



MOHAMED ZAMAN BIN RAMZAN DIN

This Dissertation is submitted in fulfilment of the requirement
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1995

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IN THE NAME OF ALLAH SWT, MOST GRACIOUS, MOST MERCIFUL.

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MOHAMED ZAMAN BIN RAMZAN DIN

Kulliyah of Laws,
INTERNATIONAL ISLAMIC UNIVERSITY,
PETALING JAYA,

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A B S T R A C T

It is the aim of this Dissertation to trace the origin and look at the development of the Law on economic loss, as it developed from the Tort of Negligence. The concept of economic loss and pure economic loss have been distinguished and differences; are highlighted.

Further the much blurring distinctions between the boundaries in the Law of Tort and Contract too are cursorily examined in trying to analyse whether the recovery of economic loss ought to remain a contractual problem or tort problem.

Attempts are also made to focus into specific areas of claims made due to such economic loss against Public Authorities for negligence, claims against Professional Advisors for being negligent in the performance of service and claims against product manufacturers for producing defective products. Also focussed is the area on such economic loss caused due to negligent acts or conduct known as the Builder's liability in constructing defective buildings, which results in massive losses to the subsequent purchasers of such buildings.

The study examines the recent House of Lords decision in the Case of LINDEN GARDENS (1994) 1 AC 85 which has raised some fundamental issues regarding the Law of Contract and Tort and economic loss unassociated with physical damage. This case seems to have created a new cause of action which sidesteps the fundamental doctrine of privity of contract as it allows recovery by reference to contractual principles rather than the Law of Tort notwithstanding any apparent lack of privity between the Defendant and the Plaintiff whilst setting no parameters for the circumstances in which this new cause of action will operate.

The impact, effect and implications of this decision are analysed.

The study is comparative. The developments in the Common Law System have been compared with Civil Law Systems principally with position in GERMANY and FRANCE where the contractual law is utilized in obtaining similar results which tort Law achieves in the Common Law.

In conclusion, the Dissertation carries a short note on the Highland Towers Tragedy in KUALA LUMPUR, which took place on 11th DECEMBER 1993 and examines its implication for the development of economic loss in MALAYSIA.

THE ORIGIN OF LAW ON ECONOMIC LOSS

(A) Introduction

The general rule in Common Law on duty to take care in avoiding injury to others (in Tort of Negligence) is restricted to physical injury either to person or property. This however does not mean that the Law refuses to protect a man's financial or pecuniary interests but there has traditionally been a reluctance to grant a remedy for the careless invasion of financial or pecuniary interests. This traditional reluctance was seen as long standing, deep rooted and was not considered to be unreasonable. However with the widening of Tort of Negligence categories, such economic loss (sometimes called as pure economic loss) was brought within its scope and recovery made permissible under certain strict circumstances.

The last 30 years have seen a great increase in claims for economic losses particularly against professionals such as accountants, surveyors and banks. English court gave some relaxation in the rule against recovery of economic losses as appears from cases like *ANNS v MERTON* (1978) (1) and *JUNIOR BOOKS v VEITACHI* (1983) (2).

However they soon restricted the circumstances in which such losses were recoverable for fear of opening the floodgates of litigation. All this has left the law relating to pure economic loss in an unsatisfactory state as many decisions are difficult to reconcile and it is difficult to predict when economic losses will be recoverable.

The origins of the tort of economic loss can thus be said to have directly originated from the tort of Negligence.

(B) Tort Defined

A simple Oxford dictionary definition and function of Tort provides that Tort in old French is harm or wrong and in Latin is tortus, twisted or crooked. It is a wrongful act or omission for which damages can be obtained in a Civil Court by the person wronged other than a wrong that is only a breach of contract.

Law of Tort mainly concerns with providing the compensation for personal injury and property damage caused by negligence and also protects other interests such as reputation, personal freedom, false imprisonment, title to property, enjoyment of property and commercial interests.

It must be shown that the wrong was done intentionally or negligently but there are however some torts of 'strict liability' (such as Trespass) whose main function is to protect rights rather than to compensate for damages. These will be actionable without proof of damage.

Some torts are also breaches of contract and recovery can either be in tort or for breach of contract.

The person primarily liable is the one who committed the tort (the tortfeasor) but under the rules of vicarious liability, one may be liable for a tort committed by another person.

(C) PURE ECONOMIC LOSS, ECONOMIC LOSS AND ECONOMIC TORTS DISTINGUISHED

- (i) Economic Torts deal with specific or nominate torts. Some examples are Torts of Passing Off, interference (unlawfully) with contracts, malicious falsehood, conspiracy, deceit and intimidation.

Basically, a number of permutations may arise. One party's economic or business activities may cause damage to another party's economic or business interests and it is the task of the Law to decide which activities should be deemed wrongful and therefore tortious and distinguish with what is justifiable pursuit of self interest in the business world.

To illustrate :-

- (a) Passing off is misrepresentation by one of his own goods or services to consumers or prospective consumers which will lead to a foreseeable consequence of damaging the business or goodwill of the other Party or goods generally recognized as that of his (the other Party).
- (b) Malicious or Injurious Falsehood is where false statement is made maliciously by one (A) regarding another's person (B), property or goods resulting in other people (public) deceived and damage caused to that other person (B). Generally classified into three categories. These are slander of title, slander of goods and false statements which damage the Plaintiff's trade or business.
- (c) Tort of intimidation may take form, either by intimidation of the Plaintiff (an illegal act) in order to influence his behaviour compelling him to do something which causes him loss or by intimidation of other parties compelling them to do some act which causes injury to the Plaintiff. For example in **ROOKES v BARNARD** (3) by which Plaintiff was dismissed with full notice lawfully but was able to sue Union representatives who had unlawfully intimidated his employers into this lawful action.

However, these so called economic torts are still unclear in their scope and furthermore very real difficulties exist in reconciling protection of one's individual economic interests with the concept of free competition in a market economy.

In general, therefore it can be stated that Tort Law gives limited protection to economic interests where the Defendant has acted unlawfully and thus caused economic loss to the Plaintiff. These are known as economic torts.

- (ii) Pure Economic Loss is that part of the Law of Negligence which deals specifically with the Plaintiff's loss of a pecuniary nature and is quite independent of any personal injuries or property damage that might be caused to the Plaintiff.

(iii) Economic Loss or Consequent Economic Loss

If one were to be run over by a negligent car driver, the damages awarded would represent not only the physical injuries suffered (pain, suffering etc.) but also financial consequences of those injuries, for example recovery of medical costs incurred and wages lost. This is the consequential economic loss.

A claim in tort for economic loss is often seen as a claim based on lost expectations. However traditional analyst has always insisted that the expectation interest is only protected by Contract Law whereas tort action only protects the status quo interest with the objective of putting the Plaintiff in the same position that he would have occupied had the tort not been committed.

This distinction is well established in the Law of Damages although obscured by the fact that so many Tort claims are personal injury claims, in which damages to put the Plaintiff back in the position he was in before he was injured, actually includes damages for his lost expected earnings.

Pure economic loss therefore is taken to mean 'economic loss that occurs which is neither consequent upon physical damage to property or injury to person nor otherwise related to such physical/personal damages. In other words it is mere loss of profits and such estimated financial loss is not related to any physical damage to person or property of the Plaintiff.'

However some textBook writers and academicians have a tendency to classify economic loss and pure economic loss as one and the same. Is this correct ?.

(D) Economic Loss and Pure Economic Loss
Distinguished - Is There A Difference?

Upon closer examination, there appears to be some differences between economic loss and pure economic loss as can be seen below:-

- (i) Consequential economic loss - where the loss arises as a consequence of physical damage or personal injuries caused to the Plaintiff or his property.

- (ii) Pure economic loss is where the loss which is sustained by the Plaintiff consists solely of loss of profits. This is an area where there has been greatest scope for divergence of opinion. Here the loss is purely economic in nature and does not stem from any physical damage to the Plaintiff or his property and the approach of Court differs. Such pure economic loss is by and large irrecoverable.

The problems that arises with pure economic loss is that it is financial loss unconnected with physical damage to the Plaintiff's person or property. There however may be physical damage to someone else's property causing purely economic loss to the Plaintiff for example making the Plaintiff's contract with that person more onerous or less profitable.

The difficulty has always been as to how to frame a liability rule that will avoid burdening the Defendant with 'liability in an indeterminate amount for an indeterminate time to an indeterminate class.'

Distinction between recoverable and irrecoverable economic loss can easily be demonstrated by the case of SPARTAN STEEL and ALLOYS LTD v MARTIN and CO. LTD (4)

Brief Facts

Building contractors were careless in digging road and damaged electricity cable running to a metal processing plant, resulting in power cut off for several hours.

The plant (SPARTAN STEEL) sued the contractor for loss of profits.

Court of Appeal in allowing partial claim made the distinction that

'profits that were lost on the metal that was being processed at the time that the electricity was cut off were recoverable as this can be considered consequential economic loss stemming from physical damage to the Plaintiff's property. As for other claims, that is inability to process other lots of metal in the time that power was cut off, this was pure economic loss and no claim is permissible on this.'

Another example of pure economic loss where such loss is solely loss of profits and the financial loss caused was not by reasons of physical damage to person or property of the Plaintiff is seen in the case of WELLER and CO LTD v FOOT and MOUTH DISEASE RESEARCH INSTITUTE (5) in which the business of cattle Auctioneers was disrupted after the local livestock was infected by foot and mouth disease which had escaped from the Defendant's laboratories.

Plaintiff (Auctioneers) sued for loss of profits but their action failed as here it was pure financial loss which was being claimed not accompanied by any physical loss to their persons or properties. Thus, such loss was not recoverable.

(E) Origins Of Economic Loss

Economic loss as stated earlier, took birth from the concept of duty of care in negligence. The tort of negligence has grown considerably in importance in recent years and emerged in its recent modern form in late 19th and early 20th Century. Its modern origins can be attributed to the case of DONOGHUE v STEVENSON (6) and in particular the famous dictum of LORD ATKIN which defined duty of care.

The primary elements of the tort of negligence can generally be stated as :-

- (a) duty of care
- (b) standard of care/breach of duty
- (c) causation
- (d) remoteness of damage

Economic loss arose from the concept of duty of care in negligence and in the early stages of the development of such duty of care, economic loss was not recognized as a sufficient form of damage; a duty not to cause economic loss was not recognized by the Law.

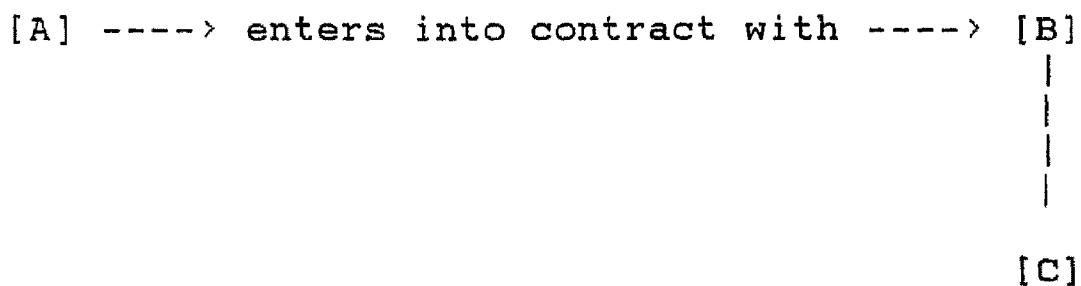
The reason that negligence law (Tort) moved into the area of economic loss was due to the perceived injustice created by the doctrine of privity in contract Law which requires that only a party to a contract may sue or be sued upon on a contract. A party to a contract is one who has provided consideration.

Traditionally where a person has suffered economic loss, the redress was in Contract Law and justification for this was the doctrine of consideration. Where a person had entered a bargain promise and provided consideration; this would justify the Court protecting his expectation interest in a breach of contract action. Damages for such breach of contract would put the Plaintiff in position that he would have been in if the contract had been performed.

The tortious objective of damages however would be to put the Plaintiff in the position he would have been in if the tort had not been committed. This protects the status quo interest.

Therefore; many difficulties have been caused by the Law of Contract in the area of economic loss and it would be easier to resolve this economic loss problems by dealing with the doctrine of privity rather than by attempting to use negligence.

It is often useful to consider economic loss cases in a diagrammatic form :-



Many of the economic loss cases fall into this triangular pattern. The question is whether Tort Law is prepared to complete the triangle by granting C a negligence action against B ?

Therefore; tort of negligence can be said to have only recently ventured into the area of economic loss and the Law on this subject is still very much unclear as it is in its early stages of development.

CHAPTER 2

THE DEVELOPMENT OF THE LAW ON ECONOMIC LOSS

(A) The HEDLEY BYRNE (1) Case

A major change in the law on economic loss came with the House of Lords decision in HEDLEY BYRNE and CO LTD v HELLER and PARTNERS LTD (2)

Brief Facts

The Appellants were advertising agents and became doubtful about the financial position of one of their clients EASYPOWER LTD who had intimated an advertising contract worth £1,000,000.

The Bankers (of the Appellants) enquired from EASYPOWER'S Bankers (the Respondents) - (HELLER and PARTNERS) as to the financial position of EASYPOWER LTD who replied that 'it was a respectably constituted company, considered good for its ordinary business engagements'.

Advice was given 'without any responsibility clause' by the Respondents. Relying on it; the Appellants lost over £17,000 when EASYPOWER LTD went into liquidation.

Action brought by the Plaintiff/Appellant alleging that the advice had been given negligently by the Defendant/ Respondents.

Action however failed because the Defendants had issued the credit reference subject to a disclaimer of liability.

However the House of Lords held that the Defendants did owe a duty of care and would have been liable if not for the disclaimer. (Under the Unfair Contract Term Act 1977, such a disclaimer would now be subject to the test of reasonableness).

(B) Position Prior To HEDLEY BYRNE'S (3) Case

Importance of the HEDLEY BYRNE'S (4) case lies in the fact that the House of Lords stated that in appropriate circumstances a duty of care would arise to give careful advice and the failure to do so could give rise to liability for economic loss caused by negligent advice.

Apart from the disclaimer clause; the Appellants in HEDLEY BYRNE (5) had to overcome 2 barriers :-

(i) Firstly

The supposed bar on claims for negligent statements arising from DERRY v PEEK (6). It was this aspect that the House of Lords really concentrated upon.

The original position and difficulty caused relating to pecuniary loss resulting from careless statements was that a person suffering economic loss through relying on a fraudulent statement could sue in the tort of deceit and it was in DERRY v PEEK (7) that the House of Lords had HELD that

'to establish deceit, the Plaintiff must prove fraud, that the Defendant knew that his statement was untrue. Negligence was insufficient.'

In other words, the Plaintiff must prove that the Defendant did not honestly believe it to be true, it is not deceit merely because he has no reasonable grounds for believing it.

The burden was an onerous one indeed as seen from the facts of the case.

Brief Facts

A company was empowered by a private Act to run trams by animal power or if consent of the Board of Trade was obtained, by steam power.

The Directors believing such consent would be given as a matter of course by the Board of Trade as it had raised no objections when plans were laid before them, issued a prospectus stating that the Company had the power to run trams by steam power.

Relying on this prospectus, the Respondent took up shares from the Company. The Board of Trade eventually refused their consent and resulting later in the Company being wound up. House of Lords HELD that

'an action of deceit against the Directors failed as no want of honest belief on the part of any Director was established by the Respondent. However negligent a Defendant maybe, that is not ordinarily sufficient to make him liable for the tort of deceit.'

Again in CANDLER v CRANE, CHRISTMAS and CO (8) the Court of Appeal relying on DERRY v PEEK (9) above

'refused remedy to the Plaintiff who had invested funds in a Company on the basis of accounts negligently prepared by the Defendant.'

Without evidence of fraud, the Court of Appeal HELD that

'the economic loss resulting from such misstatement was irrecoverable

(ii) Secondly

The second barrier was the one against recovery of economic loss and this received little attention.

The result was that the decision above had the effect of allowing actions for economic loss caused by words but not economic loss caused by acts and this unfortunate distinction has been followed since by the Courts.

(C) Recovery of Economic Loss - Whether A Contractual or Tort Problem ?

In the past, the protection of economic interests under the Common Law traditionally fell exclusively under the Law of Contract. The Law of Contract, expressing a laissez faire ideology, assumes that entrepreneurs are able to negotiate appropriate contractual guarantees in conducting their business affairs freely between themselves.

However, such an assumption of contracting parties being able to look after their own best interests only stands up when we look at the members of the business community. Consumers should be treated very differently for they have neither the bargaining power nor the detailed legal knowledge necessary to protect themselves fully. Therefore the primacy of contract should only be asserted in the commercial context.

If the Parties have a contractual relationship, can there also be tortious liability ? Unfortunately; as the Law stands presently, no clear answer can be given to this question and very necessary to look at the actual relationship between the Parties.

There are however situations in which a Plaintiff may have a choice between contract and tort. For example :-

- (i) Where a person receives private medical treatment and is negligently injured, he may sue the doctor in negligence or for breach of contract.

Here the substance of the action will not differ. In negligence, the doctor must take reasonable care and in contract there is an implied term that the doctor will take reasonable care. It is unlikely that there was a guaranteed cure given by the doctor. Therefore no advantage to the Plaintiff to sue the doctor in contract to protect his expectation interest. Damages in either case will be same.

(ii) There is however no doubt that tortious duty can be owed between parties in a contractual relationship or in other words one incident may give rise to both contractual and tortious liability. For example doctor - patient. Again in early/mid 1970's the Courts were enthusiastically creating such duties and phenomenon of such both contractual and tortious liability were evidenced in the few cases below :-

(a) **ESSO PETROLEUM CO v MARDON** (10) between petrol company and tenant.

(b) **BATTY v METROPOLITAN REALISATION LTD** (11) Property developer and purchaser, where the property developer had negligently built on unsuitable land.

(c) **MIDLAND BANK TRUST CO. LTD. v HETT, STUBBS and KEMP** (12) between Solicitor and Client, where Solicitor had failed to register a land charge.

(iii) Again the recent trend has been to minimise the differences between tortious and contractual liabilities and some Academicians have written of Law of Obligations. LORD ROSKILL in **JUNIOR BOOKS LTD. v VEITACHI CO. LTD.** (13) took the view that

'.....today proper control lies not in asking whether the proper remedy should lie in contract or tort; not in somewhat capricious judicial determination whether a particular case falls on one side of the line or the other but in the first instance in establishing the relevant principles and then in deciding whether the particular case falls within or without those principles

(iv) However subsequently doubts were cast and mixed reaction received with statement of LORD SCARMAN in **TAI HING COTTON MILL v LIU CHONG BANK LTD** (1986) (14)

'Their Lordships do not believe that there is any advantage of the Law development in searching for a liability in tort where the parties are in a contractual relationship. This is particularly so in a commercial relationship.....
It is correct in principle and necessary to avoid confusion in the Law to adhere to the Contractual analysis; on principle because it is a relationship in which the Parties have; subject to a few exceptions, the right to determine their obligations to each other and for the avoidance of confusion because different consequences do follow according to whether liability arises in contract or tort, for example in the limitation of action

Comments

Rules on limitation governs the time period within which a Plaintiff must bring an action. In Contract, time period generally run from the time Contract is made and in tort commences from the time damage is suffered.

- (v) Although statement above was received with a mixed reaction; concurrent liability is still accepted but the Courts are now reluctant to impose a tortious duty when this would be wider than the contractual duty; particular in commercial cases. In REID v RUSH and TOMKINS GROUP plc (1989) (15)

Brief Facts

Plaintiff was employed by Defendants and sent abroad to work. He was injured in a motor accident by a hit and run driver. He sued his employers amongst other for breach of duty in tort for failure to take all reasonable steps to protect his economic welfare by not taking out appropriate insurance cover for him or advising him to take one himself.

Court of Appeal in referring to LORD SCARMAN'S dicta above HELD that " As there was no term in the contract, the Plaintiff was therefore precluded from suing for economic loss in tort

- (vi) However in contrast to the above; the House of Lords in 1987 was of the view that an architect could be liable in tort for economic loss suffered by his Client in KETTEMAN v HANSEL PROPERTIES (1987) (16)
- (viii) The following was a contract action case but contains an interesting link between contract and tort and if approach of majority were adopted on the point of express terms over-riding implied terms, this would reduce the whole of the Law of Negligence on employer's liability to a question of contract. This was in JOHNSTONE v BLOOMSBURRY HEALTH AUTHORITY (1991) (17).

Brief Facts

Plaintiff was a junior doctor employed by the Defendant Health Authority.

Essence of the claim was by his contract he was required to work 88 hours per week and this was in breach of the employer's duty to take reasonable care for his safety and well being.

HELD that although under contract of employment was required to work 88 hours per week, the Defendants had to exercise discretion in such a way so as not to injure the Plaintiff's health and could not require him to work so much overtime in a week that his health might reasonably foreseeably be damaged.

Comments

Majority of the Judges (two) took the view that an implied contractual term in a contract of employment will be subjected to any express terms in the contract. However it is unlikely for the Judiciary to adopt such an attitude of placing the whole of the Law on Negligence on employer's liability to a question of contract.

In this context it is perhaps of interest to have a brief look and highlight the various differences that may exist or seen to be existing between the Law of Contract and Tort. This will be dealt with next.