

# Theoretical Justifications for the “Reliance Bar”: *Howmet Ltd v Economy Devices Ltd*

Neil Moody QC\*

Timothy Killen\*\*

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The claim in *Howmet*<sup>1</sup> is the latest in a long line of case law to consider the legal mechanics of the “reliance bar”.

The reliance bar, as it shall be referred to in this note, is the well accepted rule of law which precludes a claimant from recovering where the claimant has (or is taken to have) knowledge of a defect or breach, but nevertheless continues to rely on the defective product or advice and suffers damage or loss. The reliance bar is best exemplified, and most often arises, in cases of a defective product, although it can also arise in instances where a professional service is being carried out (e.g. in a stockbroker-bank relationship<sup>2</sup>).

In *Schering*,<sup>3</sup> Scott LJ (as he then was) described the relevant principles of law applicable to a case of the reliance bar as being “well established” although “the correct application of the principles of law to the facts is elusive”. Unfortunately, the state of the law remains elusive following the decision in *Howmet*.

The claim in *Howmet* arose out of a serious fire at the claimant’s factory in February 2007, which originated in a hot water tank. A “thermolevel” device was supplied and fitted in the tank by a company known as Electromechanical Supplies Ltd (who in turn subcontracted the fitting works to a company known as MJD Supplies Ltd). The thermolevel was designed and manufactured by the defendant, Economy Devices Ltd (EDL). The thermolevel was intended to measure the level and temperature of water in the tank, and to cut out the tank’s heating units when there was a low water level.

Unfortunately, when in operation, the thermolevel failed to isolate the tank’s heating units, causing them to overheat and catch fire. There had previously been (less serious) fires in the tank in December 2006 and January 2007. Following the January 2007 fire, the claimant became aware that the thermolevel was not functioning. In February 2007, and prior to the replacement of the thermolevel by

\* Barrister, Gray’s Inn, Head of Chambers at 2 Temple Gardens, London.

\*\* Barrister, Gray’s Inn, practising from 2 Temple Gardens, London.

<sup>1</sup> *Howmet Ltd v Economy Devices* [2016] EWCA Civ 847; [2016] B.L.R. 555; 168 Con. L.R. 27.

<sup>2</sup> See, *County Ltd v Girozentrale Securities* [1996] 3 All ER 834; [1996] 1 B.C.L.C. 653.

<sup>3</sup> *Schering Agrochemicals v Resibel NV SA* unreported 26 November 1992 CA (Civ Div) Transcript at 1298.

the claimant, a further, serious, fire broke out which was alleged to have caused losses valued at some £20 million.

The claimant alleged that the February 2007 fire was caused by the negligent design of the thermolevel and that EDL was in breach of reg.14 of the Electrical Equipment (Safety) Regulations 1994 (the “1994 Regulations”) in that the thermolevel was not “safe”.

The claim at first instance was dismissed by Mr Justice Edwards-Stuart, who held that causation had not been proved.<sup>4</sup> Although Edwards-Stuart J was satisfied that the fire was the result of a failure in the thermolevel to operate properly, he was unable to reach a conclusion about the mechanism of the failure, and therefore held that he was unable to find that the failure was due to EDL’s negligence when manufacturing the device.<sup>5</sup>

The claim for breach of the 1994 Regulations was also dismissed on what the judge referred to as “causation” grounds, as it was held that the claimant company (through its employees) knew that the thermolevel had failed, and was therefore not continuing to rely upon the thermolevel as a reliable safety device following the January 2007 fire. In reaching this decision, Edwards-Stuart J relied on the decision of the House of Lords in *Lambert v Lewis*.<sup>6</sup>

The appeal in *Howmet*<sup>7</sup> was heard by Jackson and Arden LJ and Sir Robert Akenhead. All three gave judgments dismissing the appeal, but each differed somewhat in their reasons for doing so. Broadly, the matters considered on appeal were whether Edwards-Stuart J had erred in his application of the principles of attribution of knowledge to a company; had erred in his treatment of reliance in relation to negligence and breach of statutory duty; and/or, had erred in treating this as a *Popi M*<sup>8</sup> type case (i.e. one where no cause of loss is proved on the balance of probabilities).

On the issue of attribution of knowledge, only Jackson LJ gave a reasoned judgment.<sup>9</sup> In short, he followed the principles set out by Lord Hoffmann in the Privy Council in *Meridian*,<sup>10</sup> and by the Supreme Court in *Bilta*.<sup>11</sup> In line with the existing authorities, having regard to both the factual context and the nature of the claim against the company, the employees whose knowledge of the unreliability of the thermolevel was to be attributed to the company were held to be those in the team who were entrusted with the task of maintaining and operating the plant line in which the thermolevel was installed. Jackson LJ therefore found that the claimant had knowledge at the time of the February 2007 fire that the thermolevel was not functioning correctly. Both Arden LJ and Sir Robert Akenhead agreed with Jackson LJ’s judgment on the question of attribution of knowledge.

<sup>4</sup> *Howmet Ltd v Economy Devices Ltd* [2014] EWHC 3933 (TCC).

<sup>5</sup> Often referred to as a “Popi M” situation. See also *Nulty v Milton Keynes BC* [2013] EWCA Civ 15; [2013] 1 W.L.R. 1183; [2013] B.L.R. 134.

<sup>6</sup> *Lambert v Lewis* [1982] A.C. 225; [1981] 2 W.L.R. 713; [1981] R.T.R. 346.

<sup>7</sup> *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27.

<sup>8</sup> *Rhesa Shipping Co SA v Edmunds (The Popi M)* [1985] 1 W.L.R. 948; [1985] 2 All E.R. 712; [1985] 2 Lloyd’s Rep. 1.

<sup>9</sup> *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [53]–[74].

<sup>10</sup> *Global Funds Management Asia Ltd v Securities Commission* [1995] 2 A.C. 500; [1995] 3 W.L.R. 413; [1995] B.C.C. 942.

<sup>11</sup> *Bilta (UK) Ltd (In Liquidation) v Nazir* [2015] UKSC 23; [2016] A.C. 1; [2015] B.C.C. 343.

On the question of the reliance bar, the court was unanimous that the bar operated to prevent the claimant recovering in this instance, but was (unfortunately) split on the theoretical justification for the operation of the bar.

Jackson LJ and Sir Robert Akenhead considered that the claimant's knowledge that the thermolevel was not functioning (by reason of the January 2007 fire) was sufficient to mean that there was, at the time of the February 2007 fire, no continuing duty on EDL in respect of the thermolevel.<sup>12</sup> In reaching this conclusion, Jackson LJ relied upon the decisions of the House of Lords and the Court of Appeal respectively in *Lambert*<sup>13</sup> and *Schering*.<sup>14</sup>

In short, Jackson LJ held that, unless there is a situation where the claimant has no choice but to continue to use a defective chattel after becoming aware of its defectiveness, the claimant's knowledge of the defectiveness of the chattel is sufficient to prevent the claimant from recovering if the known defect later causes damage. This, in Jackson LJ's judgment, is an application of the principles of either duty or causation<sup>15</sup>; duty because it can be said that when a claimant knows of a defect the manufacturer's "duty" in respect of the item's fitness for purpose ceases; causation because it could be said that once a claimant became aware of the defect and put in place an alternative system, it was the failure of the alternative system which was the effective cause of the fire, not the failure of the thermolevel. Which, of these two analyses is to be preferred, however, Jackson LJ did not say.

Arden LJ, on the other hand, preferred to treat the question as a "more nuanced" question of whether the reliance bar operated as a question of causation (and contributory fault), or possibly as a question of mitigation, rather than one of duty.<sup>16</sup>

Put this way, it was Arden LJ's judgment that the question was one of whether the claimant's knowledge of the defect in the thermolevel was such as to break the chain of causation, or whether its response in light of this knowledge was unreasonable to the extent that it should not be permitted to recover as a matter of mitigation. In this regard (and without explicitly saying so) Arden LJ seems to have applied a test similar to that propounded by Gross LJ in *Borealis*<sup>17</sup> which, in essence, requires recklessness on the part of a claimant in order for any subsequent intervening act carried out by that claimant to constitute a *novus actus* or to otherwise bar recovery.

Arden LJ took support for this view from the judgment of Nolan LJ in *Schering*<sup>18</sup> (which Jackson LJ had indicated was obiter and did not represent the law as it "now stands, in 2016"<sup>19</sup>). Arden LJ considered that Nolan LJ's observation that, had the claim in *Schering* been in tort, it would have been a case for apportionment under the Law Reform (Contributory Negligence) Act 1945 (the "1945 Act") meant that Nolan LJ considered the issue to be one of causation, and not duty; presumably because questions of apportionment under the 1945 Act would arise only if there had been a breach of duty. In fact, and as Arden LJ notes, Nolan LJ's

<sup>12</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [97].

<sup>13</sup> *Lambert* [1981] 2 W.L.R. 713; [1981] R.T.R. 346.

<sup>14</sup> *Schering* unreported 26 November 1992 CA (Civ Div).

<sup>15</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [97].

<sup>16</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [119], [120] and [126].

<sup>17</sup> *Borealis AB v Geogas Trading SA* [2010] EWHC 2789 (Comm); [2011] 1 Lloyd's Rep. 482.

<sup>18</sup> *Schering* unreported 26 November 1992 CA (Civ Div).

<sup>19</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [92].

preferred analysis was that the issue of reliance in *Schering* was a matter of mitigation, rather than causation.<sup>20</sup>

Arden LJ also considered that the approach in contract (which relies upon a continuing warranty of fitness for purpose and for which non-reliance operates as an absolute bar) should not be merged with an approach in tort—or at least not where direct property damage or personal injury is caused, as opposed to pure economic loss (as a straightforward tortious duty relies upon the establishment of a common law duty which can be apportioned—subject to the rule in *Vesta v Butcher*<sup>21</sup>—under the 1945 Act).<sup>22</sup>

With regard to the “*Popi M*” question, the court was again split; Jackson LJ expressed doubt that the judge at first instance was right to find that this was a *Popi M* situation (i.e. that no cause of the thermolevel had been proved on the balance of probabilities).<sup>23</sup> Sir Robert Akenhead held that the judge at first instance was entitled to find that none of the three possible causes of the fire had been proved on the balance of probabilities, and that this was a *Popi M* situation,<sup>24</sup> whilst Arden LJ, held that the “judge failed to stand back and consider the question of causation in the round”.<sup>25</sup> Without holding that this was, in fact, not a *Popi M* situation, Arden LJ held that there was a “shortcoming” in the judge’s approach.<sup>26</sup>

It is unfortunate that there is no clear ratio to the decision of the Court of Appeal, either on the issue of the reliance bar, or on the *Popi M* question. That said, it is the divergence between Arden and Jackson LJ on the proper approach to reliance which is considered to be the most troubling aspect of the judgment in *Howmet*.<sup>27</sup> As explained below, the distinction in the different approaches is not simply academic, and may in fact have a significant impact on future cases.

In short, there emerges from the Court of Appeal’s judgment four competing justifications for the reliance bar:

- first, that a claimant’s knowledge of a defect extinguishes the existence of a duty (Jackson LJ);
- second, that a claimant’s knowledge of a defect is a matter of causation because the defect ceases to be the effective cause of loss (Jackson LJ);
- third, that (in tort for non pure economic loss, at least) a claimant’s knowledge of a defect is a “nuanced” matter of causation and contributory fault (Arden LJ); or
- fourth, that a claimant’s knowledge and continued use of a defective article amounts to a failure to mitigate (see Nolan LJ in *Schering*;<sup>28</sup> Arden LJ in *Howmet*.<sup>29</sup> See also Hobhouse LJ (as he then was) in *Girozentrale*<sup>30</sup>).

<sup>20</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [126].

<sup>21</sup> *Forsikringsaktieselskapt Vesta v Butcher* [1989] A.C. 852; [1989] 2 W.L.R. 290; [1989] 1 All E.R. 402.

<sup>22</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [125].

<sup>23</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [100].

<sup>24</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [110]–[112].

<sup>25</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [129].

<sup>26</sup> See *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27 at [129].

<sup>27</sup> *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27.

<sup>28</sup> *Schering* unreported 26 November 1992 CA (Civ Div).

<sup>29</sup> *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27.

<sup>30</sup> *Girozentrale* [1996] 1 B.C.L.C. 653.

Finally, and whilst not discussed directly in *Howmet*, it is worth mentioning that a fifth potential approach to, or justification of, the reliance bar has also been suggested, and that is one of remoteness. The argument runs that if a party's continued use of a defective article when that party has knowledge of the defect is such as to have been outside of the reasonable contemplation of the parties, then any damage occasioned as a result of such use is to be considered too remote to be recoverable. This approach was the basis of Scott LJ's judgment in *Schering*<sup>31</sup> (at least, as it was subsequently interpreted by Beldam and Hobhouse LJ in *Girozentrale*<sup>32</sup>).

Whilst it is right that in *Howmet*<sup>33</sup> the result (i.e. that the claimant was prevented from recovering by operation of the reliance bar) was held to be the same, regardless of which approach was taken, it is suggested that it is nevertheless important to have a consistent approach to the issue of reliance for at least two reasons.

First, because of burdens of proof. Whilst it is true that cases are rarely decided on the burden of proof, there are some (indeed, the decision in *Howmet* at first instance is one) where it is decisive. If the question is one of breach, the burden would be on the claimant. If, however, it is a question of *novus actus*, a failure to mitigate or remoteness, the burden would be on the defendant. Which test is chosen and where the burden of proof lies could, therefore, significantly affect the outcome.

Second, because each approach is of wider application than simply the question of reliance and each has its own distinct, established and developed line of jurisprudence (see, e.g. *Banco de Portugal*<sup>34</sup> for failure to mitigate; *Borealis*<sup>35</sup> for causation and *novus actus*; *Caparo*<sup>36</sup> for breach of duty).

It is perfectly conceivable, therefore, that different results may be reached on any one set of facts depending upon which test or line of authority is used. It is the case that the bar for a failure to mitigate has been held to be "high" (*Banco de Portugal*<sup>37</sup>), but that a claimant's conduct must amount, essentially, to recklessness for it to be considered a *novus actus* (*Borealis*<sup>38</sup>). It is not at all clear that these two tests, for instance, would produce the same conclusion.

To take this further, one only has to imagine a situation where an item has two defects, each defect being sufficient to render the item dangerous, or at least very unreliable; the claimant discovers one such defect, but continues to use the item regardless. Later the second (undiscovered) defect causes damage to other property and the manufacturer is sued. If the matter is considered a question of duty, the question arises as to whether the manufacturer ceased to owe a duty in respect of the item by reason of the discovery of the first defect? If the duty is owed in respect of the item as a whole, then it would seem to follow that notwithstanding that there was no duty owed in respect of the discovered defect, the duty continued to exist in respect of the undiscovered. Analysed thus, as a question of duty, it seems the putative claimant would still be able to recover.

<sup>31</sup> *Schering* unreported 26 November 1992 CA (Civ Div).

<sup>32</sup> *Girozentrale* [1996] 1 B.C.L.C. 653 at 848 and 857.

<sup>33</sup> *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27.

<sup>34</sup> *Banco de Portugal v Waterlow and Sons Ltd* [1932] A.C. 452; [1932] All E.R. Rep. 181.

<sup>35</sup> *Borealis* [2011] 1 Lloyd's Rep. 482.

<sup>36</sup> *Caparo Industries Plc v Dickman* [1990] 2 A.C. 605; [1990] 2 W.L.R. 358; [1990] B.C.C. 164.

<sup>37</sup> *Girozentrale* [1996] 1 B.C.L.C. 653.

<sup>38</sup> *Borealis* [2011] 1 Lloyd's Rep. 482.

If, however, the matter is considered as an issue of causation, as explained by Jackson LJ, then the question becomes one of whether the “discovered” defect was the effective cause of the loss. In the circumstances mooted above, it clearly was not, and so the claimant would also probably be able to recover.

If the question is one of *novus actus*, however, it might be said that notwithstanding that it was the unknown defect that caused the loss, the continued use of the article was nevertheless reckless such as to constitute a *novus actus* and the putative claimant would be left unsuccessful. Likewise, the continued use of the defective article may be considered a failure to mitigate resulting in the reliance bar operating.

This theoretical example shows, therefore, just how important it is that there is a consistent approach to the application of the reliance bar.

The question which naturally looms large is which approach ought to be favoured. It is to this question which the remainder of this note is addressed, and it is suggested that it is the *novus actus* analysis that most comfortably provides both a theoretical justification for, and a clear test to be applied in cases of, the reliance bar.

The “duty” approach, as set out by Jackson LJ and Sir Robert Akenhead is, on closer analysis, one which is rather unorthodox, as it essentially conflates what is more comfortably a contractual issue of the continuing warranty as to fitness for purpose with the manufacturer’s common law duty of care (as is noted by Arden LJ). A duty of care either exists in respect of a certain action or item, or it does not, and it is odd to think of a duty of care as existing, but only for so long as particular knowledge does not come to the claimant. The only other situation where such an analysis of a tortious duty holds true is in the case of a pre-contractual misrepresentation which ceases to have effect if the claimant knows the falsity of a statement prior to concluding the contract, and whether as a matter of legal taxonomy misrepresentation is, strictly, a tortious “duty of care” or some other quasi-contractual duty is, it is suggested, far from certain. Although one might see how an argument could be constructed that the warranty as to fitness for purpose is somehow an “implied representation” made by the supply of the goods, and which continues only so long as the user does not know it to be false, on the whole the relationship between a manufacturer and a user of goods is not apt to be treated in such terms; primarily because such an approach could lead to the conclusion that the manufacturer could be sued for breach of such a representation even if the item manufactured does not cause personal injury or damage to other property, but simply because it is defective. Absent a direct contract between the manufacturer and the consumer, that is clearly not the present state of the law, and to hold as such would require the complete rewriting of the rules on the recoverability of pure economic loss.

Second, Jackson LJ’s application of “causation” could lead to some surprising results. On Jackson LJ’s “effective cause” analysis, if the claimant knows of the defect and puts in place an alternative system to avoid it, but damage still eventuates, the “effective cause” is considered to be the failure of the replacement system, and not the original (defective) item. On such an approach, however, if a claimant knows of a defect but does nothing, rather than, as in *Howmet*,<sup>39</sup> puts in

<sup>39</sup> *Howmet* [2016] B.L.R. 555; 168 Con. L.R. 27.

place an alternative system, then on Jackson LJ's analysis the defect would seem to continue to be an effective cause. It would be strange indeed if a claimant who has knowledge and does nothing is held to be in a more favourable position than a claimant who has knowledge and puts in place an alternative (albeit flawed) system. Further, a causation explanation as proposed by Jackson LJ would be contrary to the decision in *Lambert*<sup>40</sup> (upon which Jackson LJ placed express reliance) as in that case the farmer knew of the defect in the tow hook and did nothing, but was nevertheless prevented from recovering (in a contribution action) against the manufacturer.

Third, describing the matter as one of "mitigation of loss" does not seem particularly apposite. It is suggested that the duty to mitigate (in tort, at least) does not properly arise until the tort is in fact complete; i.e. once at least some damage has occurred. Indeed, this appears to have been the view of Scott LJ in *Schering*.<sup>41</sup> To say, therefore, that a claimant's continued use of a damaged item is a "failure to mitigate" on the claimant's part is an allegation essentially that the claimant has failed to prevent the loss from occurring, rather than an allegation that the claimant has failed to mitigate the consequences of a breach. To hold otherwise would either require a recalibration of the concept of a "failure to mitigate", or of the nature of damage in tort, neither of which is otherwise considered necessary.

Fourth, taking the suggestion of Beldam and Hobhouse LJ in *Girozentrale*,<sup>42</sup> that (as per Scott LJ in *Schering*<sup>43</sup>) the matter could perhaps be considered as one of "remoteness" could also present its own problems; namely that given the differing approaches to the question of remoteness in tort and contract, the reliance bar could be taken to operate differently depending upon which cause of action is relied upon (albeit that in cases of concurrent contractual and tortious duties, it is now settled that the contractual rule prevails—see *Wellesley*<sup>44</sup>). Nevertheless, there appears to be no good justification for treating the reliance bar in tort and in contract differently, and so it is suggested that the "remoteness" justification also fails to adequately explain the reliance bar.

This, then, leaves the *novus actus* justification and, tentatively, it is this approach which is endorsed. Treating the question of the reliance bar as one of *novus actus* is, it is thought, more in keeping with established principles; it avoids the need to reformulate the duty as a "continuing" duty which can be extinguished, and provides (through the *Borealis* test) a clear approach to deciding the circumstances in which knowledge of a defect will debar a claimant from recovering. It is suggested that if and when the courts are provided with a further opportunity to provide some guidance on the issue of the reliance bar, some serious thought ought to be given to the *novus actus* approach, as doing so may remove some of the elusiveness identified by Scott LJ all those years ago in *Schering*.<sup>45</sup>

<sup>40</sup> *Lambert* [1981] 2 W.L.R. 713; [1981] R.T.R. 346.

<sup>41</sup> *Schering* unreported 26 November 1992 CA (Civ Div), per Scott LJ, see also *Girozentrale* [1996] 1 B.C.L.C. 653 at 848.

<sup>42</sup> *Girozentrale* [1996] 1 B.C.L.C. 653.

<sup>43</sup> *Schering* unreported 26 November 1992 CA (Civ Div).

<sup>44</sup> *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146; [2016] Ch. 529; [2016] P.N.L.R. 19.

<sup>45</sup> *Schering* unreported 26 November 1992 CA (Civ Div).