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**ECONOMIC LOSS WITH SPECIAL REFERENCE TO  
BUILDING PROFESSIONALS' LIABILITY - A  
COMPARISON BETWEEN MALAYSIAN LAW,  
ENGLISH LAW, AND AUSTRALIAN LAW**

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**THIS DISSERTATION IS SUBMITTED IN PARTIAL  
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## ABSTRACT

This dissertation discusses on the duty of care in torts and elaborates the reasons why economic loss requires special treatment and why it is considered a problem area in the law of negligence. The distinction between economic loss and pure economic loss, as well as the many ways in which economic loss cases may arise, are also included in the discussion.

The main focus is on the question of building professionals' liability and why the courts have been reluctant to allow claims for pure economic losses incurred by a plaintiff from the negligence of the said professionals. The dissertation touches on the general principles behind economic loss claims, and on the different approaches taken by the three legal systems, namely, the English Law, the Malaysian Law, and the Australian Law.

Economic loss cases in Malaysia, with special reference to professional liability, are normally treated in the same manner as in English Law. There are, however, new cases that have been decided that seem to have changed this position. One particular case which is of great importance that will be examined is the case of *Dr. Abdul Hamid Abdul Rashid & Anor v Jurusan Malaysia Consultants (Sued as a Firm) & Ors [1997] 3 MLJ 546*. The purpose of this dissertation, therefore, compares the Malaysian Law, the English Law, the Australian Law, and where useful, references were made to other jurisdictions, to be able to look into possibilities in which permanent reforms can be made in the local scene.

## فكرة الرسالة

هذا البحث يناقش وحووب الذرفى القنون التورت ونبوضح اسباب الخسرا لاقتصادى التى تحتاج إلى الاىباه الأكرلى بها. ولما ذا هذا الاسباب توءدى إلى الغموض فى القوانىن الإهمال. وكذلك المناقشة عن الفروق بىن الخسرا لاقتصادى فى الأموال والأغراض و الخسرا لاقتصادى الذى لاىتعلق بالأموال والأغراض وأنواعها.

فالجدىر للإىتابه إلى قضاىا مسؤولىه الخىراء فى مجال البناء وعدم إىستعداد القانون فى قضاء على الخسرا التى يقدمها المطالب نىبجة من مسؤولة الخىراء. فهذا البحث ىتكلم عن اركان المطالبة الخساره الاقتصادىة عامة والاختلاف فى اىستخدمها أو تطبىقها فى ثلاثة انظمة القانون وهى القنون الإنجلىزىة و القنون المالىزىة و القنون الاوسىرالىة.

الجساره الاقتصادىة فى مالىزىا عند الخىراء تعامل نفس الشىء مع القنون الإنجلىزى. مهما كان ذلك قد بىغىر هذه الحالة نظرا إلى وجود القضاىا الجدىدة. فعلى سبىل المئال قضية الدكتور عبءالحمىء عبءالرشىء ضءالمجال الإىششارالمالىزى. فهى من قضية هامة التى بىعتمد عليها هذا البحث. ومن اءءاف البحث هى للمقارنة بىن قوانىن الإنجلىزىة والمالىزىة والاوسىرالىة - نحو هذا الموافق أو القضية - إىضافة إلى النظر إلى القنوانىن الأخرى الذى سىساعد فى بىغىر أو القضية أو المسألة فى مالىزىا.

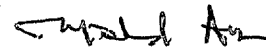
## APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Comparative Laws.



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## DECLARATION

I hereby declare that this dissertation is the result of my investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

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## CHAPTER I

### INTRODUCTION AND BACKGROUND OF ECONOMIC LOSS

#### Introduction

The duty of care in the law of negligence is normally restricted to the duty of not causing any physical injury or harm to others. When it comes to financial interests, however, there are no definite and clear-cut rules or guidelines on how they can be protected. It is for this reason that the courts have been reluctant to allow claims for injury related to financial interests, even when the non-physical or purely pecuniary loss was clearly foreseeable<sup>1</sup>. From time to time, the courts, particularly the English courts, have arrived at contradictory decisions when dealing with cases involving financial or economic losses.

While many Commonwealth countries have taken a different direction, the English courts have remained as they were. It was unfortunate that for a considerable period of time, the Malaysian courts have applied the law of their English counterparts despite vast differences between the two legal systems.

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<sup>1</sup> R.A. Percy & C.T. Walton, *Charlesworth & Percy on Negligence*, Sweet & Maxwell, London, 1997, p. 73.

The main reason for disallowing claims of purely financial nature is primarily the “floodgates” argument or what is also known as the “ripple effect”<sup>2</sup>. This argument has adverse effects in the development of the law on economic loss. However, is it really a practicable argument? It is thus necessary to look back into the origins of the law of negligence, and trace the steps leading to the current situation of economic loss cases.

### **Tort Introduction**

Tortious liability arises from the breach of a duty primarily fixed by law. This duty is towards persons generally and its breach is redressible by an action for unliquidated damages<sup>3</sup>. This definition distinguishes tort from other branches of law, including that of contract. This means that the liability in tort is not necessarily a liability in contract. And it follows that tortious liability can be distinguished from contractual liability<sup>4</sup>. At this point, it is sufficient to mention that the reason for this short introduction to tort is that economic loss cases are generally not contractual in nature.

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<sup>2</sup> K.M. Stanton, *The Modern Law of Tort*, Sweet & Maxwell, London, 1994, p. 333.

<sup>3</sup> W.V.H. Rogers (ed.), *Winfield and Jolowicz on Tort, 14<sup>th</sup> Edition*, Sweet & Maxwell, London, 1994, p. 4.

<sup>4</sup> *ibid.*, p. 5.

## Liability in the Tort of Negligence

The existence of a separate tort of negligence has been judicially accepted beginning with the speech of Lord Atkin<sup>5</sup> in *Donoghue v Stevenson*<sup>6</sup>. Negligence is said to be the most general of all English torts. It consists of any behaviour, causing damage to another person, for which the law provides a remedy under the tort of negligence on the ground that the person causing the damage did not take sufficient care in what he was doing<sup>7</sup>. A better, simpler, and a more complete way of putting it would be: negligence is made up of duty, breach, causation and of damage.

### Previous Position

Prior to the case of *Donoghue v. Stevenson*<sup>8</sup>, the courts refused to recognise the existence of a general duty in tort. Legal liability for carelessness was clearly established only in a number of separate, specified situations that did not have a unifying principle, partly because of the courts' adherence to the strict common law principle of privity of contract<sup>9</sup>.

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<sup>5</sup> Clerk & Lindsell, *Clerk and Lindsell on Torts, Seventeenth Edition*, Sweet & Maxwell, London, 1995, p. 217.

<sup>6</sup> [1932] AC 562.

<sup>7</sup> P. Kaye, *An Explanatory Guide to the English Law of Torts*, Barry Rose Law Publishers Ltd., Chichester England, 1996, p. 15.

<sup>8</sup> [1932] AC 562.

<sup>9</sup> B.S. Markesinis & S.F. Deakins, *Tort Law, Third Edition*, Clarendon Press, Oxford, 1994, p. 66.

To illustrate further, cases of negligence before *Donoghue v Stevenson* were dealt stringently with the rules of contract. Thus, if A drinks a beverage manufactured by B, and later on A suffers injury due to the drink, B would not be liable for anything if there was no relationship between A and B. B would only be liable if he personally sold the beverage to A. With the advent of *Donoghue v Stevenson's* case, major developments in the law of negligence took place.

### **Donoghue v. Stevenson**

The decision of this case opened a whole new range of liabilities in the tort of negligence. As stated above, the courts refused or had a very limited allowance when it came to negligence liability.

In this case, there was a decomposed snail in the drink manufactured by the respondent. The appellant only realised this after drinking most of the contents. It was not seen easily because the drink was in an opaque bottle. The appellant then claimed that the drink caused her illness. The defence of the respondent was that, among others, there could be no liability because the appellant was not privy to the contract, that is, the contract being as between the manufacturer and the party who sold the drink.

The House of Lords gave a decision that overturned all previous cases. In Lord Atkin's judgement, the neighbour principle was enunciated. He said:

"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 into question."<sup>10</sup>

The difficulty therefore is in determining the situations in which this duty arises. How does one ascertain that such a damage is foreseeable? In what situations would a damage be foreseeable? If these questions were answered, then it would be easier to pinpoint exactly when the duty of care arises. Only then can a liability in negligence be said to exist.

Thus, the liability for negligence became wider after *Donoghue's* case. It was once limited by reference to such factors as physical injury to a person or property, and the

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<sup>10</sup> [1932] AC 562, at p. 580.



existence of a special relationship between the parties arising from contract. Now, liability has been extended to include nervous shock, verbal or written communications and economic loss unconnected to any physical damage<sup>11</sup>.

### **Development of the Law**

From the 1960's to the 1970's, i.e. in the early years after *Donoghue v. Stevenson*, the courts leaned toward giving a broader interpretation of Lord Atkin's formula. This interpretation placed greater emphasis on the duty to impose reasonable care, as opposed to the test of the reasonable foreseeability of damage to the victim<sup>12</sup>. This is evident in decisions such as *Home Office v Dorset Yacht Co. Ltd.*<sup>13</sup> where it would seem to state that there was a duty of care and the reasonable foreseeability was presumed unless proven otherwise.

The *Dorset Yacht* case actually brought changes to the foreseeability and proximity test. Previously, the ratio in *Donoghue's* case was used by the courts but confined it only to the liability of a manufacturer of goods towards ultimate consumers. In *Dorset Yacht's* case, Lord Atkin's test was used to support the conclusion that prison officers owed a national duty of care in respect of the custody of prisoners to owners of nearby property

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<sup>11</sup> G.H.L. Fridman, *Torts*, Waterlow Publishers, 1990, p. 16.

<sup>12</sup> Kaye, p. 36.

<sup>13</sup> [1970] AC 1004.

likely to be damaged if the prisoners escaped. The likelihood that a property would be damaged meant that the owners were “closely and directly affected” by the officers’ conduct and hence the requirement of proximity was satisfied<sup>14</sup>.

This change in law brought about the development of the law of torts relating to economic loss claims. The reason being, a party suffering economic loss can claim from another party despite the fact that there is no contractual relationship between them, or even if there is no direct relationship between them, as long as it can be shown that there was close proximity between the parties that the actions of another may affect the claimant.

This can be seen in the “two-stage” test formulated by Lord Wilberforce in *Anns v Merton London Borough Council*<sup>15</sup>, which will be discussed later<sup>16</sup>.

### **Definition of Economic Loss in Tort and Difference between Economic Loss and Pure Economic Loss**

Economic loss occurs when a person suffers financially. This can either be a loss arising out of injury to person or property, or it can be a loss which is purely economic. For

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<sup>14</sup> Clerk & Lindsell, pp. 224-225.

<sup>15</sup> [1978] AC 728.

<sup>16</sup> *infra*, p. 37.

example, a person involved in a car crash will have to pay for medical bills for his treatment and will also have to pay for the repair of his damaged car. These expenses will fall under the category of economic loss.

On the other hand, if the same person from the above example becomes unable to work for three months after the crash, and as a consequence, loses some profit in his unattended business for that span of time in which he was disabled, such losses would be considered as purely economic.

Economic loss is a very broad category and pure economic loss is a specific category falling under it. Pure economic loss cases do not normally involve injury or damage to one's person or property. Whereas, economic loss, being wider, can include different types of losses. For instance, financial harm arising out of a breach of contract falls under the economic loss category.

In other words, pure economic loss refers to financial loss suffered by a plaintiff which is unconnected with, and does not flow from, damage to his own person or property<sup>17</sup>. In economic loss cases, there is clarity because anyone can specifically determine the exact amount lost. For example (albeit a very simple one), if a person is hospitalised, there will be hospital bills and receipts, and the person would have known how much exactly he has

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<sup>17</sup> Clerk & Lindsell, p. 271.

spent. Therefore, it is easy to determine the amount. However, this is not the case with pure economic losses. In pure economic loss, claims may include future profits that may have been gained by a person, or claims for expenses accrued for repairing a damaged building; for instance, a bad advise given by one party to his client may cause the client to lose some amount of money, or it could be that a buyer of a building discovers that the property he bought needs more repairs. The financial claims may not be easily ascertained and may not be estimated accurately.

It is said that English law of tort draws a clear distinction between physical damage to property and damage to other economic interests. Damage to property, as well as physical damage, receives a higher degree of protection as compared to intangible economic interests, particularly when the damage is inflicted by negligence<sup>18</sup>. It is this “intangible economic interests” in which pure economic loss is relevant.

### **Duty of Care: Economic Loss as A Problem Area**

One of the difficulties with economic loss is that it is harm inflicted upon an intangible interest<sup>19</sup>. The reluctance to permit tortious actions for economic loss can be attributed to a number of reasons. In particular, economic losses often give rise to a fear of indeterminate liability, in that they tend to spread further than purely physical harm. In

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<sup>18</sup> K.M. Stanton, p. 307.

<sup>19</sup> P.J. Cooke and D. Oughton, *Common Law of Obligations*, Butterworths, London, 1993 at p. 147.

contract, this would not apply because the liabilities of the contracting parties are confined to themselves alone<sup>20</sup>.

Thus, the problem faced by lawyers and judges when dealing with economic loss is that there is no direct relationship between the claimant and the defendant. This, in turn, leads to another problem which is the fear of creating liability indeterminate in extent or amount<sup>21</sup>. Satisfying the requirement of reasonable foreseeability becomes difficult, as well as defining foreseeability itself. It is due to these facts that general outlines need to be laid down for uniformity.

There have been a number of reasons advanced why the courts are reluctant to allow full-scale recovery for all economic loss<sup>22</sup>. These reasons are mainly:

- a. the floodgates argument - the concern that by generating a wide class of action for economic loss the courts would be flooded by cases which would overtax judicial resources and lead to unacceptable delays in the finalisation of cases;
- b. there has to be some priority given between the various types of loss which may be sustained by an individual, and the law should be more sensitive to the rights of an individual where his personal health and safety have been adversely affected;

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<sup>20</sup> P.J. Cooke and D. Oughton, *Common Law of Obligations*, Butterworths, London, 1993 at p. 147.

<sup>21</sup> E.K. Banakas (ed.), *Civil Liability for Pure Economic Loss*, Kluwer Law International, 1996 at p. 2.

<sup>22</sup> J. McMullan, 'Liability Outside the Contract', *Electronic Contract Law*, <http://www.mcmullan.net/eclj/liability.html>, 1999.

- c. economic loss is not subject to any physical constraints so that the defendant's potential liability is unpredictable.

*Floodgates.* The main reason being used normally is the floodgates argument. The origin of this argument can be traced back to the case of *Ultramares Corp. v. Touche*<sup>23</sup>. In that case, Judge Cardozo upheld the defendant's argument of lack of privity. The defendant, an accountant, was sued by a third party lender based upon the negligent preparation of a financial report. The lender used the financial information in deciding to extend credit to the accountant's client. Ruling for the defendant, Cardozo stated that if privity were eliminated, "a thoughtless slip or blunder . . . may expose accountants to a liability in an indeterminate amount for an indeterminate class." The words of Cardozo since then have gained widespread popularity when refusing claims for pure economic loss.

Other cases have also used a similar reasoning. For example, in the case of *Spartan Steel & Alloys Ltd. V. Martin*<sup>24</sup>, Lord Denning commented that if claims for economic loss were permitted for certain types of hazards (in this case it was a power cut), there would be no end to claims. Some of them might be genuine, but many might be inflated or false. Blackburn J in *Cattle v Stockton Waterworks Co.*<sup>25</sup> was also concerned that there might be claims for loss of wages by the workmen affected by physical damage to their place of

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<sup>23</sup> 225 N.Y. 170, 174 N.E. 441 (1931).

<sup>24</sup> [1973] QB 27.

<sup>25</sup> (1875) LR 10 QB 453.

employment and he endorsed the view that the courts should only redress the proximate and direct consequences of wrongful acts.

What is obvious here is that English courts are concerned with the possibility of indeterminate liability. If, for instance, there is a building and there are many offices in it, and defects are found in it, should the companies in that building be allowed to claim for loss of profits during the time when the building was being fixed? Alternatively, should they be allowed to claim for loss of profits because the building collapses and that they had to spend more money trying to find a new workplace?

A slightly different scenario was conceived by Lord Fraser in *Candlewood Navigation Corporation Ltd. v Mitsui OSK Lines Ltd.*<sup>26</sup>. He argued that if claims by time charterers were permitted, so too would those of a sub-charterer and if those were admitted, why not also claims by any person with a contractual interest in goods being carried in the vessel, and by any passenger of the ship, who suffers economic loss by reason of the delay attributable to the collision? Although this case does not directly deal with building professionals, this argument clearly illustrates the floodgates theory.

To allow all claims for relational economic loss would lead to unacceptable indeterminacy because of the ripple effects caused by contracts and expectations<sup>27</sup>.

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<sup>26</sup> [1986] AC 1.

<sup>27</sup> Clerk & Lindsell, p. 274.

*Priority to personal health and safety over economic losses.* As mentioned above, the law gives more priority to the rights of an individual where his personal health and safety have been adversely affected. Courts have concluded that damage to a structure as a result of faulty design, which does not result in further physical damage to other property apart from the structure so designed, is a specie of economic loss, notwithstanding that it has a physical manifestation. Accordingly, if an architect or engineer is negligent in the course of designing a building, and the building then suffers distress, the damage suffered by the owner of the building will be characterised as economic rather than physical.

In *Leigh and Silavan Ltd v Aliakmon Shipping Co Ltd*<sup>28</sup>, Robert Goff LJ made the point that:

"the philosophy of the market place presumes that it is lawful to gain profit by causing others economic loss, and that recognised wrongs involving interference with others' contracts are limited to specific intentional wrongs such as inducing a breach of contract or conspiracy. Certainly there seems to have developed an understanding that economic loss at the hands of others is something we have to accept without legal redress, unless caused by some specifically outlawed conduct such as fraud or duress; though how far this is the outcome of our reasoning, or the product of our law, is not altogether clear."<sup>29</sup>

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<sup>28</sup> [1985] QB 350.

<sup>29</sup> [1985] QB 350 at 393.