactions where private ordering is possible (if one accepts this presumption in neo-classical economic theory); 2) assuming transaction costs are low, regardless of which tort rule applies,

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<sup>789</sup> See sections 3.5.2.1 and 3.5.2.2 above.



the parties can negotiate an alternate position if they believe it will benefit them; 3) certainty – allowing the information provider to clearly define its liability costs eliminates Uncertainty Costs associated with controlling liability under the reliance model (this is more important in the direct advice context than the basic contract context); and 4) with respect to the direct advice situation, it will be more efficient to let the information provider control liability costs with respect to information that has not been paid for (because of the possible difficulty in appropriating the benefits of the information).

Arguments about efficiency in the secondary markets situation in relation to the choice of rules issue are less meaningful.<sup>790</sup> The non-appropriability problem is most pronounced in this setting. Information providers are not able to collect the benefits of the information from all users. And because transaction costs would be high, controlling liability costs with all users through negotiation would not be practically feasible.<sup>791</sup> But limits on liability can and have been imposed using the reliance model (e.g., the end and aim limitations which are part of the *Anns* second stage analysis in *Hercules*). It is not clear whether this is an efficient solution. The problem of Uncertainty Costs related to controlling liability under a reliance regime also applies here (just as in the direct advice context), but again it is not clear whether overall the limited reliance rule is inefficient. All that is clear, without detailed testing and experimentation with different models of liability, is that some form of limited liability is needed to counter the non-appropriability problem. Whether it should be based on reliance, consent, a composite of the two, or perhaps even an entirely different concept is speculative.

The conclusions one can draw, then, are that in the direct advice and basic contract situations, economic analysis seems to favour the consent model, provided one accepts the assumption that in localized settings commercial actors are best able to assess costs and benefits and to determine what is in their best interests. Imposed solutions must have a clear economic rationale which is not present here. Uncertainty Costs associated with the reliance model particularly weigh against that model. In the free rider context, some form of limited liability seems to be required for the sake of efficiency, but the assumption just mentioned that applies

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<sup>790</sup> See section 3.5.2.3 above.

<sup>791</sup> This is easiest to see in the auditors' liability cases. However, a negotiated solution is conceivable, although it could still prove difficult, in cases like *Edgeworth Construction*, *supra* note 334 (see also section 4.3.3.1 for a discussion of this case) or in the wills cases, such as *Whittingham*, *supra* note 335.

in localized settings does not apply here. The possible users of information in the free rider context are varied and numerous, making a precise efficiency determination extremely difficult. Because there is no clear winner between consent and reliance in this context, one solution might be to have a dual approach to negligent misrepresentation: consent for the direct advice and basic contract scenarios, and reliance in the free rider context. I would argue, however, that without a clear efficiency reason for keeping the reliance model, it makes more sense to adopt an approach consistent with the direct advice and basic contract situations where efficiency arguments weigh in favour of the consent model.

Are there any other arguments supporting the consent model? There is yet another claim based on coherence. As described in Chapter 4, negligent misrepresentation developed as an extension of fiduciary doctrine and contract law. The connection that unites them may be the idea of voluntarism as a basis of liability.<sup>792</sup> The argument for coherence with contract law has already been made. Is there a persuasive reason why there should be coherence with fiduciary doctrine? While it must be recognized that the influence of voluntarism in fiduciary law is open to debate, there is a strong argument that the idea of undertaking or agreement is and should be essential to the creation of fact-based fiduciary obligations. These obligations arise most frequently in commercial settings, settings where tortious duties to use words with care also arise. However, La Forest J., who has been a key figure in the development of fiduciary doctrine in Canada, stresses not consent but “vulnerability” and “reliance” as common elements between fiduciary law and negligent misrepresentation.<sup>793</sup> It does not make sense to require agreement or undertaking to found a fiduciary obligation in a commercial setting, but to impose a non-consensual duty in tort to use words with care. Fact-based fiduciary obligations rest on trust, confidence and other similar factors. *Hedley Byrne* liability can exist without the dependency that justifies these obligations. There is no reason to apply a completely separate form of liability to negligent misrepresentation.

Looking to the experiences in other jurisdictions, the current English approach based on voluntary assumption of responsibility is preferable to the others.<sup>794</sup> The Quebec civil law approach is attractive for its apparent simplicity, but there is little chance the common law

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<sup>792</sup> See section 4.2 above for a more detailed discussion.

<sup>793</sup> See *supra* note 575 and accompanying quote and text.

<sup>794</sup> See sections 4.3.5 and 4.4 above for a more detailed comparative analysis.

courts in Canada will open up duty to a broad conception of fault, and control the extent of liability through causation and directness. The U.S. approach based on § 552 of the *Restatement (Second) of Torts* and the focus on pecuniary interest (nearing the requirement of consideration) is too strict and not necessarily consistent with contract doctrines that do not require an exchange. The Australian and New Zealand common law approaches are evolving against the backdrop of extremely powerful consumer protection legislation, which makes their experiences less relevant to the Canadian context.

If legal principles mirror the underlying culture and its social values, I see the English approach to negligent misrepresentation and duty of care as reflective of a culture that values and is trying to renew a belief in individualism and self-reliance. *Cooper* and *Edwards* have moved Canada in that direction. *Hercules* is out of step with that underlying philosophy – reliance promotes dependence.

## **5.2 PROPOSAL FOR IMPROVEMENT**

One of the biggest criticisms of the voluntary assumption of responsibility test is that it is vague.<sup>795</sup> What exactly is the defendant consenting to? The confusion is caused in part by the word “responsibility”. It is not realistic to base the duty on an assumption of legal responsibility. Most defendants, if asked whether they agree to take on legal responsibility for their words, would answer no. Finding such an implied undertaking, even applying an objective test, would be a fiction in most cases. What the courts are really doing when they apply the assumption of responsibility test is finding that the defendant has consented not to legal responsibility but to the use of care in making the statement.

A comparison with the *defence* of consent (or *volenti non fit injuria*) in negligence may illustrate the difference between assuming legal responsibility and as opposed to undertaking to use care. At one time, the defence of *volenti* was established by proving consent to the physical risks associated with the activity in question.<sup>796</sup> More recently, the Supreme Court of Canada has narrowed the defence such that the defendant must prove not only that the plaintiff consented to the physical risk but also the legal risk (i.e., the plaintiff has waived the right to sue in

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<sup>795</sup> See generally sections 3.5.3.2 and 3.5.3.3.

<sup>796</sup> See Linden, *supra* note 191 at 472-73.

negligence).<sup>797</sup> Without a contractual waiver, this is difficult to establish. Requiring a waiver of legal rights considerably diminishes the scope of the defence. By way of comparison, requiring an undertaking of legal responsibility to establish duty of care would have the same effect in reverse. It would considerably diminish the scope of the duty. The courts have shown no inclination that they wish to go this far. It should be made apparent that the consent in this context relates to the use of care.

*The Proposed Test.* The following test clarifies the nature of the consent:

A duty to use care with words exists when an information provider voluntarily undertakes to exercise reasonable care in ensuring the accuracy of information provided to a specific person or limited class of persons for a specific purpose in the course of the information provider's business, profession or employment ("undertaking of care").

Once such an undertaking of care is established, the law should impose a *legal* duty to exercise that care. It is thus a hybrid form of liability, partly based on consent, partly imposed. This approach preserves the idea of voluntarism, which is in accordance with commercial expectations, while at the same time recognizing the "simple justice" of being required to keep one's word.

*Methods of Implementation.* There are a number of ways the Canadian courts could implement a consent model. The following lists four of them in order of increasing adherence to the proposed test (and disruption to the existing approach in *Hercules*). The first three operate within the *Anns* framework; the fourth applies the "pocket" of negligence approach.

- 1) *Volenti defence.* The courts would recognize a defence of consent, keeping the test for duty in *Hercules*, i.e., the foreseeable and reasonable reliance proximity test and "end and aim" limitations, without any changes. This *volenti* defence would be such that a basic "without responsibility" non-contractual disclaimer would provide an effective excuse. Contractual disclaimers would have the same effect as they do currently.
- 2) *Undertaking of Care Limitation.* Under this method, the test for duty in *Hercules* would remain unchanged as with the first method. However, a mandatory additional *Anns* second stage consideration would be recognized: consent. The courts would limit duties to those situations where there was an undertaking of care as proposed. This is a composite model incorporating both the reliance and consent models.
- 3) *Proximity Based on Foreseeability and Undertaking of Care.* The courts would change the test for proximity in *Hercules* from foreseeable and reasonable reliance to reasonable foreseeability of injury and undertaking of care as proposed.

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<sup>797</sup> See, for example, *Crocker v. Sundance Northwest Resorts Ltd.*, [1988] 1 S.C.R. 1186, 51 D.L.R. (4th) 321 and *Linden*, *ibid.* at 473-74.

4) *Pocket of Negligence*. To implement the proposed test using this method the courts would adopt an approach similar to the English one, recognizing two branches of negligence, one based on proximity, and the other, applicable here, on an undertaking of care (with or without foreseeability which is essentially made redundant by the terms of the proposed test).

The first method is the least desirable. It does not actually implement the consent model; it only approximates it. One problem with it is that it creates a reverse onus on the defendant to prove lack of consent, rather than making consent part of the plaintiff's case. Another problem is that it would make the question factual not legal. The *volenti* defence is decided by the trier of fact. Duty, on the other hand, is a legal question. Appeal courts would be unable to overturn a finding of liability in the face of a disclaimer unless the finding of fact could be characterized as perverse.

The second approach has problems too. It suffers primarily from a confusion of objectives. Why have the reliance test at stage one if consent is mandatory at stage two? This lends an artificiality to the analysis. However, it is preferable to the first method, because, while the burden of persuasion would be with the defendant, the legal burden would rest with the plaintiff. Also, it causes little disruption to the existing regime based on *Hercules*. Ryan J.A., in dissent in *Micron Construction*, may have had this approach in mind when she suggested there might be policy reasons for limiting proximity based on reasonable reliance where there is a disclaimer (i.e., no undertaking of care).<sup>798</sup>

In my opinion, the third method is the best one. It keeps the *Anns* framework of analysis, maintaining a formal, analytical coherence within the general law of negligence. And at the same time it promotes certainty, functional coherence and efficiency (so far as can be determined without experimentation), all of which justify the implementation of the consent model in the first place. In terms of second stage considerations, the indeterminate liability concern would be covered by the undertaking of care and therefore would not arise. Other stage two considerations extraneous to the relationship might arise such that the court would limit or negate the duty of care despite an undertaking of care.

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<sup>798</sup> See *supra* note 662 and accompanying quote and text.

The fourth method is the next best option. Like the third method, it achieves the objectives of certainty, functional coherence and efficiency, but it does so at the expense of formal, analytical coherence.

*Proving an Undertaking of Care.* I have borrowed heavily from the collective wisdom of the American Law Institute (§ 552 of the *Restatement (Second) of Torts*)<sup>799</sup> and the work of Professor Feldthusen<sup>800</sup> in fashioning the following list of indicators of the undertaking of care. I do not think much turns on the debate about how the undertaking is classed, whether as a promise, choice, or something else.<sup>801</sup> What is required is that the information provider has indicated to the recipient, expressly or impliedly, that care has been taken in ensuring the accuracy of the statement.

In the rare case where an undertaking of care is expressly given, there should be no problem. In the vast majority of the cases, however, the undertaking would have to be inferred or implied using an objective test based on “things said or done by the defendant or on his behalf”, to use the words of Lord Steyn in *Williams*.<sup>802</sup> The following is a suggested non-exclusive list of indicators of such an undertaking:<sup>803</sup>

- 1) *Business, profession or employment.* Representations would have to be made in a commercial setting before they could support a claim for negligent misrepresentation.
- 2) *Information provided to a specific person or limited class of persons for a specific purpose.* This indicator limits the range of potential plaintiffs and types of claims controlling the problem of indeterminacy.
- 3) *Direct or indirect financial interest of the defendant in the transaction about which the representation is made.* This is the first of the five *indicia* of Professor Feldthusen adopted by the Supreme Court of Canada.<sup>804</sup>
- 4) *Information provided in response to a specific request.* This is the fifth *indiciu*m of Professor Feldthusen adopted by the Supreme Court of Canada.<sup>805</sup>
- 5) *Reasonable likelihood of reliance or inducement.* If the defendant knows or ought to know that the information might be relied on, this would be evidence of an undertaking of care. This is not the same thing as the reasonableness of the reliance itself. A plaintiff could reasonably rely on information without the defendant being aware of the reasonable likelihood of such reliance.

<sup>799</sup> See discussion above section 4.4.4.

<sup>800</sup> See *supra* note 646 and accompanying quote for a list of Feldthusen's indicators. For a detailed discussion of them, see *Economic Negligence*, *supra* note 281 at 64-77.

<sup>801</sup> See discussion in section 3.5.3.2 above.

<sup>802</sup> *Williams*, *supra* note 5 at 582.

<sup>803</sup> How these indicators would be integrated analytically would depend on which one of the four methods of implementation were adopted. If the third method were adopted, for instance, they could be integrated in the same way that they were in *Hercules*, except that they would be indicators of consent not reasonable reliance.

<sup>804</sup> See *supra* note 646 and accompanying quote, and in *Economic Negligence*, *supra* note 281 at 65.

<sup>805</sup> *Ibid.*

The first indicator is actually an element of the proposed test, and therefore technically not an “indicator” of an undertaking of care. However, even if it were not built into the test, it could still be justified as a necessary factor (even in the case of express undertakings of care). This indicator is part of § 552 of the U.S. Restatement, which makes it clear that the duty does not apply in social settings. In *Hedley Byrne*, Lord Reid argued that people who are generally careful sometimes say things in a social context without the care that they would exercise in a business setting; as a consequence, there should be no duty in social settings.<sup>806</sup> I would argue that even if care were undertaken in a social setting, there should be no duty. This is consistent with the presumption in contract law against an intention to contract with respect to social engagements.<sup>807</sup> In *Hercules*, the Supreme Court of Canada adopted Professor Feldthusen’s *indicia* of reasonable reliance, which included information provided in business or professional contexts and not on social occasions. The idea of special skill and knowledge is included here too. However, these *indicia* were expressly stated not to be a strict test of reasonable reliance,<sup>808</sup> so it is at least possible that under *Hercules* a duty could extend into a social setting. This is a weakness in *Hercules* which could be avoided by adopting the proposed test.

The second indicator, like the first, is a required element of the proposed test, and therefore technically not an indicator of consent. In effect, it makes the “end and aim” limitation part of the consent. It roughly follows § 552, and as well the approach taken in England.<sup>809</sup> At least under the third method of implementation, it can also be seen as a proximity matter, relating as it does to the closeness and directness of the relationship. By way of contrast, La Forest J., in *Hercules*, considered knowledge of the user and purpose of use as factors to neutralize the indeterminate liability concern at the second stage of *Anns*.

While the first two elements are necessary (as required elements of the test), it would be up to the court to decide whether in the particular circumstances of the case they established the undertaking of care. It may be that these two indicators by themselves would create a

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<sup>806</sup> *Hedley Byrne*, *supra* note 3 at 482-83.

<sup>807</sup> Waddams, *supra* note 312 at para. 151. Admittedly, the parallel is not exact, because important financial information could be communicated in a social setting, which is not the same thing as a “social engagement”.

<sup>808</sup> See *supra* note 646 and accompanying quote.

<sup>809</sup> See, for example, Lord Oliver’s list of elements in *Caparo*, *supra* note 712. The English approach is not entirely clear, however. The exact basis of *Hedley Byrne* liability was not agreed on in *Caparo*. Since *Williams*, *supra* note 5, voluntary assumption of responsibility is clearly the test, but the House of Lords did not have to deal with the indeterminate liability issue in that case. End and aim limitations were not analyzed.

presumption of an undertaking of care. The remaining indicators, together with any others (such as the prior dealings of the parties, for instance), would be important in cases of doubt. The third indicator, financial interest, is, according to some U.S. authority interpreting § 552, a required element for careless words liability.<sup>810</sup> This approximates the need for contractual consideration and narrows the field of recovery. There do not appear to be any good policy reasons for making it a required indicator. The existence of a specific request, the fourth indicator, should bring home the seriousness with which the response should be taken. The final factor, the reasonable likelihood of reliance or inducement, would be a strong indicator, particularly when coupled with the required elements. A business person who is or should be aware of the reasonable likelihood of reliance or inducement when providing information ought to feel some sense of obligation to exercise care. If reasonable foreseeability were part of the duty test already (as it would be if the second or third methods of implementation were adopted, for example), this factor would have a dual purpose. Its relevance to the consent question, as opposed to basic foreseeability, would be slightly different, however. The greater the likelihood of reliance, the more likely a court would imply an undertaking of care.

*Relevance of Disclaimers.* Because consent is at the heart of the duty of care in negligent misrepresentation, as proposed, disclaimers should be considered of primary importance in determining whether care has been undertaken. The effect of *Hercules* as interpreted by *Micron Construction* is to reduce the status of disclaimers to “factors” the court may consider when determining the reasonable reliance question. As Esson J.A. explained, in the majority of cases a disclaimer will be sufficient to negative an inference of reasonable reliance,<sup>811</sup> but they are not conclusive, as evidenced by the decision in *Micron Construction* itself. Under the consent model, clearly communicated standard “without responsibility” disclaimers would be virtually conclusive, as they have been for close to one hundred years prior to *Micron Construction*. In the words of Lord Devlin, “[a] man cannot be said voluntarily to be undertaking a responsibility if at the very moment he is said to be accepting it he declares that in fact he is not.”<sup>812</sup> The primacy of disclaimers is in fact the key difference between the reliance and consent models of liability in negligent misrepresentation.

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<sup>810</sup> In Feldthusen’s opinion, financial interest should be a sufficient but not a necessary basis of duty. *Economic Negligence*, *supra* note 281 at 65.

<sup>811</sup> See *supra* note 669 and accompanying text.

<sup>812</sup> *Hedley Byrne*, *supra* note 3 at 533.



### **5.3 IN THE MEANTIME**

The reliance model is here to stay at least until the Supreme Court of Canada decides to revisit the issue of duty in negligent misrepresentation. Given the uncertainty created by the decision in *Micron Construction*, what can be done in the meantime? A few options are briefly described next.

*Silence is not necessarily golden.* As explained, one obvious response by banks and other advisors to the decision in *Micron Construction* is to say nothing. Given that the information in the direct advice cases is being gratuitously provided, why take the chance of being sued? The reason is that advisors may be concerned about the unknown costs associated with silence. As Lord Devlin remarked in *Hedley Byrne*, banks do not furnish this information out of an altruistic desire to assist commerce. Customers would be discouraged if their deals fell through because banks refused to give credit references.<sup>813</sup> This option would lose its appeal if savings on liability costs were overtaken by lost business. Further, this option, as unappealing as it may be, is no option, realistically, in the basic contract and free rider scenarios. In those cases, the information is being generated pursuant to contractual obligation.

*New Improved Disclaimer.* As mentioned, Esson J.A. was of the view that “clear” disclaimers would work in most cases under the reliance model and that *Micron Construction* was an exceptional case. Accepting that “without responsibility” became unclear in 2000 after almost one hundred years of clarity, how might the standard disclaimer be made more effective? The disclaimer set out next is one suggestion:

This information is provided to A without responsibility on the part of B. Specifically, while this information is provided with an honest belief in its accuracy, B gives no undertaking and offers no assurance that reasonable care has been exercised in its preparation, nor assumes any legal obligation for loss, injury or damage suffered in consequence of reliance on it by A or by any third party.

It is a little bulkier and less friendly than the basic “without responsibility” disclaimer, but the decision has to be made whether it is worth the extra security. It incorporates parts of the *Hedley Byrne* and *Wolverine Tube* disclaimers,<sup>814</sup> and makes it plain that no undertaking whatsoever has been given, whether in relation to the exercise of care or the assumption of legal responsibility. Addition features relating to notice could be employed to bring its

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<sup>813</sup> See *supra* note 421 and accompanying quote, and section 3.5.2.1 generally.

meaning home, such as placing the disclaimer on the page before the information (as in *Hedley Byrne*) not after it (as in *Micron Construction*), printing the disclaimer in red ink, including a “sign-here” space next to or under the clause, and providing a contemporaneous verbal explanation of the clause. Some of these may be considered excessive by some businesses.

It should be noted that this clause is principally designed for the direct advice situation. The third party reference would only be relevant in the free rider context, as in *Wolverine Tube*. In the basic contract scenario, any disclamatory statements would be more effectively dealt with in the form of contractual exclusions of liability, although there is no reason why similar language could not be used in contractual exclusion clause.<sup>815</sup>

*Release.* Another possibility is to structure the provision of information in the form an exchange and require a release. A seal could be required but the provision of the information should be considered “real” consideration. This option is not a practical option in the free rider context where there are many potential third party users. Accounting firms certifying financial reports would be hard pressed to obtain releases from every shareholder and potential investor.

*Information Review.* In combination with any of the above or by itself, information providers could implement strategies for checking the accuracy of information provided. A cost analysis would be necessary.

*Self-insure.* Again, in combination with any of the above or by itself, an information provider could self-insure if it were cost efficient, assuming independent liability insurance is not possible or is more expensive. Banks are particularly well suited to self-insure.

## **5.4 SUGGESTIONS FOR FURTHER STUDY**

Two issues are set out next, which present themselves as a result of the conclusions in this thesis. The first looks at the need for further research “on” the law with respect to efficiency analyses. The second examines the possibility of extending the consent model of liability into other areas of economic loss.

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<sup>814</sup> See section 4.3.4.2.

<sup>815</sup> See section 4.3.4.3.

*Economic Analysis of the Reasonable Reliance Rule.* As was apparent from the discussion of efficiency and negligent misrepresentation,<sup>816</sup> without empirical data, only very broad conclusions are possible using economic analysis concerning the approach to liability.

Professor Bishop noted:

Courts evidently perceive a limited liability as generating a net gain... Whether their perceptions of the facts are accurate or not is a complex question and one that can be answered finally only by a detailed investigation requiring experimentation with different rules. That is an expensive and difficult process.<sup>817</sup>

Bishop went on to conclude that he suspected the courts' intuitions are correct. What is undecided, however, is precisely which limited liability rule is best. In Canada in 1997, the reliance model was clearly established as the basis of liability in negligent misrepresentation (*Hercules*). In England in 1998, the voluntary assumption of responsibility model was clearly established (*Williams*). An opportunity exists, difficult though it might be to measure, to compare the economic effects of the two regimes operating during roughly the same period. Possible avenues of investigation include surveying all the cases in the two jurisdictions<sup>818</sup> to determine rates of success and liability costs. This could be supported by surveys to determine how liability costs have impacted business practice. Was insurance coverage effective? Was it changed, and if so how? For example, were forms of self-insurance employed? Was other behaviour changed, and at what cost? Any studies would likely have to be sector-specific.

A narrower investigation could be undertaken with respect to changed behaviour in Canada in banking resulting from the *Micron Construction* decision. A survey would have to be designed to determine precisely how banks have changed their practice with respect to gratuitous information giving. Have any banks adopted a policy of silence? Have new disclaimers been designed, or information review protocols implemented, etc.? If so, what effect have these responses had on business, and at what cost?

*The Consent Model and Other Categories of Pure Economic Loss.* The policies which favour the consent model in negligent misrepresentation (e.g., individualism, certainty and functional coherence, etc.) are also relevant to other areas of pure economic loss.

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<sup>816</sup> See sections 3.5.2 and 5.1.

<sup>817</sup> Bishop, "Negligent Misrepresentation Through Economists' Eyes", *supra* note 282 at 369.

<sup>818</sup> Fortunately, the level of "commercial" consumer protection in the two countries is roughly equivalent. A comparison with jurisdictions like Australia and New Zealand would be more difficult because of their comprehensive trade practices legislation which overlaps the tort of negligent misrepresentation.

However, finding a unified approach to all forms of economic negligence is likely not possible. They are too disparate in nature.<sup>819</sup> The relational claims stand apart in the group of five categories, and are closely related to ordinary property damage cases. There is an appeal at first glance to consider relational claims as such, and treat the economic loss of the plaintiff not as a duty issue but as a remoteness issue, just as, for instance, a loss of profits claim by the property owner would be treated. The indeterminacy problem is significant in relational claims, though, and there is strength in La Forest J.'s economic arguments in *Norske*.<sup>820</sup> A general exclusionary rule with carefully grafted exceptions seems to be the best approach.

On the other hand, the other four categories (i.e., negligent misrepresentation, services, shoddy structures and goods, and public authorities cases) could be brought together under one umbrella, despite Professor Feldthusen's contrary view.<sup>821</sup> A justification for unifying this group follows from the interplay of the core policies mentioned. The one qualification is that this unification is defensible only where the activity is not dangerous to health or safety. This would exclude, for instance, dangerous construction cases (*Winnipeg Condominium*),<sup>822</sup> or dangerous inspection cases (*Just*).<sup>823</sup> Other policies such as deterrence and public protection may support a broader form of responsibility in health and safety cases.

Further study may show, therefore, that duties based on undertakings of care are justifiable in all areas of pure economic loss, except relational claims and claims involving danger to person or property. Issues surrounding consumer protection and abuse of bargaining power generally would, as they are now, be dealt with separately. The idea of applying the consent model in other areas of economic negligence is not radical. Nor is it necessarily that restrictive. As explained in connection with negligent misrepresentation, it would not be necessary to find an assumption of legal responsibility – it never has been. The defendant's behaviour objectively viewed would determine whether there was an undertaking of care which would support the imposition of a duty. The list of indicators for an undertaking of care in negligent misrepresentation<sup>824</sup> would need to be expanded upon to cover the other areas. For instance,

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<sup>819</sup> See *Economic Negligence*, *supra* note 281 at 15-20.

<sup>820</sup> See section 3.3.2.5.

<sup>821</sup> See *Economic Negligence*, *supra* note 281 at 15-20.

<sup>822</sup> See discussion of this case above section 4.3.2.5 under "Negligent Supply of Shoddy Goods or Structures".

<sup>823</sup> See discussion of this case above section 4.3.2.5 under "Public Authorities".

<sup>824</sup> See section 5.2.

reliance will not always be present in the other categories. The misrepresentation and services cases are already covered by an extended *Hedley Byrne* principle in England.<sup>825</sup> The experience there could be more closely examined. In the defective construction cases, a close relationship where the parties know each other, as in *Junior Books*, should suffice in most situations.<sup>826</sup> And in the public authority cases, the voluntary conferring of public economic benefits should suffice as well. It may be that an approach to duty based on undertakings of care is the best way to deal with economic negligence generally in a society that seems to be renewing its belief in the importance of the strength of individual, and of promoting independence and self-reliance.

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<sup>825</sup> Professor Feldthusen argues that the extendability of the voluntary assumption of responsibility test into other areas such as the services cases supports its adoption: see *supra* note 485 and accompanying text.

<sup>826</sup> In *Yuen*, *supra* note 709 at 196, Lord Keith, for the Court, commented how *Junior Books* (see discussion of this case in section 4.4.1 above) could be explained on the basis of voluntary assumption of responsibility and reliance because of the close relationship between the building owner and the subcontractor.

## Glossary

**Contractualism:** Contractualism is not defined in the *Oxford English Dictionary*. It means different things depending on the writer and the context. It is frequently used to refer to the idea that government authority is derived from a contract with or between its citizens. But there are many variations. For instance, Thomas M. Scanlon advocates a theory of moral philosophy which he refers to as a form of contractualism, and which is rooted in Rousseau's idea of a social contract.<sup>827</sup> Morris R. Cohen used the word in a different (though related) sense to describe a political theory which is based on the idea that all restraint is evil and that individuals should have complete liberty to define the obligations to which they will be subject.<sup>828</sup> In this thesis, I use contractualism not in the social contract sense, but to refer to a less extreme version of the political theory referred to by Cohen. As such, it is simply a convenient label to encapsulate the related concepts of freedom of contract, *caveat emptor* and contractual overlap, i.e., to refer to the idea that economic obligation should be voluntary. See section 3.4.5.4 above.

**Consequentialism:** "The view that the value of an action derives entirely from the value of its consequences. This contrasts both with the view that the value of an action may derive from the value of the kind of character whose action it is (courageous, just, temperate, etc.), and with the view that its value may be intrinsic, belonging to it simply as an act of truth-telling, promise-keeping, etc. The former is the option explored in virtue ethics, and the latter in deontological ethics..."<sup>829</sup>

**Deontology:** The *Oxford English Dictionary* defines deontology as, "The science of duty; that branch of knowledge which deals with moral obligations; ethics."<sup>830</sup> This is a broad definition. The phrase "deontological ethics" is defined more narrowly as, "Ethics based on the notion of a duty, or what is right, or rights, as opposed to ethical systems based on the idea of achieving some good state of affairs...or the qualities of character necessary to live well... The leading deontological system is that of Kant."<sup>831</sup> In tort theory, it is often used in this latter sense to refer to duty based on inherent notions of right of wrong without regard for the broader social consequences of the action or the rule.<sup>832</sup> I use the word in this sense.

<sup>827</sup> Thomas M. Scanlon, *What We Owe to Each Other* (Cambridge, Massachusetts: Harvard University Press, 1998).

<sup>828</sup> See *supra* note 297 and accompanying text.

<sup>829</sup> *The Oxford Dictionary of Philosophy*. Simon Blackburn. Oxford University Press, 1996. *Oxford Reference Online*. Oxford University Press. 2 March 2003 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t98.000501>>, s.v. "consequentialism".

<sup>830</sup> *The Oxford English Dictionary*, 2d ed., s.v. "deontology".

<sup>831</sup> *The Oxford Dictionary of Philosophy*. Simon Blackburn. Oxford University Press, 1996. *Oxford Reference Online*. Oxford University Press. 2 March 2003 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t98.000655>>, s.v. "deontological ethics".

<sup>832</sup> See, for example, Stephen R. Perry, "Responsibility for Outcomes, Risk, and the Law of Torts" in Gerald J. Postema, ed., *Philosophy and the Law of Torts* (Cambridge: Cambridge University Press, 2001) at 75-81.

**Instrumentalism:** “[A] pragmatic philosophical approach which regards an activity (e.g. science, law, or education) chiefly as an instrument for some practical purpose”.<sup>833</sup> In this thesis, I do not distinguish between “practical” purposes which are attached to a theory of morality or justice (see consequentialism), and those objectives which are not – normative and non-normative approaches are included under this banner. Also, no distinction is made between positive goals (e.g., the attainment of some result, such as responsible behaviour through deterrence) and negative goals (e.g., the avoidance of some consequence, such as indeterminate liability). The word “functionalism” is sometimes used by tort theorists to mean the same thing as instrumentalism.<sup>834</sup>

**Liberalism:** “A political ideology centred upon the individual..., thought of as possessing rights against the government, including rights of equality of respect, freedom of expression and action, and freedom from religious and ideological constraint. Liberalism is attacked from the left as the ideology of free markets, with no defence against the accumulation of wealth and power in the hands of a few, and as lacking any analysis of the social and political nature of persons. It is attacked from the right as insufficiently sensitive to the value of settled institutions and customs, or the need for social structure and constraint in providing the matrix for individual freedoms.”<sup>835</sup>

**Neo-liberalism:** “A loosely knit body of ideas which became very influential during the 1980s and which were premised upon a (slight) rethinking and a (substantial) reassertion of classical liberalism...”<sup>836</sup>

**Normative:** The *Oxford English Dictionary* defines normative as, “Establishing or setting up a norm or standard; deriving from, expressing, or implying a general standard, norm or ideal.”<sup>837</sup> In this general sense, many laws can be described as normative. “Normative theory”, however, is usually defined more restrictively – one definition is, “Hypotheses or other statements about what is right and wrong, desirable or undesirable, just or unjust in society...”<sup>838</sup> I use the word in this latter sense to describe legal analysis which is evaluative, that is, which evaluates the law based on ideas of rightness, goodness, justice, etc.<sup>839</sup>

<sup>833</sup> *The Concise Oxford Dictionary*. Ed. Judy Pearsall. Oxford University Press, 2001. *Oxford Reference Online*. Oxford University Press. 16 May 2003 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t23.028660>>, s.v. “instrumentalism”.

<sup>834</sup> See, for example, Martin Stone, “The Significance of Doing and Suffering” in Gerald J. Postema, ed., *Philosophy and the Law of Torts* (Cambridge: Cambridge University Press, 2001) at 131.

<sup>835</sup> *The Oxford Dictionary of Philosophy*. Simon Blackburn. Oxford University Press, 1996. *Oxford Reference Online*. Oxford University Press. 9 May 2003 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t98.001375>>, s.v. “liberalism”.

<sup>836</sup> *A Dictionary of Sociology*. Ed. Gordon Marshall. Oxford University Press, 1998. *Oxford Reference Online*. Oxford University Press. 9 May 2003 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t88.001526>>, s.v. “neo-liberalism”.

<sup>837</sup> *The Oxford English Dictionary*, 2d ed., s.v. “normative”.

<sup>838</sup> *A Dictionary of Sociology*. Ed. Gordon Marshall. Oxford University Press, 1998. *Oxford Reference Online*. Oxford University Press. 18 February 2003 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t88.001573>>, s.v. “normative theory”.

<sup>839</sup> See *supra* note 79 and accompanying text.

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*Appendix*

CONCURRENT LIABILITY IN NEGLIGENT MISREPRESENTATION AND  
CONTRACT<sup>840</sup>

As soon as *Hedley Byrne* was decided it was realized that there might be concurrent liability in contract and negligent misrepresentation.<sup>841</sup> *Hedley Byrne* itself involved non-contracting parties but, theoretically, liability could arise in circumstances where the parties were negotiating toward or were in a contractual relationship. What could be more “equivalent to contract”, to use Lord Devlin’s phrase, than an actual contract? If the misrepresentation were pre-contractual, i.e., made during negotiations, it could still be a term of the contract (collateral or otherwise) if the parties so intended – there could therefore be a claim for breach of contract and also possibly for negligent misrepresentation. If the misrepresentation were post-contractual (i.e., made after the contract was entered into), and the contract included an obligation to use words with care,<sup>842</sup> similarly there could be a claim in both contract and tort. These situations give rise to a concurrent liability issue.

After *Hedley Byrne* was decided, it was not entirely clear whether negligent misrepresentation claims could be pursued concurrently with breach of contract claims. The Supreme Court of Canada in *Nunes Diamonds* appeared to conclude that such claims were generally barred. Pigeon J., for the majority, wrote:

[T]he basis of tort liability considered in *Hedley Byrne* is inapplicable to any case where the relationship between the parties is governed by a contract, unless the negligence relied on can

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<sup>840</sup> In Chapter 3 (section 3.5), the three main contexts in which negligent misrepresentation claims might arise were described schematically. The second one, the basic contract scenario, sometimes also gives rise to concurrent liability issues as described in this Appendix. See Fig. 3.5-2 and the accompanying explanation outlining the different stages of a contract in which a negligent misrepresentation might occur.

<sup>841</sup> Concurrent liability should not be confused with the issue of contractual overlap. Concurrent liability issues arise when the parties are in a contractual relationship. Contractual overlap deals with the lack of functional coherence that results from some forms of imposed tortious liability when the parties do *not* have a contractual relationship (see also *supra* note 318 and accompanying text).

<sup>842</sup> Contracts which provide for the giving of advice will generally have express or more frequently implied obligations to use care: for example, see *Nocton*, *supra* note 397 at 956 per Viscount Haldane L.C. (also *supra* note 397 and accompanying text), and *Nunes Diamonds*, *supra* note 330 (this case is considered from an economic efficiency standpoint in section 3.5.2.2).

properly be considered as "an independent tort" unconnected with the performance of that contract...<sup>843</sup>

In *Nunes Diamonds*, the alleged negligent misrepresentation occurred during performance of the contract. Restricting claims to independent torts unconnected with contractual performance meant negligent misrepresentation claims would be very rare in this context. A few years after *Nunes Diamonds*, the English Court of Appeal recognized an apparent exception to this "independent tort" rule, allowing a *Hedley Byrne* claim with respect to a *pre-contractual* misrepresentation.<sup>844</sup> Canadian courts soon followed suit.<sup>845</sup>

The wisdom of *Nunes Diamonds* was questioned, and as a result of two subsequent Supreme Court of Canada decisions, *Central Trust Co. v. Rafuse*<sup>846</sup> and *BG Checo*,<sup>847</sup> it has been effectively overruled.<sup>848</sup> There is now no general restriction against pursuing a claim for negligent misrepresentation (or any other tort) just because the parties were negotiating toward or were in a contractual relationship at the time the alleged misrepresentation or other tort occurred.<sup>849</sup> Further, a claimant can pursue claims for breach of contract and in tort concurrently, making a choice between the two at trial.<sup>850</sup>

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<sup>843</sup> *Nunes Diamonds*, *ibid.* at 777-78.

<sup>844</sup> *Esso Petroleum*, *supra* note 329.

<sup>845</sup> For example, see *Sodd Corp.*, *supra* note 329.

<sup>846</sup> *Central & Eastern Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147, 31 D.L.R. (4th) 481 [*Rafuse* cited to S.C.R.].

<sup>847</sup> *BG Checo*, *supra* note 329.

<sup>848</sup> See generally Peter Sim, "Negligent Misrepresentation in a Pre-Contractual Setting: *BG Checo International Ltd. v. British Columbia Hydro & Power Authority* and *Queen v. Cognos Inc.*" [Case Comment] (1993) 15 Advocates' Q. 238.

<sup>849</sup> One specific exception to this relates to infants' contracts in British Columbia. The *Nunes Diamonds* non-concurrency "independent tort" rule still survives in legislative form under section 25 of the *Infants Act*, R.S.B.C. 1996, c. 223, which provides:

Liability in tort

25 Nothing in this Act affects the rule of law by which a person is not liable in tort, if the action in tort

(a) is connected with,

(b) arises out of,

(c) was contemplated by, or

(d) is an indirect means of enforcing

a contract that is unenforceable against the person under section 19 (1).

This provision was first enacted in 1985 (S.B.C. 1985, c. 10, s. 1) one year before *Rafuse* was decided. The "rule of law" referred to in the section is the rule from *Nunes Diamonds*, and even though the rule referred to no longer exists, it remains in the legislation having been re-enacted in the 1996 statute revision. Whether or not this is a legislative oversight is not clear, but it does present an issue of statutory interpretation.

<sup>850</sup> The English position also allows for concurrent claims in contract and tort. See *Henderson*, *supra* note 330 at 184-94.



However, there are limits to concurrency. The most important one is that a claim in tort cannot be pursued to avoid a valid contractual provision limiting the right to sue in tort.<sup>851</sup> Another limitation, which will rarely arise in practice, is that the breach of a duty in tort, which depends for its existence on an express contractual stipulation, must be pursued in contract not in tort. That is not to say that a tort duty and an identical express contract term cannot give rise to concurrent claims, just that the tort duty must be one that would exist in the absence of any coterminous express contract duty.<sup>852</sup>

There are two common reasons for wanting concurrency: limitation periods and remedies. One claim may have a more generous limitation period. For example, limitation periods for tort claims can be delayed under most limitation statutes until the claimant has knowledge of the material facts supporting the claim, and this can sometimes be an advantage over a contract claim where limitation periods are not delayed. Remedial benefits may also present themselves. In tort and contract the measure is very often the same but not always – contract damages are usually based on the measure of the expectation, whereas tort damages attempt to return the injured party to her position before the tort.

Two other *quasi*-concurrency issues can arise in relation to negligent misrepresentations. The first relates to pre-contractual “mere” misrepresentations, i.e., statements made during negotiations which are not terms of the contract because of lack of contractual intent. Innocent mere misrepresentations (as well as fraudulent misrepresentations) may support an action for rescission. The question arises: Can an innocent mere misrepresentation which is negligently made support both a claim in rescission and for damages in tort? This is a little different than the issue that arises where there is a concurrent breach of contract. In that case

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<sup>851</sup> This point is made clear in both *Rafuse*, *supra* note 846 at 206, and *BG Checo*, *supra* note 329 at 30. See also section 4.3.4.3 where the use of contractual exclusion clauses to limit liability for negligent misrepresentation is examined. Professor Blom argues that even if there is no express clause dealing with the right to sue in tort, the plaintiff should not be able to sue for pre-contractual negligent misrepresentation if the plaintiff could not have reasonably expected that the defendant was assuming legal responsibility for the type of loss in question: see Joost Blom, “Contract and Tort - Negligent Misstatement Inducing Contract - Concurrent Liability - Effect of Contractual Terms: *BG Checo International Ltd. v. British Columbia Hydro & Power Authority, Queen v. Cognos Inc.*” [Case Comment] (1994) 73 Can. Bar Rev. 243. See also his comments in Joost Blom, “Tort Recovery for Economic Loss and the Intersection between Tort and Contract” (1996) 54 Advocate (B.C.) 367 at 391-92. This argument relates not only to concurrency matters, but also to the underlying nature of liability in negligent misrepresentation generally.

<sup>852</sup> This is explained in *BG Checo*, *ibid.* at 38-41, clarifying some passages in Le Dain’s judgment in the earlier case of *Rafuse*, which were interpreted by some to mean that only *implied* contract terms were concurrent with tort duties.

the two claims may be pursued concurrently, but they are alternative claims – the plaintiff has to make a choice between the contract and tort claim at trial. In this case the question is whether the plaintiff is entitled both remedies at the same time, i.e., rescission *and* damages. This question does not appear to have been addressed squarely by the courts. It is clear that both remedies are available if the misrepresentation is fraudulent.<sup>853</sup> There does not seem to be any good reason why they should not also be both available in the case of negligent misrepresentation. The remedies of rescission and damages in tort are compatible. Both are backward looking, attempting to place the aggrieved party in her pre-contract/pre-tort position. A claim for expectation damages in contract, on the other hand is not compatible with a claim for rescission – rescission seeks to place the parties in the position they would have been had there been no contract, whereas the claim for expectation damages seeks to affirm the contract by substituting damages for the failed performance.<sup>854</sup>

The second issue relates to post-contractual misrepresentations occurring after the contract has been fully performed. For instance, the former parties to the contract may still have occasion to communicate with one another, but without contractual obligation to do so. In this situation, a tort action for negligent misrepresentation will be the only option.

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<sup>853</sup> See Fridman, *The Law of Contract*, *supra* note 312 at 316, and John Cartwright, *Misrepresentation* (London: Sweet & Maxwell, 2002) at para. 3.16.

<sup>854</sup> Cartwright, *ibid.*

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