BBLS LEVEL 1 & 1BCL

Law of Tort: Tutorial No.2: Negligent Misstatements

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THE CASES:

The cases in this tutorial can be put into three categories:

Part One: The Development of the Hedley Byrne Principle

- *Hedley Byrne & Co v. Heller & Partners* [1963] 2 All ER 575
- *Smith v. Eric S. Bush; Harris v. Wyre Forest District Council* [1989] 2 All ER 514
- *Caparo Industries v. Dickman* [1990] 1 All ER 568

Part Two: The Anomaly

- *Ministry of Housing and Local Government v. Sharpe* [1970] 1 All ER 1009

Part Three: Extension of Hedley Byrne – The Provision of Services

Solicitors Duties to 3rd Parties:

- *Ross v. Caunters* [1979] 3 All ER 580
- *White v. Jones* [1995] 2 AC 207
- *Doran v. Delaney* [1998] 2 ILRM 1

Auctioneers Duties to 3rd Parties:

- *McCullagh v. P.B. Gunne and ICC plc* Unreported, High Court, January 17, 1997, Carroll J.

PART ONE: DEVELOPMENT OF THE HEDLEY BYRNE PRINCIPLE

Hedley Byrne v. Heller

Facts: The Plaintiffs were considering supplying advertising services to a potential client, Easipower. Through their bank, they sought a credit reference from the defendants, Easipower's bank. The defendant replied with a specific disclaimer of responsibility. They said that Easipower was sound. The plaintiffs supplied the services on basis of that reliance. Easipower went into liquidation and the plaintiffs lost a large sum of money.

What did they want? They wanted the House of Lords to hold that the defendant owed them a duty of care to ensure that their statements were accurate and correct.

Did they win? Even though the House of Lords recognised that a duty of care could be owed for negligent misstatements, they did not impose a duty here because of the explicit disclaimer of liability.

What did they say about the test for negligent misstatements? Each of the Lords had a different opinion about why a duty of care existed in this case. Consequently, it is very difficult to discern one all encompassing principle that runs through all the judgments. Weir, when commenting on the decision, had this to say about the judgment:

> *"Never has there been such a judicial jamboree as Hedley Byrne, where one almost has the feeling that their Lordships had been on a trip to Mount Olympus and perhaps smoked a joint on the bus. Something went to their heads, presumably not the merits of the claim which they dismissed."*

Lord Reid identifies the two requirements that make up the Hedley Byrne Principle:

> *"…He speaks of other special relationships and I can see no logical stopping place, short of all .. relationships where it is plain that the party seeking the information or advice was trusting the other to exercise such a degree of care as the circumstances required, where it was reasonable for him to do that, and where the other gave the information or advice when he knew or ought to have known that the inquirer was relying on him."*

Lord Reid also specifically stated that the duty would not be extended beyond the commercial realm:

> "*Quite careful people often express definite opinions on social or informal occasions, even when they see that others are likely to be influenced by them; and they often do that without taking the care which they would take if asked for their opinion professionally, or in a business connexion."*

Lord Devlin commented on the special relationship requirement of the principle:

> *"… the categories of special relationships, which may give rise to a duty to take care in word as well as deed, are not limited to contractual relationships or to relationships of fiduciary duty, but include also relationships which … are equivalent to contract that is, where there is an assumption of responsibility in circumstances in which, but for the absence of consideration, there would be a contract … Payment for information or advice is very good evidence that it is being relied on and that the informer or adviser knows that it is. Where there is no consideration, it will be necessary to exercise greater care in distinguishing between social and professional relationships and between those which are of a contractual character and those which are not. It may often be material to consider whether the adviser is acting purely out of good nature or whether he is getting his reward in some indirect form."*

Out of all of the judgments, we can distil two requirements for the imposition of the duty of care for economic loss resulting from negligent misstatements:

1. There must be a special relationship between the parties so that there could be said to be an assumption of responsibility on the part of the advice giver which, but for the absence of consideration, would be equivalent to contract. The other party must have reasonably placed his trust in the advice giver. (Proximity).
2. The advice giver must have known or ought to have known, that when he was giving the advice, the other person was relying on his advice. (Reasonable Foreseeability).

<u>Chaudry v. Prabhakar</u>

Facts and Decision: This case may have been wrongly decided, given the warnings their Lordships gave in Hedley that the principle was limited to commercial contexts and could not be imposed in purely social situations. It nonetheless provides an exception. The Court of Appeal held that advice seriously given between friends might give rise to liability. The defendant took it upon himself to advise the plaintiff in her purchase of a second hand motor car. He failed to notice that the car he recommended had previously been involved in an accident. A few months after the plaintiff bought the car it was declared unroadworthy and she sued him successfully for loss of value. It is unlikely that the decision will be extended to produce a general liability for gratuitous advice. The existence of a duty was conceded by counsel at first instance and was no the subject of full argument in the Court of Appeal.

Smith v. Bush; Harris v. Wyre Forest DC

Facts:
Smith Case: The plaintiff applied to the building society for a mortgage. The building society instructed the defendant surveyor to prepare a valuation report. The plaintiff paid the fee for this report through their building society and were provided with a copy of the report. There was a specific disclaimer of responsibility on the form. The report said that no repairs were necessary. The plaintiff bought the house on sole reliance of the report. It turned out that there was a structural defect in the chimney. The chimney collapsed 18 months after the plaintiff purchased the house causing considerable damage. She said that the surveyor owed her a duty of care.

Harris Case: The plaintiffs applied for a council mortgage. A council employee carried out a survey on the property. There was a specific disclaimer in the report. The report was never actually shown to the plaintiffs. The house was valued at the asking price and they were granted a mortgage of 90% of the asking price. Because they were granted this, the plaintiffs assumed that the house was worth the asking price. They tried to resell the house 3 years later, but because of a structural defect, the house was unsaleable. It would cost the plaintiffs more than the house was worth to fix the problem. They sued the surveyor for negligence.

Different to Hedley Byrne
The paradigm situation of Hedley Byrne is a two party situation. A gives advice to B and B relies on it to his detriment.
In Bush the principle was extended to cover a new type of situation. A gives information to B, who passes it on to C. C then relies on the information to his detriment. Bush extended the Hedley Byrne principle to impose a duty on the maker of a statement in favour of a third party recipient of that information.

Lord Templeman: Uses the traditional Hedley Byrne language. He said that there was a special relationship between the parties which was akin to contract. The valuer knows that his fee derives from the purchaser and is passed on by the building society. The valuer also knows that the valuation will determine whether or not the purchaser buys the house. Therefore there is reliance.

Lord Griffiths: Prefers to use the common duty of care language, but he takes the same factors into account as Lord Templeman. Really, the only difference between the Hedley Byrne principle and the ordinary neighbourhood principle is that there is a higher threshold of proximity in Hedley. In other words, the relationship must be akin to contract. Hedley Byrne is the neighbour principle phrased differently.

> *"In what circumstances should a duty of care be owed by the adviser to those who act on his advice? … only if it is foreseeable that the advice is negligent, the recipient Is likely to suffer damage, that there is a sufficiently proximate relationship between the parties and that it is just and reasonable to impose liability. In the case of a surveyor valuing a small house for a building society or local authority … he owes a duty of care to the purchaser. If the valuation is negligent and is relied upon, damage in the form of economic loss to the purchaser*

> *is obviously foreseeable. The necessary proximity arises from the surveyor's knowledge that the overwhelming probability is that the purchaser will rely on his valuation … and the fact that the surveyor only obtains his work because the purchaser is willing to pay his fee. It is just and reasonable that the duty should be imposed [because] the advice is given in a professional as opposed to a social context and liability for breach of the duty will be limited both as to its extent and amount. The extent of the liability is limited to the purchaser of the house … The amount of the liability cannot be very great because it relates to a modest house."*

Disclaimer: Why did the disclaimer work in Hedley Byrne but not in this case? The simple answer is a change in the law. When Hedley Byrne was decided a party could exclude their liability in negligence with a specific exclusion clause in the contract. However, in 1977 in England, Parliament introduced the Unfair Contract Terms Act. This changed the law so that a party could only exclude liability in negligence if the exclusion was explicit and if the exclusion was just and reasonable. The court held that the exclusion in this case was not just and reasonable; therefore a duty was imposed. The Ireland, the Unfair Contract Terms Directive has been transposed into Irish law by virtue of the European Communities (Unfair Contract Terms in Consumer Contracts) Regulations 1995. For a discussion of this topic please see Paul McDermott, Contract Law, Chapter 11, Section VI, Page 492 – 506.

Caparo Industries v. Dickman

Facts: The plaintiff was a shareholder in Fidelity. Fidelity's accounts were audited in accordance with their duty under the Companies Acts. The defendants carried out the audit. As an existing shareholder in Fidelity, Caparo were entitled to a copy of the audit. Relying on the audit accounts, the plaintiff bought more shares in Fidelity and subsequently took it over. After the takeover, the plaintiffs discovered that the accounts were grossly inaccurate and misleading. The accounts said that there had been a pre tax profit of £1.3 million, when in reality there had been a £4000,000 loss. The plaintiffs sued the auditors for negligence.

Did they win? No.

Why not? As noted in the previous tutorial, the general duty of care was reformulated In Caparo so that it is now much harder to establish a duty in situations which are said to be at the frontiers of tort liability like nervous shock, relational economic loss[1] and economic loss resulting from negligent misstatements. This attitude was carried through to the Hedley Byrne principle. The court in this case reformulated the Hedley Byrne principle and made it much stricter and narrower. Lord Bridge accepts that a duty of care can arise for negligent misstatements, but only if the following factors exist:

1. The defendant giving the advice must be fully and actually aware of the nature of the plaintiff's intended transaction.
2. The defendant must have actually known that his advice would be communicated directly or indirectly to the plaintiff as an individual or as a member of an identifiable class.
3. The defendant must know that it is very likely that the plaintiff would rely on that advice in deciding whether or not to enter into the intended transaction.

Much stronger language than original principle, because now actual knowledge is required of the particular transaction rather than the constructive knowledge of a reasonable person. Both Lord Bridge and Lord Oliver also stressed the original purpose for which the advice was given as an

[1] Relational economic loss arises where the plaintiff is trying to recover for pure economic damage which resulted because of damage to the person or property of a third party.

element of proximity. In this case the audit accounts were prepared to satisfy a statutory duty imposed by the Companies Acts. The accounts were prepared for the benefit of shareholders so that they could exercise their powers in the company's general meeting. It was not prepared for individual investors to help them in making their investment decision. The only class to whom a duty was owed were the shareholders when exercising their powers in general meeting. When Caparo bought the extra shares, they were not acting as shareholders in Fidelity. They were acting as investors. Therefore, even though they relied on the report, there was insufficient proximity between Caparo and the auditors.

Why did the plaintiffs win in Smith v. Bush but not in Caparo? Before we can answer this question, we must first ask ourselves why the cases were similar. In both cases, information was prepared for one recipient for a particular purpose, but it was relied upon by a third party, for a different but related purpose, to their detriment. Thus, in Smith, the valuation was prepared for the mortgage company so that it could decide whether it would grant the mortgage or not. However, the valuation was relied upon by the purchaser in deciding whether or not to purchase the house. In Caparo, the report was prepared by the auditors to fulfil a duty under the Companies Acts to enable shareholders to exercise their powers in general meetings. However, the report was relied upon by the plaintiff in deciding whether or not to invest further in the company.

But if both cases were conceptually similar, why did the plaintiffs succeed in Smith and not in Caparo? There are a number of reasons:

1. In Caparo, the auditors did not carry out the audit merely because the company felt it needed its accounts audited. There was a statutory duty under the Companies Acts to provide shareholders with information about the company's performance so that they could take action at a general meeting. It was not for the benefit of individual investors. In Smith, the survey was made for the specific transaction that the plaintiffs were negotiating. The purpose of the audit in Caparo had nothing to do with the transaction for which it was relied upon.
2. In Smith, the plaintiffs paid for the report, whereas Caparo received the account free of charge as existing shareholders of the company.
3. **Public Policy:** In Smith, you had individuals of modest wealth making the most important decision of their lives. In Caparo, the victim was a faceless commercial enterprise engaged in a profit making exercise. When commenting on the decision, Weir had this to say: *"Caparo was not investing in Fidelity plc, it was buying it, taking it over. Caparo was a predator. Nor was Caparo exactly wet behind the ears. With a turnover of over £150 million, it is among the top 500 manufacturing companies in Britain. Its chairman … chairs over twenty other companies. Allegedly the directors of Fidelity were fraudulent. Greed foiled by fraud is not quite maiden virtue rudely strumpeted, but it is hurtful all the same, and none the less so when the fraud is facilitated by negligence. But if Caparo were conned out of their booty, let them go against the vendors for fraud or breach of contract. Let not the predator turn and rend those who failed to catch the fraudster who succeeded in catching them. Caveat Praedator is a sound and moral rule."*
4. **Underlying Social Policy:** At the time Caparo was decided, accountants could only form partnerships, not limited liability companies. Therefore, when the partnership was liable, each of the partners became severally and personally liable for the debt of the partnership. The potential liability for individual accountants was huge if something went wrong. In 1995, the English High Court held an accounting firm liable for £65 million, which increased to £105 million after interest and costs. They were held liable because of an off hand remark by one of the firms audit partners at a meeting 6 years prior to the claim. The amount exceeded the firm's liability insurance by £34 million. Therefore each of the firms 120 partners became personally liable to pay £325,000 each. After the collapse of BCCI, Pricewaterhouse Coopers and Ernst & Young, who audited the collapsed bank's accounts, were held liable for £300 million in respect of their roles in the bank's collapse. In 2000, Parliament in England passed the Limited Liability Partnerships Act in order to alleviate the increasing huge personal liability of accountants and auditors. It allowed the creation of a new entity which gave the partners limited liability. It is now possible to limit the personal liability of auditors in a way that was not

possible at the time of Caparo. In Smith, the Court imposed a duty to allow recovery for £9000. In Caparo, if a duty had been imposed, the auditors would have been personally liable for the £900,000 difference between the accounts and the reality of the company's financial situation. This must surely have influenced their decision.

PART TWO: THE ANOMALY

Ministry of Housing and Local Government v. Sharpe

This case is not really a true Hedley Byrne situation and falls outside the normal misstatement liability. This is because the negligent was not directed to the plaintiff. Instead, the plaintiff's loss was caused because a third party relied on the statement.

Facts and Decision: A clerk in a local authority registry carelessly stated that certain land was free of charges when answering a request from solicitors acting for a prospective purchaser. In fact, a charge had been registered by the Ministry, giving it a right to demand a sum from the owner of the land in return for granting planning permission. The land was sold under the presumption that no charge existed; the legal effect of this was to deprive the Ministry of the right to recover the sum in question. The Court of Appeal held that a duty of care existed between the plaintiff and the local authority, and that they were entitled to recover, event though the plaintiffs themselves had not relied on the negligent misstatement. Even though the case is an anomaly, it is possible that the same result would be reached today given that the plaintiff was foreseeable as an individual and that there was no danger of indeterminate liability arising.

PART THREE: THE EXTENSION OF HEDLEY BYRNE: THE PROVISION OF SERVICES

Hedley Byrne has been extended beyond the provision of information to the provision of services. The courts felt that it would be an odd result if a solicitor could be liable under Hedley for careless advice, but not for carelessly drafting a document. The difficulty lies in the extension of the remedy to persons who were adversely affected by a service performed by the defendant who is under contract to another party.

SOLICITORS AND THIRD PARTIES

Ross v. Caunters

Facts: A section of the Wills Act stated that if a beneficiary or the spouse of a beneficiary of a will, witnesses that will, then any gift to them under the Will will be void. The defendants were the solicitors of a Mr. Phelp. They drew up his will. The plaintiff was a named beneficiary under the will. However, the defendants got the plaintiff's husband to witness the will. When Mr. Phelp died the plaintiff could not receive anything left to her under the will. She sued the solicitors for negligence.

Did she win? Yes.

Why? The solicitors, in what I would characterise as a bold move, freely admitted that they had been negligent. They said that it didn't matter because they owed no duty to the plaintiff because she was not a client. Megarry VC thought that this was a ridiculous state of affairs:

> *"If this is right, the result is striking. The only person who has a valid claim has suffered no loss, and the only person who has suffered a loss has no valid claim. However grave the negligence, and however great the loss, the solicitors would be under no liability to pay substantial damages to anyone. No doubt they would be liable to the testator if the mistake was discovered in his lifetime, though in that*

> *case the damages would, I think, be merely for the cost of making a new and valid will or otherwise putting matters right. But the real question is whether the solicitors are under any liability to the disappointed beneficiary."*

In imposing a duty of care in this case Megarry VC emphasised three factors:

1. Proximity. The plaintiff was named and identified in the will. Therefore, the plaintiff was in actual, nominate and direct contemplation of the defendant.
2. The solicitors owed a duty to the testator to confer a benefit on the plaintiff. He said that this duty may be readily extended to the 3rd party who is the intended beneficiary.
3. There was no possibility of unlimited or indeterminate liability in this case. The liability was to one person alone and the amount was limited to the value of the residue.

Therefore, he concluded that:

> *"A solicitor who is instructed by his client to carry out a transaction that will confer a benefit on an identified third party, owes a duty towards that third party in carrying out the transaction, in that the third party is a person within his direct contemplation as someone who is likely to be so closely and directly affected by his acts or omissions that he can reasonably foresee that the third party is likely to be injured by those acts or omissions."*

White v. Jones

Facts: A solicitor was instructed to draw up a will for the testator. The new will, unlike the old one, benefited the two daughters. Due to the solicitor's negligence, the new will had not been drafted by the time the testator died. The daughters sued the solicitor for negligence.

Held: The House of Lords held that a solicitor could be liable in negligence for failing to prepare timeously a new will, thereby depriving the claimant beneficiaries of the benefits intended by the testator. Lord Goff said that:

> *"The assumption of responsibility by the solicitor towards his client should be held in law to extend to the intended beneficiary who (as the solicitor can reasonably foresee) may, as a result of the solicitors negligence, be deprived of his intended legacy in circumstances in which neither the testator nor his estate will have a remedy against the solicitor."*

The House of Lord approved of the earlier case of Ross v. Caunters by rejected the reasoning of Megarry VC who had based his reasoning on the wider neighbour principle. The extent of the underlying tort duty was said to be shaped by the underlying contract between the solicitor and the testator. No potential conflict because the interests of the client and the intended beneficiary overlap completely.

Clark v. Bruce, Lance

Facts and Decision: The Court of Appeal concluded that the interests of the client who had contracted for the services potentially conflicted with those of the claimant who claimed to have been the intended beneficiary of the contractual performance. The case concerned the granting by a lessor to a lessee of an option to purchase the freehold upon the death of the lessor or his wife, whichever was later. The terms of the option were not favourable to the lessee, and he claimed that the lessor's solicitor had been negligent in not pointing this out to his client. The court distinguished Ross v. Caunters and held that the solicitor's principle responsibility laid to his client, and that to impose upon him the suggested duty of care in tort with regard to the claimant, was not compatible with this responsibility.

<u>Doran v. Delaney</u>

Facts: There was a dispute about access to a plot of land. Mrs McKimm claimed, rightly so, that she owned it. The original owners had submitted erroneous plans to the planning office showing that they owned the land. McKimm threatened legal action. The original owners decided to sell to the plaintiffs. The plaintiff's solicitor asked the defendant solicitor a number of questions about the property and title. He asked if there had been any dispute or litigation or threatened litigation with the adjoining owners. The Defendant solicitor knew of the dispute with Mrs. McKimm. She asked the original owners about it, and they said that it had been settled. She didn't inquire any further into the matter. She responded to all of the questions: "Vendor says no." The plaintiff started building but Mrs. McKimm threatened action and refused to sell. The plaintiff's land was now landlocked. They sued the defendant solicitor for negligence.

Held: Where the solicitor is aware of adverse claims and asks about them, he or she assumes some responsibility for the information given and cannot be exonerated solely on the ground that she is simply transmitting the vendor's instructions. Knowing the facts of the case, she must have known that the reply to the question would be relied upon by the plaintiff. It was in fact relied upon. The reply gave no hint of any trouble as to the boundary. The defendants owed a duty of care and they breached that duty because they failed to ascertain the terms on which the dispute was settled. The reply, even though it was technically and literally true, was framed in a misleading manner.

> *"A partial statement or the omission of significantly relevant facts may be sufficient to convert a literally accurate statement into a misstatement."*

<u>AUCTIONEERS AND THIRD PARTIES</u>

<u>McCullagh v. P.B. Gunne</u>

Facts: The case concerned the purchase of licensed premises by a naïve married couple with no business experience, where the price of £125,000 was just beyond their means. The business venture was a disaster. When the property was put up for sale, in spite of the earlier representation by the defendant auctioneer's employee at the time of purchase that he could get the plaintiffs a profit of £10,000 to £20,000 if they resold, the highest offer received was only £85,000. The employee had taken a proactive role in the process. The plaintiffs had told him that they had never previously bought property and they asked him to keep them straight. He said he was not going to advertise the premises because if he did the phone would never stop ringing. In fact, the owner had asked him to put the market on the market but to keep it very quiet.

The plaintiffs claimed that the defendants had held themselves out to find them a premises at a price they could afford and that it would arrange finance. McCullagh said he was aware that the defendant employee had been paid a commission by the vendor but he said that the employee had never told him that he could not also act for the McCullaghs or advise them. McCullagh did "*not understand figures [nor] what turnover meant"* and the plaintiffs had out their trust in the employee.

Carroll J imposed liability for negligent misstatement. She said:

> *"[The Employee] gave the impression that he was on the McCullaghs' side and that they were on some kind of inside track … An Auctioneer is employed by the vendor to get the best price and should always make it clear that the vendor is his only client, not the purchaser as well. Auctioneers cannot be all things to all men."*

In the instant case, the auctioneer had taken over the burden of assisting the McCullaghs arrange adequate finance in their quest for a suitable business. He got them loan approval, sold their farm, opened accounts for them, found them solicitors, got them to sign loan approval without advice etc. It was obvious to him that the plaintiffs were depending on him and his expertise to get them adequate finance. He had done nothing to disabuse them of the obvious trust they had placed in him.

> *"The plaintiffs are naïve but they impressed me as very straight and honest people. They did not deserve the treatment they had received from the defendant's employee and this was certainly a case where it is fair, just, equitable and reasonable that a duty of care be recognised by the Court."*