House of Lords[540] **2.E.47.**
Caparo Industries plc v. *Dickman*

LIABILITY IN TORT FOR FALSE STATEMENTS

Inaccurate audit

Auditors, having made inaccurate statements in their audit of a company's accounts are under no duty of care towards potential investors or existing shareholders who have suffered financial losses as a consequence thereof.

Facts: The plaintiff bought, with a take-over in view, 100,000 shares in Fidelity Plc, a company which had some weeks earlier announced unexpectedly poor results, leading to a fall in share price from 143p to 64p. When the accounts and the audit report prepared by the defendants were issued to the shareholders four days after the plaintiff's initial purchase of shares, the plaintiff bought a further 50,000 shares and finally bought the rest of the shares at 125p. The take-over proved to be a very bad bargain, since, far from making a profit of GBP 1.3 million as indicated in the accounts, Fidelity made a loss of GBP 400,000. In addition to claims in deceit against Fidelity's directors, Caparo sued the auditors for negligence.

Held: The court of appeal held that the accountants owed a duty to existing shareholders but not to prospective investors. A unanimous House of Lords was of the opinion that no duty was owed to either group.

Judgment: LORD BRIDGE:[541] "The damage which may be caused by the negligently spoken or written word will normally be confined to economic loss sustained by those who rely on the accuracy of the information or advice they receive as a basis for action. The question what, if any, duty is owed by the maker of a statement to exercise due care to ensure its accuracy arises typically in relation to statements made by a person in the exercise of his calling or profession. In advising the client

[538] See generally J. Steiner, "How to Make the Action Suit the Case" (1987) 12 ELRev 102 at 111–12.
[539] [1965] AC 269, [1964] 3 All ER 102, HL. See for other references and discussion, Rogers at 649.
[540] [1990] 2 AC 605, [1990] 1 All ER 568.
[541] Some passages from Lord Bridge's speech, preceding the one reproduced here, were included *supra*, Chapter I, 1.4.1.B, Introductory Note, together with some passages from Lord Oliver's concurring speech.

who employs him the professional man owes a duty to exercise that standard of skill and care appropriate to his professional status and will be liable both in contract and in tort for all losses which his client may suffer by reason of any breach of that duty. But the possibility of any duty of care being owed to third parties with whom the professional man was in no contractual relationship was for long denied . . . until the decision of this House in *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd* [1964] AC 465, [1963] 2 All ER 575 . . . [I]t is to [this and other] authorities . . . that we should look to determine the essential characteristics of a situation giving rise, independently of any contractual or fiduciary relationship, to a duty of care owed by one party to another to ensure that the accuracy of any statement which the one party makes and on which the other party may foreseeably rely to his economic detriment . . .

[THE PROXIMITY TEST]

The most recent decision of the House, which is very much in point, is that of the two appeals heard together of *Smith* v. *Eric S. Bush* and *Harris* v. *Wyre Forest District Council* [[1990] 1 AC 831]. The plaintiffs in both cases were house purchasers who purchased in reliance on valuations of the properties made by surveyors acting for and on the instructions of the mortgagees proposing to advance money to the plaintiffs to enable them to effect their purchases. In both cases the surveyors' fees were paid by the plaintiffs and in both cases it turned out that the inspections and valuations had been negligently carried out and that the property was seriously defective so that the plaintiffs suffered financial loss . . . The House held that in both cases the surveyor making the inspection and valuation owed a duty of care to the plaintiff house purchaser . . .

The salient feature of all these cases is that the defendant giving advice or information was fully aware of the nature of the transaction which the plaintiff had in contemplation, knew that the advice or information would be communicated to him directly or indirectly and knew that it was very likely that the plaintiff would rely on that advice or information in deciding whether or not to engage in the transaction in contemplation [emphasis added]. In these circumstances the defendant could clearly be expected, subject always to the effect of any disclaimer of responsibility, specifically to anticipate that the plaintiff would rely on the advice or information given by the defendant for the very purpose for which he did in the event rely on it. So also the plaintiff, subject again to the effect of any disclaimer, would in that situation reasonably suppose that he was entitled to rely on the advice or information communicated to him for the very purpose for which he required it. *The situation is entirely different where a statement is put into more or less general circulation and may foreseeably be relied on by strangers to the maker of the statement for any one of a variety of different purposes which the maker of the statement has no specific reason to anticipate* [emphasis added]. To hold the maker of the statement to be under a duty of care in respect of the accuracy of the statement to all and sundry for any purpose for which they may choose to rely on it is not only to subject him, in the classic words of Cardozo CJ, to 'liability in an indeterminate amount for an indeterminate time to an indeterminate class': see *Ultramares Corporation* v. *Touche* (1931), 174 NE 441 at 444; it is also to confer on the world at large a quite unwarranted entitlement to appropriate for their own purposes the benefit of the expert knowledge or professional expertise attributed to the maker of the statement. Hence . . . I should expect to find . . . in this category of the tort of negligence, as an essential ingredient of the 'proximity' between the plaintiff and the defendant, that the defendant knew that his statement would be communicated to the plaintiff, either as an individual or as a member of an identifiable class, specifically in connection with a particular transaction or transactions of a particular kind (e.g. in a prospectus inviting investment) and that the plaintiff would be very likely to rely on it for the purpose of deciding whether or not to enter on that transaction or on a transaction of that kind . . .

[TEST APPLIED TO POTENTIAL BUYERS OF SHARES AND TO EXISTING SHAREHOLDERS]
These considerations amply justify the conclusion that auditors of a public company's accounts owe no duty of care to members of the public at large who rely on the accounts in deciding to buy shares in the company. If a duty of care were owed so widely, it is difficult to see any reason why it should not equally extend to all who rely on the accounts in relation to other dealings with a company as lenders or merchants extending credit to the company. A claim that such a duty was owed by auditors to a bank lending to a company was emphatically and convincingly rejected by Millett J in *Al Saudi Banque* v. *Clark Pixley* [1990] Ch 313, [1989] 3 All ER 361 . . .

I should . . . be extremely reluctant to hold that the question whether or not an auditor owes a duty of care to an investor buying shares in a public company depends on the degree of probability that the shares will prove attractive either en bloc to a take-over bidder or piecemeal to individual investors . . .

The position of auditors in relation to the shareholders of a public limited liability company arising from the relevant provisions of the Companies Act 1985 is accurately summarised in the judgment of Bingham LJ in the Court of Appeal [1989] QB 653 at 680–681 . . . No doubt these provisions establish a relationship between the auditors and the shareholders of a company on which the shareholder is entitled to rely for the protection of his interest . . . But in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself and any loss suffered by the shareholders, e.g. by the negligent failure of the auditor to discover and expose a misappropriation of funds by a director of the company, will be recouped by a claim against the auditor in the name of the company, not by individual shareholders . . ."

NOTION OF SCHÄDIGUNGSVORSATZ. "PROTECTIVE AMBIT OF CONTRACT" THEORY

Inaccurate audit

An auditor supplying incorrect financial statements is acting contra bonos mores *vis-à-vis a bank which used these statements, even if the statements were not prepared for the bank.*

Facts: The plaintiff, a bank, had allowed credit, in the amount of DEM 500,000, to its client to finance his purchase of shares in V-GmbH. The credit was granted on the basis of interim financial statements of V-GmbH. Those statements had been prepared and certified by the defendant, who was V-GmbH's tax adviser and who had been engaged by V-GmbH's sole shareholder and manager, M, to prepare and certify the statements. One copy of the statements was supplied to M and two other copies were supplied to the plaintiff bank's client, who used the statements to obtain the credit from the plaintiff.

One year after the purchase V-GmbH was declared bankrupt. The plaintiff who as a creditor of the bankrupt company remained unpaid, sought compensation from the defendant, claiming that the certified statements were false. The firm of the defendant was also sued as a second defendant, on the basis of a contractual relationship with the plaintiff.

Held: The court of first instance dismissed the action. The court of appeal upheld that judgment. The BGH allowed the appeal and remitted the matter to the court of appeal.

Judgment: "I. The court *a quo* is of the opinion that the plaintiff has no right to claim damages in contract or in tort. Its reasoning on both counts is, however, not free from error.

1. The question whether the action may be founded in tort is examined by the court *a quo* under § 826 BGB. It proceeds on the correct assumption that a careless and unconscionable (*gewissenlos*) conduct can also be *contra bonos mores* within the meaning of the abovementioned provision. However, the court *a quo* held that no action for damages lay, on the ground that the plaintiff was unable to prove that the defendant had acted intentionally . . . *The question whether, in drawing up the interim statement and issuing the certificate, the defendant acted carelessly and intentionally caused injury to a third party, can be answered appropriately only by first clarifying whether and on what points the interim statement contains objective errors* [reference omitted, emphasis added]. On this point the following observations should be made:

a) . . . The state of the GmbH's books of account was of decisive importance for the person having to take a decision on the basis of the certified interim statement. The lack of properly kept books of account did not merely cast doubt on the balance sheet items; it was rather this factor which in itself was capable of giving rise to well-founded doubts as to the proper management of the company . . .

b) Subjective consequences also flow from this. If the defendants were aware that the books of account of the V-GmbH disclosed serious irregularities, and for that reason considered that it was not possible to draw up a reliable interim balance sheet, then it was careless conduct to certify the interim statement of 31 May 1981 . . . However, the court of appeal agreed with the lower court that an intention to cause injury was not proved and took the view that such could only be assumed if the defendants could at least expect that their careless and incorrect interim statement would reach the plaintiff or at least another bank to be used as a basis for a loan decision . . .

[582] NJW 1987, 1758. Translation by N. Sims.

[However,] for there to be intent it is sufficient if it was conceivable on the part of the defendants that the statement could be used in negotiations with a provider of finance and could lead that person into taking a decision disadvantageous to him [emphasis added]. [The BGH then concluded that the defendant, on the basis of its professional experience as tax adviser, had to take into account that the purchaser of V-GmbH would have recourse to bank financing for his purchase. It noted furthermore that only the defendant tax adviser, and not his firm, had the requisite *Schädigungsvorsatz* for the application of § 826 BGB.]

2. [The BGH then examines if and on what basis the defendant's firm could also be held liable.] The court of appeal correctly assumed that there was a contract to draw up an interim statement, the contract being between the partnership of the defendants and V-GmbH (or its manager and sole shareholder M). It took the view, however, that the plaintiff was not included within the scope of protection of the contract, and that such could be the case only if the party who was in a contractual relationship with the defendant owed a duty of protection toward the injured third party. According to the court of appeal, however, no such relationship subsists between V-GmbH (or its shareholder M) and the plaintiff. *That legal assessment is, however, not in conformity with the case law of the BGH . . . whereby the contracting parties may create a duty of protection also in favour of persons who are not entrusted to their welfare. Whether there was such intent is for the court trying the merits of the case to determine on the basis of general principles of interpretation* [emphasis added]. In the present case there is evidence to suggest that the contracting parties did wish to include third parties within the protective scope of the contract . . . In so far as the second defendant infringed a contractual duty of protection, the plaintiff may also proceed against the first defendant on a claim for damages. As partners the defendants are jointly and severally liable for any breach of contract by one of them . . ."

Cass. comm., 17 October 1984[599] **2.F.55.**
S.A. T. et H. v. *T.*

FAULT TOWARDS A NEW SHAREHOLDER

Inaccurate corporate documents

An accountant and a corporate auditor who had negligently certified incorrect corporate accounts are liable in damages to a shareholder who subscribed to an increase in capital on the basis of the documents.

Facts: The plaintiff, a company called T and H, had subscribed to an increase in the share capital of the N company. It did so on the basis of financial accounts drawn up by N's accountant, the first defendant T, and purportedly verified by N's statutory auditor, the second defendant C. Over and above the nominal value of the new shares of FRF 710,000, the plaintiff paid a premium of a further FRF 540,000. It subsequently emerged that, at the time of the increase in capital, contrary to what the financial accounts led one to believe, the N company suffered from shortfall in assets, which was subsequently assessed at over FRF 3,000,000.

Held: The court of appeal, having found that the financial statements were inaccurate, had, according to the Cour de cassation, incorrectly dismissed the plantiff's action in tort.

Judgment: "Having regard to Art. 1382 C.civ.: In dismissing the claims by T and H, the court of appeal stated that T had not been guilty of fault because it had not been proved that he had been in a position to verify the 'state of execution' of certain transactions and that there was no causal link connecting C to the alleged loss.

In so holding, although it found that the accounts drawn up by T, an accountant, and verified by C, statutory auditor, were factually inaccurate, the court of appeal did not draw the appropriate legal consequences from its findings. It thus applied the provisions of [Article 1382 C.civ.] incorrectly."