

## CANDLEWOOD NAVIGATION CORPORATION LTD. v. MITSUI OSK LINES LTD

**Judith Miller\***

### **Introduction**

It has long been recognised that for policy reasons there was a need to have some limit on the extent to which a negligent party could be held liable for the damage caused by him.<sup>1</sup> Thus in relation to damages for economic loss the courts have held<sup>2</sup> that such damages were only recoverable by a plaintiff against a negligent party where the economic loss was consequential upon damage to the plaintiff's property; in other words pure economic loss<sup>3</sup> was not recoverable.

However in the latter half of this century the courts have recognised at least two exceptions to the rule forbidding recovery of pure economic loss. The first departure was accomplished by the House of Lords in *Hedley Byrne and Co. Ltd v. Heller and Partners Ltd*<sup>4</sup> in which it was established that in certain circumstances a plaintiff could recover for pure economic loss caused by the negligent misstatement of a party. A second recognised departure occurred in *Junior Books Ltd v. Veitchi Co. Ltd*<sup>5</sup> where the House of Lords held that pure economic loss consequential on defects in work was recoverable.

Beyond those two areas a third and more contentious area of pure economic loss has arisen, namely that of recoverability for loss of profits by a third party whose only relationship to the property damaged by the negligent party was contractual. To what extent, if any, a party could recover for pure economic loss in these circumstances was the issue that confronted the Judicial Committee of the Privy Council in *Candlewood Navigation Corporation Ltd v. Mitsui Osk Lines Ltd and Another*<sup>6</sup> and the High Court some nine years earlier in *Caltex Oil (Australia) Pty Ltd v. The Dredge "Willemstad"*.<sup>7</sup> In order to appreciate the significance of the decision in *Candlewood* it is necessary to consider it in the light of the earlier High Court pronouncements in *Caltex* which seemed to have brought about a fundamental change in the law.

### **The Law Prior to Caltex**

For the purposes of this note it is unnecessary to provide an historical review of all the cases dealing with this issue. It is enough to cite the judgment of Scrutton L.J. in *Elliot Steam Tug Co. Ltd v. Shipping Controller*<sup>8</sup> where the pre-*Caltex* position was aptly described. Scrutton L.J. who relied very much on the judgment of Blackburn J. in *Cattle v. Stockton Waterworks Co.*<sup>9</sup> stated:

In case of a wrong done to a chattel the common law does not recognize a person whose only rights are a contractual right to have the use or services of the chattel for purposes

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1. Such a rule has been recognised expressly or impliedly in every negligence case; for instance, a recent pronouncement provided by Deane J. in *Jaensch v. Coffey* (1984) 58 A.L.J.R. 426 at 439.

2. *S.C.M. (United Kingdom) Ltd v. W.H. Whittal & Son Ltd* [1971] 1 Q.B. 337.  
*Spartan Steel & Alloys Ltd v. Martin & Co. Contractors Ltd* [1973] Q.B. 27.

3. 'Pure economic loss is financial damage not suffered as a consequence of physical damage to either the plaintiff's person or his property', per D. Partlett, 'Recovery of Economic Loss for Negligence in Australia', (1980-81) 9 *Syd. L.R.* 121.

4. [1964] A.C. 465.

5. [1983] 1 A.C. 520.

6. (1985) 60 A.L.R. 163.

7. (1977) 136 C.L.R. 529.

8. [1922] 1 K.B. 127.

9. (1875) L.R. 10 Q.B. 453.

of making profits or gains without possession of or property in the chattel. Such person cannot claim for injury done to his contractual right. . .<sup>10</sup>

### The Decision in *Caltex*

The rule stated by Scrutton L.J. was held to be no longer applicable in Australia by a majority of the High Court in *Caltex Oil (Australia) Pty Ltd v. The Dredge "Willemstad"*,<sup>11</sup> which held unanimously that on the facts before it a third party was able to recover for pure economic loss against a negligent party for damage to property even though that third party had only contractual rights with respect to that damaged property.

Before considering the individual judgments the facts so far as they are relevant to this note may be briefly stated. A pipeline connected an oil refinery on the southern shore of Botany Bay to an oil terminal on the northern shore. The pipeline and the oil refinery were owned by Australian Oil Refining Pty Ltd (A.O.R.) and the oil terminal was owned by Caltex which had no proprietary interest in the pipeline. The arrangement between A.O.R. and Caltex was that crude oil was supplied to Caltex by A.O.R. and the refined product was delivered through the pipeline to the terminal. Under the arrangement Caltex owned the refined oil in the pipeline but the risk of loss or damage to it rested with A.O.R. The dredge "Willemstad" fractured the pipeline.

Caltex claimed as damages the expense of shipping the refined oil from the refinery to the terminal while the pipeline was unable to be used.

The High Court held that Caltex was entitled to recover for this pure economic loss. While all the Justices agreed in the result they did so for different reasons.

Gibbs J., (as he then was), recognised the general rule as stated by Scrutton L.J. but stated that the instant case was an exception to that general rule because the defendant had knowledge or means of knowledge that the plaintiff individually and not merely as a member of an unascertained class, was likely to suffer economic loss as a consequence of his negligence.

Stephen J. refused to lay down a rule of 'universal application'. His Honour stressed the need for 'sufficient proximity between tortious act and compensable detriment'.<sup>12</sup> His Honour listed five features<sup>13</sup> which indicated that there was sufficient proximity in the present case.

Mason J. stated more generally that:

A defendant will then be liable for economic damage due to his negligent conduct when he can reasonably foresee that a specific individual, as distinct from a general class of persons, will suffer financial loss as a consequence of his conduct.<sup>14</sup>

Jacobs J. stated that a duty of care was owed by the owners of the dredge to Caltex. His Honour stated that a duty of care was owed:

. . . to those whose persons or property are in such physical propinquity to the place where an act or omission of the defendant has its physical effect that a physical effect on the person or property of the plaintiff is foreseeable as the result of the plaintiff's act or omission.<sup>15</sup>

Murphy J. simply stated that he did not ' . . . accept the contention that economic loss not connected with physical damage to the plaintiff's property is not recoverable'.<sup>16</sup> His Honour further stated he could ' . . . find no reason for limiting recovery'.<sup>17</sup>

10. *Supra* n.8 at 139.

11. *Supra* n.7.

12. *Ibid.* at 575.

13. *Ibid.* at 576-577.

14. *Ibid.* at 593.

15. *Ibid.* at 597.

16. *Ibid.* at 606.

17. *Ibid.*

Thus of all the members of the court only Gibbs J. recognised that the rule as stated by Scrutton L.J. was still applicable in Australia. The other four Justices found that the rule preventing recovery of pure economic loss in the stated situation was no longer the law in Australia. However, with the exception of Murphy J. all recognised that even if pure economic loss is recoverable by a third party whose only rights with respect to the damaged property are contractual there needed to be some control mechanism limiting this recoverability.

The Privy Council in *Candlewood* was thus confronted with the decision of the High Court that in limited circumstances pure economic loss was recoverable but with a lack of unanimity as to what was the extent and the method of determining the limitation to that general proposition.

#### **Candlewood: The Facts**

On 10 July 1981 two ships, the *Ibaraki Maru* and the *Mineral Transporter* collided off Port Kembla, N.S.W.

The *Mineral Transporter* was owned by Candlewood Navigation Corporation Ltd.

At the time of the accident the *Ibaraki Maru* was the subject of a bareboat charter from the owner, Mitsui Osk Lines Ltd, to Matsuoka Steamship Co. Ltd and also the subject of a time charter from Matsuoka Steamship Co. Ltd back to the owner. Under the terms of both charters the bareboat charterer, Matsuoka Steamship Co. Ltd, was liable to the owner to bear the costs of repairs resulting from the collision.

The owner and bareboat charterer of the *Ibaraki Maru* joined as plaintiffs and brought this action for damages for negligence against the owner of the *Mineral Transporter*.

#### **The Supreme Court of N.S.W.**

In the Admiralty Division of the Supreme Court of New South Wales, Yeldham J. held that both plaintiffs were entitled to succeed.<sup>18</sup>

The decision of his Honour so far as it is relevant to this note was that the negligence alleged against the *Mineral Transporter* had been proved, there being no contributory negligence on the part of *Ibaraki Maru* and that the first plaintiff, the owner, was entitled to recover for pure economic loss in the form of loss of profits which the owner would have made as time charterer from the use of the *Ibaraki Maru* during the period when it was laid up as a result of the collision and wasted time.

In coming to this conclusion, Yeldham J. relied chiefly on the decision in *Caltex* and to a lesser extent the House of Lords decision in *Junior Books Ltd v. Veitchi Co. Ltd*.<sup>19</sup>

His Honour stated that there were two main tests enunciated in *Caltex*, the first being that of Gibbs and Mason JJ. Yeldham J. interpreted their statements as establishing that it was not necessary in the circumstances of this case that the defendant know the precise identity of the time charterer; rather it was sufficient that he:

... knew or should have been aware that it was at least likely that the "Ibaraki Maru", like many other vessels, would be the subject of a time charter and hence the charterer would be likely to suffer economic loss if the ship was damaged.<sup>20</sup>

His Honour held in this case that that test had been satisfied, further stating that even if the specific identity of the time charterer was necessary, because of the distinctive markings of the owners on the ship, this would also have been satisfied.

Alternatively, Yeldham J. stated that if the appropriate test from *Caltex* be that of Stephen J., namely that there needed to be a sufficient degree of proximity between the negligence of the defendant and the pure economic loss in the form of loss of profits suffered by the plaintiff then this test was also satisfied. In this respect it was relevant that:

18. [1983] 2 N.S.W.L.R. 564.

19. *Supra* n.5.

20. *Supra* n.18 at 572-573.

... the defendant must necessarily have known that it was likely that a commercial vessel damaged by its negligence would be the subject of a time charter, and that such damage would be productive of consequential economic loss in the form of loss of profits the charterer would have made from the use of the vessel during the period when it was laid up as a result of the collision.<sup>21</sup>

In his Honour's view it was also relevant, in satisfying Stephen J.'s test, that the first plaintiff was both the owner and time charterer of the vessel, that under both charters it had a reversionary right to the possession of the vessel and that the *Ibaraki Maru* was identifiable as belonging to the first plaintiffs.

Thus Yeldham J. concluded, whatever the appropriate test, the first plaintiff, the owner, was entitled to recover for the pure economic loss it claimed.

It was from this finding, *inter alia*, that the defendants appealed to the Judicial Committee of the Privy Council.

### The Privy Council

The appeal from the Supreme Court of N.S.W. was allowed by the Privy Council.<sup>22</sup> The judgment of the Board was delivered by Lord Fraser of Tullybelton.

The Board initially stated the position in relation to time charters: specifically that they were not entitled to recover for pecuniary loss caused by damage by a third party to the chartered vessel.<sup>23</sup> While this proposition alone would have been sufficient to dispose of the time charterer's claim the Board declined to decide the case on a principle of such limited application.

Instead the Board stated that that limited proposition was merely just one example of the wider proposition stated by Scrutton L.J. in *Elliot Steam Tug Co. Ltd v. Shipping Controller*.<sup>24</sup>

The Board found it necessary to stress the policy reasons behind the limitation and in order to do this they cited in support the cases of *Cattle v. Stockton Waterworks Co.*<sup>25</sup> and *Simpson & Co. v. Thomson*.<sup>26</sup>

In *Cattle v. Stockton*, Blackburn J. citing Coleridge J. in *Lumley v. Gye*,<sup>27</sup> stressed the necessity for the courts to refrain from pursuing 'perfectly complete remedies for all wrongful acts'. Thus in a *Fletcher v. Rylands*<sup>28</sup> situation for instance, Blackburn J. concluded it would be inexpedient for the court to allow the workmen to recover from the defendant on the ground that they worked in the mine and its closure resulted in lost wages.

To stress the point, the Board cited Lord Penzance from *Simpson's case*<sup>29</sup> who also thought that to allow a claim such as the plaintiffs' would lead to a multiplicity of actions.

Thus the Board concluded there were policy reasons for disallowing the plaintiffs claim in these circumstances.

Counsel for Mitsui Osk Lines Ltd sought, however, to distinguish the present facts from those cases cited by the Board on the ground that the time charterer also had a reversionary interest in the ship as owner and that this was enough to give it title to sue.

The Board rejected this submission stating that Mitsui's claim was based on the loss it suffered as time charterer and not as owner. It suffered no loss as owner because the bareboat charterer had repaired the ship and was successful in its action with respect to that. The

21. *Ibid.* at 573.

22. *Supra* n.6.

23. The Board was relying on the principle as stated in *Scrutton on Charter Parties and Bills of Lading*, (1984), at 47.

24. *Supra* n.8.

25. *Supra* n.9.

26. (1877) 3 App. Cas. 279.

27. [1843-60] All E.R. Rep. 208 at 221.

28. (1866) L.R. 1 Ex. 265.

29. *Supra* n.25 at 289.

Board, however, declined to express an opinion as to whether the outcome would have been different had the situation been that the bareboat charterers had failed to repair the vessel.

Counsel also submitted that the present case was distinguishable on another ground, namely, that to apply that limitation to this case would be unreasonable because 'if the time charterers, in their capacity as owners, had themselves been operating the *Ibaraki Maru* they would clearly have been entitled to recover the whole cost of repairing the collision damage and also their whole loss of profits while the ship was non-operational.'<sup>30</sup>

The Board's answer to this submission was that to allow this argument would mean treating the bareboat charter and the time charter as though they were non-existent and this could not be done as they were valid and effective contracts.<sup>31</sup> Alternatively, the Board stated, the submission could well be answered on the ground that it would be contrary to the policy of the law. It would mean, for example, that where a boat was subject to a multitude of subcharters those subcharterers and indeed even passengers on the damaged vessel, would be entitled to succeed, even though they themselves had suffered no physical damage. Thus the Board concluded the first plaintiff's claim could not be admitted in this case as the ramifications of doing so would open up 'an exceedingly wide new range of liability'.<sup>32</sup>

Counsel's last submission was that the law has changed. It was submitted that the rule espoused in *Cattle's case* against admitting a claim such as the plaintiff's was no longer the law because of the decisions in *Hedley Byrne and Co. Ltd v. Heller and Partners Ltd*,<sup>33</sup> *Morrison Steamship Co. Ltd v. Greystoke Castle*,<sup>34</sup> *Caltex Oil (Australia) Pty Ltd v. The Dredge "Willemstad"*<sup>35</sup> and *Junior Books v. Veitchi*.<sup>36</sup> The present position of the law, it was claimed, was that it is enough that the loss is a direct result of a wrongful act and that it was foreseeable.

The Board recognised the progressive easing of the law with respect to the allowance of claims and in doing so cited Lord Wilberforce in *Anns v. Merton L.B.C.*<sup>37</sup> His Lordship in that case stated that as a result of the decisions in *Donoghue v. Stevenson*,<sup>38</sup> *Hedley Byrne*<sup>39</sup> and *Dorset Yacht Co. Ltd v. Home Office*<sup>40</sup> it was no longer necessary in order to establish a duty of care to bring the facts 'within those of previous situations in which a duty of care has been held to exist'.<sup>41</sup> The approach was two tiered; the first was to establish a sufficient relationship of proximity between the wrongdoer and the party who has suffered damage and the second, if there be that sufficient relationship, to examine any policy considerations which may negative that duty.

The Board re-iterated the warning issued by Lord Keith of Kinkel in *Peabody Donation Fund (Governors of) v. Sir Lindsay Parkinson Ltd*<sup>42</sup> not to take the passage as 'being of a definitive character'. In any event the Board did not consider either *Anns* or the cases cited by Lord Wilberforce as directly applicable to the present facts since none was specifically concerned with a third party whose only rights to the damaged property were contractual. The Board, once again citing Lord Wilberforce, stressed the policy considerations necessary in limiting a wrongdoer's liability.

30. *Supra* n.6 at 168-169.

31. *Ibid.* at 169.

32. *Ibid.*

33. *Supra* n.4.

34. [1947] A.C. 265.

35. *Supra* n.7.

36. *Supra* n.5.

37. [1978] A.C. 728 particularly at 751.

38. [1932] A.C. 562.

39. *Supra* n.4.

40. [1970] A.C. 1004.

41. *Supra* n.6 at 170.

42. [1984] 3 W.L.R. 953 at 960.

The Board then considered the High Court decision in *Caltex*, the only case which was truly on point.

The Board stated that it was unable to extract a single ratio from the case and in examining which, if any of the approaches to adopt, it clearly expressed dissatisfaction with the different tests espoused by the members of the High Court, with the exception of Jacobs J.

In relation to the reasons set forth by Gibbs and Mason JJ. the criticism was levelled at the uncertain dividing line between 'a plaintiff as an individual and a plaintiff as a member of an unascertained class'.<sup>43</sup> It was due to this lack of certainty that the Board considered their Honour's test an unsatisfactory control mechanism. The Board said that such dividing line could not possibly be based on the wrongdoer knowing the plaintiff by name, or the plaintiff being a single individual. Furthermore the Board found difficulty in justifying in principle a distinction between the wrongdoer who knows that a definite number of persons who are able to be identified are likely to be affected by his negligence as opposed to one who merely knows that several persons, the exact number being unknown, would be likely to be hurt. A more specific criticism by the Board was that the efficacy of the test seemed to rely on the ascertained class consisting of only a few individuals and yet the Board could see no justification in principle for denying relief simply on the ground that the number of possible plaintiffs was large while granting it in a case where they were few.

Lack of certainty was also the inadequacy the Board found in Stephen J's test. It did not appear 'to offer a satisfactory and reasonable guide'.<sup>44</sup>

The only satisfactory test in the Board's view was that of Jacobs J. which the Board found to be of no use to the first plaintiff.

The Board, because of its dissatisfaction with the tests espoused in *Caltex* thus decided the case before them free from any influence *Caltex* may have had on the decision. The Board did attempt to explain the decision in *Caltex* by saying that it may have been an exceptional case because of the factors listed by Gibbs and Stephen JJ.

Finally in considering the House of Lords decision in *Junior Books*, the Board, while recognising that the decision may have indeed extended the scope of liability, held it inapplicable to the present case because it did not extend liability in the direction that was contended by the plaintiffs.

The Board concluded that there was still a recognised need to have some control mechanism limiting the liability of a wrongdoer and also the need to provide some certainty to this limit. These requirements in the Board's view were fulfilled by the principle as expressed by Scrutton L.J. Thus the plaintiffs were excluded from succeeding in their claim.

#### **The effect of *Candlewood* on Australian Courts**

The decision of the Privy Council in *Candlewood*, rather than expressing new law, heralded a return to principles well established even before *Donoghue v. Stevenson*. In spite of the decision in *Candlewood* it is unlikely, however, that the High Court and indeed Australian courts will depart from the course set by *Caltex* particularly in view of a number of pronouncements since the decision in *Caltex*.

In *L. Shaddock & Associates Pty Ltd v. Parramatta City Council*<sup>45</sup> Mason J.,<sup>46</sup> with whom Stephen and Aicken JJ. agreed, recognised the extension to the law made by the High Court in *Caltex* with Murphy J.<sup>47</sup> citing *Caltex* with approval.

43. *Supra* n.6 at 173.

44. *Ibid.* at 174.

45. (1981) 55 A.L.J.R. 713.

46. *Ibid.* at 723.

47. *Ibid.* at 725.

In *Sutherland Shire Council v. Heyman*<sup>48</sup> both Mason<sup>49</sup> and Deane JJ.<sup>50</sup> cited *Caltex*. In particular Deane J. defended Stephen J's judgment in *Caltex* against criticism of it by Goff L.J. in *Leigh and Sullivan Ltd v. Aliakmon Shipping Co. Ltd.*<sup>51</sup>

More particularly the Full Court of the Federal Court (consisting of Blackburn, Franki and McGregor JJ.) held the *Caltex* principle to be directly relevant but declined to apply it on the facts in *Candy v. Millar*.<sup>52</sup>

### **Conclusion**

Policy considerations have a deep influence on the development of the common law. It is not surprising therefore that different appellate courts in different jurisdictions of the Commonwealth give greater or lesser weight to particular matters. Hence divergence will not be uncommon and in some cases will be unsuitable. The High Court in *Caltex* has adopted a more liberal approach than that which was later espoused by the Privy Council and there is no reason to suppose that this will be departed from in the foreseeable future.

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48. (1985) 59 A.L.J.R. 564.

49. *Ibid.* at 579.

50. *Ibid.* at 594.

51. [1985] 2 W.L.R. 289 at 326-327.

52. (1981) 38 A.L.R. 299.