ARE THE FLOODGATES SHUT?
A Summary Review of Recent Decisions on the Duty of Care relating to Professional Negligence
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"A liability in an indeterminate amount for an indeterminate time and to an indeterminate class" was the description applied by Cardozo C.J. to a legal Doomsday which he felt would be faced principally by the professional practitioner in the event that the concept of tortious liability were expanded to include liability for negligent misstatement. With the exception of medical negligence, the principal type of claims by parties outside a contractual relationship against professionals is of failure to take care in the making of statements, giving rise usually but not exclusively to loss of an economic, rather than physical nature. In the past decade, accountants have been held liable to third parties who have relied on accounts bearing their auditors' report when acquiring the subject company; solicitors have been held liable to disappointed beneficiaries, who did not receive the expected bequest because of defective execution of the will; surveyors reporting on the condition of a property for prospective mortgagors have been held liable to the mortgagors for failing to reveal a physical defect in the property where the mortgagee proceeded to lend funds for the purchase, even though the mortgagor was not shown a copy of the surveyor's report. Cardozo C.J. expressed his concern in 1931 in the New York case of *Ultramares Corporation -v- Touche* 225 NY 170. At that time the English Courts eschewed the idea that the professional could and should be liable to third parties, outside the context of a contractual relationship, for negligence. That position had been firmly established by the Court of Appeal in 1893 in the case of *Le Lievre -v- Gould* [1893] QB 491. It seems that the concern of the judiciary was that, if a basis of liability were recognised which was dependent on simply showing that the victim had suffered economic, as opposed to physical, damage, this would dramatically widen the scope of liability to the third parties. It would lead to an explosion of claims or an opening of the "floodgates".

When did the floodgates open? Historically, the modern origin of the concept of professional negligence is usually traced to Denning L.J.'s dissenting judgment in the Court of Appeal in *Candler -v- Crane Christmas & Co.* [1951] 2 KB, where he expressed the view that accountants could owe a duty of care, by virtue of the knowledge and skill of their calling, to third parties, outside a contractual relationship in connection with accounts which they had prepared. However, he considered certain conditions had to exist, namely (1) the accountants showed, or knew that the accounts would be shown, to the third party; (2) they knew of the transaction for

which the third party required the accounts; (3) they knew that the third party would be likely to rely on the accounts when deciding whether to proceed. Denning L.J. further considered that the existence of such a duty was not limited to accountants, but applied equally to other professions such as surveyors, valuers and analysts. It was in 1964 in the case of *Hedley Byrne & Co. Ltd. -v- Heller & Partners Ltd.* [1964] AC 465 that negligent misstatement was recognised as a basis of tortious liability and the professions were placed at serious risk. Even so, the reasoning of the House of Lords was not entirely clear as to the extent of the duty of care. It seemed to require the existence of a special relationship between the tortfeasor and the victim, or a voluntary assumption of responsibility for taking care. In subsequent cases, notably *Mutual Life & Citizens Assurance Co. Ltd. -v- Evatt* [1971] AC 793, which was decided by the Privy Council, the Courts seemed to want to adopt a more restrictive approach. In that case, the majority view suggested that the tortfeasor had to be in the business of supplying information or held itself out as possessing the necessary skill to give reliable advice. This, of itself, may not have had much bearing on the exposure to liability of the professional, but indicated that at that stage the English judiciary shared similar concern to Cardozo C.J.

The pressure on the floodgates in fact came from the developments generally in the law relating to negligence. Coincidentally, a major development occurred in 1970, the year before *Evatt's* case, in the House of Lords' decision in *Home Office -v- Dorset Yacht Co. Ltd.* [1970] AC 1004, where Lord Reid considered whether, as a matter of public policy, the law ought to impose a duty of care on the Home Office in relation to the management of the Borstal system. The 1970s showed a steady liberalisation of judicial thinking prepared to extend the scope of situations in which a duty of care could be held to exist. Inevitably, this led to attempts to define a general principle of negligence of universal application. These culminated in the judgment of Lord Wilberforce in the case of *Anns -v- London Borough of Merton* [1977] AC 728. His Lordship considered that is was not necessary to establish whether the facts of the case corresponded to a previous situation in which a duty of care had been held to exist. He formulated a two stage test. First, it had to be established that there existed a "sufficient relationship of proximity" between the wrongdoer and the person suffering the damage such that, "in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter". If so, a *prima facie* duty of care arose. The second stage of the test was to see if any considerations existed which would negative, reduce or limit either the scope of the duty or the class of person to whom it was owed or the damage occasioned by the breach of the duty. The effect of this judgment was that the Courts became more willing to break new ground in considering whether a duty of care existed. In the next few years, the Courts sought to hold the professional man to owe a duty of care much more readily. I have given 3

examples in the opening paragraph of this article. The liability of the solicitors was established in *Ross -v- Caunters* [1980] Ch 297; the surveyors in *Yianni -v- Edwin Evans & Sons* [1982] 2 QB 438. In *Standard Chartered Bank -v- Walker* [1982] 3 All ER 938 a receiver of a company appointed by a bank was held to owe a duty of care to persons who had guaranteed the company's liability to the bank. The accountants were held to owe a duty of care as auditors to third parties relying on the audited accounts in *JEB Fasteners Ltd. -v- Marks Bloom & Co.* [1983] 1 All ER 583 followed in the case of *Twomax Ltd. - v- Dickson, Macfarlane & Robinson* [1982] SC 113. However, by this stage, the ramifications of Lord Wilberforce's judgment was starting to be assessed. In *McLoughlin -v- O'Brien* [1982] 2 All ER 583, Lord Wilberforce himself observed that it was clear that foreseeability of harm should not of itself lead to a duty of care.

By 1985, it seems that the tide was beginning to turn more in favour of the professional man. In *The Governors of the Peabody Donation Fund -v- Sir Lindsay Parkinson & Co. Ltd.* [1985] AC 210, the House of Lords said that the tendancy to treat the *Anns* test as definitive should be resisted, and that it was also necessary to consider whether it was just and reasonable to impose a duty of care in the circumstances. *In Leigh & Sullivan Ltd. -v- Aliakmon Shipping Co. Ltd.* [1986] AC 785, Lord Brandon considered that the use of the *Anns* test should be confined to new situations which were not analogous to any previously considered by the Courts and not to re-open categories of factual situations in which a duty of care had been held not to exist.

The major statement from the House of Lords of retrenchment from the broad statement of principle expounded in the *Anns* case was made in *Yuen Kun Yeu -v- Attorney General of Hong Kong* [1987] 2 All ER 705 by the Privy Council. Their Lordships were considering a claim by investors against the Commissioner of Deposit-taking Companies where a company which had been registered went into liquidation. It was claimed that the company had been run fraudulently to the detriment of investors, who claimed to have relied on the the fact of registration as indicating that the company was a fit and proper body and that the Commissioner knowingly failed to take steps to protect the investors. Their Lordships considered that foreseeability of damage was a necessary ingredient in establishing a relationship giving rise to a duty of care, but it was not the only one. They stressed that the principle formulated by Lord Atkin in *Donoghue -v- Stevenson* [1932] AC 562 required not only foreseeability of harm, but also a close and direct relationship, and that the *Anns* test should not be regarded as a suitable guide to the existence of a duty of care in all circumstances. As Lord Keith observed: "Otherwise, there could be liability in negligence on the part of one who sees another about to walk over a cliff with his head in the air and forebears to shout a warning".

Following the decision in the *Yuen Kun Yeu* case, the Courts have scrutinised the circumstances of cases before them to see if the relationship of the parties was a close and direct one. If it was not, they have declined to hold that a duty of care exists. In *Clarke -v- Bruce Lance & Co.* [1988] 1 All ER 364, no such duty was held to be owed by a solicitor to a disappointed beneficiary under a will, where the solicitor failed to advise the deceased that an option to purchase property forming part of the estate after his death at a fixed price was uncommercial. In *Huxford -v- Stoy Hayward* [1988] 5 BCC 421, accountants retained by a bank to advise on the financial position of a debtor company were held to be under no duty to directors and guarantors of the company's debt. In these cases, there was no close and direct relationship.

The position of surveyors was recently examined by the House of Lords in 2 cases heard together. *Smith -v- Eric S. Bush* and *Harris -v- Wyre Forest District Council* [1989] 2 WLR 790. The facts were similar. Surveyors were instructed by proposed mortgagees to value properties for mortgage purposes. In the former case, the surveyor was independent and a copy of the report was provided to the claimant. The report contained a disclaimer. The claimant relied on the report. Some time after the purchase was completed, a chimney collapsed in the roof, due to a defect which was reasonably ascertainable at the time of the survey. In the latter case, the surveyor was in-house and the report was not disclosed. The mortgage application form contained a disclaimer by the local authority, which proceeded to loan the necessary funds on the strength of the report. The mortgagors did not obtain an independent report, relying on the fact that the local authority were prepared to advance the funds. The house had in fact suffered serious settlement rendering it unsaleable. In these cases, it was held that the valuer would have known that the mortgagee would probably and the mortgagor, who was the intended purchaser who had paid the valuation fee, would certainly rely on the valuation. The valuer therefore knew that the claimant would rely upon him and the nature of the transaction which was entered into by the claimant. In both cases, the valuer and mortgagor had a sufficiently close and direct relationship to give rise to a duty of care. But what of the disclaimers? Their Lordships decided that these constituted notices within the meaning of the *Unfair Contract Terms Act 1977* but did not satisfy the requirements of s.2(2) as to fairness and reasonableness, given the high cost of houses and rates of mortgage interest. In circumstances where a prudent purchaser ought to obtain his own survey, such as for an industrial property, a block of flats or a very expensive house, their view might have been different. In such cases, it is clear that the purchaser is able to negotiate the scope of the report, when agreeing the fee.

The trend has continued in two recent cases relating to auditors. In *Al Saudi Banque -v- Clarke Pixley* [1990] 2 WLR 344, the Court at first instance considered whether

auditors owed a duty of care to banks who relied on accounts audited by them in deciding whether to loan monies to a company, where it was alleged that the accounts were inaccurate.Some banks were existing creditors at the date of the audit; others lent subsequently. Millet J.held that there was no duty of care owed to either category of bank. As to the latter, there was no close and direct relationship, so no proximity. As to the former, even though it was a limited definable class known to the Defendants, they had to know that there was an intention to provide the information to those banks. Further the fact that there is no question of creating a liability of an indeterminate amount to an indeterminate class is not sufficient to create the necessary relationship. However, the learned judge considered that the relationship could exist if the auditors had by implication represented the accuracy of the accounts to the plaintiff, or when accounts are supplied with the intention or knowledge of the company's intention that they would be supplied to the plaintiff. If the necessary relationship exists, it then is enough that it is foreseeable that the plaintiff may rely on it for a future transaction whether or not contemplated by the auditors. The expected appeal to the House of Lords was not pursued.

The second case is the House of Lords' decision in *Caparo Industries Plc. -v- Dickman* [1990] 2 WLR 358. Here the claimant was an investor in a company who relied on the audited accounts. Shares were purchased in two tranches, so that on the first purchase the claimant was a stranger to the company. On the second, which was a takeover bid, it was an existing member. In a unanimous decision, their Lordships again disapproved of the *Anns* test as one of universal application. Foreseeability of damage was an ingredient, but there had to be a relationship of proximity and a situation in which it would be just and reasonable to impose a duty of care. Their Lordships felt that the existence of a duty of care could only be resolved by a pragmatic examination of the facts, categorising distinct and recognisable situations as guides to the existence and scope of the duty of care. Commending this traditional approach, Lord Bridge observed that the salient feature of the approach adopted in *Cann -v- Wilson* [1888] 39 Ch. D. 39, by Denning L.J. in *Candler -v- Crane Christmas & Co.*, *Hedley Byrne,* and *Smith -v- Bush* was that the Defendant giving the advice was: (1) fully aware of the nature of the transaction contemplated by the Defendant; (2) knew the advice or information would be communicated to him; and (3) knew it to be likely that the Plaintiff would rely on it when deciding to engage in the transaction. He distinguished the situation where a statement for more or less general circulation might foreseeably be relied on by strangers for any one of a variety of purposes, which the maker of the statement had no reason to anticipate. Thus auditors owed no duty of care to members of the public at large nor existing members who might rely on the accounts to decide whether to purchase shares. As Lord Oliver explained, the purposes of the auditors' report was to fulfil a statutory duty to enable the members to

approve the financial statements in annual general meeting, not to protect the interests of investors in the markets. He declined to distinguish between the two types of investor personified by the Plaintiff in this case. Of note are the obiter remarks of Lord Bridge endorsing Millett J.'s judgement in *Al Saudi Banque*.

It would seem that the present trend of judicial opinion is now firmly set against application of a general statement of principle as in the *Anns* test as the basis for establishing whether a duty of care is owed to a third party outside the contractual relationship. The current approach, which has developed over the last 6 years or so, is a pragmatic one. It requires close analysis of the facts in order to ascertain the existence of a close and direct relationship. This will be based on (a) whether the tortfeasor actually knew what the claimant had in mind, and (b) that his advice would be passed to the latter who would be likely to rely on it when deciding whether to proceed with what he had in mind. In short, the current state of the law appears to be that after nearly 40 years, Denning L.J.'s dissenting judgment now forms the basic criteria for establishing when the professional is negligent. The floodgates thrown open by *Hedley Byrne* and *Anns* cannot be shut, but it seems that the volume of claims flowing though them may be coming under control.

BOOK REVIEWS
1. "The Law of Insurance Contracts" by Malcolm A Clarke

(Lloyd's of London Press, £95)

In this major new work on insurance law published last December, Dr Malcolm Clarke, Fellow of St John's College Cambridge, lays out for our inspection over some 645 pages of text (and a table of cases of over 70 pages) the life of the insurance contract from insurable interests through cover notes via construction of the contract, illegality, and claims procedure, to reinstatement and subrogation. The declaration in the preface of a view beyond the jurisdiction of England and Wales sets the scene for drawing on decisions of other common law jurisdictions where assistance can be got from them, and a chapter is included on the conflict of laws.

The rights and duties of the parties, and the central position of agents, are given detailed consideration. In dealing with the formation of insurance contracts a section is devoted to aspects of formation of contract particular to business at Lloyd's. A chapter on the duties of agents examines fiduciary duties as well as those in contract