ECONOMIC ANALYSIS AND SOME PROBLEMS IN THE LAW OF TORTS

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[*In recent years there has been a trend towards the use of economic analysis, notably in the United States, as a means of examining the common law rules and principles formulated by the courts. In this article, in the context of the tort of negligence, Mr Partlett suggests that economic analysis reveals the concern of the courts to maximize wealth at the cost of limiting altruistic principles. Use can be made of the tool of economic analysis to add a wider perspective to notions of compensatory justice for plaintiffs and rationalize the imposition of vicarious liability. He concludes that economic analysis may be a useful device for gaining insight into the common law decision making process and the development of the law.*]

INTRODUCTION

The lens of economic analysis has been used extensively in the United States to examine common law rules and doctrines. Less use has been made of this analysis elsewhere in the common law world. The law of torts, and its centrepiece, negligence, was an early subject and has remained a firm favourite. The reasons are readily apparent. Tort law has remained relatively untainted by legislation — it is still law made by the courts. Thus we are led to inquire whether economic analysis may aid an understanding of that great mystery — the common law and judicial decision-making. Moreover, the dynamism of negligence law provides a moving, alive subject. Especially since the Second World War negligence has come to be regarded as policy oriented, as openly instrumental or 'result oriented'.[1] The dominant thinking has regarded it as a compensation system for the victims of accidents mainly arising out of the use of motor vehicles and in the work place, and further, as a means of spreading those losses throughout society.

In this article my primary aim is to investigate the usefulness of economic analysis in the context of three different types of questions that arise in tort law, or indeed, in any common law area. First, I wish to see whether any light may be shed on the inner recesses of common law decision-making. The second and third questions are less ambitious. I wish to inquire in the second whether economic analysis can add useful perspectives to compensatory justice, a widely used but vaguely defined datum in judicial decision-making. In the third, I intend to canvass the efficacy of economic analysis as a rationalizing instrument in those areas of tort law that raise

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1 Kennedy D., 'Form and Substance in Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685, 1741.

private law problems in establishing consistency and certainty. In essence, I ask whether economic analysis may aid '[t]he judge [when] asked to add to the corpus of common law rules and standards by deciding how to fill a gap, resolve a contradiction, or harmonize an old doctrine with new perceptions'.[2] In other words, I inquire whether economic analysis may be useful in that most common of pursuits in legal analysis — finding patterns, interlinking reasoning, and establishing trends in bodies of rules and doctrines enunciated by the courts.

The separate characteristics of the three questions will become apparent but at the outset I should warn readers that the first question, discussed in Part II, raises the most complex issues. It examines that area of law labelled by Professor Dworkin as 'hard cases'.[3] The courts in these cases move beyond the comfortable confines of areas covered by precedent[4] to uncharted waters. Such cases place special strain on traditional concepts of the judicial function.[5] Parts III and IV deal respectively with questions two and three, which in comparison with the marginal or frontier problem of 'hard cases' discuss central, more mundane, but no less important issues of clarifying the implications of value judgments (Part III) and rationalizing bodies of common law rules and doctrines (Part IV). However, a condition precedent to tackling the core issues of this article, is an explanation of what is meant by economic analysis. Accordingly, Part I attempts to briefly outline the development and nature of the economic analysis of law; a movement which, without doubt, has revitalized tracts of moribund and sterile law.

PART I:
A BRIEF SKETCH OF ECONOMIC ANALYSIS

The law of torts constitutes a body of liability rules. These rules signal when a person is to compensate another by the payment of damages or be restrained from doing certain acts by way of injunction. Those rules, then, indicate whether or not losses generated by human conduct will be shifted from one party to another. The economic analysis of law views persons as rational utility maximizers. That is, faced with a choice, a person will opt for an alternative that tends to maximize his utility or welfare. Liability rules have a direct impact on such economic beings. They will respond to liability rules as rational maximizers and will order their affairs according to the incentives and disincentives so set up. In so doing resources will be allocated and reallocated.

[2] *Ibid.* 1760.
[3] Dworkin R., *Taking Rights Seriously* (1977) 81 ff.
[4] Kennedy, *op. cit.* 1760.
[5] *Ibid.* See also Regan D. H., 'Glosses on Dworkin: Rights, Principles, and Politics' (1978) 76 *Michigan Law Review* 1213.

The lawyer/economists in the law of torts have been concerned with the allocation of resources in the face of liability rules and, the extent to which those rules work a so-called efficient allocation of resources, or more particularly, an allocation that tends to maximize social wealth.

It is important to note that the economic analysis of the law has been primarily concerned with the operation of legal rules in the way described, rather than with the perspective that has so much occupied the lawyers in the law of torts, of whether the law of torts, and specifically negligence, provides an adequate medium of compensation for victims of accidents.[6] It is also implicit that the operation of legal rules is viewed prospectively — how will a particular rule affect the behaviour of persons? Rather than, with the more common legal perspective — how did the rule operate and how fair was it in the setting of a particular case?

The modern starting point of economic analysis of liability rules is Coase's article 'The Problem of Social Cost'; this is often now referred to as Coase's theorem.[7] Coase chose to analyse liability rules in torts in situations of conflicting uses of resources. The theorem holds that under certain conditions a liability rule will have no impact on the allocation of resources. The conclusion put in Coase's language is that the 'ultimate result (which maximizes the value of production) is independent of the legal position if the pricing system is assumed to work without cost'.[8]

The Coase theorem addressed the problem of 'externalities' in the theory of welfare economics.[9] The definition of externality is contentious but it may be said to exist when 'some activity of party A imposes a cost or confers a benefit on party B for which party A is not charged or compensated by the price system'.[10] If, for instance, a railway company does not pay the damage caused by the sparks emitted from its engines it creates a cost for which the price system does not charge the railway company; this is an externality. Traditionally it was thought that externalities caused inefficiencies by preventing the true pricing of activities. For example, without the railway company having to pay for the cost of fires the trains would be operated too frequently or at too low a cost; the resulting

[6] See Calabresi G., *The Costs of Accidents* (1970).

[7] Coase R. H., 'The Problem of Social Cost' (1960) 3 *Journal of Law and Economics* 1.

[8] *Ibid.* 8.

[9] That branch of economics that is concerned with '(1) defining the basic terms of microeconomic policy analysis ("an increase in allocative efficiency", "an improvement in the distribution of income", and "an increase in economic welfare"), (2) determining the circumstances in which policies with given positive microeconomic effects would increase allocative efficiency . . . (3) selecting the kinds of positive microeconomic data policy analysts should collect, given the cost and accuracy of the relevant information'. Markovits R. S., 'A Basic Structure for Microeconomic Policy Analysis in our Worse-Than-Second-Best World: A Proposal and Related Critique of the Chicago Approach to the Study of Law and Economics' (1975) *Wisconsin Law Review* 950, 952.

[10] Dewey D., *Microeconomics* (1975) 221.

allocation of resources would be inefficient.[11] Externalities represented a market failure[12] and the way to prevent inefficiency was either to create private property rights, impose a tax, or to manipulate liability rules to make those responsible for harmful externalities, such as fires, bear the cost. The gap between private and social cost would thus be closed by internalizing the externalities. Accordingly, the railway company has to organize its affairs taking into account the true social costs of its activities. This analysis had a considerable influence in tort law. In liability for defective products for instance, it was and still is strenuously argued that manufacturers should be strictly liable to consumers because to do so would internalize the externalities, that is, make the manufacturers bear the full social cost of their products,[13] which could then be reflected in the pricing of products.

Coase's purpose was to uncover a fallacy in this reasoning. He convincingly demonstrates that a liability rule will have no impact on the allocation of resources where we have a frictionless market, that is, a market with full information and zero transaction costs. Under these conditions externalities will not cause any inefficiencies. The theorem in this case is a tautology for in a free market there must, by definition, be an efficient or Pareto optimal allocation of resources. Nevertheless, the lesson which has been extracted holds; that the key to maximizing wealth is not via a liability rule to internalize the externalities but so far as possible, to approximate the free market by reducing transaction costs. The law, thus, should be designed to mimic the market.[14] In the free market, resources are allocated in such a way as to maximize 'value', that is, human satisfaction as measured by aggregate consumer willingness to pay for goods and services.

However, as Coase well recognizes, the real world is beset with transaction costs. It is the presence of high transaction costs that rules out bargaining between parties and presents a choice as to strategies for any system to adopt in the allocation of scarce resources. The Government, for instance, could decree that an activity should not be engaged in. Alternatively, the law may provide a means of allocation of resources through

[11] More accurately the term is 'Pareto inefficient'.

[12] Pigou A. C., *The Economics of Welfare* (4th ed., 1932). For recent discussion of these issues see Ng, *Welfare Economics: Introduction and Development of Basic Concepts* (1979) 166-86.

[13] Such an approach may be observed in the judgment of Baron Bramwell in *Vaughan v. Taff Vale Railway* (1860) 5 H. & N. 679, 157 E.R. 1351; for discussion see Atiyah P. S., 'Liability for Railway Nuisance in the English Common Law: A Historical Footnote' (1980) 23 *Journal of Law and Economics* 191. A valuable discussion utilizing an economic analysis is contained in Henderson J. A., 'Extending the Boundaries of Strict Products Liability: Implications of the Theory of the Second Best' (1980) 128 *University of Pennsylvania Law Review* 1036.

[14] Polinsky A. M., 'Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's *Economic Analysis of Law*' (1974) 87 *Harvard Law Review* 1655, 1665.

ascribing liability rules in negligence and nuisance. In torts we are particularly concerned with the role of liability rules in the allocation of resources.[15]

In any liability rule regulating conflicting resource use, there is a choice upon whom to place liability. In economic terms in order to obtain an efficient allocation of resources, liability is to be placed 'on that party who in the usual situation could be expected to avoid the costly interaction most cheaply'.[16] In cases of uncertainty in the identity of the cheapest cost avoider, transaction costs will be lowered by placing liability on the best briber; he who is the cheapest initiator of appropriate transactions.[17] This will encourage that person to enter into negotiations with others which would achieve the efficient result either through himself taking precautions or bribing the others to take precautions.[18] A rule fashioned in this way will optimize the allocation of resources. It will 'bring about the production of just that mix of goods, services, and environmental states for which the total of the maximum individual offering prices, given the extant distribution of wealth, would be highest'.[19] This is the wealth maximization principle — a convenient term for the theory developed by Posner and others.

Professor Richard Posner has sought to show that common law rules on the whole are fashioned so as to maximize social wealth through an efficient allocation of resources.[20] His thesis is controversial. Its defence as Posner admits lies in finding empirical backing.[21] Posner in an ambitous program with others continues to analyze rules of common law liability seeking to establish the validity of this thesis. The work remains partially completed but he asserts on the basis of work done that it is striking 'how wide a range of rules, outcomes, procedures, and institutions appear to support the efficiency hypothesis'.[22] In the light of incomplete and some equivocal data he submits 'that the theory deserves to be taken seriously, especially

[15] See Posner R. A., 'Utilitarianism, Economics, and Legal Theory' (1979) 8 *Journal of Legal Studies* 103.

[16] Demsetz H., 'When Does the Rule of Liability Matter?' (1972) 1 *Journal of Legal Studies* 13, 28.

[17] Calabresi G. and Melamed A. D., 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089.

[18] Ogus A. I. and Richardson G. M., 'Economics and the Environment: A Study of Private Nuisance' (1977) 36 *Cambridge Law Journal* 284, 293. It should be noted that the Coase theorem is not uncontroversial. Recently Veljanovski, 'The Coase Theorems and the Economic Theory of Markets and Law' Paper prepared for Ohlin Fellows Law and Economics Workshop, Law and Economics Center, University of Miami, November 1979 has attacked it, *inter alia*, on the grounds that bargaining indicates uncertainty, and that uncertainty produces inefficiency in Coase's model. *Sed quaere* if full information is assumed can there be uncertainty. See also Rizzo M. J., 'Law Amid Flux: The Economics of Negligence and Strict Liability in Tort' (1980) 9 *Journal of Legal Studies* 291, 298-318 who argues that the uncertainties of the negligence system create inefficiencies and that as a system strict liability is preferable.

[19] Michelman F. I., 'A Comment on Some Uses and Abuses of Economics in Law' (1979) 46 *University of Chicago Law Review* 307, 309.

[20] Posner R. A., 'A Theory of Negligence' (1972) 1 *Journal of Legal Studies* 29.

[21] Posner R. A., *Economic Analysis of Law* (2nd ed. 1977) 12-3.

[22] Posner R. A., 'Some Uses and Abuses of Economics in Law' (1979) 46 *University of Chicago Law Review* 281, 291.

in its more moderate form of a claim that efficiency has been the predominant, not sole, factor in shaping the common-law system'.[23]

In what follows the wealth maximization thesis is studied in the three different functional roles adumbrated in the introduction.

PART II: HARD CASES

Law students learn early that the law of negligence has changed fundamentally in the last fifty years and that the rate of change is accelerating. Ideas in negligence have little time to become settled. There is a general trend towards wider liability. Nervous shock is now more readily recoverable.[24] Trespassers are owed a modified duty of care.[25] Usually susceptible plaintiffs have a greater chance of recovery.[26] Liability for mere omissions may be found where the defendant falls within a particular class.[27] Proof of causation in negligence has been relaxed, especially with respect to industrial diseases.[28] The concept of reasonable foreseeability in the remoteness of damage issue encompasses an extremely broad range of damage.[29] In the assessment of damages in negligence for personal injuries, mechanical rules have been replaced by rules recognizing policies of compensation and loss spreading.[30] This trend is not limited to negligence. Other torts such as inducement to breach of contract,[31] intimidation,[32] passing off[33] and

[23] *Ibid.* 294.

[24] *Mt. Isa Mines Ltd v. Pusey* (1970) 125 C.L.R. 383; but *cf. McLoughlin v. O'Brian* [1981] 2 W.L.R. 1014.

[25] *British Railways Board v. Herrington* [1972] A.C. 877; *Southern Portland Cement Ltd v. Cooper* [1974] A.C. 623.

[26] *Mt. Isa Mines Ltd v. Pusey* (1970) 125 C.L.R. 383; *Haley v. London Electricity Board* [1965] A.C. 778 .

[27] *Hargrave v. Goldman* (1963) 110 C.L.R. 40; *Goldman v. Hargrave* [1967] 1 A.C. 645 (Privy Council); *Geyer v. Downs* (1977) 17 A.L.R. 408.

[28] *John Pfeiffer v. Canny* (unreported, High Court of Australia, 6 October 1981); *Tubemakers of Australia Ltd v. Fernandez* (1976) 10 A.L.R. 303; *McGhee v. NCB* [1972] 3 All E.R. 1008.

[29] *Overseas Tankship (U.K.) Ltd v. The Miller Steamship Co. Pty Ltd (The Wagon Mound (No. 2))* [1967] 1 A.C. 617; *Hughes v. Lord Advocate* [1963] A.C. 837; *Chapman v. Hearse* (1961) 106 C.L.R. 112; *The Council of the Shire of Wyong v. Shirt* (1980) 54 A.L.J.R. 283 (policy reasons may reduce the breadth of foreseeability); *Rowe v. McCartney* [1976] 2 N.S.W.L.R. 72.

[30] *Griffiths v. Kerkemeyer* (1977) 139 C.L.R. 161, 176 *per* Stephen J. A particularly good illustration is the treatment of collateral benefits: *National Insurance Co. of New Zealand Ltd v. Espagne* (1961) 105 C.L.R. 569, 571-4 *per* Dixon C.J., 597-8 Windeyer J., *Parry v. Cleaver* [1970] A.C. 1.

[31] *J.T. Stratford & Son Ltd v. Lindley* [1965] A.C. 269 (casting doubt on requirement of unlawfulness where the breach is procured indirectly); *Torquay Hotel Co. Ltd v. Cousins* [1969] 2 Ch. 106, 138 *per* Lord Denning M.R. (requirement of particular knowledge by defendant of contract diluted; hindrance in performance short of breach actionable).

[32] *Rookes v. Barnard* [1964] A.C. 1129.

[33] *Henderson v. Radio Corporation Pty Ltd* (1960) 60 S.R. (N.S.W.) 576 (passing-off extended to appropriation of exploitable commercial or business image); *J. Bollinger v. Costa Brava Wine Co.* (1960) 1 Ch. 262; *Erven Warnink Besloten Vennootschap v. J. Townsend & Sons (Hull) Ltd* [1979] 3 W.L.R. 68 (passing-off extended to representations that threaten the established goodwill of a product by deceptive use of description or name). See especially, 75 *per* Lord Diplock:

nuisance[34] have had imported to them rules allowing for wider recovery.

The seminal case in negligence of *Donoghue v. Stevenson*[35] took the law into uncharted waters. It established a general tort of negligence. The House of Lords decisions of *Home Office* v. *Dorset Yacht*,[36] and *Anns* v. *Merton London Borough*[37] built on *Donoghue v. Stevenson*; they asserted the applicability of the negligence formulation to new areas of liability. In *Dorset Yacht* and *Anns* the House of Lords was concerned to devise rules that would balance the interests of the other branches of government. In *Hedley Byrne* v. *Heller*,[38] the House of Lords found that negligence embraced negligent mis-statements causing economic loss. Negligence was made a potential guardian of economic interests. The nineteenth century *laissez-faire* and freedom of contract ideals epitomized in *Derry* v. *Peek*[39] were cast aside. The High Court of Australia in *Caltex Oil (Australia)* v. *The Dredge "Willemstad"*[40] moved negligence into a last outpost. Prior to the *Caltex* case, courts in the Anglo-American legal world had refused to find liability where a negligent act caused pure economic loss; that is, a loss which affected only economic interests without causing any physical damage. The High Court's decision shows the quality of those of the House of Lords: the law took a step beyond precedent, it embraced a new area of liability. The courts have made new law.[41]

It is intriguing to ask why the courts have undertaken this task of furthering the boundaries of negligence. A combination of reasons may be marshalled. First, the intellectual environment had changed markedly.[42] Nineteenth century legal theory was conceptual and formal.[43] The realist

> [T]he increasing recognition by Parliament of the need for more rigorous standards of commercial honesty is a factor which should not be overlooked by a judge confronted by the choice whether or not to extend by analogy to circumstances in which it has not previously been applied a principle which has been applied in previous cases where the circumstances although different had some features in common with those of the case which he has to decide. Where over a period of years there can be discerned a steady trend in legislation which reflects the view of successive Parliaments as to what the public interest demands in a particular field of law, development of the common law in that part of the same field which has been left to it ought to proceed upon a parallel rather than a diverging course. See also *Cadbury-Schweppes Pty Ltd v. Pub Squash Co.* [1981] 1 W.L.R. 193, 200.

[34] *Hargrave v. Goldman; Goldman v. Hargrave supra* n. 27; *Leakey v. National Trust* [1978] 3 All E.R. 234 (extension of nuisance liability for naturally occurring dangers).

[35] [1932] A.C. 562.

[36] [1970] A.C. 1004.

[37] [1978] A.C. 728.

[38] [1964] A.C. 465.

[39] (1889) 14 App. Cas. 337.

[40] (1976) 136 C.L.R. 529.

[41] Dworkin R., *Taking Rights Seriously* 82.

[42] White G. E., *Tort Law in America: An Intellectual History* (1980); Gilmore G., *The Ages of American Law* (1977); Friedman W. G., 'Social Insurance and the Principles of Tort Liability' (1949) 63 *Harvard Law Review* 241.

[43] For a description of this formalism, see Unger M. A., *Law in Modern Society* (1976) 205-6. Unger in similar fashion to Kennedy uses models of opposing rule types — 'formality' and 'equity'. In the case law of the nineteenth century formalism

school of jurisprudence was in the ascendant from the late 1920's and into the 1950's.[44] This led to an instrumental view of negligence — that it was a means to the end of compensating persons.[45] Secondly, society had been transformed. Notions of individual economic freedom gave way to the regulated welfare state.[46] Property rights and freedom of contract were no longer inviolable. These trends placed untold strain on institutions whose foundations were rooted in those earlier ideas. My interest is to examine, in this part, the process of judicial decision-making in accommodating the changes. For it is in this accommodation that the nature of judicial decision-making may be effectively viewed. In the hard cases already cited the courts have appealed to policy. Doctrine and rules have been insufficient, the courts must look, it is said, to further matters — to policy issues.[47] Such cases call attention to the limits of judicial decision-making and its uniqueness. Professor Dworkin powerfully focused attention on this question in his article 'Hard Cases'[48] which has been expanded upon in his book *Taking Rights Seriously*. My thesis is that economic analysis can aid an understanding of the nature, limits, and uniqueness of the common law decision-making process.

As Dworkin notes wealth maximization is not necessarily in conflict with his 'rights theory' of common law decision-making. If common law rules are not designed by judges to be efficient, but are efficient nevertheless, this does not disturb the theory that judges apply principles and not policy.[49] Further, even where courts refer to economic considerations, as does Judge Learned Hand in *U.S.* v. *Carroll Towing*,[50] they are merely concreting abstract rights in economic terms. Wealth maximization is, then, not one of Dworkin's abstract rights, but a means by which abstract rights may be balanced with other abstract rights.[51] It is but a means by which rights can be clarified.[52] In order to capture the essence of change in the law and hence the underlying values of it, theorists have turned to the characterization of ideal types. The law, then, may be seen in Maine's terms as an evolution from status to contract, although now we may witness

may be observed in *Allen v. Flood* (1898) A.C. 1 (H.L.); *Mogul Steamship Company Limited v. McGregor, Gow & Co.* (1889) 23 Q.B.D. 598, [1892] A.C. 25.

[44] White G. E., *op. cit.* 82, 112; Green L., 'The Thrust of Tort Law Part 1, the Influence of Environment' (1961) 64 *West Virginia Law Review* 1, 13.

[45] Atiyah P. S., *Accidents, Compensation and the Law* (2nd ed. 1975).

[46] Kamenka E. and Tay A., 'Social Traditions, legal traditions' in Kamenka E. and Tay A. (eds.) *Ideas and Ideologies, Law and Social Control* (1980) 3, 5.

[47] An oft repeated statement is that of Lord Denning M.R. in *Dorset Yacht Co. Ltd v. Home Office* [1969] 2 Q.B. 412, 426: 'It is, I think, at bottom a matter of public policy which we, as judges, must resolve. This talk of "duty" or "no duty" is simply a way of limiting the range of liability for negligence'.

[48] Dworkin R., 'Hard Cases' (1975) 88 *Harvard Law Review* 1057.

[49] Dworkin R., *Taking Rights Seriously* 96-7.

[50] (1947) 159 F. 2d 169.

[51] Dworkin R., *Taking Rights Seriously* 97-100.

[52] This view avoids the criticism of Kennedy, *op. cit.* 1762-4.

a reversal of that cycle.[53] It may be seen at any time as an admixture of private and public law.[54] It can be conceptualized in terms of a general legal societal type — *Gemeinschaft and Gesellschaft*:[55] to which, a third distinct paradigm, should be added, that of the bureaucratic-administrative society and 'legal' system.[56] A recently suggested approach is Professor Kennedy's. It relies upon the opposed ideals — individualism and altruism.[57] Kennedy puts them in this way:

> The essence of individualism is the making of a sharp distinction between one's interests and those of others, combined with the belief that a preference in conduct for one's own interests is legitimate, but that one should be willing to respect the rules that make it possible to coexist with others similarly self interested.[58]

The rhetoric of individualism has dominated legal discourse. Indeed, legal thought has generally been content to keep well within this mainstream, pointing occasionally to departures but rarely to competing paradigms. But in competition with it Kennedy posits the notion of altruism.

> The essence of altrusim is the belief that one ought *not* to indulge a sharp preference for one's own interest over those of others.[59]

It is submitted that this paradigm expresses well the tensions in the law of negligence. In hard cases the courts have replaced individualistic rules and doctrine with doctrine and rules having a greater capacity for altruistic application.

The real significance of *Donoghue* v. *Stevenson*, or the American equivalent *MacPherson* v. *Buick*,[60] was the reordering of adherence to precedent and of individualistic rules that tended to restrain the movement of the law, forcing it to take second place to altruistic morality. The increasing power of the altruistic perspective led to *Dorset Yacht, Anns,* and *Hedley Byrne* in the House of Lords representing the highwater mark of this century's altruistic drive in the law. No longer do judges recoil when told that basically their decisions are based on policy. No longer is the imperative of judicial law making in the prescription of clear rules rather than standards.[61]

[53] Jamieson N. J., 'Status to Contract — Refuted or Refined' (1980) 39 *Cambridge Law Journal* 333.

[54] *Cinnamond v. British Airports Authority* [1980] 1 W.L.R. 582 *per* Lord Denning M.R.

[55] A paradigm used powerfully by Professors Kamenka E. and Tay A., 'Social Traditions, Legal Traditions' *supra* n. 46, 6-26.

[56] *Ibid.* 19.

[57] Kennedy, *op. cit.* 1713-24; see also *supra* n. 43.

[58] *Ibid.* 1713.

[59] *Ibid.* 1717.

[60] (1916) 217 N.Y. 382.

[61] The House of Lords decision in *Anns v. Merton London Borough* [1978] A.C. 728 and particularly the dictum of Lord Wilberforce, 751-2, has been a dominant influence in this trend. See *Scott Group v. McFarlane* [1978] 1 N.Z.L.R. 553, 570-80 *per* Woodhouse J., 580-9 *per* Cooke J.; *The Council of the Shire of Wyong v. Shirt* (1980) 54 A.L.J.R. 283, 284 *per* Mason J.

The interplay of the basal values of individualism and altruism may be witnessed in two leading cases *Dorset Yacht* and *Caltex*. My interest is to investigate under economic analysis the form that these new rules assume.

In *Dorset Yacht* the Home Office was held to owe a duty of care in negligence to the owners of a yacht damaged by Borstal boys during an escape from an institution run by the Home Office. The law of negligence has generally refused to find duties to take affirmative actions. The law relating to rescue is a good example. Unless a person has through some affirmative act put another in a position of danger, the law will not impose a duty to rescue, no matter how obvious the danger, or cheap the measures, and available the means, to rescue.[62] In the same way, the courts generally refused to find a duty of care to control the activities of others acting voluntarily. But this highly individualistic principle could give way where a sufficient relationship of control — a special relationship — existed between the defendant and the third party whose voluntary acts had caused the damage. Thus parents may owe a duty of care in respect of the activities of their children.[63] This was not a sufficient test. Lord Diplock stipulated that the duty was owed only to those reasonably forseeable as having property situated in the vicinity of the place of detention in order to delimit the class of persons to whom a duty would be owed.[64]

The other constraint on the duty of care in *Dorset Yacht* was the potentiality of its trespassing on the preserves of the executive and legislative arms of government. The Borstal home was conducted by the Home Office under legislation, the Prisons Act 1952 (Eng.). Under the individualistic ideal[65] the judicial arm must forswear broad policy. The judicial method operates by rule-making and rule application which limits discretion.[66] The premise is that the courts lack the institutional competence to weigh the impact of policy choices.[67] In the *Anns* case the two constraints joined forces under the then prevailing rule that a duty of care could not arise from the mere exercise of a power under statute. A mere exercise of power may be seen as neither an affirmative action nor as constituting proper material from which a court could formulate a duty of care in

[62] See generally Ratcliffe J., *The Good Samaritan and the Law* (1966). Landes W. M. and Posner R. A., 'Salvors, Finders, Good Samaritans and other Rescuers: An Economic Study of Law and Altruism' (1978) 7 *Journal of Legal Studies* 83.

[63] *Smith v. Leurs* (1945) 70 C.L.R. 256; *Carmarthenshire C.C. v. Lewis* [1955] A.C. 549; *Geyer v. Downs* (1977) 17 A.L.R. 408.

[64] [1970] A.C. 1004, 1070-1. But compare Lord Reid, 1030 who limits potential liability to the same class but through a causation analysis.

[65] For similar observations see *Owen v. City of Independence* (1980) 445 U.S. 622; 48 U.S.L.W. 4396 *per* Brennan J.

[66] Kennedy, *op. cit.* 1752.

[67] Kennedy, *op. cit.* 1752; Atiyah P. S., *Accidents, Compensation and the Law* (2nd ed. 1977) 59-63; Jaffe L. L., 'Suits Against Governments and Officers: Damage Actions' (1963) 77 *Harvard Law Review* 209, 237. An outstanding recent reaffirmation by the House of Lords of the Courts' traditional attitude is *Duport Steels & Sirs* [1980] 1 W.L.R. 142 where their Lordships rejected the altruistic stance of the Court of Appeal. See especially in the Court of Appeal Lord Denning M.R. 153-4.

private law.[68] Lord Diplock in *Dorset Yacht* proceeded to attempt a description of the proper sphere of private law; that is, how far negligence liability should penetrate into a public law area.[69] No duty of care could in the ordinary case arise out of an exercise of discretion or policy within a statute.[70] On the other hand, a duty could be fashioned where the exercise of power was purely operational involving no element of discretion. This compromise between the individualistic and altruistic ideals was adopted by Lord Wilberforce in *Anns*.[71]

Does economic analysis aid in determining the borders of liability? The House of Lords was concerned to generate a liability rule with limits. The requirement of close foreseeability of the plaintiff reduces the costs imposed on potential defendants. It is clear that ordinary conceptions of foreseeability in negligence will be too broad.[72] The discretionary/operational dichotomy recognizes the superior position of the legislature or executive in making requisite cost-benefit calculations in respect of complex policy matters.[73] Only where discretionary power is exercised unreasonably in the sense of giving no proper consideration to the exercise of power will the other branches of government have forfeited that comparative advantage. A rational cost-benefit analysis cannot derive from a totally unreasonable exercise of power. And this is precisely when the law will recognize a duty of care to arise.

Whether the defendant in *Dorset Yacht* would have been found to have breached its duty of care is another question. It was a point not determined, as the case went to the House of Lords on a preliminary point of law. The issue before the House of Lords was whether, assuming the facts pleaded, the Home Office owed a duty of care to the plaintiff. Whether the Home Office would have been found in breach, in large measure, must depend on which party was in the better position to take precautions against the

[68] The rule denying a duty of care arose out of *East Suffolk Rivers Catchment Board v. Kent* [1941] A.C. 74.

[69] [1970] A.C. 1004, 1063.

[70] *Ibid.* 1068.

[71] [1978] A.C. 728, 754-7. The American Courts have wrestled with the same problems. See *Owen v. City of Independence* (1980) 445 U.S. 622 where the United States Supreme Court found that the defendant city was subject to a tort action under §1983 of the Civil Rights Act 1871 (U.S.). But *cf.* strong dissent by Powell J. See also Note, 'Police Liability for Negligent Failure to Prevent Crime' (1981) 94 *Harvard Law Review* 821.

[72] See the broad concept of reasonable forseeability adopted by the Australian High Court in *The Council of the Shire of Wyong v. Shirt* (1980) 54 A.L.J.R. 283, 285-6 *per* Mason J. This was the source of concern for the Australian High Court in *Caltex Oil (Australia) v. The Dredge "Willemstad"* (1976) 136 C.L.R. 529; the famous formulation is that of Cardozo C.J. in *Ultramares Corporation v. Touche* (1931) 255 N.Y. 170; 174 N.E. 441, 444: 'liability in an indeterminate amount, for an indeterminate time, to an indeterminate class'. For an economic analysis of foreseeability in negligence liability see Shavell S., 'An Analysis of Causation and the Scope of Liability in the Law of Torts' (1980) 9 *Journal of Legal Studies* 463, 490-2.

[73] *Cf.* Jaffe, L. L., 'Suits Against Governments and Officers: Damage Actions' *supra* n. 67.

occurrence.[74] It is possible that securing a Borstal Home may be more costly than anchoring a yacht safely, fitting alarms and taking other steps.

On the other hand, the anterior issue of the duty of care is a legal mechanism permitting the court to directly regulate the scope of inquiry to a narrow range of situations, where the costs of potential liability generated by the duty of care are less than the benefits in terms of both safety precautions by the Home Office and attention to policy. Even potential liability to a broadly foreseeable class of persons demands a response by a potential defendant, although the likelihood of finding a breach of duty is small, for the defendant will be unable to accurately calculate the calculus of risk in anticipation. Suppose, for instance, that the Borstal boys, had escaped from the island, emigrated to Australia and robbed a bank. Potential liability where the allegedly tortious actions result from broad discretionary powers is likely to cause miscalculations through overly cautious policy making. An open Borstal policy may be restrained where benefits of rehabilitation demand it. The House of Lords in *Rondel* v. *Worsley*[75] and *Saif Ali v. Sydney Mitchell*[76] recognized the disincentives created by the potential of liability. Therefore, where an advocate acts within the confines of a cause in court or where in a preliminary matter closely connected therewith, he enjoys immunity from suit.[77] Without immunity, potential liability would have a chilling effect on the maximization of two policies fundamental to the judicial system: the duties that advocates owe the court and the finalization of litigation.[78]

Altruism, although perfusing the House of Lords decision in *Dorset Yacht*, is constrained. The decision denies the assertion that negligence liability simply searches for the best loss bearer.[79]

The second hard case is the Australian High Court decision *Caltex Oil (Australia) v. The Dredge "Willemstad"*.[80] This case broke new ground in the common law. Previously, the exclusory rule had prohibited recovery of damages in negligence for purely economic loss.[81] The Law of negligence

[74] In *Ryan v. Fisher* (1976) 51 A.L.J.R. 125, 126 Stephen J. stated that the following considerations enter, 'consciously or unconsciously', into the determination of the issue of breach:

> [I]n determining whether a defendant's course of conduct involves any breach of that duty which he owes to others, there should be considered the risks inherent in that conduct, the seriousness of the consequences should any of those risks eventuate and the opportunities reasonably available to the defendant of reducing or wholly eliminating those risks.

[75] [1969] 1 A.C. 191.

[76] [1980] A.C. 198.

[77] *Cf.* test of McCarthy P. in *Rees v. Sinclair* [1974] 1 N.Z.L.R. 180 approved by Lords Wilberforce, Salmon, Diplock.

[78] See also the observations on the immunity of arbitrators in *Arenson v. Casson Beckman Rutley & Co.* [1977] A.C. 405.

[79] The yacht was insured. See Lord Denning M.R. in the Court of Appeal [1969] 2 Q.B. 412, 424.

[80] (1976) 136 C.L.R. 529.

[81] *Cattle v. Stockton Waterworks Co.* (1875) L.R. 10 Q.B. 453; *S.C.M. (United Kingdom) Ltd v. W.J. Whittall & Son* [1971] 1 Q.B. 337.

has come late to protect economic loss; it is an unnatural guardian, the form of the action being moulded by concern for protection of physical interests.[82] The individualism of the exclusory rule is apparent. Economic interests should be protected by contract; that if persons of free will[83] deem an interest to be worth protecting they will bargain for its protection.[84] Negligence as part of tort law imposed a non-consensual obligation; the affinity here was with altruism: negligent conduct if it results in injury to a valuable interest demands compensation.

The seams of the exclusory rule had burst in several cases.[85] But no major rupture had occurred until the *Caltex* case. The economic basis of the exclusory rule may be viewed as follows. Activities create costs. Economics teaches us that the optimal allocation of resources will result where the costs of any activity are accurately reflected in the pricing system. For instance, the optimal amount of motor vehicle usage would occur if drivers were faced with the full cost of the activity. If costs are not so internalized they are borne generally by society — a social cost. The creation of private property rights serves this economic function by forcing owners to face the costs of the usage of the resource. For example, if a stream is common property the costs created by pollution become social costs and the polluters bear few of the costs of their activities. If the stream is privately owned, the owner will charge for the right to pollute.[86] Where the creation of property rights is not practicable, liability rules may serve the same function. The imposition of a liability rule will depend, then, on the extent to which that activity creates costs not captured in the pricing system and, if the costs are not captured, whether the shifting of liability via the rule will create greater costs than are avoided. This, of course, assumes a world of transaction costs. In the world of no transaction costs the Coase theorem holds that the presence of a liability rule will not affect the efficient allocation of resources.

Pure economic losses may be internalized more cheaply than physical injury in the pricing system. Broadly speaking economic losses are more easily predicted than physical losses; the risk of their occurrence is usually

[82] Bohlen F. H., 'Misrepresentation as Deceit, Negligence, or Warranty' (1929) 42 *Harvard Law Review* 733, 734, 741. See also *L. Shaddock & Associates Pty Ltd v. Parramatta City Council* [1979] 1 N.S.W.L.R. 566, 593-607 *per* Mahoney J.A.

[83] Kennedy, *op. cit.* 1728-31.

[84] Exemplifying this position are the late nineteenth century tort cases: *Allen v.* Flood [1898] A.C. 1; *Mogul S.S. Co. Ltd v. McGregor Gow & Co.* [1892] A.C. 25; *Quinn v. Leathem* [1901] A.C. 495; *Derry v. Peek* (1889) 14 App. Cas. 337.

[85] *Rivtow Marine Ltd v. Washington Iron Works* [1974] S.C.R. 1189; *Spartan Steel & Alloys Ltd v. Martin & Co. (Contractors) Ltd* [1973] 1 Q.B. 27.

[86] Demsetz H., 'Wealth Distribution and the Ownership of Rights' (1972) 1 *Journal of Legal Studies* 223, 229. Alchian A. and Allen W., *Exchange and Production: Competition, Coordination and Control* (2nd ed., 1977) 114-5. For application of the economic paradigm, Calabresi G. and Melamed A. D., 'Property Rules, Liability Rules and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089; *cf.* Ogus A. I. and Richardson G. M., 'Economics and the Environment: A Study of Private Nuisance' (1977) 36 *Cambridge Law Journal* 284.

accounted for. This is especially so when the parties bargain with one another. In the usual case, the risk of economic loss through negligence would be anticipated in the price. Thus the contract will usually determine the rights and obligations of the parties. The costs of negotiating the allocation of the risk of losses are therefore low. Tort law intrudes where this pattern is unrealistic. An instance is the contract of employment; here the parties are generally of unequal bargaining power. This situation should be contrasted with that obtaining where the parties are not in a contractual relationship. Here the transaction costs may be insuperable and a liability rule may be called for, but the question remains of what form any rule should take. In economic terms this will depend on who is the cheapest cost avoider and on whether the costs of shifting liability outweigh the benefits in avoidance of the damage.

On both bases the efficiency gain in shifting economic loss is more equivocal than in physical loss. There are two reasons: first, in most economic loss situations, it is probable that the plaintiff may be in the better position to avoid the costly transaction; secondly, the costs of liability for pure economic loss may radiate to an extremely wide class of plaintiffs. To illustrate. If electricity is negligently cut off from an industrial plant it is foreseeable that property damage and pure economic loss may result. Liability of the negligent actor will clearly lie for physical damage limited by the rules of remoteness of damage depending on reasonable foreseeability.[87] Pure economic loss such as profits on lost production and loss of goodwill in delivering goods on time would be unrecoverable under the exclusory rule.[88] Who would be in the better position to avoid the economic losses? The answer in the usual case is clear — the plant owner. Only he has the knowledge of the production schedule, the capacity to put in an emergency power plant or organize contracts so as to cost or shift the risks of power failure. Furthermore, the potential costs of shifting loss would be great. The potential magnitude of liability may lead to a radical underproduction of activities such as digging trenches near industrial sites.[89] Those costs, in other words, may outweigh any gains from avoiding such accidents.

Clearly some situations will exist where the negligent actor was in the better position to avoid the costly transaction and where shifting of the loss, or some part of it, is not outweighed by the costs produced. The situation in *Caltex* fell within this class. The defendant Dredge fractured an oil pipeline belonging to a company A.O.R. The pipeline ran along the bottom of a bay and connected Caltex's terminal and refinery. At the time the

[87] *Overseas Tankship (U.K.) Ltd v. Morts Dock & Engineering* [1961] A.C. 388.
[88] *S.C.M. v. W.J. Whittall* [1971] 1 Q.B. 337, 342; *Spartan Steel v. Martin* [1973] 1 Q.B. 27, 36-8.
[89] *Cf.* Bishop W., 'Negligent Misrepresentation Through Economists' Eyes' (1980) 96 *Law Quarterly Review* 360, 362, 366.

Dredge was following a track plotter chart prepared by the second defendant Decca Survey Australia Ltd. The chart contained a negligent error which was a material cause of the accident.[90] The officers of the Dredge were negligent in following the chart.[91] Caltex claimed damages for economic loss agreed at $95,000. These losses were caused by the necessity of transporting oil by ship or road, and diverting low sulpur oil to another terminal. No amount was claimed for lost production of the refinery. The High Court found the defendants liable. The judgments generally stress the arbitrariness of the exclusory rule: it was purely adventitious that Caltex did not own the pipeline, in which case it could have recovered under ordinary principles. But further, Gibbs, Stephen and Mason JJ. highlight the problems of indeterminate liability — the burdens of unbounded liability.[92] The test adopted by the majority of the High Court depends upon the knowledge of the defendant. Gibbs J. put it this way:

> The fact that the loss was foreseeable is not enough to make it recoverable. However, there are exceptional cases in which the defendant has knowledge or means of knowlegde that the plaintiff individually, and not merely as a member of an unascertained class, will be likely to suffer economic loss as a consequence of this negligence, and owes the plaintiff a duty to take care not to cause him such damage by his negligent act.[93]

Stephen J. found that the question was one of whether there existed sufficient proximity between the plaintiff and the defendant. Factors to be considered in this issue were:

(i) the defendant's knowledge that the property damaged . . . was a kind inherently likely, when damaged, to be productive of consequential economic loss to those who rely directly upon its use;

(ii) the defendant's knowledge or means of knowledge, of the pipeline and its use;

(iii) the infliction of damage by the defendant to the property of the third party .. . in breach of duty of care owed to that third party;

(iv) the nature of detriment suffered by the plaintiff;

(v) the nature of the damages claimed reflecting loss of use, representing not some loss of profits arising because collateral commercial arrangements are adversely affected, but the quite direct consequence of the detriment suffered.[94]

In economic terms the actual knowledge requirement is a highly important element in demonstrating that the defendants were the cheapest avoiders of the accident. Knowledge of the plaintiff and the likelihood of damage implies that the defendant will have comprehensive information about the

[90] *Ibid.* 543 *per* Gibbs J.
[91] *Ibid.*
[92] *Ibid.* 554-5 *per* Gibbs J.; 568 *per* Stephen J.; 591-2 *per* Mason J.
[93] *Ibid.* 555, see also Mason J. 593.
[94] *Ibid.* 576-7 *per* Stephen J.

costs of the activity. Moreover, Stephen J.'s limitation on the type of damages is similarly justifiable. Losses of a collateral kind, such as loss of profits on supply contracts are usually remote from the negligent act: the defendants could not anticipate this kind of loss, and the plaintiffs would be in a better position to avoid such costs, for instance, through terms negotiated in relevant supply contracts. The limited range of damages also reduces the costs of shifting the loss to the plaintiff. Liability is not indeterminate. A defendant, then, must bear some, but by no means all, of the economic loss caused by his negligent act. To do so will act as an incentive for actors to adopt cost justified steps to avoid such accidents.[95]

It is noteworthy that the altruistic perspective of loss spreading was dismissed by Stephen J.:

> The task of the courts remains that of loss fixing rather than loss spreading and if this is to be altered it is, in my view, a matter for direct legislative action rather than for the courts.[96]

As in *Dorset Yacht*, the rule cannot be explained as a search for altruism. Seen in context, the *Caltex* case is within that line of judicial authority increasing the province of negligence liability. But the individualistic ideals in judicial decision-making adhere. Stephen J. saw liability depending upon concepts of morality.[97] The shifting sands of morality will yield different mixes of individualism and altruism at any time. In *Dorset Yacht* and *Caltex* the courts took novel steps. The House of Lords and the High Court, talk of policy. However, they were not unbridled steps in law reform. The policy perspectives were constrained, in that they were aimed at defining a rule possessing a blend of individualism and altruism. The courts did not adopt the open-ended policy concerns of the legislature or executive; the approach was not wholly result oriented. The blend adopted in *Dorset Yacht* and *Caltex* (and in other cases) can be seen in terms of an economic paradigm.

Economic analysis shows, in the cases discussed, that courts in hard cases develop rules which seem to take account of resource allocation concerns. It is a particular quality of judicial decision-making that these concerns loom large. The increase in the scope of liability in negligence, represented by such cases as *Dorset Yacht* and *Caltex*, is marked by a willingness of the courts to examine with greater particularity the ramifications of liability rules. The rules in *Dorset Yacht* and *Caltex* are fine-

[95] But *cf.* Cane P., 'Economic Loss and the Tort of Negligence' (1980) 12 *M.U.L.R.* 408 who argues that no distinction may be drawn — that loss of profits should be recoverable. It follows from my argument that loss of profits may be recoverable where the defendant could have anticipated this type of loss from, for instance the type of process or activity with which he is interfering. In other words, loss of profits are not excluded. But as a factor in determining the sufficiency of proximity between the negligence and the resulting detriment the distinction holds, for in *most* circumstances the defendant will not be able to anticipate this loss.

[96] *Ibid.* 580-1 *per* Stephen J.

[97] *Ibid.* 574.

tuned in that, those rules and principles there formulated assume the task of closely weighing factors going to economic rationality. In contrast, the previous law relied upon more roughly hewn rules; the rules placed less faith on the ability of courts to make close policy appraisals and greater emphasis on the conclusive nature of the law as instilling certainty.[98]

The movement of negligence accompanies a willingness by the courts to formulate rules investing a greater degree of judgment in courts to optimize the allocation of resources in individual cases. The trend is away from broad rules that, while certain, are usually over-inclusive.[99] The former rules in both *Dorset Yacht*, that denied a duty of care in the exercise of a mere power, and *Caltex*, that denied a duty of care for pure economic loss, clearly would in some situations lead to a misallocation of resources. I do not contend that this is the exclusive way of viewing hard cases in negligence but I do contend it is an enlightening perspective. Nor does economic analysis explain why the courts should have moved in the direction of replacing broad rules with finely tuned rules. Here we must look to the fundamental clash or tension between individualism and altruism. Sympathy for altruistic goals explains the movement; economic analysis shows that even altruistic principles within judicial decision-making are limited by resource allocation concerns — by a concern to maximize wealth.

PART III:
COMPENSATORY JUSTICE AND ECONOMIC ANALYSIS

The altruistic drive in modern tort law is championed by compensatory justice. I term it compensatory justice because the law of torts in this guise has been particularly concerned with compensating persons for damage or injury caused by the wrongs of others. It is then a more particular description of corrective justice: rendering to a person redress for the violation of his rights by another. The aim of this section is to examine, within the confines of one case, whether economic analysis can aid in viewing the role of compensatory justice. This part does not attempt, as did Part I, an internal analysis of judicial decision-making. Rather, it attempts a more usual application of economic analysis; it proposes an external analysis, an economic impact study as a means of clarifying choice.[1]

The House of Lords in the recent decision of *Allen* v. *Gulf Oil Refining Ltd*[2] discussed the application of the defence of statutory immunity in

[98] *Scott Group v. McFarlane* [1978] 1 N.Z.L.R. 553, 580-5 *per* Cooke J. See also, Carroll D. W., 'Two Games that Illustrate Some Problems Concerning Economic Analysis of Legal Problems' (1980) 53 *Southern California Law Review* 1371, 1411-2; Epstein R. A., 'Nuisance Law: Corrective Justice and Its Utilitarian Constraints' (1979) 8 *Journal of Legal Studies* 49, 76.

[99] Another example is the House of Lords decision in *Saif Ali v. Sydney Mitchell & Co.* [1980] A.C. 198. The broad and certain approach is espoused in the dissenting speech of Lord Keith of Kinkel 234.

[1] Hirsch W. Z., *Law and Economics: An Introductory Analysis* (1979).

[2] [1981] 2 W.L.R. 188.

nuisance. The facts were that the defendant oil company under a private Act, The Gulf Oil Refining Act 1965 (Eng.), had been authorized to construct certain works. The plaintiff was one of several villagers living near the defendant's refinery who brought actions in nuisance based on noxious odours, vibrations and offensive noise levels, allegedly caused by the refinery. A preliminary point of law was taken by the defendant that the defence of statutory authority applied. At first instance this point was sustained. The plaintiff appealed to the Court of Appeal which reversed the finding of first instance,[3] only to be reversed in turn by the House of Lords.

The particular observations pertinent here were uttered in the Court of Appeal by that boldest of bold spirits the Master of the Rolls, Lord Denning.

> I have considered this case on the construction of the statute according to the principles laid down in the railway cases of the 19th century. But I venture to suggest that modern statutes should be construed on a new principle. Wherever private undertakers seek statutory authority to construct and operate an installation which may cause damage to people living in the neighbourhood, it should not be assumed that Parliament intended that damage should be done to innocent people without redress. Just as in principle property should not be taken compulsorily except on proper compensation being paid for it so, also, in principle property should not be damaged compulsorily except on proper compensation being made for the damage done. No matter whether the undertakers use due diligence or not, they ought not to be allowed — for their own profit — to damage innocent people or property without paying compensation. They ought to provide for it as part of the legitimate expenses of their operation, either as initial capital cost or the subsequent revenue. *Vaughan* v. *Taff Vale Railway Co.*, 5 H. & N. 679, exposes the injustice of the Victorian rule. A landowner had a wood of eight acres before the railway came. The railway company got a private Bill and built the railway. Sparks from an engine burnt down the wood. He was denied any compensation at all. To avoid such injustice, I would suggest that, in the absence of any provision in the statute for compensation, the proper construction of a modern statute should be that any person living in the neighbourhood retains his action at common law; and that it is no defence for the promoters to plead the statute. Statutory authority may enable the promoters to make the installation and operate it but it does not excuse them from paying compensation for injury done to those living in the neighbourhood.[4]

I wish to examine whether economic analysis can cast light on this compensatory justice perspective. The wealth maximization principle certainly may support Lord Denning in his initial presumption that liability should be placed on the cheapest cost avoider. The oil company would ordinarily be a cheaper cost avoider than the villagers. The latter would have great and probably insuperable transaction costs imposed in bargaining for the right to be free from pollution or in relocating. But the presence of the statute is vital in changing assumptions about the positions of the parties under an economic analysis.

The oil company can be thought of as having bargained for its legislation.[5] The parties will have ordered their relationship on the basis of existing

[3] [1979] 3 W.L.R. 523.
[4] *Ibid.* 532.
[5] Posner R. A., *Economic Analysis of Law* (2nd ed. 1977).

law,[6] which established the guidelines for bargaining. In effect the law says if a private, or public undertaker for that matter, wishes to establish an enterprise and be free of possible private law actions the legislative charter must contain certain elements. The nature of those necessary elements divided the Court of Appeal and the House of Lords. In the Court of Appeal, Lord Denning found that the defence did not apply because, while the legislation permitted the construction of the refinery, it did not expressly permit its operation or use.[7] Cumming-Bruce L.J. disagreed with this[8] and found that the defence failed because the statute merely granted a power to acquire land on which to construct an unspecified refinery. There was nothing which gave authority to build or use the refinery which was the subject of the action.[9] The majority of their Lordships found that the Court of Appeal had put too fine a point on it. The nuisance arose from the changed environment of the countryside which was an inevitable result of the authorized refinery.[10]

If a private undertaker had bargained in terms to satisfy the pre-existing law, not requiring an express abrogation of individual rights,[11] and thus gained an apparently good defence, the new rule proposed by Lord Denning would defeat established contractual rights.[12] Not only would the new rule upset pre-existing rights, clearly an important interest,[13] but it would be costly in economic terms. It would create a disincentive for parties to commit resources on faith of such bargains.

The certainty of a rule of law will often lower transaction costs.[14] It may be argued that Lord Denning's rule has that attribute but the analysis needs to be pressed further; it should be recognized that government and a private undertaker may, notwithstanding Lord Denning's proposed rule, bargain to negate private rights of action through appropriate legislation. An abrogation in sufficiently bold terms will be bought at a higher political price; it will be more obvious that rights are being abrogated; pressure will be greater for compensation and will serve the interest of justice in that sense. However, the new rule would impose increased transaction costs on

[6] A factor emphasized by Lord Keith in his dissenting speech, *supra* n. 99, 235-6. Firm reliance is placed upon previous case law. The rules of precedent in the common law increase efficiency by 'firming up' rules, see Landes W. M. and Posner R. A., 'Legal Precedent: A Theoretical and Empirical Analysis' (1976) 19 *Journal of Law and Economics* 249.

[7] *Ibid.* 531.

[8] *Ibid.* 538.

[9] *Ibid.* 541.

[10] [1981] 2 W.L.R. 188, 193 *per* Lord Wilberforce.

[11] *Ibid.* 202 *per* Lord Roskill.

[12] *Cf. Rose v. Plenty* [1976] 1 W.L.R. 141, 145 *per* Lawton L.J. who emphasizes the importance of this certainty.

[13] The contractual basis of, at least, private Acts was well recognized in the nineteenth century: *Atkinson v. The Newcastle and Gateshead Waterworks Co.* [1877] 2 Ex. D. 441, 445 *per* Lord Cairns and *Davis & Sons v. Taff Vale Railway Co.* [1895] A.C. 542, 559 *per* Lord Macnaghten.

[14] *Cf.* Carroll D. W., 'Two Games that Illustrate Some Problems Concerning Economic Analysis of Legal Problems' *supra* n. 98.

the bargaining parties, as the new rule precludes in the established way the abrogation of private rights.[15] The established rule lowers the cost of information between the parties. With its replacement, new strategies would have to be devised and those strategies receive the stamp of court approval.[16]

A thorough analysis will enter into a cost-benefit analysis. The new rule with its increased transaction costs may produce an under-investment in enterprises in the public good. Even if no mis-allocation results, the rule may increase the costs of allocating resources to their most efficient use resulting in a waste of social resources.

The statutory immunity defence applied by the House of Lords allows the legislature or executive to signal when it regards itself as being in the superior position to weigh the costs and benefits of any enterprise. Accordingly, it is entirely consistent with the law developed in *Dorset Yacht* and in *Anns*, and discussed in Part II. For better or for worse, the Courts regard such decisions as being within the province of other arms of government. Lord Wilberforce in *Allen* v. *Gulf Oil* stresses that the relevant Act found the refinery to be 'essential'.[17] Lord Roskill was concerned that without the defence an injunction may be granted, making the operation of a refinery impossible and thus defeating the purpose of the Act.[18]

Accordingly, a wider consideration of justice is raised. May it be that Lord Denning's new test would increase the costs of goods to the public? In the long term that may act as a regressive tax, its impact being felt disproportionately by the poor.[19] A consideration of the ramifications of an increase in the cost of oil should give pause to a narrow application of Lord Denning's justice notions.

Yet, we should pause. I have observed that the statutory immunity defence may be viewed as a signal by the legislature that it is in a superior position to weigh the costs and benefits. Now the Courts in accepting this view may be rather naive and, indeed, ride roughshod over sacred notions of compensatory justice. Distinguished economists and others from the time of Adam Smith,[20] to Karl Marx and to the Chicago School in George Stigler[21] have argued that regulatory legislation, of which this is a type, may be seen as serving sectional rather than general or public interests. The central thesis of Stigler is 'that, as a rule, regulation is acquired by the

[15] Goetz C. J. and Scott R. E., 'Enforcing Promises: An Examination of the Basis of Contract' (1980) 89 *Yale Law Journal* 1261.

[16] For discussion of implication of transaction costs see Leff A. A., 'Injury, Ignorance and Spite — The Dynamics of Coercive Collection' (1970) 80 *Yale Law Journal* 1.

[17] [1981] 2 W.L.R. 188, 191.

[18] *Ibid.* 202.

[19] For economic analysis see Alchian A. and Allen W., *Exchange and Production: Competition, Co-ordination and Control* (2nd ed. 1977) 279-80.

[20] Adam Smith, *The Wealth of Nations* (Everyman's Library) i, 231-2.

[21] Stigler G., 'The Theory of Economic Regulation' (1971) 2 *The Bell Journal of Economics and Management Science* 3.

industry and is designed and operated primarily for its benefit'.[22] If the oil company has 'captured' the government, the costs of Lord Denning's interference on the basis of compensatory justice will be much less.

Economic analysis provides no magic solution but it lays open the available choices. It forces an exposure of assumptions and a clarification of implications — a notorious weakness of traditional legal analysis. We may agree that compensatory justice should provide a remedy for the plaintiff in *Allen* v. *Gulf Oil* but an analysis from the point of view of wealth maximization alerts us to broader considerations.

PART IV: VICARIOUS LIABILITY AND ECONOMIC ANALYSIS

There are few more apparently maze-like areas of tort law than vicarious liability. The law is contradictory and complex.

A 'master' is vicariously liable for the torts or acts of his servant performed in the course of employment.[23] Thus, to attach liability to an employer, the plaintiff must prove that the wrongdoer was a 'servant' of the employer and that the tort was perpetrated in the course of employment. Vicarious liability in the instrumentalist vogue has been seen as a legal mechanism by which the law spreads losses, by shifting the loss from the servant, a man of straw, to the employer, who can spread the losses through the pricing of his products and services.[24]

The Courts have foregone nice legal distinctions in favour of broader policy. Scarman L.J. in *Rose* v. *Plenty* stated:

> [T]he employer is made vicariously liable for the tort of his employee not because [of the legal categorization of the employee or his authority] but because it is a case in which the employer, having put matters into motion, should be liable if the motion that he has originated leads to damage to another.[25]

It is with this open judicial mind that we can usefully examine two perennial problem areas in vicarious liability.

The first addresses the problem of whom of two employers[26] or of an employer and an independent contractor will bear the cost of accidents.

The second is raised by the many and conflicting cases, on what constitutes an act in the course of employment.

[22] *Ibid.*

[23] For exposition of theories of vicarious liability in Australian law see *Darling Island Stevedoring & Lighterage Co. Ltd v. Long* (1957) 97 C.L.R. 36.

[24] *Cassidy v. Ministry of Health* [1951] 2 K.B. 343, 359-66 *per* Lord Denning. Similar instrumental approaches have been taken in the impressive American literature, Douglas W. O., 'Vicarious Liability and Administration of Risk' (1929) 38 *Yale Law Journal* 584; Laski H. J., 'The Basis of Vicarious Liability' (1916) 26 *Yale Law Journal* 105; and Smith Y. B., 'Frolic and Detour' (1923) 23 *Columbia Law Review* 444. In economic terms the reasoning is flawed as the final incidence of losses is uncertain and will depend amongst other things on the elasticity of supply and demand for the product and information.

[25] *Rose v. Plenty* [1976] 1 W.L.R. 141, 147 *per* Scarman L.J.

[26] *Mersey Docks & Harbour Board v. Coggins & Griffith (Liverpool) Ltd* [1947] A.C. 1.

An employee may be loaned by his employer to do a job for another. If whilst engaged in that job he injures someone, the question is posed: which employer will be vicariously liable? Vicarious liability traditionally depended on control of the servant by the master. It will be apparent that control under modern conditions must be attenuated.[27] Suffice it to say that Professor Patrick Atiyah in his book *Vicarious Liability in the Law of Torts*,[28] finds that the best general distinction is that the original employer will remain liable, where the giving or hiring of the employee is part of a contract for the employee to produce a given result.[29] It is more likely that the relationship will be severed where the servant is loaned absolutely without any other contractual obligations, and where the original employer has no detailed knowledge of his assigned tasks. The wealth maximization thesis supports this distinction. In the latter situation — the absolute loan — the new employer *vis a vis* the old will be in a better position to avoid the costly transaction by taking safety steps, close supervision or otherwise. In the former situation — the temporary loan — the original employer will ordinarily have the information better to avoid any potential negligent acts.

It should be observed that the independent contractor rule in *Quarman* v. *Burnett*[30] is also supported by this analysis. An employer of an independent contractor is not liable for the latter's torts; it is usually the independent contractor rather than his employer who has the information and expertise to take precautions against accidents. The Coase theorem implies that, regardless of the initial assignment of liability at law, liability will be assigned to the independent contractor. The rule in *Quarman* v. *Burnett* obviates the need to shift liability contractually thus avoiding transaction costs. An uncertain exception to this rule is that an employer of an independent contractor employed to do inherently dangerous or hazardous work will be liable where injury results from that work.[31] Perhaps, this exception may be explained by observing that where the hazardous nature of the activity is obvious to the employer, it is by no means plain that the independent contracor would remain the cheapest loss avoider. Where the employer is vicariously liable he will either bear the entire liability or under relevant contribution legislation will bear part of the damage burden with the independent contractor as a concurrent tortfeasor. To the extent he is the cheapest cost avoider, placing liability on him will impose the correct incentive to encourage him to take precautionary steps. The leading case of *Honeywill & Stein Ltd v. Larkin*

[27] *Yewens v. Noakes* (1880) 6 Q.B.D. 530, 532-3 *per* Bramwell L.J.; *Zuijs v. Wirth Bros* (1955) 93 C.L.R. 561, 571 *per* Dixon C.J.; *F.C.T. v. Barrett* (1973) 129 C.L.R. 395 at 400-2 *per* Stephen J.; *Albrighton v. Royal Prince Alfred Hospital* [1980] 2 N.S.W.L.R. 542, 557 *per* Reynolds J.A.

[28] Atiyah P. S., *Vicarious Liability in the Law of Torts* (1967).

[29] *Ibid.* 158-68.

[30] (1840) 6 M. & W. 499; 9 L.J.Ex. 308; 151 E.R. 509.

[31] *Black v. Christchurch Finance Co.* [1894] A.C. 48.

Brothers Ltd[32] serves as an example. A photographer was retained by a company to take flash photographs of sound reproduction equipment installed in a cinema. The Court of Appeal found that the company was liable to the owners of the cinema for damage caused when the ignition of magnesium powder set the curtains alight. In this case the explosive nature of the operation was obvious to both the photographer and the company. Nothing showed that the former had a greater knowledge of the risks or possible precautions than the latter. Indeed, although it was not expressly found, it may have been that the latter had the greater knowledge of the dangers of fire in cinemas as it sold the equipment to the cinema.

However, the High Court of Australia has doubted this exception[33] and the hesitation of the High Court in supporting this as an exception from the usual rule, may be well founded. To put the test on the basis of the ultra-hazardous nature of the operation may be over-inclusive, for it will include situations where because of the superior knowledge of the independent contractor he remains the superior cost avoider. Accordingly, any exception should be restricted to situations where the employer reasonably knows how the danger may act to cause the resultant damage but the independent contractor was not privy to that information. Stephen J. was inclined to this view:

> [T]he . . . doctrine should not in any event extend beyond the quite different case of work authorized by the employer which, however performed, inherently involves peculiar danger to others.[34]

Mason J. in observing the temptation to apply a rule of strict liability where the plaintiff has suffered such loss, thought that it 'should be repelled in these circumstances when its consequence is to cast a liability on a party in whom no fault resides and who in the nature of things is compelled to rely on the expertise of contractors in a matter which lies outside the realm of his own capacity and experience'.[35]

In addition to this exception to the *Quarman v. Burnett* principle are situations where the courts have found the employer liable to an employee for the negligence of an independent contractor. The courts have found that the employer owes a direct non-delegable duty to the employee to ensure that care is taken. A classic example is the duty of an employer to provide a safe system and place of work for his employees.[36] If an employee is injured as a result of the negligence of an independent contractor carrying out the work that he was retained to do, the employer will be liable. He will be in breach of his direct non-delegable duty. This represents a judgment by the Court consonant with the wealth maximization principle that

[32] [1934] 1 K.B. 191.
[33] *Stoneman v. Lyons* (1975) 133 C.L.R. 550, 563-4 *per* Stephen J., 574-5 *per* Mason J.
[34] *Ibid.* 565-6.
[35] *Ibid.* 575.
[36] *Wilsons & Clyde Coal Co. v. English* [1938] A.C. 57.

the employer *vis-a-vis* the independent contractor, would usually be in the better position to take precautions.

In conformity with the foregoing, if the negligence is collateral or casual, in the sense that the negligent act takes place outside the scope of activities for which the independent contractor was employed, the employer is not liable[37] for breach of his non-delegable duty whether imposed because of the dangerousness of the activity or otherwise. In *Penny v. Wimbledon Urban District Council*[38] Romer L.J. said:

> When a person, through a contractor, does work which from its nature is likely to cause danger to others, there is a duty on his part to take all reasonable precautions against such danger, and he does not escape from liability for the discharge of that duty by employing the contractor if the latter does not take these precautions. . . . [A]ccidents arising from what is called casual or collateral negligence cannot be guarded against beforehand, and do not come within this rule.[39]

In the nomenclature of economics Romer L.J. was basing the rule directly on the identification of the better cost avoider. In respect of casual or collateral negligence he finds that the contractor is in the better position to take precautions against the risks. Professor Atiyah has noted that the distinction has rarely been successful in exculpating employers of contractors from liability.[40] Once the courts have imposed a direct non-delegable duty on the employer they assume he possesses a wide scope of foresight of possible risks. It is not surprising then to discover this paucity of authority and the High Court's observations in *Stoneman*, are equally applicable that any exception to the *Quarman* rule must be narrowly delimited. Moreover, with respect to the non-delegable duty owed by employers to employees the courts have developed a stringent duty. The refusal to apply the casual or collateral negligence exception save in unusual circumstances guards against the undermining of the duty. Similar reasoning applies when the duty adheres under statute.

Perhaps more supportive, and another example of the direct non-delegable duty, is the liability of the occupier of premises who employs an independent contractor. If a person enters premises for a purpose connected with the material advantage of the occupier and is injured by

[37] *Hole v. Sittingbourne & Sheerness Ry Co.* (1861) 6 H. & N. 488; 158 E.R. 201; *Pickard v. Smith* (1861) 10 C.B. (N.S.) 470, 480; 142 E.R. 535-9 *per* Williams J.; *Gray v. Pullen* (1864) 5 B. & S. 970, 985; 122 E.R. 1091-6 *per* Erle C.J. In the foregoing cases the proposition was *obiter dicta*, the respective courts finding the defendant employer liable for the actions of his independent contractor where a duty was imposed by statute. The writer has found the plea successful in only two cases: *Padbury v. Holliday & Greenwood (Ltd)* (1912) 28 T.L.R. 494 (iron tool falling from windowsill, when contractor engaged to put in casement) and in *Thompson v. Anglo-Saxon Petroleum Co.* [1955] 2 Lloyd's Rep. 363 (hatch left in dangerous condition by plumbing contractors). In other cases although the argument was admittedly open, the court did not find the case proved on the facts: *Walsh v. Holst & Co.* [1958] 3 All E.R. 33 and *Salsbury v. Woodland* [1969] 3 All E.R. 863, especially 878 *per* Sachs L.J.

[38] [1899] 2 Q.B. 72.

[39] *Ibid.* 78.

[40] Atiyah P. S., *supra* n. 28, 374.

the negligence of an independent contractor, he will have an action against the occupier. To found this action the invitee, as he is classified, must show a breach of the occupier's duty to warn an invitee and take reasonable precautions against unusual dangers of which the former knew or ought to have known. Here the law has drawn a distinction between, on the one hand, independent contractors retained to perform non-technical tasks and on the other, tasks requiring the application of special knowledge and experience. The leading case in the former category is *Woodward v. Mayor of Hastings*.[41] In this case the defendant occupeir was liable for the negligence of the independent contractor — a charwoman. The leading case in the latter category is *Haseldine v. C.A. Daw & Son*,[42] where the defendant occupier was not liable to an entrant who was injured as a result of the negligence of the independent contractor — a lift repairer. Although the rationality of the distinction has been doubted[43] the wealth maximization principle provides a firm reason for the rule. In the case of an independent contractor undertaking a technical task, he and not the employer is likely to be in the better position to appraise the risks of the task and take precautions; that the corollary holds is quite clear. Here, as in other areas, wealth maximization is not the only principle at play. It is more likely that an independent contractor who performs a technical task will carry his own insurance. On the other hand, it is less likely that a non-technical independent contractor such as a charwoman in the *Woodward* case would carry such insurance. It follows that the loss spreading principle provides further grounds for this distinction.

Windeyer J. in the Australian High Court decision of *Voli v. Inglewood Shire Council* found that the rule establishing the dichotomy should be distinguished. Here the question was whether the Council should be liable for the negligence of an architect retained to design a Council hall. An action in negligence was brought by the plaintiff who was injured when the stage collapsed. The reason that the rule was not applied in this case was that circumstances showed that the Council, despite the expertness of the architect, was in a superior position to avoid the accident. The Council was not, his Honour said, 'like a person who employs a contractor because he does not himself understand what is required and is unable to check what is proposed or examine what is done'.[44] Moreover, the legislature under relevant legislation had imposed a duty to take safety precautions upon the Council.[45] The exception in *Voli* then is merely an example of the application of the economically rational basis for the rule.

[41] [1945] K.B. 174.
[42] [1941] 2 K.B. 343.
[43] *Vial v. Housing Commission of New South Wales* [1976] 1 N.S.W.L.R. 388: Glass J.A. after referring to *Woodward & Haseldine* said: 'No convincing reason has been assigned for the irresponsibility of the employer where the contracted work involves technical features' 394-5.
[44] (1963) 110 C.L.R. 74, 98.
[45] *Ibid.* 99.

The rules discussed thus far are those obtaining at common law. The most important inroad made in these rules is legislation providing for contribution between tortfeasors.[46] The relevant statutes have abrogated the common law rule in *Merryweather v. Nixan*.[47] Landes and Posner have shown that under certain conditions, the common law rule of no contribution was efficient.[48] The rule may be seen as an effort to impose upon actors the correct incentives to minimize the sum of relevant accident, accident avoidance and administrative costs. The authors show that even where it is necessary for all tortfeasors to take care in avoiding the accident, the decision on which rule is the more efficient will depend on the administrative cost savings under the common law rule, against the informational and insurance benefits of contribution:[49] a balance that is not clearly on one side or the other.

The foregoing analysis does not, of course, take account of the fact that the actors will not always act as economically rational beings. In the real world they will not always act to minimize their wealth; an employer may not take measures to prevent costly accidents, even where encouraged to by a liability rule. It is not contended that the Courts are blind to these realities. Clearly no court will expect that the articulation of a liability rule that conforms with the wealth maximization principle will attain an optimal level of safety, maximizing social wealth but a court faced with a choice may opt for a rule which will tend to that end. In the particular rules of vicarious liability canvassed so far, the decision on whom to place liability has been one free of wide-ranging justice considerations. The question has not been: will the injured party obtain compensation? It has been: who will pay the injured party's compensation? As the analysis has shown this is a question that lends itself to a wealth maximization explication.

The second problem arises from the seemingly contradictory cases on the criteria applying to the issue of when a servant may be said to be in the course of employment.[50] Professor Atiyah once again suggests that two enquiries must be made:

1. What acts are authorized?

[46] In England: Civil Liability (Contribution) Act 1978 which replaced the Law Reform (Married Women and Tortfeasors) Act 1935. N.S.W.: Law Reform (Miscellaneous Provisions) Act, 1946; Vic.: Wrongs Act 1958, s. 24. All other Australian jurisdictions have adopted the model. In the U.S.A. the adoption of contribution either through statute or by the court decisions has been marked see Landes W. M. and Posner R. A., 'Joint and Multiple Tortfeasors: An Economic Analysis' (1980) *Journal of Legal Studies* 517, Appendix I, 550.

[47] (1799) 8 T.R. 186. Subsequent case law had restricted the doctrine, see *Winfield and Jolowicz on Tort* (Rogers W. V. H. (ed.) 11th ed. 1979) 583-4.

[48] Landes W. M. and Posner R. A., 'Joint and Multiple Tortfeasors' *supra* n. 46, 549. For alternative approach to, and criticism of, Landes and Posner see Rizzo M. J. and Arnold, 'Causal Apportionment in the Law of Torts: An Economic Theory' (1980) 80 *Columbia Law Review* 1399.

[49] *Ibid.* 531.

[50] For general discussion, Atiyah *supra* n. 28, chapter 19.

2. Is the act closely enough connected with the authorized acts as to amount to a mode of performing it?[51]

In a general sense these inquiries go to the ability of the employer to take steps to avoid accidents. We ask which of the employer or the victim was in the better position to avoid the accident. For instance, in *Deatons v. Flew*,[52] a barmaid, Opal Ruby Pearl Barlow, a servant of the defendant, threw a glass at the plaintiff, putting out his eye. This tortious act was completely outside the zone of authorized activities and the defendant employer was not vicariously liable. The assumption here is that it will be costly for the employer to take preventive steps and that the victim could more cheaply avoid the accident. Important in this calculus was the intentionally tortious nature of the act and the behaviour of the plaintiff in, to an extent, inducing the assault. If, however, the act can be regarded as a mode, albeit prohibited, of performing an authorized activity as in *London County Council v. Cattermoles (Garages) Ltd*,[53] the employer can be said to have knowledge of the risks so as to be in the better position than the victim to avoid the costly transaction. In this case a garagehand had the task of shunting cars; he was expressly prohibited from driving them. He was asked to move a vehicle but instead of pushing it, he drove it and collided with a vehicle belonging to the plaintiff. The distinction may be stated that in the usual case the employer will be vicariously liable where because of his knowledge he is in a better position to avoid the costly transaction, that is, the accident. He could take precautions at low cost to ensure compliance with the instruction. The corollary also holds.

So far we have devoted attention to the relationship of the employer *vis a vis* the victim. The third party is of course, the employee. If the wealth maximization thesis is to be borne out, we should find that the courts have placed liability on the cheapest cost avoider of the employee and employer. Here the common law fulfills that efficiency promise: in *Lister v. Romford Ice and Cold Storage Co.*,[54] the House of Lords found that the respondent employer, who had been found vicariously liable to the father of the appellant, had a right under an implied term in the contract of employment to a full indemnity from the latter. The appellant was the better loss avoider. The accident was due to driver error and not to work system or design. The defendant employer gave neither authority, consent, nor had he knowledge of the circumstances.[55] It followed that the appellant was in a better position than the respondent employer to take precautions against the accident by keeping a reasonable look-out. Viscount Simonds echoes this perspective in his speech.

[51] *Ibid.* 178.
[52] (1949) 79 C.L.R. 370.
[53] [1953] 1 W.L.R. 997.
[54] [1957] A.C. 555.
[55] These factors also show the employee to be more 'casually responsible' than the employer, Rizzo M. J. and Arnold *supra* n. 48, 1423.

> The common law demands that the servant should exercise his proper skill and care in the performance of his duty: the graver the consequences of any dereliction, the more important it is that the sanction which the law imposes should be maintained. That sanction is that he should be liable in damages to his master: other sanctions there may be, dismissal perhaps and loss of character and difficulty of getting fresh employment, but an action for damages, whether for tort or for breach of contract, has, even if rarely used, for centuries been available to the master, and now to grant the servant immunity from such an action would tend to create a feeling of irresponsibility in a class of persons from whom, perhaps more than any other, constant vigilance is owed to the community.[56]

In this passage is the assumption that liability rules have an impact on the allocation of resources and create incentives and disincentives to which persons will respond.[57] The rule in *Lister* is that in some circumstances, an employer, while liable to an injured plaintiff, may subsequently shift the loss to the negligent employee. It is clear that in efficiency terms the employee in *Lister*, as the cheapest cost avoider, must be ultimately liable,[58] but why should the rule operate per medium of the employer? Why should not the plaintiff have recourse against the employee only? In the first place, the employee will often be a man of straw. He will have no incentive to take care. If the employer is not even initially liable no incentive to take care will exist at all. If, however, the employer is initially liable he will have some incentive to select a standard of care which, although not optimal, is a second-best solution.[59] Second, it will usually be cheaper for the employer to collect the damages by way of indemnification than for the plaintiff to have recourse to only the employee. The employer will have superior information about the identity and mode of operation of his employee.[60] Thirdly, the employer will usually be able to take measures to assure the financial responsibility of the employee.[61] The reasoning, however, ignores the costs of placing liability on employees. In the real world of organized labour general imposition of liability on employees under the *Lister* doctrine may increase transaction costs in contracting for employment. Furthermore, it ignores what the courts have long-recognized — that workers are poorly placed to realize risks and take precautions. In *Caswell v. Powell Duffryn Associated Collieries* Lord Wright discussing the defence of contributory negligence said:

[56] *Ibid.* 579.

[57] Another example of judicial faith in the deterrent effect of liability rules is supplied by Viscount Radcliffe in *Imperial Chemical Industries v. Shatwell* [1965] A.C. 656, 675-6.

> [I]f an employer is to be liable to pay damages to his employee, even though he has failed in no part of his duty and has done all that vigilance can suggest to deter the employee from the action that produces the damage, the law deprives the employer of any reason to be vigilant, since that protects him no better than inertia: while, on the other hand, the employee is released by the law from a useful stimulus to prudence, if he knows that not even imprudence or disobedience is going to disqualify him from looking to his employer for compensation.

[58] Landes W. M. and Posner R. A. *supra* n. 46, 532-7.

[59] *Ibid.* 528.

[60] *Ibid.* 534.

[61] *Ibid.*

> What is all-important is to adapt the standard of what is negligence to the facts, and to give due regard to the actual conditions under which men work in a factory or mine, to the long hours and the fatigue, to the slackening of attention which naturally comes from constant repetition of the same operation, to the noise and confusion in which the man works, to his pre-occupation in what he is actually doing at the cost perhaps of some inattention to his own safety.[62]

The rule in *Lister* met with a hostile reception[63] because it assaulted an entrenched, altruistic bastion of the common law in an environment that found tort law moving from individualism to altruism.[64] The liability of employers for the torts of employees had been an active stage of conflict with such key players as Common Employment, Volenti Non Fit Injuria and Contributory Negligence. The closing scene featuring the victory of strict liability imposed on the employer was widely applauded as a form of judicially imposed social insurance. (The play is post-Second World War). It seemed in poor taste to introduce a contradictory denouement in the curtain call.

It is plain that wealth maximization is not the *terminus a quo* in policy determination but nevertheless, the wealth maximization principle can be viewed as a significant clarifying and rationalizing principle in vicarious liability. It is a powerful tool in sharpening the contours of liability. It shows us a way through the maze but it goes further. Its explicatory function puts into relief the social goals implicit in the repudiation of *Lister v. Romford Ice*. Accordingly, we are given to hesitate before joining the ranks of those who condemn the House of Lords out of hand. If we attack the decision we do so not because it was without foundation in principle or policy, but on the basis that that policy does not serve the wider interests of justice.

It is submitted that the knotty problems of vicarious liability, while not completely unravelled by economic analysis, become manageable. A consistency may be perceived in the law.

CONCLUSION

Parts II, III and IV have raised important questions in the law of torts. In each, economic analysis has proved to be a powerful explicatory tool. In the hard cases discussed in Part II we observed the courts widening the scope of liability in negligence. In doing so, the courts may be seen as

[62] [1940] A.C. 152, 178-9. See also *Davies v. Adelaide Chemical and Fertilizer Co. Ltd* (1946) 74 C.L.R. 541.

[63] See dissenting speech of Lord Radcliffe [1957] A.C. 555, 586; *Morris v. Ford Motor Co. Ltd* (1973) Q.B. 792. Reluctantly followed in *Northern Assurance v. Coal Mines Insurance* [1970] 2 N.S.W.R. 223 and *Marrapodi v. Smith-Roberts* (unreported A.C.T. Supreme Court (1970)). In South Australia the rule has been abrogated by legislation: Wrongs Act 1936 (S.A.) s. 27C. In the U.K. a gentleman's agreement reached with the insurance companies not to invoke the doctrine has obviated the need for legislation.

[64] Leflar R. A., 'Contribution and Indemnity Between Tortfeasors' (1932) 81 *University of Pennsylvania Law Review* 130, 148; Stone C. D., 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1981) 90 *Yale Law Journal* 1, 48.

replacing rules based on the individualist ideal with those based in altruism. Those new rules whilst steeped in altruism do not simply embody it. The new rules exhibit a close concern with the impact on resource allocation. The cases reveal that in widening the scope of liability, in importing elements of altruism, the courts have developed rules which permit of more particular considerations on the allocation of resources.

In Part III, I concluded that compensatory justice may not always be a sufficient basis to change prevailing legal rules and doctrines. Economic analysis enables a wider inquiry; it measures the impact of changes. It was observed that those impacts may have ramifications in terms of justice.

Part IV found economic analysis perspectives extremely useful in investigating some problems in vicarious liability. Hitherto those problems had seemed intractable. Legal analysis had failed to find patterns and a rationale of liability. Economic analysis puts into relief a persistent tendency in legal doctrine in the vicarious liability context to formulate rules which are economically efficient.

The article reveals a common thread — a fundamental nerve — in tortious liability. It exposes and highlights a tension between the individualistic and altruistic ideals in tortious liabilty. An economc analysis demonstrates that limits inhere within the judicial method in moving to altruistic goals. The reasons for these apparent limits have not been explored. The limits are endemic in the common law decision-making process; they may be found in English, Australian, Canadian and United States case law. The universality of this observation leads to a deeper inquiry, not touched on in this article, that transcends social conditions, philosophies and moods of place and time.

I wish to emphasize the narrow nature of my conclusions. No holy grail has been found. The analysis simply leads to the possibility of asking more profound questions about the development of the law of torts and of the common law decision-making process. I contend that the learning brought to the law by economists provides a powerful paradigm that can be harnessed to enable more rigorous and searching inquiry.