IN THE COURT OF APPEAL OF NEW ZEALAND

CA81/04

	BETWEEN	MCKINLAY HENDRY LIMITED First Appellant
	AND	KINGS WHARF HOLDINGS LIMITED (IN LIQUIDATION) Second Appellant
	AND	TONKIN & TAYLOR LIMITED Respondent

Hearing: 29 November 2005

Court: Glazebrook, Robertson and Rodney Hansen JJ

Counsel: D G Dewar and S J Pickett for Appellants
G S A Macdonald for Respondent

Judgment: 9 December 2005

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appeal is dismissed with costs of $6,000 to the respondent and usual disbursements.

REASONS

(Given by Rodney Hansen J)

Introduction

[1] The respondent, Tonkin & Taylor Limited (Tonkin & Taylor) was asked to carry out a geotechnical investigation into the proposed site for a coolstore on reclaimed land at the Wellington waterfront. It reported that the site required improvement to increase the density of the ground. A technique known as dynamic compaction was recommended.

[2] The building owners, the second appellant, Kings Wharf Holdings Limited (In Liquidation) (Kings Wharf Holdings) entered into a fixed price contract for the construction of the coolstore. Provision was made for the cost of dynamic compaction. It eventually transpired that the recommended ground treatment was not needed. Kings Wharf and the first appellants, McKinlay Hendry Limited (McKinlay Hendry) which initially promoted the project, sued the building contractor and Tonkin & Taylor, to recover the sum allowed for the cost of dynamic compaction.

[3] Miller J found that Tonkin & Taylor had been negligent. It had used incorrect data and methodology. Its negligence caused loss to Kings Wharf Holdings. However, Miller J held the appellants could not recover from McKinlay Hendry because it did not suffer the loss or from Kings Wharf Holdings because it was not owed a duty of care. It is this latter finding which is challenged on appeal.

Further background.

[4] McKinlay Hendry is a merchant bank. Its shareholders and directors at material times were Mr Jim McKinlay and Mr Paul Hendry. At the suggestion of a marine surveyor, Mr Iain MacLeod, they promoted the development of a coolstore at the Wellington port. They approached Long International Limited (Long) which has expertise in the construction of coolstores.

[5] Long engaged Mr Richard Sullivan, a consulting engineer, to design the coolstore. He asked Tonkin & Taylor to investigate foundation conditions at the proposed site. He identified the proposed owner of the coolstore as Centreport

Coolstores Limited (Centreport Coolstores) and advised that it would pay Tonkin & Taylor's costs. Tonkin & Taylor's letter of engagement was signed by Mr MacLeod on behalf of Centreport Coolstores. Tonkin & Taylor accepted that firm as its client. Unknown to Tonkin & Taylor, however, Centreport Coolstores was not incorporated until some weeks later. Following incorporation it took no steps to ratify the terms of engagement.

[6] It was common ground before Miller J that Tonkin & Taylor's contract was with McKinlay Hendry as the undisclosed principal of Mr MacLeod. All parties accepted that, in the absence of ratification by Centreport Coolstores or of Tonkin & Taylor seeking validation of the contract under s 184 of the Companies Act 1993, Tonkin & Taylor accepted McKinlay Hendry as the contracting party.

[7] Tonkin & Taylor addressed its report to Centreport Coolstores. It based its findings on three bore holes drilled on the site. It said that without ground improvement foundations would undergo elastic settlements in the order of 100 to 150 millimetres. There would be significant differential settlements depending on loadings. The report said, however, that seismically induced liquefaction was of greater concern. It identified a high risk of liquefaction in the upper levels of fill if an earthquake occurred, resulting in vertical ground settlements in the order of 200 to 300 millimetres and horizontal movements of up to two metres. It concluded that without ground improvements settlements would be unacceptably high and the static load conditions and, in the event of a major earthquake, there was a high risk of widespread liquefaction occurring down to depths of 10 to 12 metres.

[8] The report canvassed three options for ground improvement, providing cost estimates for each. It recommended dynamic compaction in the following terms:

> Dynamic Compaction is the most promising [option] but further investigation and analyses would be required to confirm the construction, methodology and resulting ground improvement.

In a passage that is of critical relevance to the existence of a duty of care and which we will later discuss in detail, the report went on to say:

> This report has been prepared solely for the benefit of you as our client with respect to the particular brief given to us, and data or opinions contained in it

> may not be used in other contexts or for any other purpose without our prior review and agreement.

[9] The cost of the report were paid by McKinlay Hendry except for that part of the fee which related to advice on the appropriate form of ground improvements. Long agreed to pay this portion of the fee as it came within its responsibility for design. Long adopted the recommendation that dynamic compaction be used to improve the ground. It asked Tonkin & Taylor to draft a specification for the dynamic compaction. Based on that specification, a quantity surveyor estimated that the work would cost $515,000. This led to an estimated fixed price of $8.46m.

[10] In November 1998, Tonkin & Taylor was asked by Long to assess the risk of excessive ground movement during the first ten years of the building's life if no ground improvement were undertaken. It was asked to assume significantly reduced loadings (although these were not eventually adopted). On 17 November Tonkin & Taylor reported to Long that static loading would produce subsidence of 10 millimetres with differential settlements of the floor slab of one in 500. This was significantly less than the projections in the May report. However, Tonkin & Taylor said there was a 53% probability of an earthquake event occurring within ten years which could result in significant damage to the development. It recommended the development would need to be carried out at the owner's risk.

[11] Tonkin & Taylor's report was sent by Long to Centreport Coolstores with the advice that Long was not willing to carry the risk of damage from an earthquake. In response, McKinlay Hendry advised that it accepted that ground improvement work should take place.

[12] Tonkin & Taylor had no further involvement in the project until a meeting on 9 May 1999 with representatives of Long. Since the May report, the design and footprint of the building had changed. Of particular significance was the relocation of the building to a site closer to the edge of the reclamation, necessitating a review of the ground improvement recommendation. Tonkin & Taylor was asked to carry out that review. At a further meeting with Long on 19 May, Tonkin & Taylor was asked to provide a new specification and drawings by 25 May 1999 and to review

the dynamic compaction design in light of the amended size and location of the building.

[13] Although Tonkin & Taylor provided drawings and specifications by or soon after 25 May, it did not report on its review until 4 June. By then, on 25 May, Long had entered into the fixed price contract which included provision for dynamic compaction based on Tonkin & Taylor's May report and the specification and estimate of cost which followed.

[14] The other party to the contract was the appellant, Kings Wharf Holdings, not Centreport Coolstores as had originally been contemplated. The cost of the building was higher than expected and exceeded the financing which McKinlay Hendry had arranged. A third tier funder, the St Laurence Group, was introduced. The ownership and operating structure changed. The new company – Kings Wharf Holdings – was to be incorporated to build and own the coolstore. St Laurence would have a minority shareholding. Centreport Coolstores would lease and operate the building.

[15] A new ownership and operating structure had been first mooted in October 1998. It was not finalised until 19 May 1999 when, just six days before the building contract was signed, Kings Wharf Holdings was incorporated. Tonkin & Taylor was not a party to the discussions regarding the revised ownership and operating structure. It learnt that Kings Wharf Holdings would be the owner at the meeting on 11 May 1999.

[16] For reasons which we need not discuss, it was established soon after ground works began that dynamic compaction would not be necessary. This came as something of a windfall for Long which had of course priced the contract on the basis that dynamic compaction would be necessary. McKinlay Hendry and Kings Wharf Holdings took the view that either Long or Tonkin & Taylor should be required to account to them for the unnecessary cost Kings Wharf Holdings had incurred.

High Court judgment

[17] A claim against Long under the Contractual Mistakes Act 1977 was dismissed and needs no further consideration. Tonkin & Taylor was sued in contract as well as for negligent misstatement. The claim in contract by McKinlay Hendry was dismissed because McKinlay Hendry had not incurred the costs claimed and could not bring itself within any of the recognised exceptions to the rule that only the person who has suffered the loss is entitled to have it made good by compensation: *Alfred McAlpine Construction v Panatown* [2001] 1 AC 518. The claim by Kings Wharf Holdings was dismissed because it was not a party to the April 1998 contract and could not avail itself of the Contracts (Privity) Act 1982.

[18] In determining the claim in negligence by Kings Wharf Holdings, Miller J adopted the established two-stage approach of considering first the degree of proximity between the parties and then how policy considerations affected the existence of a duty of care: *Attorney General v Carter* [2003] 2 NZLR 160. He noted that in cases of negligent misstatement, the proximity enquiry generally focuses on the concepts of assumption of responsibility and foreseeable and reasonable reliance.

[19] The Judge found that Tonkin & Taylor knew its May report would be relied upon by Centreport Coolstores and Long in negotiating a construction contract, and that such reliance was reasonable. He rejected a submission that, because Tonkin & Taylor were not aware that a fixed price contract was to be entered into, Kings Wharf Holdings' loss arose from its decision to enter into such a contract which precluded adjustment to the price should dynamic compaction not be required. He said that Tonkin & Taylor knew that provision would be made in the construction contract for dynamic compaction and there was no expectation that its recommendation (or the testing on which it was based) would be revisited.

[20] However, the Judge said, Tonkin & Taylor did not assume responsibility to Kings Wharf Holdings or any future owner. He referred to the stipulation in the May report, quoted in full in [8] above, that the report had been prepared solely for the benefit of the client. He said Tonkin & Taylor clearly sought to confine reliance on

its report to Centreport Coolstores and to preclude reliance by other parties without its prior review and agreement. He noted also that from May 1998 Tonkin & Taylor had acted, with McKinlay Hendry's approval, solely as a subcontractor to Long.

[21] Miller J then turned to policy considerations. He said at [88]:

> I also consider that considerations of policy militate against a relationship of proximity between Tonkin & Taylor and Kings Wharf Holdings in these circumstances. The parties chose to regulate their relationships through contract. Tonkin & Taylor was careful to limit its liability by providing that only Centreport Coolstores Limited could rely on its advice. A building of this kind has an economic life of at least 25 years, and may be owned by any number of investors throughout that period. The engineer has no way of charging subsequent investors for the work on which they may claim to rely. It is unsurprising that an engineer would specify that it accepts responsibility only to the client with which it has entered a contract. The opportunity exists for any party seeking to rely on the engineer's work to obtain an acknowledgement that the work may be relied upon, or to seek its own advice should the engineer refuse to provide the acknowledgement. Appropriate limits to liability can then be negotiated. Mr Miller [a witness for Tonkin & Taylor] explained that it is common to seek such acknowledgements as parties change over the life of a project.

[22] Miller J concluded that Kings Wharf Holdings had failed to establish a relationship of proximity between itself and Tonkin & Taylor. The claim in negligent misstatement accordingly failed.

Appellants' submissions

[23] Mr Dewar first took issue with Miller J's finding that Tonkin & Taylor had successfully excluded reliance by a stranger to the contract by the quoted passage in its report. He argued that it did not preclude another party from relying on the report as long as it was used for the purpose of the coolstore project. He said the report came to be relied on by Kings Wharf Holdings in the precise circumstances contemplated by the report itself. Alternatively, he submitted that, by its continuing participation in the project, Tonkin & Taylor must be taken to have agreed to the report being used by others.

[24] Mr Dewar pointed out that Tonkin & Taylor continued to advise Long knowing that Long's client, McKinlay Hendry, would also be relying on the advice

given. Referring to the dissenting judgment of Denning LJ in *Candler v Crane, Christmas and Co* [1951] 2 KB 164, Mr Dewar said Tonkin & Taylor would have known, actually or inferentially, that the advice would have been communicated to Kings Wharf Holdings as a member of a class, namely, the entity which would, at the behest or direction of McKinlay Hendry, enter into the building contract. The precise identity of that party did not need to be known. Kings Wharf Holdings was incorporated for the purpose of entering into the contract with Long. It was a creature of the developers, McKinlay Hendry. It came within the class of persons who Tonkin & Taylor could reasonably have foreseen would rely on its advice.

[25] Mr Dewar took issue with the Judge's suggestion that Kings Wharf could have sought to bind Tonkin & Taylor contractually. He pointed out that Tonkin & Taylor failed to formalise its terms of engagement with Long during 1998 and, after its re-engagement in May 1999, terms were not agreed until much later that year. There was therefore no contract at the relevant time which was inconsistent with a duty of care. Furthermore, Kings Wharf Holdings had no opportunity to contract with Tonkin & Taylor. The absence of a contract should not therefore permit Tonkin & Taylor to avoid a duty of care.

Respondent's submissions

[26] Mr Macdonald submitted that Miller J's factual findings fully supported his conclusion that there was no relationship of proximity between Tonkin & Taylor and Kings Wharf Holdings. It was not reasonably foreseeable in May or November 1998 that an entity not then in existence would, in May 1999, rely on advice given 6 - 12 months before. Mr Macdonald said Tonkin & Taylor assumed responsibility only to those to whom it contracted. The parties chose to regulate their relationship by contract. It can be assumed that, if Tonkin & Taylor had entered into a contract with Kings Wharf Holdings, it would have done so on its standard terms which limited its liability. It would not be fair, just and reasonable for Kings Wharf Holdings to enjoy the benefit of a contract with Tonkin & Taylor without the cost burden or contractual limitations which a contract would have imposed.

Discussion

Legal principles

[27] In accordance with the established approach, we consider first whether the necessary relationship of proximity existed between Tonkin & Taylor and Kings Wharf Holdings. That focuses, as discussed in *Attorney General v Carter and Wright* (supra) and *Rolls-Royce New Zealand Limited v Carter Holt Harvey Limited* [2005] 1 NZLR 324, on the interdependent concepts of assumption of responsibility and foreseeable and reasonable reliance. Responsibility will have been assumed if the maker of the statement foresees or ought to have foreseen that the plaintiff will reasonably place reliance on what the maker has said.

[28] As Tipping J said in *Attorney General v Carter* at [26], whether it is reasonable for the plaintiff to place reliance on what has been said will depend on the purpose for which the statement was made and the purpose for which the plaintiff relies on it. It will not usually be reasonable for the plaintiff to rely on a statement made for a purpose other than the one for which it was made. Nor will it be reasonable for the plaintiff to rely on a statement if he was not the person to whom it was made or a member of the class of person for whose benefit it was made.

Exclusion clause

[29] The first obstacle which the appellants must surmount in order to establish that it was reasonably foreseeable that Kings Wharf Holdings would rely on the May report is the words of exclusion which appear near its conclusion, quoted in [8] above. If, as the Judge found, they were effective to confine reliance to Tonkin & Taylor's then client, they tell against any assumption of responsibility to Kings Wharf Holdings. As Lord Devlin said in *Hedley Byrne & Co v Heller & Partners* [1964] AC 465 at 533; [1963] 2 All ER 575 at 613:

> A man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that in fact he is not.

[30] Mr Dewar sought to remove the hurdle before attempting to clear it. He argued that, read as a whole, the passage did not limit Tonkin & Taylor's liability to Centreport Coolstores. He submitted that the later words, prohibiting use of the report in other contexts and for other purposes without Tonkin & Taylor's prior review and agreement, prevailed over the earlier words. He maintained that Tonkin & Taylor's intention was simply to ensure that the report was relied on only for the purpose of the coolstore project unless it agreed otherwise.

[31] We are unable to accept this submission. The opening words of the sentence are unambiguous:

> This report has been prepared solely for the benefit of you as our client with respect to the particular brief given to us …"

In our view, these words cannot be read down. The later words restrict the way in which the report can be used, even by the client. It cannot be used in other contexts or for other purposes unless Tonkin & Taylor agree and are able to review the findings in the report.

Proximity

[32] An assumption of responsibility by Tonkin & Taylor to Kings Wharf Holdings could occur therefore only if Tonkin & Taylor subsequently conducted itself in such a way as to make it reasonably foreseeable that a third party would rely on the report, contrary to the clearly stated intention when the report was submitted. We can find nothing in what occurred afterwards to support such a finding.

[33] Tonkin & Taylor became a subcontractor to Long. Its focus shifted from an investigation of ground conditions to the implementation of its recommendation for ground improvement by dynamic compaction. Its initial brief had been to investigate and report on foundation conditions as part of an investigation by Centreport Coolstores and Long into "the feasibility of the project". The next phase was to give effect to its recommended solution to the unsatisfactory ground conditions, a recommendation which, as already noted, McKinlay Hendry insisted that Long pay for as coming within Long's brief to design and build.

[34] On instructions from Long, Tonkin & Taylor drafted the specification for ground improvement by dynamic compaction. That, as we have earlier said, formed the basis of the cost estimate of $515,000 which Long used to price the contract. Tonkin & Taylor's further report in November 1998, following Long's request to assess likely ground movement if no ground improvements were undertaken, was also submitted in its capacity as subcontractor to Long. A copy was sent by Long to McKinlay Hendry to support Long's position that it would not carry the risk of seismic damage if no improvements were carried out. On that basis, McKinlay Hendry accepted the need for ground improvement.

[35] Tonkin & Taylor's further involvement in the project before the contract was signed on 25 May was again at the behest of Long. Tonkin & Taylor then learnt that the owner of the building would be Kings Wharf Holdings, but it had no dealings with that company (after its incorporation on 19 May) or with McKinlay Hendry or Centreport Coolstores. Tonkin & Taylor dealt only with Long which asked it to review its recommendations in light of the decision to re-site the building closer to the end of the reclamation.

[36] After the May 1998 report was submitted, Tonkin & Taylor therefore had no dealings with McKinlay Hendry or either of the proposed owners of the coolstore. There is nothing to suggest that during that period it expressly or impliedly agreed to the report being used by Kings Wharf Holdings. It agreed, of course, to the report being used by Long, for the purpose of its developing the design of the building and to arrive at the tender price. Miller J also found that Tonkin & Taylor would have known that its report would be relied on by Centreport Coolstores as well as Long in negotiating a construction contract. But knowledge of the report's use for that purpose does not, without more, constitute an agreement to its use as required by the words of exclusion.

[37] More generally, the course of events since May 1998 casts doubt on the proposition that it was reasonably foreseeable that the report would be used by Kings Wharf Holdings for the purpose of the building contract entered into a year later. The report was sought and prepared as part of a feasibility study, not for the purpose of a building contract. There was an intermediate review of aspects of the initial

findings, at the request of and for the benefit of the builder. The building design and location changed and a further geotechnical review was underway when the contract was signed. These circumstances tell against a finding that reliance for the purpose of the contract was reasonably foreseeable.

Contractual arrangements

[38] The contractual arrangements between the parties are relevant to the existence of any agreement to use the report and also to the broader question of whether it is fair, just and reasonable to impose a duty of care. As this Court said in *RM Turton & Co Limited (In Liquidation) v Kerslake* [2000] 3 NZLR 407 at [9]:

> The question is not simply whether there is an established contractual chain of rights, but whether the contractual chain shows or supports intentions regarding the assumption or allocation of risk and responsibility inconsistent with the claimed tort duty.

[39] Tonkin & Taylor was careful to identify to whom it was contracted at any particular time and to limit its liability. Long was meticulous to measure and define its obligations. Following the May report, it took all the steps necessary to develop and cost the recommendation for ground improvements. Costs were significantly higher than initially estimated by Tonkin & Taylor. Long arranged for the further seismic risk assessment to be carried out in November and for the further review following a change to the building location.

[40] The steps taken by Long to control the risks it was assuming include its advice to Centreport Coolstores in November 1998 that it was not prepared to carry the risk of damage by earthquake if ground improvements were not carried out. On the other hand, in its contract with Kings Wharf Holdings, it reserved the right to review the foundation design. As Mr Macdonald submitted, that explicitly left open the possibility that the cost of ground improvements could reduce.

[41] In this regard, it is significant that in its May report Tonkin & Taylor said:

> During excavation and construction, the site should be examined by an engineer or engineering geologist competent to judge whether the exposed subsoils are compatible with the inferred conditions on which the report has

> been based. We would be pleased to provide this service to you and believe your project would benefit from such continuity. However, it is important that we be contacted if there is any variation in subsoil conditions from those described in the report.

Miller J pointed out that such an examination would not occur until after the contract was let. What is significant, however, is that from the outset it was recognised that actual conditions may differ from those anticipated with a consequential change to the ground improvements required. The risk (and the benefit) of any such change was assumed by Long.

[42] Kings Wharf Holdings (and McKinlay Hendry and Centreport Coolstore) were content to agree to the proposal put forward by Long. They could have engaged their own consultant (as they did in relation to refrigeration) or sought a contractual commitment from Tonkin & Taylor. Kings Wharf Holdings chose to assume the risk that ground improvements would cost less than provided for, just as Long assumed the risk that they could cost more. That is precisely the allocation of risk which it is commonplace for a building contract to determine. The parties accept the risks they have negotiated and paid for.

[43] The contractual arrangements tell against an assumption of responsibility contrary to the express stipulation in the May 1998 report. They are also a compelling policy consideration against the imposition of a duty of care. In *Rolls Royce v Carter Holt* this Court said at [118]:

> The main policy factor militating against a duty of care is the need for commercial certainty. Commercial parties are normally entitled to expect that the risk allocation they have negotiated (and paid for) will not be disturbed by the Courts. It is also to be expected that commercial parties are capable of looking after their own interests, including, especially in an industry where insolvency is a major risk, the risk of insolvency of an intermediate party.

[44] The appellants were content to define their rights and obligations by contract. The way in which they chose to allocate the risk associated with ground improvements turned out to be to their disadvantage. It was a risk they voluntarily assumed. In the circumstances, they must live with the consequences. It would not be fair, just and reasonable to impose a duty of care.

Result

[45] The appeal is dismissed with costs of $6,000 to the respondent and usual disbursements.

Solicitors
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Phillips Fox, Auckland for Respondent