

THE UNEXPLORED CONTRACT AND INSOLVENCY LAW DIMENSIONS OF *HEDLEY BYRNE V HELLER*

DAVID CAMPBELL  AND DAVID MILMAN*

ABSTRACT. *It has been argued in previous work that Hedley Byrne v Heller addressed no actual mischief. In the case itself, the defendant’s credit reference about Easipower Ltd. was neither a misstatement nor negligently given, and in general the indemnification of reliance on negligent statements is far better regulated by contract than it can possibly be by negligent misstatement. This paper expands on the significance of contract relative to tort in Hedley Byrne, but mainly argues that the mischief perceived by the claimant was caused by the operation of the statutory regime regulating Easipower’s insolvency. This makes regarding Hedley Byrne as a necessary response to “the privity of contract fallacy” even more implausible.*

KEYWORDS: *negligent misstatement, privity of contract fallacy, insolvency law, intervention, judicial legislation.*

I. INTRODUCTION: WHAT WAS *HEDLEY BYRNE V HELLER* ABOUT?

One of the current authors has previously argued that the creation by judicial legislation of the tort of negligent misstatement in *Hedley Byrne and Co. Ltd. v Heller and Partners Ltd.*¹ was undermined from the start because the credit reference central to the case was not a misstatement and was not given negligently.² It was also argued that the creation of negligent misstatement at all was a grave policy error because indemnification of reliance on a negligent statement is, as a matter of fundamental principle, something

* Lancaster University Law School. We should like to thank the Editor and her referees for their particularly helpful comments.

¹ [1962] 1 Q.B. 396 (hereafter, *Hedley Byrne C.A.*); [1964] A.C. 465 (hereafter, *Hedley Byrne H.L.*). The unreported judgment at first instance, handed down by McNair J. in the Commercial Court on 20 December 1960, is now available in K. Barker, R. Grantham and W. Swain (eds.), *The Law of Misstatements* (Oxford 2015), 345–57 (hereafter, *Hedley Byrne Q.B.D.*). The *Hedley Byrne* House of Lords case papers (hereafter, *Hedley Byrne* papers) are available in the Parliamentary Archives at HL/PO/JU/4/3/1107. These papers contain the parties’ Statements of Case before the Lords, and, in two Appendices, other matters including the Writ of Summons, the parties’ Points of Claim and Defence before trial, and the oral and documentary evidence at trial. The Petition of Appeal to the Lords is also available at this location. Other papers are held at HL/PO/JO/10/11/810/358, but these are purely procedural.

² D. Campbell, “The Absence of Negligence in *Hedley Byrne v Heller*” (2016) 132 L.Q.R. 266.

which is very much better handled by the law of contract.³ But, of course, the significance of *Hedley Byrne* is precisely that it is one of the foundational interventionist circumscriptions of contract in the law of private obligations. Lord Denning was entirely right to claim⁴ that *Hedley Byrne* effectively made his dissent in *Candler v Crane, Christmas and Co.*⁵ into law, and in that case he had criticised the barrier to non-contractual liability for negligent statements presented by “the privity of contract fallacy”⁶ as evidence that England and Wales were not “in a state of civilisation”.⁷ As doing so is the entire point of the previous work mentioned,⁸ we do not wish to here criticise this circumscription of contract as a matter of policy. In this paper we will criticise *Hedley Byrne* as resting on a mistaken understanding of what caused the grievance which led to the case being brought. This mistake is significantly characteristic of interventions in the market.

As any reader of this paper will know, the plaintiff (hereafter, claimant), Hedley Byrne and Co. Ltd., was an advertising agency which had suffered a very substantial loss in the liquidation of its client, Easipower Ltd., and *Hedley Byrne* turned on a credit reference given by Easipower’s bank, Heller and Partners Ltd., less than four months before Easipower went into insolvent liquidation. The wording of a second reference, sought on 4 November, namely only two months before liquidation, does in fact raise additional issues of interest, but these need not be discussed here. For reasons set out in the previous work mentioned but which will be briefly recapitulated, there was *no* prospect of the claimant succeeding in a negligence action brought on the basis of the giving of references of this nature. When *Hedley Byrne* is considered as private litigation, though it very rarely is despite the extent of the discussion it has received, the question arises why the case went to the House of Lords when this could not possibly have benefitted the claimant.

The main answer to this question lies in the unknowing role the claimant was led to play in this major act of judicial legislation, the account of which in the previous work mentioned will again be briefly recapitulated. But in this paper we will additionally argue that what is all but universally

³ D. Campbell, “The Curious Incident of the Dog that Did Bark in the Night-time: What Mischief Does *Hedley Byrne and Co. Ltd. v Heller and Partners* Correct?” in Barker et al. (eds.), *Law of Misstatements*, ch. 5 and D. Campbell, “The Consequences of Defying the System of Natural Liberty: The Absurdity of the Misrepresentation Act 1967” in T.T. Arvind and J. Steele (eds.), *Contract Law and the Legislature* (Oxford 2020), ch. 7.

⁴ Lord Denning, *The Discipline of Law* (London 1979), 237.

⁵ [1951] 2 K.B. 164 (C.A.).

⁶ *Ibid.*, at 177.

⁷ *Ibid.*, at 176; quoting Knight Bruce L.J. in *Slim v Croucher* (1860) 45 E.R. 462, 466 (Court of Chancery). The defendant in *Candler* could and should have been found liable on the existing law criticised as unable to ground such liability: Campbell, “Curious Incident”, 114–15, 129.

⁸ The argument is expanded to cover the entire doctrine of consideration, and so the entire regulation of private economic action, in D. Campbell, *Contractual Relations* (Oxford 2022), ch. 5.

analysed in terms of negligence can properly be understood only in the context of the defendant's conduct of its banking relationship with Easipower, which was fundamentally a matter of corporate insolvency law. The claimant took such a poor view of that conduct that it made a complaint about it to the police,⁹ and *Hedley Byrne* was originally brought as an action alternatively in negligence and fraud.¹⁰ Throughout the relevant period, Easipower's continued trading was entirely dependent upon financial support from the defendant, until it was the defendant itself which placed Easipower in receivership, followed by a liquidation in which the defendant obtained full protection of its own interests in the company, in marked contrast to the very substantial loss suffered by the claimant. It was not the specific reference but the defendant's general conduct as Easipower's bank which gave rise to the claimant's grievance, and that the reference was treated in the way it was in the hearing of *Hedley Byrne* has led to the law of negligent misrepresentation resting on a most fundamental misunderstanding.

The defendant's power to conduct itself as it did was entirely derived from the prevailing statutory law of corporate insolvency. As is by no means unknown in the history of interventionist criticism of market failure, the mischief in *Hedley Byrne* was caused, not by private economic action, but by government intervention, in this case the companies legislation establishing the prevailing statutory insolvency regime. Given the significance of *Hedley Byrne*, it is of great concern that the tort it created is not merely much inferior to the contractual position it ousted, but that judicial legislation of such significance could be undertaken which completely misunderstood the cause of the mischief, which was not contractual at all.

II. THE INSOLVENCY OF EASIPOWER

A. *The Events Leading to Hedley Byrne and Co.'s Loss*

Though Easipower was a company of substance and prospects, *Hedley Byrne* arose because of its troubled financial situation during the time of its relationship with the claimant.¹¹ Since its incorporation by one Mr. F.A. Williams, Easipower had had a successful record of the manufacture of electrical appliances, especially electric blankets, and Mr. Williams had been able to sell the entire share capital in Easipower to Pena Industries Ltd., which thereby added it to the group of industrial companies of which

⁹ Letter from the defendant's solicitors to the claimant's solicitors, in *Hedley Byrne* papers, Appendix Pt. II, 311.

¹⁰ Writ of Summons, in *Hedley Byrne* papers, Appendix Pt. I, 2.

¹¹ *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 346–52; *Hedley Byrne* C.A., [1962] 1 Q.B. 396, 397–99, 402–03; Appellant's Statement of Case, in *Hedley Byrne* papers, 1–8; and *Hedley Byrne* H.L., [1964] A.C. 465, 467–69. We have sought to keep the identification of the confusingly numerous individuals and legally distinct companies involved in *Hedley Byrne* to the minimum necessary for the purposes of this paper.

Pena Industries was the holding company. Mr. Williams remained as the managing director of Easipower.¹² In 1957, the Pena Group, through an intermediary, Applied and Marketing Advertising Ltd., began to engage the claimant's advertising services, and a contract between the claimant and Easipower for a £100,000¹³ advertising campaign was proposed at the end of 1957. Very substantial bookings of advertising space for this campaign were made in July and August 1958. These placed the claimant at a particular financial risk because Easipower paid on a month's credit, and, more importantly, because, in order to attain the "recognition" from major media companies which would allow it to book advertising with them, any advertising agency had itself to assume liability for all bookings made. This meant that in this case the claimant effectively was Easipower's *del credere* agent, and the claimant estimated its exposure at any one time to be between £8,000 and £9,000.

In April or May 1958, the claimant became aware that the Pena Group was in financial difficulties, and indeed by its own petition Pena Industries went into liquidation on 23 June. The claimant was given assurances by Applied and Marketing Advertising that Easipower itself was in receipt of satisfactory financing from Heller and Partners, the merchant bank which was to become the defendant in the case. From early 1958, the defendant had provided, in effect, short-term loans to Easipower through forms of artificial financing variously described as "sales finance" and "stock finance". McNair J. clearly disapproved of what he described as "schemes intended in effect to provide advances on the security of goods in such a way as to avoid the operation of the Bills of Sale Acts", but he thought it "unnecessary . . . to express any opinion on their legal validity".¹⁴ On the known facts, the arrangements between the defendant and Easipower, which required the creation and use of an intermediary company to make "sales" so as to provide the short-term loans, would seem to exemplify Atiyah's description of "Parties [going] through the motions of entering into . . . a contract to sell goods with the intention of using the goods as security for a loan of money",¹⁵ doing so in a way which would avoid the registration requirement under The Bills of Sale Act 1878, s. 8. As *Hedley Byrne* involved a company creating security in effect but not

¹² On Easipower's liquidation, much of its assets, stock and goodwill was purchased by Mr. Williams, and a re-formed Easipower resumed trading as Dreamland Electrical Appliances Ltd.: R. Stevens, "*Hedley Byrne v Heller: Judicial Creativity and Doctrinal Possibility*" (1964) 27 M.L.R. 124, n. 6. Effectively this company remains in business today as the UK's leading supplier of domestic electrically heated bedding and related goods.

¹³ If we may point out the obvious, the real sums at issue in *Hedley Byrne* are much more significant than this nominal figure, and other figures to be quoted, indicate. The Bank of England online inflation calculator states the value of £100,000 in 1958 to be circa £1,650,000 in 2022. The £15,354 3s. 6d. claimed is now circa £250,000.

¹⁴ *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 348.

¹⁵ P.S. Atiyah, *The Sale of Goods*, 8th ed. (London 1990), 18. This wording is abandoned in C. Twigg-Flesner and R. Canavan, *Atiyah and Adams' Sale of Goods*, 14th ed. (Harlow 2021), 19.

in name, the equivalent resistration requirement at the Companies Registry (which was being circumvented) would have been imposed by the Companies Act 1948, s. 95(2)(c).

But the sales aspect of these arrangements would not seem to have involved anything outside of the ordinary practice of receivables financing and similar arrangements regulated by a law which “condones artificial transactions, so long as the parties to the transaction do what they say they are doing”.¹⁶ The Bills of Sale Act registration requirement itself, which is directed towards parties which might take a direct interest in the goods sold, was not really germane to the claimant. We shall turn to a company law aspect of this financing below. For the moment it is necessary only to note that it was only a serious weakness in its finances that would have led Easipower to enter into such arrangements.

These arrangements must be put in the context that, leaving aside sums owed to trade creditors which came to include the claimant, during 1958 Easipower’s survival became entirely dependent on direct bank finance from the defendant. On 9 May, the defendant took over a debt of £45,730 9s. 7d. which Easipower owed to Concor, a bank in, and a member of, the Pena Group. On or about 13 May, the defendant took over an overdraft of £15,164 8s. 3d. extended to Easipower by another merchant bank, Martins Bank Ltd.,¹⁷ and with this obtained a debenture securing the overdraft by creating a floating charge over the undertaking and property of the Easipower company. Having thus consolidated Easipower’s position, on 23 May the defendant extended it an overdraft of up to £50,000. This would all seem to have been done on the basis of an expectation that Easipower’s position, especially with the aid of the advertising campaign, would markedly improve towards the end of 1958 as sales of electric blankets, on which Easipower was concentrating, would increase in anticipation of the seasonal cold weather. In early 1958, Mr. Williams had submitted to the defendant an estimate that by November Easipower would be showing a profit of £46,000 on its trading account. Furthermore, from May 1958 Mr. Williams sought to put together an offer to buy Easipower out of the distressed Pena Group, and the defendant thought this would constitute a major improvement in Easipower’s management.

Despite the defendant’s support, Easipower’s financial difficulties grew during 1958, and these were manifested in pressing demands from creditors which were satisfied only after substantial delays. Far from seeing the overdraft reduced, the defendant had to increase it by £5,000 until the end of

¹⁶ M.G. Bridge, *The Sale of Goods*, 4th ed. (Oxford 2019), paragraph 2.68.

¹⁷ In its Points of Claim, in Hedley Byrne papers, Appendix Pt. I, 5, the claimant alleged that the circumstances, of which the defendant must have known, involved Easipower having been “refused credit facilities” by Martins Bank, but McNair J. describes the refusal in terms which preclude one putting the worst construction on the defendant’s conduct: *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 349.

August 1958. On 18 August, the day that the claimant, prior to making further bookings, sought the reference that became the centre of the litigation, the overdraft stood at £53,865. Understanding that reference to be a satisfactory basis on which to undertake exposure to the possible loss of £8,000–£9,000, the claimant continued to make bookings, though that its concerns were not fully allayed is shown by its seeking the second reference. Easipower's position had in fact deteriorated to the point where, on 27 November, it instructed the claimant to cancel all outstanding advertising bookings, which the claimant sought to do, the commitments it was unable to cancel being the basis of the claim in *Hedley Byrne*.

Prior to Easipower issuing this instruction to the claimant, it had on 20 November been given formal notice by the defendant that its overdraft must be reduced to £40,000 by the end of November, but it did not comply. On 2 December, the defendant refused to honour a cheque for £2,711 drawn by Easipower in favour of the claimant, and on 14 January 1959 the defendant, on the joint request of Mr. Williams and the liquidator of the parent company, appointed a Receiver under the debenture it had acquired from Martins Bank. Easipower was then, as McNair J. put it, "forced into liquidation".¹⁸

The results of this liquidation were markedly different for the defendant and the claimant. As a secured creditor, the former received payment of the entire outstanding overdraft plus interest. In contrast, the claimant's exposure to media companies was double what it had anticipated, having reached £17,661 18s. 4d. As an unsecured trade creditor, the claimant received only a dividend of 2s. 6d. in the £1, amounting to £2,207 14s. 10d. The action was brought in regard of the £15,354 3s. 6d. which represented the difference between these sums.¹⁹

B. The Criticisms of Heller and Partner's Conduct

Though it plays a vanishingly small part in the enormous literature on *Hedley Byrne*, it was crucial to the case that the claimant originally alleged that the reference was given fraudulently, this allegation being abandoned at trial,²⁰ apparently on the first morning of the six-day hearing.²¹ McNair J. rightly proceeded on the basis of the defendant's honesty, but, we submit, he was uncomfortable in doing so. We have noted that he raised, but did not pursue, a question of the legality of the defendant's support of Easipower through forms of artificial financing, and though this question was not a

¹⁸ *Ibid.*, at 351.

¹⁹ There was the prospect of a further dividend of £2,000, but this was not taken into account in the proceedings: *ibid.*, at 356. It would appear that the cheque for £2,711, presumably for Hedley Byrne and Co.'s services in themselves, was eventually paid, but we are unable to say how: Stevens, "*Hedley Byrne v Heller*", 124 n. 6.

²⁰ *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 345.

²¹ Stevens, "*Hedley Byrne v Heller*", 124.

very substantial one, his raising of it conveyed an atmosphere of dubiousness about these arrangements to which we shall return. This atmosphere was certainly thickened when McNair J. said that on 18 August, the date of the reference at the heart of *Hedley Byrne*, that “If not insolvent, as I suspect [Easipower was, it was] showing all the signs of early insolvency”.²² The facts leading McNair J. to this view were then “within the knowledge”²³ of the defendant, and included the “vital” one that Mr. Williams buying back Easipower, which he had been “unsuccessfully attempting to do since May”, was an “uncertain contingency”.²⁴ In the most telling passage of his judgment in this respect, McNair J. said: “In my judgment [*sic*] [on 18 August the defendant did not have] any reasonable ground for supposing that the overdraft would be reduced below £55,000 by the end of August. I accept without reservation the concession made by the plaintiffs during the course of the hearing that the reference given by [the defendant] on 18 August was honestly given.”²⁵

The claimant’s case, of course, rested on their being misled by the reference about Easipower’s financial state, for it argued that if it had possessed accurate knowledge of that state, it would have taken steps to minimise its exposure:

the plaintiffs claim that in reliance on the references, which they had no reason to question, they refrained from cancelling the orders so as to relieve themselves of their current liabilities if [the first reference] had been unsatisfactory [the claimant] would have gone to Easipower Limited and requested them to pre-pay their accounts, and . . . if this request was not complied with [the claimant] would have taken immediate steps to cancel the outstanding order so far as [it] could.²⁶

It is readily possible to understand why an allegation of fraud was made: “It was urged on behalf of the Plaintiff that the fact that Easipower Limited were heavily indebted to the defendants and that the defendants might benefit from the advertising campaign financed by the Plaintiffs. [These facts] clearly [would have been] relevant on the question of honesty if this had been an issue.”²⁷

On the facts known to us, it is not possible to say exactly why the allegation of fraud was abandoned, though in the remainder of this paper we will offer two reasons for this. The first, relating to the framing of the case in negligence, adds an important further dimension to the account of the litigation in the previous work mentioned; and the second, about the

²² *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 349.

²³ *Ibid.*

²⁴ *Ibid.*, at 350–51.

²⁵ *Ibid.*, at 349–50.

²⁶ *Ibid.*, at 345, 350.

²⁷ *Ibid.*, at 354.

allegation's scant prospect of success, speaks to the main argument of this paper about the role of insolvency law.

C. Hedley Byrne as Negligence

In correspondence with one of the present authors, the late Hon. David Ipp, A.O., Q.C., formerly a Judge of the New South Wales Court of Appeal, provided previously unknown detail about the way the claimant came to bring its action. Mr. Ipp recalled a conversation he had had in 1963 with Mr. J.O. (Oliver) Hedley, the Chairman and Managing Director of the claimant, when the disaster that had befallen his firm was still evidently at the forefront of Mr. Hedley's mind:

In 1963, I attended a cocktail party in Johannesburg. In the course of the evening, a large, burly man confronted me. He introduced himself as Oliver Hedley and mentioned that he had been informed that I was a recently admitted solicitor. When I conceded that this was correct, he commiserated with me on my choice of career and launched into violent criticism of the legal profession. He explained that his company, Hedley Byrne, had been involved in unsuccessful legal proceedings in London that had ended in the House of Lords, with his company being required to pay an extraordinarily high amount of costs. He said that his lawyers had told him that the case had established the existence of a new tort, negligent misstatement, but this did not interest him and, indeed, was cold comfort. Above all, he was aggrieved at the legal advice he had received.

Mr. Hedley informed me that when he first consulted his solicitor about the loss Hedley Byrne had suffered through his reliance on the satisfactory credit reference given by the defendant in the proceedings, he was told that there was no remedy in law available to his company. He was not prepared to accept this advice, however, as he believed the absence of a remedy, in the circumstances, was very unfair. He requested his solicitor to arrange a conference with "the best barrister in England".

Thus, his solicitor retained Gerald Gardiner Q.C., and in due course a meeting was arranged with the great man. At the conference, Gardiner was enthusiastic about the proposed action. He told Oliver Hedley that he had long been waiting for such a case, as it was time in his view that the tort of negligent misstatement was recognised, and he wished to be part of the steps taken to achieve that result. He told Mr. Hedley that his company would lose at first instance, would lose before the Court of Appeal, but would win before the House of Lords. On the strength of this advice, Mr. Hedley agreed to pursue the action. Gardiner said that he would not appear for the claimant until the matter came before the Lords.²⁸

It is clear that Gardiner wanted this action to proceed because he thought it would lead to the creation of the tort of negligent misstatement when

²⁸ Campbell, "Misrepresentation Act", 145–46. An anonymous reviewer has rightly sounded a note of caution about relying on what was said of a legal action by the losing party. But we place no reliance on any judgments by Mr. Hedley, only on his statements of fact, albeit ones we are unable to corroborate, which would have to be flat lies to be untrue.

Hedley Byrne reached the Lords. This was all part of a wider attempt to reform the law of liability for negligent statements made in the 1960s of which Gardiner must be seen as the main driver, even before taking into account his full role in *Hedley Byrne*.²⁹ His role in this reform is described in the previous work mentioned, but, in sum, in addition to advising the claimant in *Hedley Byrne*, he had provided very influential political support for the creation of the tort, was a member of the Law Reform Committee that proposed the Misrepresentation Act 1967, and, as Lord Chancellor in the Wilson Governments of 1964–70, secured the passage of that Act.

Gardiner's advice was disastrous for the claimant in *Hedley Byrne*. He would seem to have disregarded the possibility of success with the allegation of fraud, but though it is one purpose of this paper to show why this allegation all but certainly would fail, it nevertheless held more possibility of success than negligence ever could. In the Court of Appeal, Harman L.J. concluded his judgment by saying: "once the plaintiffs . . . decided to abandon their charge of fraud, they had no hope of success".³⁰ By this His Lordship meant that there was no legal ground on which the claimant could succeed. But even if we regard the ultimate passing of the judicial legislation as settled from the outset, as Gardiner seems to have done, the claimant had no hope of success in negligence. It was shown in the previous work referred to that the reference was not negligently given, and, even if it was, it was given with an agreed disclaimer of liability. McNair J. effectively set up the judicial legislation by finding the reference to be negligent, the demolition of which finding by the Court of Appeal was endorsed in the Lords, and by completely ignoring the disclaimer, but the disclaimer alone meant that the House of Lords was never going to find liability in *Hedley Byrne* itself.³¹ This may, in fact, have eased the passing of the judicial legislation, for it meant that the defendant would not be held retrospectively liable for a tort that did not exist when the reference was given.

D. *Hedley Byrne as Contract*

If we leave aside the superiority in principle of contract over tort in handling indemnification of reliance on negligent statements, there is a specific

²⁹ Prior to Mr. Ipp's letter, it was a puzzle why, in the House of Lords, Gardiner replaced the claimant's previous counsel: P. Mitchell, "*Hedley Byrne and Co. Ltd. v Heller and Partners Ltd. (1963)*" in C. Mitchell and P. Mitchell (eds.), *Landmark Cases in the Law of Tort* (Oxford 2010), ch. 7, 182; and Campbell, "Absence of Negligence", 277.

³⁰ *Hedley Byrne C.A.*, [1962] 1 Q.B. 396, 416.

³¹ We do not wish to repeat the detail of the argument in previous work, but it is convenient to emphasise that in *Hedley Byrne H.L.* [1964] A.C. 465, 533, even Lord Devlin, whose speech most closely prefigured what was to become the law of negligent misstatement, accepted that "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." See also *ibid.*, at 492 (Lord Reid), 504 (Lord Morris), 511 (Lord Hodson), 539–40 (Lord Pearce).

contractual issue in *Hedley Byrne* that has received very markedly inadequate attention in the literature on the case. The claimant did not have any direct contact with the defendant. It brought its concern about Easipower's finances to the attention of its own bank, the National Provincial Bank, in terms which are described thus by McNair J.: "On 18th August [the claimant] telephoned [the National Provincial] asking for a reference as to the ability of Easipower Limited to meet a debt of £8,000 to £9,000, this being the figure that [the claimant] estimated would be at risk at any one time."³²

The National Provincial contacted the defendant by telephone on 18 August, and later that day received a telephone reply, the substance of which, constituting the reference central to the case, it shortly afterwards communicated to the claimant, confirming this in writing on 21 August. That the defendant gave the reference in a brief, impromptu telephone conversation merely emphasises what really should have been unarguable, that this was a common form bankers' credit reference, given without payment as a commercial courtesy, and it could not reasonably be expected to involve more than a duty to give an honest answer to the question whether Easipower had a commercial bad character, and indeed an honest answer which had to be understood in the context of a bank giving a reference about one of its own customers.

If the reference was given dishonestly by the defendant, the National Provincial could argue that it itself had been deceived. On the other hand, though the issue was not raised, if the defendant was negligent in giving the reference, then it must be the case that the National Provincial was also negligent in just communicating it. But the National Provincial was, of course, in a contractual relationship with the claimant, and had the claimant brought its action against it, there would have been no ground for creating negligent misstatement. This contractual relationship repays closer attention, and whilst the facts known to us do not allow a full picture of this relationship to be drawn, some things can be said with confidence.

In its Points of Claim, the claimant alleged that:

At the time of [the first reference] the Defendants were well aware of the . . . facts and matters concerning the standing and financial position of Easipower Limited, but failed to communicate any of such facts to the Plaintiffs' said bankers and stated or implied (contrary to the fact) that the said Easipower were solvent and could safely be granted credit . . . the aforesaid dishonest and or alternatively negligently given information about Easipower Limited was passed on to the Plaintiffs . . . in order to induce the Plaintiffs to continue to give credit to the said Easipower Limited, the Defendants by giving the [second] reference . . . to the Plaintiff's bankers on their behalf, falsely and fraudulently represented that the said Easipower Limited were solvent or could safely be granted credit and or alternatively continued credit.³³

³² *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 347.

³³ *Hedley Byrne* papers, Appendix Pt. I, 5–6, 9.

This could have succeeded in fraud, but the defendant could not possibly have been negligent because, despite the conclusion of McNair J. that the reference “meant that Easipower could safely be granted credit for that sum”,³⁴ no common bankers’ reference could reasonably be expected to go beyond whether Easipower had a bad character. It is, with respect to McNair J., preposterous to think it could. We cannot improve on the way the point was made in previous work:

If the claimant wanted a detailed investigation made of Easipower’s finances on which it could confidently rely to protect it from the risk of assuming the *del credere* obligations it undertook, it would have had to take steps very different from those it did take. It would have had to pay for such an investigation by accountants or other business analysts (perhaps as employees or agents of its bank) who were able to secure access to normally private information about Easipower (and Pena Industries). Such parties will by default be liable in contract, not merely for fraud, but for negligence assessed against the background of the scope and scale of the investigation and the size of the payment for it.³⁵

But though the reference sought could not properly assess creditworthiness, is it not arguable that such a proper assessment was exactly what the claimant asked of the National Provincial? If, objectively interpreted, the relationship between the claimant and the National Provincial shows this to be what the claimant did ask for, then by merely seeking a common banker’s reference from the defendant, or at least by passing it on without explanation of what could be expected from such a reference, the National Provincial arguably would have breached the duty to provide its service with reasonable care and skill now codified under The Supply of Goods and Services Act 1982, s. 13.³⁶ We by no means suggest that the objective interpretation of this relationship would yield this result, for even though an advertising agency can legitimately generally defer to the financial expertise of its banker, it is not easy to think that a reference given in the form and manner of the reference central to *Hedley Byrne* would allow reasonable reliance to be placed on it regarding complex questions of creditworthiness and insolvency. What is more, the National Provincial entered its own disclaimer when conveying the defendant’s reference,³⁷ and whilst such an exclusion of contractual liability does, of course, involve issues different to the existence of a duty of care in negligence, we will say no more of this as we believe we have said sufficient to, as is our intention, raise this contractual aspect of the case.

³⁴ *Hedley Byrne* Q.B.D., in Barker et al. (eds.), *Law of Misstatements*, 350.

³⁵ Campbell, “Absence of Negligence”, 274.

³⁶ This relationship would have to go back at least as far as 1 November 1957 when, whilst initially considering the advertising campaign, the claimant asked the National Provincial “whether it would be possible for your people to explore the whole financial set-up [of the Pena Industries group] and let us know whether it is a good risk?”: *Hedley Byrne* papers, Appendix, Pt. II, 206.

³⁷ *Ibid.*, Appendix, Pt. II, 207.

It is, however, not merely that a negligence action in contract, if we can put it this way, had better prospects for the claimant than negligence in tort, but that a contract action could have reached the right answer in a way that negligent misstatement works against. If the claimant had objectively asked for a proper evaluation of creditworthiness, National Provincial would be liable. If, whatever its subjective wishes or hopes, the claimant had failed to do this, National Provincial would not be liable. The right answer would be determined by the intentions of the parties. Negligent misstatement is intended to change this way of determining liability by replacing it with whatever constitutes the duty of care judicial legislation deems necessary for a state of civilisation to exist. We wish to avoid repeating the conclusions of previous work,³⁸ but must observe once again that the course of the abysmal jurisprudence of the tort of negligent misstatement was set in *Hedley Byrne* itself, which involved no misstatement and no negligence.

E. Hedley Byrne as Company Law

There was, we repeat, more prospect of success for an allegation of fraud against the defendant than an allegation of negligence. But this was because the prospect of the latter was zero. The prospect of the former was very small. It is essential to distinguish what we might call the injustice of the relationship between the claimant and the defendant, and the legal possibility of obtaining a remedy for that injustice. The claimant's adverse view of the defendant's conduct was given plausibility by the broad context of the claimant's and the defendant's respective relationships with Easipower. The defendant would have benefitted from the claimant increasing, rather than reducing, its exposure to Easipower, and it would have continued to do so long after the claimant had reached the optimum point for it to try to untangle itself from Easipower's affairs. We are certain that this context was heavily influential in the claimant ever seeing the issue as one of fraud. It is a point of the first importance, however, that this context had nothing whatsoever to do with the common law of contract; it was a context generated by company law, and specifically by the statutory law of corporate insolvency.

III. THE INSOLVENCY REGIME AND HELLER'S CONDUCT

A. Receivership and Liquidation Under the Companies Act 1948

The facts of *Hedley Byrne* can be understood only in the context of the prevailing corporate insolvency regime, which was far less sophisticated and intendedly fair than the one now established in the UK. Essentially, it

³⁸ Campbell, "Absence of Negligence", 276.

was then assumed that when a company became insolvent, there was no way back for it. “Selling up” was the course overwhelmingly often taken. Corporate rescue, which came to the fore only after the 1982 publication of the *Cork Report*,³⁹ was not on the agendas of practitioners or policy-makers.⁴⁰ If a company was burdened by secured debt, in the event of it becoming insolvent it would normally be placed into receivership by the secured creditor, typically its bank. This could be done out of court, initiated by the giving of notice to the company under a procedure prearranged under a debenture.⁴¹ The bank was not required to consider the consequences of this traumatic intervention for other stakeholders in the company.⁴² It was merely crystallising the rights which it had obtained when it loaned money to the company under the debenture. The receiver would very much be acting for the bank,⁴³ and would normally realise any available secured assets in order to allow the bank to recover its loans. Once this destructive process was completed, the company would be placed into liquidation, as happened to Easipower, with the proceeds of the winding-up of any remaining unencumbered assets being used to pay dividends to unsecured creditors *pro rata* under the *pari passu* rule. At that time, insolvency practitioners such as receivers and liquidators were not subject to the intendedly fairer regulatory regime that applies to insolvency office holders today. Investigations into the causes of the corporate collapse were perfunctory, if made at all.

The corporate insolvency model of the 1950s and 1960s was heavily geared towards protecting the interests of secured creditors, which were

³⁹ Sir Kenneth Cork, Chairman, *Report of the Committee to Review Insolvency Law and Practice* (Cmnd 8558 1982).

⁴⁰ There was one important exception, Cork Gully, the accounting firm of which K.R., later Sir Kenneth, Cork was Managing Director at the time of *Hedley Byrne*. It is fascinating to note that the correspondence entered as evidence shows that Mr. Cork was one of the joint liquidators in the voluntary liquidation of Easipower (*Hedley Byrne* papers, Appendix Pt. II, 313), part, it would seem, of a wider role he played in the liquidation of the Pena Group. We are confining this material to a footnote because it is not possible to describe in any detail either Sir Kenneth’s role in the Pena liquidation or the impact this personal experience had on the *Cork Report*, but points of a general kind certainly may be made. Since it was founded in 1935 by Cork’s father, Cork himself and a third partner, Cork Gully had sought to encourage the approach of taking a much more optimistic view of the prospects of distressed companies: K. Cork with H. Barty-King, *Cork on Cork: Kenneth Cork Takes Stock* (London 1988), 28. The Pena liquidation was an important stage in the development of this approach. Describing Peto-Scott Electrical Instruments Ltd. as the “principal manufacturing interest” of the Pena Group, acquired “not with cash but with worthless paper – shares in other companies in [the] group” (*ibid.*, at 38–39), Sir Kenneth goes on to tell us that it was “only [when] in 1958 that [I] was appointed receiver of Peto-Scott Electrical Instruments Ltd. that we were able to practise on a large scale what we had preached for so long: that receivership did not necessarily lead to closure. At last we were able to demonstrate our approach, that being a receiver involved a much wider responsibility than merely satisfying the debenture holder by a quick sale of assets and withdrawal” (*ibid.*, at 38).

⁴¹ The notice could be followed by the immediate appointment of a receiver: *Cripps (Pharmaceuticals) Ltd. v Wickenden* [1973] 1 W.L.R. 944 (Ch.D.). The out of court procedure superseded the former practice of petitioning the court for the appointment of a receiver. Easipower entered receivership by out of court appointment.

⁴² *Re Potters Oil Ltd.* (No. 2) [1986] 1 W.L.R. 201 (Ch.D.). The concept of a “stakeholder” was, of course, not then recognised in English Law: *Parke v Daily News* [1962] Ch. 927 (Ch.D.).

⁴³ Notwithstanding the legal fiction that the receiver was the company’s agent. The *Cork Report*, ch. 8 made a number of criticisms of this aspect of the receivership model.

the key players in the contemporary corporate finance model.⁴⁴ Since 1870,⁴⁵ secured creditors had had at their disposal the device of the floating charge, which enabled them to hold all but unrestricted security over the company's assets, whilst allowing the company the freedom to utilise those assets in the ordinary course of business.⁴⁶ This "invisible" financing arrangement, which did not alert unsecured creditors to a possible security existing over company assets, had long attracted serious adverse judicial comment⁴⁷ because of its unfairness towards unsecured creditors who, if suspicions had not been aroused by their dealings with the company, typically did not check the charges register. It was, nevertheless, still the norm in commercial practice in the 1950s and 1960s. Unsecured creditors of an insolvent company like Easipower could well find that they received "little or nothing"⁴⁸ on liquidation because most assets were covered by security. The atmosphere we are trying to convey is powerfully captured by the Cork Committee saying it still, in 1982, agreed with the assessment of the situation by Lord Macnaghten in *Salomon v Salomon*!⁴⁹ His Lordship had said:

For such a catastrophe as has occurred in this case some would blame the law that allows the creation of a floating charge. But a floating charge is too convenient a form of security to be lightly abolished. I have long thought, and I believe some of your Lordships also think, that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is.⁵⁰

The fundamental parameters of this insolvency regime were set by the twin concepts of general limited liability and separate corporate personality created by the Victorian Companies Acts, which, together with the modern creation of fiat money, are arguably the most far-reaching interventions

⁴⁴ We put to one side that matters could be even more difficult for unsecured creditors when a group of companies was involved, as there was no such thing as group liability, even when there had been cross-financing between members, as in the case of Easipower receiving finance from a bank in the Pena Group. This additional difficulty was generally discussed in the *Cork Report*, ch. 51. Of his experience of this concerning the Pena Group, Sir Kenneth told us (*Cork on Cork*, 39), that "Once Pena had borrowed money from [a] bank on the security of the . . . assets of Peto-Scott – a floating charge as well as a fixed charge – they used it not for [investment in Peto-Scott] but to pump life into other ailing companies in the Pena Group. The borrowed money was switched around the group – a multiplicity of inter-subsidary transactions which gave a paper impression of solvency, of profitability even. But the lack of substance was evident to anyone who took trouble to trace the maze of pledging assets, borrowing money [and] losing it in some remote corner of the Pena Empire".

⁴⁵ *Re Panama, New Zealand and Australian Royal Mail Co.* (1870) L.R. 5 Ch. App. 318 (Court of Appeal in Chancery).

⁴⁶ *Illingworth v Houldsworth* [1904] A.C. 355 (H.L.).

⁴⁷ *Re London Pressed Hinge Co. Ltd.* [1905] 1 Ch. 576 (Ch.D.) (Buckley J.).

⁴⁸ *Cork Report*, paragraph 1487.

⁴⁹ *Ibid.*

⁵⁰ *Salomon v Salomon and Co. Ltd.* [1897] A.C. 22, 53.

ever made.⁵¹ These concepts of course meant that there was no common law recourse available against those who controlled the company, save in cases where a written guarantee of the company's debts had been provided, or possibly in cases where a written confirmation of its creditworthiness had been supplied.⁵²

The Companies Act 1948, s. 332(1)⁵³ gave the court a power to declare "any persons" that had engaged in "fraudulent trading" "in the course of winding up a company" "personally responsible, without any limitation of liability for the debts . . . of the company".⁵⁴ Introduced during the reforms of the late 1920s, fraudulent trading sought to discourage the abuse of limited liability to "defraud" creditors upon insolvency. As section 332(1) was explicitly directed at "any persons", those against whom a claim could be brought were not restricted to the directors or other officers of Easipower, and could have included those in control of the Pena Group, or possibly the officers of Heller as the bankers of Easipower.

But save in the clearest of instances, there were good reasons not to pursue a claim based on fraudulent trading against a company's bank. Actual *dishonesty* and *active participation* in the fraud had to be established.⁵⁵ It was expressly provided that a claim of fraudulent trading could be pursued by the liquidator "or any creditor or contributory of the company", but persuading a liquidator to bring such a claim would be difficult to say the least, so in reality the onus of doing so lay with an aggrieved creditor, who therefore would, of course, take on the risk of an adverse costs liability. Litigation funding models in the 1950s and 1960s offered little encouragement to such claims.

As we have discussed, the motivation of the argument of the claimant in *Hedley Byrne* was its belief that the defendant bank had facilitated prolonged trading on credit by Easipower, thus exposing unsecured creditors, whilst ensuring that it itself was well protected if Easipower went into liquidation. The defendant had an interest in unsecured creditors continuing to trade with Easipower, which obviously did not match, or was even opposed to, the interests of those creditors. *Hedley Byrne* could have been devised to illustrate the misalignment of incentives created by the

⁵¹ D. Campbell, "Adam Smith, *Farrar on Company Law* and the Economics of the Corporation" (1990) 19 *Anglo-American Law Review* 185; and D. Campbell and S. Griffin, "Enron and the End of Corporate Governance" in S. MacLeod (ed.), *Global Governance and the Quest for Justice*, vol. 2 (Oxford 2006), ch. 3.

⁵² In its Points of Defence before trial, the defendants raised the requirement of writing in regard of the reference at the heart of the action, with a view to pleading the defence afforded by the Statute of Frauds Amendment Act 1828, s. 6 (Lord Tenterden's Act): *Hedley Byrne* papers, Appendix Pt. I, 24. The case proceeded without the point being raised.

⁵³ Now the Insolvency Act 1986, s. 213.

⁵⁴ Under the Companies Act 1948, s. 332(3), fraudulent trading was also made a criminal offence.

⁵⁵ *Re Wm. C. Leitch Bros. Ltd.* [1932] 2 Ch. 71 (Ch.D.) and *Re Patrick and Lyon Ltd.* [1933] Ch. 786 (Ch. D.). In its Points of Defence, in *Hedley Byrne* papers, Appendix Pt. I, 22, the defendant denied any knowledge that the claimant was to be the ultimate recipient of the reference sought by the National Provincial Bank.

insolvency regime. At the time of the case, the use of floating charges late in the day by secured creditors seeking to protect against formerly unsecured exposure to a debtor company's insolvency was addressed by the Companies Act 1948, s. 322.⁵⁶ This avoided floating charges created by insolvent companies within one year of liquidation, save to the extent of any fresh finance provided in consideration of, and at the same time as or after the date of, the charge. Banks, as repeat players, were aware of this potential threat to their security and were able to find ways around it.⁵⁷ The company's bank would provide post-floating charge finance to be used by the company to repay pre-floating charge unsecured debt owed by the company to that same bank. Shortly after *Hedley Byrne*, an application by a liquidator to prevent the use of this circular stratagem, often characterised as "hardening" the floating charge, was unsuccessful, the Court of Appeal deferring to this contentious banking practice in *Re Yeovil Glove Co. Ltd.*⁵⁸

Despite all this, though as Harman L.J. said, "once the plaintiffs . . . decided to abandon their charge of fraud, they had no hope of success",⁵⁹ that charge was most unlikely to have succeeded. On the known facts, the defendant could not have been said to have acted in a fraudulent manner; it acted to maximise the advantage conferred on it by its legal rights. The injustice manifestly and understandably felt by the claimant was the result of the legal regime prescribing how banks as secured creditors could deal with situations of distress, insolvency and failure. The facts of *Hedley Byrne* known to us reveal a particularly clear example of the situation we are trying to describe.

We have mentioned that McNair J. clearly was disquieted by the "sales" or "stock" financing the defendant extended to Easipower, and that his comments conveyed an atmosphere of dubiety about this artificial financing. His disquiet was expressed in regard to the, as it were, sales aspect of the arrangement, but there was an important company law aspect that was not discussed.⁶⁰ We have also mentioned that, as part of the growing dependency of Easipower on direct bank finance from the defendant, on 9 May the defendant took over the debt of £45,730 which Easipower owed to Concor, a bank in, and a member of, the Pena Group. Easipower then agreed that the "sales" or "stock" financing was to be applied to the discharge of this unsecured debt – that is, effectively a charge in favour of

⁵⁶ Now Insolvency Act 1986, s. 245.

⁵⁷ D. Milman, "Companies Act 1948, s. 322: A Suitable Case for Treatment" (1980) 31 Northern Ireland Legal Quarterly 255.

⁵⁸ [1965] Ch. 148.

⁵⁹ *Hedley Byrne C.A.*, [1962] 1 Q.B. 396, 416.

⁶⁰ It is not, of course, a criticism of McNair J., but it would not have helped at this point that, as he himself freely put it during the re-examination of Mr. Lipman Heller (the Director of the defendant who gave the reference) he (McNair J.) could not claim to be "familiar with company law": *Hedley Byrne* papers, Appendix Pt. II, 151.

the defendant was given a priority over the revenues from Easipower's future sales.⁶¹ But the ploy of using what may have looked like an absolute assignment of what might, in a differently structured finance model, otherwise have become Easipower's book debts to the defendant, would have meant that no registrable company charge was created over these debts.⁶² The defendant itself must have had concerns about these complex arrangements, because the correspondence exhibited in evidence reveals that in May 1958 counsel's opinion was twice sought whether they constituted a fraudulent preference in breach of the Companies Act 1948, s. 320,⁶³ and the opinion was that they did not.⁶⁴

The claimant did make these arrangements the basis of one of its Points of Claim, in a way which was intended to stress that the defendant knew the degree of Easipower's distress. It was claimed that: "The Defendants *under threat of appointing a receiver* had caused the said Easipower Limited to enter into [the arrangements]."⁶⁵ This played no part in any of the judgments, but, to be frank, it caused the defendant little disquiet. Their response to this claim in the Points of Defence was to admit that the claim was indeed true, though the admission did not, of course, employ the words used by the claimant:

The Defendants admit that on 9th May 1958 [a bank in the Pena Group] assigned to them a debt of £45,730 9s. 7d. owing by Easipower Limited The Defendants admit that they *required* Easipower Limited to enter into the said ["sales" or "stock" financing arrangements to pay off the debt] *as one of the terms* on which the Defendants agreed to extend the overdraft facilities available to Easipower.⁶⁶

The defence, which was not required at trial, was, *in nuce*, that under company law, these arrangements were perfectly correct, and, it is submitted, they were. This is by no means to deny that they engendered an atmosphere in which an allegation of fraud was formulated, and in which it could be thought right that an action in negligence as an alternative, but inevitably disastrous, way of restating that allegation should be pursued.

B. What Went Wrong in Hedley Byrne v Heller?

The criticisms of the insolvency regime from which Heller so benefitted that have been made here are by no means intended to amount to an evaluation, much less condemnation, of the overall law of corporate insolvency, or a fortiori of the overall law of general limited liability and corporate

⁶¹ *Ibid.*, Appendix Pt. II, 247.

⁶² Companies Act 1948, s. 95(2)(e).

⁶³ Now the Insolvency Act 1986, s. 239.

⁶⁴ *Hedley Byrne* papers, Appendix Pt. II, 247.

⁶⁵ *Ibid.*, Appendix Pt. I, 5, emphasis added.

⁶⁶ *Ibid.*, Appendix Pt. I, 22, emphasis added.

personality which gives insolvency its basic shape. As it happens, the authors are critical, but to different, degrees, of the latter,⁶⁷ and the current author who is qualified to form an opinion about the former believes the law to be unnecessarily flawed but on balance of value.⁶⁸ This is all incidental to the point that this paper seeks to make.

The defendant's conduct obviously was found highly objectionable by the claimant, and this view *does* have a substantial justification in the unfairness of the prevailing relationship of secured and unsecured creditors, an unfairness which was a main impetus for the *Cork Report*, and so the Insolvency Act 1986. Nevertheless, this view always had little prospect of being the ground of a successful legal action, and it ended up leading to an action being brought against a mischief that did not exist at all. It may very well be the case that the statutory alignment of the incentives of the various parties involved in cases such as the receivership and liquidation of Easipower will always be imperfect or even clearly inadequate, whatever the law.⁶⁹ But what has this to do with a private action concerning reliance on negligent statements under the law of contract? The answer is: nothing. *Hedley Byrne* is a grave policy failure, being largely understood by those who heard it as a serious shortcoming of contract requiring the creation of a tort. This would now commonly be called a market failure. In the previous work we have mentioned, this understanding was argued to rest on a mistaken understanding of the economic action believed to call for this profound intervention, and aspects of this argument have been developed here. In this paper we have also argued that *Hedley Byrne* arose because of the claimant's great, and in a sense justified, dissatisfaction with a legal position created, not by the common law of contract, but by company law statute. Confusion of this sort in the formulation of policy is, however, not uncommon in state intervention, as we shall see in the next section, in which *Hedley Byrne* will be analysed in terms of the criticism of this confusion which was central to the law and economics of the late Ronald Coase.

IV. CONCLUSION: THE FALLACY OF THE PRIVACY OF CONTRACT FALLACY

A. The Railway Sparks Example

Though his own terminology and the specifics of his approach have largely fallen into desuetude, the core concepts of what is now called welfare economics, such as market failure, externality, and social cost, were first organised into a unified theoretical framework by A.C. Pigou, Professor

⁶⁷ Campbell and Griffin, "Enron and the End of Corporate Governance"; and D. Milman, *The Company Share* (Cheltenham 2018).

⁶⁸ V. Finch and D. Milman, *Corporate Insolvency Law*, 3rd ed. (Cambridge 2017).

⁶⁹ It is an irony that one is sure would have been lost on Oliver Hedley that the dividend of 12.5p in the £1 paid to his company as an unsecured creditor of Easipower might well be seen as not ungenerous today.

of Political Economy at the University of Cambridge between 1908–43. The very first example of an externality given in the most important statement of that framework, *The Economics of Welfare*, is the now famous railway sparks example: “It might happen . . . that costs are thrown on people not directly concerned, though, say, uncompensated damage done to surrounding woods by sparks from railway engines. All such effects must be included . . . in reckoning up the social net product of the marginal increment of any volume of resources turned into any use or place.”⁷⁰

The recognition of the centrality of Pigou’s thinking to modern welfare economics is, paradoxically, in substantial part the result of the vehement criticism made by Coase at the end of the 1950s of a Pigouvian influence he then thought “largely the product of an oral tradition”.⁷¹ In particular, that the railway sparks example has been elevated from all but total obscurity is due to its being a substantial focal point of the criticism of “The Pigouvian Tradition” in “The Problem of Social Cost”.

Pigou’s mention of the railway sparks example is cursory. We have quoted all that is said of it in the 200-page Part 2 (of a book which in its first edition exceeded a thousand pages) of *The Economics of Welfare*, the part which discusses what would now be called the divergence of private and social costs. In the analytic contents of the book, Pigou says: “The general problem of this Part is to ascertain how far the free play of self-interest, acting under the existing legal system, tends to distribute the country’s resources in the way most favourable to the production of a large national dividend, and how far it is feasible for state action to improve upon ‘natural’ tendencies.”⁷²

From this perspective, Pigou saw railway sparks as an example of a private economic activity imposing a social cost, with the necessary implication that public intervention to reduce or eliminate that cost should be considered. The “people not directly concerned” could, of course, range from uncompensated landowners, to others enjoying the amenity of the woods, to those objecting to environmental harm in general. If we focus on the first class, a question which did not occur to Pigou but which the approach Coase was then developing made it essential to ask arises: how could the railway companies legally impose this uncompensated harm? A full answer to this question would have to address all of the reasons why Coase believed that the “central role in welfare economics” played by the externality had been “wholly unfortunate”,⁷³ but we shall confine ourselves to one.

⁷⁰ A.C. Pigou, *The Economics of Welfare*, 5th ed. (New Brunswick 2002), 134.

⁷¹ R.H. Coase, “The Problem of Social Cost” in R.H. Coase, *The Firm, the Market, and the Law* (Chicago 1986), ch. 5, 149.

⁷² Pigou, *Economics of Welfare*, viii.

⁷³ R.H. Coase, “The Firm, the Market, and the Law” in Coase, *Firm, Market, Law*, ch. 1, 26.

The details of the legal position are of a fascinating complexity, and have been subject to, in fact, acrimonious debate, but the essentials of the answer Coase gave⁷⁴ to the question of why the sparks example could arise are unarguably correct.⁷⁵ In the period from which Pigou must have drawn his example,⁷⁶ railway companies enjoyed enormous privileges from the statutory authorisation of their operations, and, in particular, the Railway Fires Act 1905, s. 1(3) limited railway companies' liabilities at common law for the harm Pigou had in mind to £100.⁷⁷ On this ground, Coase concluded that "compensation would be paid in the absence of governmental action. The only circumstances in which compensation would not be paid would be those in which there had been governmental action. It is strange that Pigou . . . should have chosen this particular example to demonstrate how it is possible 'for state action to improve upon natural tendencies'"⁷⁸.

Coase was not arguing that the sparks should either legally have been prevented or allowed; nor that the full common law liabilities for the harm they caused should have been imposed; nor that a "bargaining solution" to the sparks problem was ever possible; nor that it would ever have been possible to construct the railway system without extensive statutory authorisation (and other intervention). His views on the railway sparks example can be understood only in the context of appreciating that he was one of the most penetrating ever critics of mainstream economics.⁷⁹

The foundation of Coase's work is his insistence that the theoretical Pareto optimum yielded by general competitive equilibrium can never obtain in the empirical world of positive transaction costs. Market order is impossible without extensive regulation ultimately by law; and cases for intervention intended to achieve a social goal which would increase

⁷⁴ Coase, "Problem of Social Cost", 135–41.

⁷⁵ P.S. Atiyah, "Liability for Railway Nuisance in the English Common Law: A Historical Footnote" (1980) 23 *Journal of Law and Economics* 191; A.M. Linden, "Strict Liability, Nuisance, and Legislative Authorisation" (1966) 4 *Osgoode Hall Law Journal* 196; J. Morgan, "Technological Change and the Development of Liability for Fault in England and Wales" in M. Martin-Casals (ed.), *The Development of Liability in Relation to Technological Change* (Cambridge 2010), ch. 2, 40–51; and M.L. Wilde, "Railway Sparks: Technological Development and the Common Law" (2019) 59 *American Journal of Legal History* 444. The theoretical context of the acrimonious debate between Coase and Professor Brian Simpson around which Wilde's paper is structured is discussed, with full referencing, in D. Campbell and M. Klaes, "What Did Ronald Coase Know About the Law of Tort?" (2016) 39 *Melbourne University Law Review* 793.

⁷⁶ *The Economics of Welfare* was published in 1920 and its last, fourth edition appeared in 1932, though a "fifth edition" reprint of the main text in 1952 added 11 appendices. The mention of railway sparks is identical in all editions. *The Economics of Welfare* is a huge expansion of thinking expressed in *Wealth and Welfare* in 1912, in which, however, the railway sparks example is not given.

⁷⁷ The limit was raised to £200 by The Railway Fires Act (1905) Amendment Act 1923, s. 1. Social and technological circumstances have, of course, so radically changed that what was once an issue of great national importance is now all but an irrelevance. The 1905 Act remains, however, in force, though the limit was raised to £3,000 by the Transport Act 1981, s. 38(1), and the Secretary of State has not exercised his power to amend this limit. Both these adjustments were of course of a merely nominal value.

⁷⁸ Coase, "Problem of Social Cost", 138.

⁷⁹ D. Campbell and M. Klaes, "The Principle of Institutional Direction: Coase's Regulatory Critique of Intervention" (2005) 29 *Cambridge Journal of Economics* 263.

the welfare yielded by an empirical market can in principle be made, and in important cases have been made. Coase was nevertheless profoundly critical of intervention because he believed that the cases for it were very commonly, or even usually, not made out remotely adequately. He was aware of the possibility that those proposing or carrying out interventions might pursue their own interests rather than the public interest, but this was incidental to his main point. This was that even when the intervention was motivated by the public interest, social costs and their causes could very well be wrongly identified, and that the likelihood of reducing or eliminating those costs was very commonly, or even usually, overestimated because of an excessive belief in the ability of public agencies to bring about an improvement.⁸⁰ Coase regarded Pigou as having set this pattern for gravely deficient cases for intervention,⁸¹ and dwelt on the railway sparks example at length because it presented an aspect of regulatory failure not found in this way in other, far more widely discussed, examples of the divergence of private and social costs which Pigou gave, such as lighthouse building and smoke pollution.⁸²

Leaving aside the difficulties of identifying the overall welfare loss from the sparks at a time when the operation of railways was completely contingent on those sparks being emitted, and the difficulties of deciding upon and implementing a policy about those emissions, Coase's point was that the very problem Pigou used as the first example of market failure was of action resulting from previous government intervention! Pigou was highly sympathetic to socialism, but whilst he seems to have acknowledged the possibility of an ultimately completely planned economy,⁸³ his views were so gradualist that he was for all intents and purposes committed to a mixed economy. In *The Economics of Welfare*, intervention is conceived of as exceptional in an economy in which "the working of self-interest is generally beneficent".⁸⁴ How far this exceptional character can possibly be retained, even if it is desired to do so, in an economy now dominated by public expenditure across the entire range of activity must be open to question.⁸⁵ What is not open to question is that the absurdity of understanding intervention as an improvement upon private action when the action complained of is the "reflexive" product of previous intervention is most unlikely to ever be more amusingly described than it was by Coase:

⁸⁰ D. Campbell, "Ronald Coase's 'The Problem of Social Cost'" (2016) 35 University of Queensland Law Review 75.

⁸¹ D. Campbell, "The Sense in Coase's Critique of Pigou" (2017) 13 The Journal of Law, Economics and Policy 39.

⁸² Pigou, *Economics of Welfare*, 184.

⁸³ A.C. Pigou, *Socialism Versus Capitalism* (London 1937), 137.

⁸⁴ *Ibid.*, at 128; quoting E. Cannan, *The History of the Local Rates*, 2nd ed. (London 1912), 176.

⁸⁵ D. Campbell, "Alcohol-related Disorder and the Nature of the Problem of Social Cost" [2005] Public Law 749.

When they are prevented from sleeping at night by the roar of jet planes overhead (publicly authorised and perhaps publicly operated), are unable to think (or rest) in the day because of the noise and vibration from passing trains (publicly authorised and perhaps publicly operated), find it difficult to breathe because of the odour from the local sewage farm (publicly authorised and perhaps publicly operated), and are unable to escape because their driveways are blocked by a road obstruction (without any doubt publicly devised), their nerves frayed and mental balance disturbed, [most economists] proceed to declaim about the disadvantages of private enterprise and the need for governmental regulation.⁸⁶

The judicial legislative intervention to correct the privity of contract fallacy made in *Hedley Byrne* is absurd in just this way.

B. *The Mischiefs in Hedley Byrne v Heller*

In the previous work mentioned, it was argued that *Hedley Byrne* corrects no actual mischief, neither in the case itself, nor in the private law generally. As an act of judicial legislation directed at a general failure of the law of contract existing only in interventionist imagination, *Hedley Byrne* has had a grave impact on the law relating to indemnification of reliance on negligent statements. But, in light of the argument here, six mischiefs actually related to the case can now be identified, though the first two of these are unproven, and may very well not have existed. First, the defendant may have been fraudulent. Second, the National Provincial Bank may have breached its contractual obligation to provide advice with reasonable care and skill. Third, the defendant's conduct was framed by laws of receivership and liquidation that inadequately regulated bankers' involvement in distressed companies' risk of insolvency. The dropping of the allegation of the first, the second never being claimed, and on the facts of the case it being all but impossible that the third would lead to legal liability, allowed the fourth, fifth, and sixth mischiefs to be brought about by the litigation of the case.

The fourth mischief is, of course, the creation of negligent misstatement. As has been argued in the previous work mentioned, the indemnification of reliance is an economic good, and when it is obtained from another, it should be paid for. In uncomprehending criticism of the law of contract's rational regulation of the allocation of this good as the privity of contract fallacy, *Hedley Byrne* created an alternative which is economically irrational and morally wrong, and for these reasons the law of the attempt to give it effect is very bad. It would be supererogatory for us to argue that negligent misstatement is therefore a graphic illustration of the fifth mischief in *Hedley Byrne*: the hazards of judicial legislation.⁸⁷ But, though doing so requires us to defy the wisdom of the comparison of laws and

⁸⁶ Coase, "Problem of Social Cost", 131.

⁸⁷ R. Buxton, "How the Common Law Gets Made: *Hedley Byrne* and Other Cautionary Tales" (2009) 125 L.Q.R. 60, 61–68.

sausages attributed, wrongly it seems,⁸⁸ to Bismarck, it should be noted that in the specific case of *Hedley Byrne*, judicial legislation involved a sixth mischief.

Lord Denning's belief that what he asked for in *Candler v Crane, Christmas* and what was done in *Hedley Byrne* was but one instance of necessary innovation in the common law turns, with respect, on an unacceptably excessive idea of such innovation.⁸⁹ To reproduce the legitimacy that lies behind the claim that "the common law . . . works itself pure",⁹⁰ that law, even or especially in cases of innovation,⁹¹ must respect the constraint that "policy is for the legislature, not for the courts, and so is change, even in pure common law".⁹² *Hedley Byrne* particularly fails to observe two conditions of such respect. Adjudication in what Llewellyn called the "Grand Style"⁹³ requires that the choice of which rules come under consideration is the result of "the utility maximising decisions of disputants rather than the wisdom of judges",⁹⁴ and that the focus should be on "the specific facts of a contested case".⁹⁵ In regard of these conditions, the facts revealed by our account of *Hedley Byrne* speak, we submit, for themselves.

One is amazed to learn that Gerald Gardiner was, in a sense, quickly called to give an account of his direct role in *Hedley Byrne*. In his recollection of his conversation with Oliver Hedley, Mr. Ipp went on to tell us that:

Ultimately, when the Lords dismissed his case, Mr. Hedley was furious. He demanded that his solicitor make an appointment for him to see Gardiner so that he could discuss the disaster that had befallen his company. He wanted an explanation. At first, his solicitor refused, saying that to question Gardiner on such a topic was unheard of, but Mr. Hedley was insistent, and eventually a conference was arranged.

According to Mr. Hedley, the conference lasted five minutes. It opened with Mr. Hedley saying, "Mr. Gardiner, you advised that we would lose before a single judge, lose before the Court of Appeal, and win before the House of Lords. But we lost in all three courts!" Gardiner responded, "Well, I was two thirds right. What are you complaining about?" Gardiner went on, "Now look Mr. Hedley I have another conference starting in a minute or two, is there anything else?" On that note, Mr. Hedley and his solicitor trooped disconsolately out of Gardiner's chambers.⁹⁶

⁸⁸ The *Oxford Dictionary of Quotations* lists this in its section on misquotation.

⁸⁹ *Candler v Crane, Christmas* [1951] 2 K.B. 164, 178: "On the one side there were timorous souls . . . fearful of allowing a new cause of action. On the other side there were bold spirits who were ready to allow it if justice so required. It was fortunate for the common law that the progressive view prevailed."

⁹⁰ *Omychund v Barker* (1744) 26 E.R. 15, 23 (Mr. Solicitor-General Murray, later Lord Mansfield).

⁹¹ L.L. Fuller, *The Law in Quest of Itself* (Boston 1940), 140: "the eternal process by which the common law works itself pure and adapts itself to the needs of a new day."

⁹² K.N. Llewellyn, *The Common Law Tradition* (Boston 1960), 38.

⁹³ *Ibid.*

⁹⁴ P.H. Rubin, "Why Is Common Law Efficient?" (1977) 6 *Journal of Legal Studies* 51.

⁹⁵ R.E. Megarry, *Lawyer and Litigant* (London 1962), 120–21.

⁹⁶ Campbell, "Misrepresentation Act", 146.

In light of the nature of the reference and, even more, the existence of the disclaimer, one might suspect that Gardiner was negligent when he advised *Hedley Byrne and Co. Ltd.* to proceed to litigation.⁹⁷ If this were the case, he would not have been liable; nor would the existence of negligent misstatement have made him liable, for in 1967⁹⁸ the House of Lords affirmed the barristers' immunity from liability for negligence after *Hedley Byrne* had undermined the contractual, or more precisely non-contractual, rationalisation of that immunity.⁹⁹ But this may not, it is submitted, have availed Gardiner, because the immunity did not, of course, extend beyond negligence,¹⁰⁰ and now that his involvement in *Hedley Byrne* from the start is known, it is not merely to a suspicion of negligence that Gardiner's conduct gives rise.

We are anxious to stress we do not intend to make a directly personal criticism of Gardiner, who we do not doubt was motivated to act in the public interest as he understood it. It is, as one of the current authors has been at pains to state previously,¹⁰¹ the hazards of unrestrained pursuit of what one believes to be the public interest to which we wish to draw attention. That an intervention is believed to be in the public interest is by no means a sufficient condition that the intervention will improve welfare. The more one departs from proper institutional channels in one's anxiety to intervene, the more one generates the hazard of reducing welfare, and the entire private law offers no stronger illustration of this than what passes for the case law of *Hedley Byrne*. Gardiner's absorption with what was necessary for the law of negligent misstatement to emerge from *Hedley Byrne* led to the real issues in the case being overwhelmed by a non-issue, and the real issues have been all but completely lost to our subsequent understanding of

⁹⁷ Our explanation of Gardiner's motivations cannot, of course, claim to be more than a suggestion. We believe, however, it is entirely justified on the available materials. Apart from the now readily publicly available materials, including the *Hedley Byrne* papers and Mr. Ipp's letter, there are five possible sources of material which we have pursued without fruitful result. Via a number of changes of ownership, *Hedley Byrne and Co. Ltd.* is now absorbed into a very large international advertising firm which will not enter into discussion of these matters. *Hedley Byrne and Co. Ltd.*'s solicitors are also now absorbed into a larger firm, and we have been told that any papers from the time of the case will have, as a matter of normal procedure, been destroyed. Papers relevant to Lord Gardiner's career held in the British Library Manuscripts collection relate exclusively to the abolition of the death penalty. A wider-ranging collection of papers deposited at the Churchill Archives Centre, Churchill College, Cambridge by Lord Gardiner's widow and daughter contains nothing of substantial relevance. A biography by Lady Gardiner written whilst her husband was still alive makes literally no mention of *Hedley Byrne*: M. Box, *Rebel Advocate* (London 1983).

⁹⁸ *Rondel v Worsley* [1969] 1 A.C. 191 (hereafter, *Rondel v Worsley* H.L.).

⁹⁹ *Hedley Byrne* H.L., [1964] A.C. 465, 502–03. In his High Court judgment in *Rondel v Worsley* [1967] 1 Q.B. 443, 455E–F, handed down on 21 December 1965, Lawton J. described the prevailing atmosphere: "Ever since the decision of the House of Lords in [*Hedley Byrne*,] many at the Bar have been watching carefully for signs of the cold wind of change blowing across the Strand into the Temple; some are said to have protected themselves with the comforting embraces of Lloyd's and others who provide like services."

¹⁰⁰ *Rondel v Worsley* H.L., [1969] 1 A.C. 191, 287F.

¹⁰¹ Campbell, "Curious Incident", 125–27, and Campbell, "Misrepresentation Act", 141–45.

that law. If one wishes to claim the legitimacy of common law reasoning, this cannot be right.

Excessive confidence in the virtue of what one is doing is not a benign feature of interventionist policy-making, though it is often essential precisely in order to override the substantive defects of the policies adopted. Committed to the widest-ranging reform of liability for negligent statements, Gardiner framed his advice in *Hedley Byrne* with so complete an indifference about his client's interests that that advice is not easily described as merely negligent.¹⁰² Subsequently encountering the impossibility of putting what Gardiner thought he wanted into practice in a way which would improve welfare, the law of negligent misstatement has, as its main feature, been unable to show any of Gardiner's fixity of purpose.

¹⁰² *Derry v Peek* (1889) 14 App. Cas. 337, 374 (Lord Herschell): "fraud is proved when it is shown that a false representation has been made: (1) knowingly; or (2) without belief in its truth; or (3) recklessly, careless whether it be true or false."