[COURT OF APPEAL]

JAMES McNAUGHTON PAPER GROUP LTD. v. HICKS ANDERSON & CO.

[1984 J. No. 2318]

1990 Feb. 20, 21, 22; July 31

Neill, Nourse and Balcombe L.JJ.

Negligence—Duty of care to whom?—Auditor—Preparation of company's accounts and answer to question about company's financial state—Company in course of being taken over by another company—Whether auditor owing duty of care to other company

While negotiations were taking place for the take-over of a group of companies by the plaintiff company, the group instructed the defendants, their accountants, to prepare accounts for the group. The defendants submitted the accounts as "final drafts" showing a net loss for the year of £48,094 and, in reply to a question put by the plaintiffs, said that the group were "breaking even or doing marginally worse." Subsequently, the plaintiffs completed the take-over and discovered a number of errors in the accounts. On the plaintiffs' claim in negligence against the defendants for loss and damage suffered as a result of the take-over, the judge, giving judgment for the plaintiffs, held that the defendants' answer to the plaintiffs was a misrepresentation and that the defendants were in breach of a duty of care they had owed to the plaintiffs in respect of the accounts and the answer.

On the defendants' appeal:—

Held, allowing the appeal, that there was not such a relationship of proximity between the plaintiffs and defendants as to establish a duty of care; that the defendants could not have been expected to foresee the damage which the plaintiffs alleged they had suffered in reliance upon the draft accounts and the answer given by the defendants in general terms; and that, accordingly it was not fair, just and reasonable to impose on the defendants a duty of care to the plaintiffs in relation to the accounts and the answer (post, pp. 123H–124A, 127F–G, 128A, C–D, G–H, 129A, D–F).

Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605, H.L.(E.) applied.

Decision of Judge Lipfriend, sitting as a judge of the Queen's Bench Division, reversed.

The following cases are referred to in the judgments:

Anns v. Merton London Borough Council [1978] A.C. 728; [1977] 2 W.L.R. 1024; [1977] 2 All E.R. 492, H.L.(E.)

Candler v. Crane, Christmas & Co. [1951] 2 K.B. 164; [1951] 1 All E.R. 426, C.A.

Caparo Industries Plc. v. Dickman [1989] Q.B. 653; [1989] 2 W.L.R. 316; [1989] 1 All E.R. 798, C.A.; [1990] 2 A.C. 605; [1990] 2 W.L.R. 358; [1990] 1 All E.R. 568, H.L.(E.)

Davis v. Radcliffe [1990] 1 W.L.R. 821; [1990] 2 All E.R. 536, P.C.

Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465; [1963] 3 W.L.R. 101; [1963] 2 All E.R. 575, H.L.(E.)
Murphy v. Brentwood District Council [1991] 1 A.C. 398; [1990] 3 W.L.R. 414; [1990] 2 All E.R. 908, H.L.(E.)
Scott Group Ltd. v. McFarlane [1978] 1 N.Z.L.R. 553
Smith v. Eric S. Bush [1990] 1 A.C. 831; [1989] 2 W.L.R. 790; [1989] 2 All E.R. 514, H.L.(E.)
Sutherland Shire Council v. Heyman (1985) 157 C.L.R. 424; 60 A.L.R. 1

The following additional cases were cited in argument:

JEB Fasteners Ltd. v. Marks, Bloom & Co. [1981] 3 All E.R. 289
Lloyd Cheyham & Co. Ltd. v. Littlejohn & Co. [1987] B.C.L.C. 303

APPEAL from Judge Lipfriend sitting as a judge of the Queen's Bench Division.

By a writ dated 18 April 1984 and an amended statement of claim, the plaintiffs, James McNaughton Paper Group Ltd., claimed damages against the defendants, Hicks Anderson & Co., for negligence and breach of duty in the preparation of accounts for M.K. Papers Group Holdings Ltd. ("M.K.") for the year ended July 1982 in or about September 1982, knowing that the plaintiffs would rely on such accounts in considering whether to acquire 11,000 £1 ordinary shares in that company, and if so, at what price; and misrepresentation by the defendants in respect of the accounts and the current trading position of M.K. on or about 7 September 1982. By their defence served on 6 September 1985 the defendants denied, inter alia, that the plaintiffs had relied on the draft balance sheets provided by the defendants; that the defendants owed to the plaintiffs a duty to ensure that all documentation and information supplied by them was accurate; that the defendants were negligent or in breach of duty to provide accurate information for the use of the plaintiffs; that the plaintiffs had agreed to pay the sum of £12,000 in reliance on any information supplied to them by the defendants; that the defendants by their servant had made an innocent or negligent misrepresentation to the plaintiffs; and that the defendants had caused the loss and damage alleged by the plaintiffs. On 2 December 1988 Judge Lipfriend gave judgment in favour of the plaintiffs and ordered the defendants to pay the plaintiffs £75,000 by way of damages for negligence.

By a notice of appeal dated 18 January 1989 the defendants appealed on the grounds, inter alia, that the judge had erred in law in holding that the defendants owed a duty of care to the plaintiffs in the preparation of draft accounts for M.K.; in finding that the draft accounts were negligently prepared when there was no or no sufficient evidence justifying such a finding of fact; in finding that the defendants' servant negligently misstated the financial position of M.K. on 7 September 1982 when there was no sufficient evidence justifying such a finding and when, in any event, he should have held as a matter of law that in all the circumstances the defendants' servant did not owe a duty of care to the plaintiffs in making a statement about M.K.'s financial position; and in holding that the plaintiffs had suffered any loss as a result of the

A acquisition of M.K. in reliance on the draft accounts and the statement on 7 September 1982.

The facts are stated in the judgment of Neill L.J.

Nicholas Padfield and *Monique Allan* for the defendants. The judge's finding that there was a duty of care was against the weight of the B evidence and contrary to the present state of the law. None of the facts found by the judge gives rise to a duty of care. The judge did not find, in particular, that it was foreseeable by the defendants that the plaintiffs would rely on the draft accounts for the purpose of making the take-over bid. The essential tests of the duty of care are foreseeability, proximity and whether as a matter of public policy it is fair, just and reasonable that the duty should be imposed: *Caparo Industries Plc. v.* C *Dickman* [1990] 2 A.C. 605. The judge failed to make any findings of fact or give reasons to support his conclusion that those tests had been satisfied. The judge erred in treating foreseeability as the only test, in reliance on *JEB Fasteners Ltd. v. Marks, Bloom & Co.* [1981] 3 All E.R. 289.

The relationship of proximity arises only where there is knowledge of D the purpose for which accounts are required and knowledge that they are likely to be relied on for that purpose. The judge made no finding of fact that either of these conditions was satisfied.

It was not foreseeable that the plaintiffs would rely on the draft accounts in making their decision to acquire the shares of the companies in question and as to the price which they were prepared to pay. The judge misapplied the foreseeability test by not giving sufficient weight to E the evidence before him: in particular, if by labelling the accounts "draft accounts" the accountant was telling his own client that he required additional information it was unreasonable to impose on him a higher duty in relation to a third party.

In relation to the question of proximity, the judge failed to address that question or did not apply the correct test. In particular, he made no F findings as to the relationship between the plaintiffs and the defendants to the effect that it was neither contractual, nor akin to contract, nor one in which there was a voluntary assumption of responsibility by the defendants towards the plaintiffs. In relation to the policy test, the judge erred in not addressing the question as to whether it was just and reasonable for the defendants to owe the plaintiff a duty of care, or if he did address the question, he did not take account of the relevant G factors: namely, that the interests of seller and buyer were diametrically opposed; that no duty should attach to the producer of draft accounts, nor to accounts not expressly required for the purpose of a valuation; that there was no implied warranty of the accuracy of the accounts; and that there should be no duty in any event towards potential investors in a company as the law stands at present.

As to the answer given by the defendants to the question put by the H plaintiffs at the meeting on 7 September, there was no evidence that the defendants knew that the meeting was for other than the general purpose of discussing the accounts. The defendants at the time of the meeting thought that the take-over had been agreed and they did not

suppose that their answer would be relied on. In any event, it was reasonable for the defendants to suppose that the plaintiffs would not have relied on the answer without seeking independent advice. Further, since the draft accounts showed a substantial net loss for the year ended 30 June 1982 the plaintiffs could not have relied on the answer for the purposes of making the acquisition. A

It is not fair, just and reasonable to impose liability on the defendants since the plaintiffs knew that the company was deteriorating rapidly but failed to take the elementary precaution of seeking independent advice or of obtaining the usual warranties from the directors: see *Lloyd Cheyham & Co. Ltd. v. Littlejohn & Co.* [1987] B.C.L.C. 303, 320. The plaintiffs should not be allowed to attribute their loss to the failure of the defendants to provide them with the protection which they did not provide for themselves. B C

Quintin Iwi for the plaintiffs. *JEB Fasteners Ltd. v. Marks, Bloom & Co.* [1981] 3 All E.R. 289 bears certain fundamental similarities to the instant case, in which the defendants were well aware, when the accounts were commissioned, that the accounts were likely to be the basis on which decisions were going to have to be taken. In *Caparo Industries Plc. v. Dickman* [1990] 2 A.C. 605, 638, Lord Oliver of Aylmerton spoke of the necessary relationship between the adviser and the advisee being based on the adviser's actual or inferential knowledge of the relevant factors. The defendants must have known, inferentially, that the accounts could only have been needed for one of three purposes: (1) to make a decision whether to wind up the company, (2) to attempt to raise further capital or (3) to show the accounts to a potential purchaser. D E

It was not reasonable to expect that the plaintiffs would obtain independent advice by getting in another accountant to go through the whole process again. As at the date of the meeting between the plaintiffs' managing director and the representative of the defendants they knew that their expertise was being tapped and that their accounts were being made use of. The meeting attended by the defendants' representative removes any doubt as to whether the defendants knew the uses to which the accounts were being put. The defendants had an opportunity to disclaim at that point. In *Candler v. Crane, Christmas & Co.* [1951] 2 K.B. 164 the accounts were also draft accounts. F

As to the defendants' answer to the question put at the meeting, it is not surprising that the plaintiffs should have acted upon it. The foreseeability and proximity tests laid down by Lord Oliver in the *Caparo* case were satisfied. The question and answer were not exchanged in a social context. Moreover, the defendants could have refused to answer the question. No policy argument justifies exclusion of liability. Further, the Court of Appeal ought not to review the judge's conclusions on a single question and answer without taking into consideration the evidence as a whole. G H

Padfield in reply. The issues here do not turn on the credibility of any witness but on the effect of primary facts which are admitted, and the inferences to be drawn from those admitted facts. The case,

A therefore, is one in which the Court of Appeal may properly reach its own conclusions.

In *Candler v. Crane Christmas & Co.* the accountants clearly knew the specific purpose for which the draft accounts were required. It is therefore distinguishable.

The *JEB Fasteners* case related to audited accounts by accountants who knew that the accounts would be relied upon. There were detailed B negotiations between the accountants and the plaintiffs over a nine-month period and that case is therefore also distinguishable.

Cur. adv. vult.

31 July. The following judgments were handed down.

C

NEILL L.J. This is an appeal by the defendants, Hicks Anderson & Co. ("H.A."), a firm of chartered accountants, from the order dated 2 December 1988 of Judge Lipfriend, sitting as a judge of the Queen's Bench Division, whereby it was ordered that H.A. should pay to the plaintiffs, James McNaughton Paper Group Ltd. ("McNaughton"), the D sum of £75,000 by way of damages for negligence. McNaughton were the parent company of a group of companies engaged in the supply of paper for the printing trade. The chairman of the group was Mr. James McNaughton. He died in November 1987. McNaughton alleged that they had suffered loss and damage when they took over a group of companies known as the M.K. Papers Group ("M.K.") of which the parent company was M.K. Papers Group Holdings Ltd. They further alleged that they had E been materially influenced in reaching their decision to take over M.K. by (a) a set of accounts which had been prepared by H.A. relating to M.K. and subsidiary companies in that group for the year ended 30 June 1982; (b) an answer given by Mr. Pritchard, an employee of H.A., on behalf of the defendants at a meeting on 7 September 1982 which was also attended by Mr. McNaughton and Mr. Barry Topsom, the chairman of M.K. The F central issue raised on this appeal is whether H.A. owed any duty of care to McNaughton either in respect of the preparation of the set of accounts or in respect of the answer given by Mr. Pritchard. I must start by stating the relevant facts.

In about 1977 Mr. McNaughton became interested in the possibility of a take-over of M.K. At that time, however, nothing came of the idea, although there was some discussion about the matter between Mr. G McNaughton and Mr. Topsom. M.K. were in the same line of business as McNaughton, though they were smaller and were mainly concerned with roll paper. The two shareholders in M.K. were Mr. Topsom and his wife. The two groups had some common customers and were to some extent competitors.

In about 1982 Mr. Topsom became concerned about the prospects for M.K. and about his own long-term future because at that time M.K. were H not prospering. He therefore raised with Mr. McNaughton the possibility of a take-over by McNaughton. On 3 June 1982 a preliminary meeting took place between Mr. Topsom and Mr. McNaughton and some of his co-directors at the McNaughton office in Camberwell. On 29 June 1982

Mr. Topsom and Mr. McNaughton met again at the Inn on the Park Hotel in London to discuss details of the proposed take-over. Following this meeting Mr. McNaughton sent to Mr. Topsom a letter dated 6 July 1982, though the letter was not actually sent until 9 July. In that letter Mr. McNaughton said:

> "I think it was useful our meeting last Tuesday in order to quietly discuss our future plans. Should we both decide to move on to a next meeting I would suggest the following points which would of course become an agenda. (1) [McNaughton] purchase the shares of M.K. in two sections: (a) 75 per cent. on 1 September 1982; (b) 25 per cent. on 30 September 1985. (2) That the basis valuation be as follows for all of the shares: (a) balance sheet value of shares as at 30 June 1982 as certificated by your auditors and examined by my auditors (this being the total of subscribed funds and retained reserves) adjusted by (b) the actual gross margins on sales for the two months to 31 August 1982 less the agreed budgeted costs for that period. (3) Item 1(b) would be adjusted should any of the debtors as of 31 August 1982 not be fully paid; this would be in direct proportion to the amount of the shortfall in debtors. (4) The company would continue to trade as M.K. although it might in the near future trade as McNaughton M.K. if this was considered to be beneficial . . . I look forward to hearing your comments."

That letter was sent under cover of a letter dated 9 July 1982, which read:

> "I do apologise for not having sent the enclosed letter on the Monday as promised but I did want Edward, John, Alan and Peter to see it before I sent it off, which they have now done. The main comment from Edward is that he would like to sit down with you on your own and go through your customer accounts from the point of view of credit taken etc. in order that he can feel happier in his own mind concerning this aspect of business. I feel sure that you would not object to this."

The four persons named in the letter were directors of McNaughton at that time. "Edward" was Mr. Edward Fenaroli, its vice-chairman.

There was then a delay of several weeks which was due, in part at least, to the fact that Mr. Stephen Ince, the managing director of M.K., was away on holiday. On 5 August, it seems, Mr. Topsom replied:

> "With Steve now back from his holiday, I have had a chance to discuss with him the points raised in your letters of 6 and 9 July and our reply is as follows. In broad terms the package is acceptable but I think it would be wise to clarify what you have in mind regarding the Midlands operation . . . our end of year accounts are being produced now and I will be able to let you have a draft by the end of next week, in the meantime perhaps we could meet to discuss the points in my letter and draw up an outline plan for the joint venture."

The reference to "the Midlands operation" in the letter was a reference to a proposal in paragraph 5 of Mr. McNaughton's letter dated 6 July about establishing a small satellite warehouse in the Midlands. It is not necessary,

however, to refer in further detail to this matter or to the other arrangements which were proposed in the letters passing between the parties.

It seems probable that by 5 August 1982 Mr. Topsom had spoken to Mr. Pritchard of H.A. to ask him to prepare the accounts for the year as quickly as possible. He had been having discussions with the defendants during the previous six months.

In the next few days Mr. Topsom met Mr. Fenaroli to discuss M.K.'s aged debt list. On 18 August Mr. Topsom wrote to Mr. McNaughton again:

> "As you know I have discussed with [Mr. Fenaroli] our aged debt list and have visited your warehouse in Bristol and both [Mr. Ince] and I feel that we are in a position to have a meaningful discussion regarding the possible take-over by you of the company. I will have the audited balance sheet available by the end of the week and have also prepared budget figures for the company remaining in its present form and what I think would be the likely cost of a warehouse operation. Perhaps we could meet next week with an agenda as per your letter of 6 July but incorporating the points in my letter to you of 5 August. I look forward to hearing from you."

The draft consolidated balance sheet of M.K. and draft balance sheets of the three subsidiaries, M.K. Papers Ltd., M.K. Papers (Leicester) Ltd. and M.K. (Leeds) Ltd., became available at about the end of August 1982. These documents were sent by Mr. Pritchard to Mr. Topsom under cover of a letter dated 27 August 1982, which read:

> "I enclose final drafts of the balance sheets of M.K. Papers Group Holdings Ltd. and its various subsidiaries for your approval. The various expenses, balances and write-offs of the subsidiaries have been transferred to and charged against M.K. Papers Group Holdings Ltd. On my return from holiday on 6 September, perhaps we can meet and finalise the accounts. In the meantime I am taking this opportunity of enclosing a note of my firm's fees on account of the audit of the group. Good luck for Tuesday."

At a meeting at McNaughton's offices in Camberwell on 31 August 1982 Mr. McNaughton was handed copies of these draft balance sheets together with copies of the balance sheets for the previous years. This meeting was also attended by Mr. Topsom and Mr. Ince. It was arranged that a further meeting should take place on Friday, 3 September 1982, after Mr. McNaughton had had an opportunity to consider the figures. It is to be noted that (a) the second draft of the group balance sheet as at 30 June 1982 showed net current assets of £11,124; (b) the draft trading and profit and loss account for the year ended 30 June 1982 showed a net loss for the year of £48,095. On 3 September 1982 the meeting took place as arranged between Mr. McNaughton and Mr. Topsom at the Inn on the Park. Mr. McNaughton then told Mr. Topsom that he thought it would be helpful if he could discuss M.K.'s position with their accountant. Mr. Topsom wrote the name of Mr. Pritchard and his firm on Mr. McNaughton's copy of the draft group balance sheet. Mr. McNaughton added the address

and the telephone number which were given to him by Mr. Topsom. In the course of the next day or so Mr. McNaughton made an appointment by telephone to meet Mr. Pritchard. On 7 September 1982 he went to Mr. Pritchard's office at Newport Pagnell. By the time of the trial Mr. McNaughton had died. The judge had before him, however, statements admitted under the Civil Evidence Act 1968, in the form of an affidavit sworn shortly before his death by Mr. McNaughton on 30 September 1987, to which was exhibited a draft proof of evidence which had been prepared by his solicitors on information given to them by Mr. McNaughton in 1986 and which had been signed by Mr. McNaughton on 22 June 1987. In the draft proof Mr. McNaughton gave this account of the meeting on 7 September 1982:

> "On 7 September 1982, having made the appointment by telephone, I drove to Newport Pagnell to meet Mr. Pritchard at his office together with Mr. Topsom. At the meeting we reviewed the draft balance sheets for M.K. Papers Group Holdings Ltd. and the other M.K. Papers companies and discussed in particular debtors, including the debtors taken over by Barclays Factoring, and creditors. We also discussed assets and saleability of the stock. During the course of this meeting I asked Mr. Topsom and Mr. Pritchard the following question: 'Would I be right in saying that because of rationalisation M.K. Papers Group is now breaking even or doing marginally worse?' Mr. Pritchard replied: 'Yes. The company is breaking even or doing marginally worse.' During the meeting I requested copies of various documents including a list of the debtors and creditors for the various M.K. companies and details of Barclays Factoring and VAT records for July and August 1982. These documents were enclosed with Mr. Pritchard's manuscript letter of 7 September 1982 which was collected by my driver from Mr. Pritchard's office the following day, 8 September 1982."

In his letter Mr. Pritchard said:

> "Please find enclosed schedule of debtors/creditors for the various companies and a consolidated summary. Also enclosed are Barclays Factoring balances, VAT summary for July and August and a copy of the inspector's letter regarding the reconstruction. The Volvo agreement now appears to be a hire-purchase agreement and not a lease type. If you require any further details do not hestitate to contact me."

On 9 September 1982 there was a further meeting at McNaughton's offices between Mr. McNaughton and Mr. Topsom. On this occasion there was a discussion about the price to be paid for the shares in M.K. In his draft proof Mr. McNaughton gave this account of the meeting:

> "Barry Topsom through another company, Helmworld Ltd., owed the sum of £23,855 to M.K. Papers Group Holdings Ltd. Mr. Topsom suggested that this sum should be agreed as the purchase price for the 11,000 £1 ordinary shares held by Mr. and Mrs. Topsom in M.K. Papers Group Holdings Ltd. I was not prepared to agree to this and stated that the purchase price would be the balance sheet value of the shares, namely £12,000. It was agreed that Mr. Topsom should

endorse the cheque over to M.K. Papers in part payment of his outstanding loan. The balance of £11,855 could be paid within six months. We shook hands on the agreement."

The take-over of M.K. then proceeded. An announcement was made on 11 September and on 20 September Mr. McNaughton handed Mr. Topsom a cheque for £12,000 in payment of the 11,000 shares in M.K. held by Mr. and Mrs. Topsom. Mr. Topsom endorsed the cheque over in favour of M.K. and it was paid into the company's bank account. It may be noted that on 12 May 1983 Mr. Topsom duly paid the remainder of the debt of £11,855 owed through Helmworld Ltd.

On 5 November 1982 Mr. Pritchard wrote to Mr. McNaughton enclosing the final draft accounts in respect of M.K. for the year ended 30 June 1982. On 5 January 1983 Mr. Pritchard sent certified copies of these accounts.

In the spring of 1983, however, Mr. John Williams, the company accountant of Mr. McNaughton, carried out a detailed investigation of the M.K. accounts. As a result of this investigation a number of errors in the accounts were detected. Mr. McNaughton raised the matter with the senior partner of H.A., but no satisfactory solution was found. On 18 April 1984 the writ in the present proceedings was issued.

The trial took place in March 1988 before Judge Lipfriend, sitting as a judge of the Queen's Bench Division. At the trial evidence was given by Mr. Topsom and Mr. Pritchard as well as by other witnesses including experts. It was not possible, however, to conclude the hearing of submissions in March and the trial was adjourned. The closing speeches were made at the end of November 1988 and the judge finally delivered his judgment on 2 December 1988. In the course of his judgment the judge said that there were the following six main issues to be determined:

"(1) Did the defendants owe a duty of care to the plaintiffs? (2) If yes, were the accounts passed to McNaughton drawn negligently? In deciding this question I must bear in mind that (a) the accounts were required urgently; and (b) the accounts were labelled 'draft accounts.' (3) At the meeting on 7 September did McNaughton ask the question and did Pritchard answer as pleaded by the plaintiffs in the amended statement of claim? (4) If yes, was the answer given by Pritchard a misrepresentation and/or made negligently? (5) If the answer to question (2) or (4) is yes, were the plaintiffs influenced thereby in their decision to take over M.K.? (6) If yes, what is the measure of damages?"

The judge concluded that a duty of care did exist and that H.A. were guilty of negligence in drawing up the accounts. He further said that he was satisfied on the balance of probabilities that "the substance or gist of the question and answer as pleaded were uttered by McNaughton and Pritchard" at the meeting on 7 September 1982. He also held that the answer given by Mr. Pritchard was a misrepresentation and was made negligently. Finally, on the issue of liability, he reached the following conclusion:

"From the totality of the evidence in this case I am satisfied that the accounts produced to McNaughton and the answer given to him by

Pritchard at the meeting of 7 September influenced him to a material degree and played a real and substantial part in inducing McNaughton to continue with the take-over."

I shall come later to consider the submissions put forward by the parties. First, however, it is necessary to make some reference to the relevant principles of law.

The law

In the last 25 years or so, since the landmark decision of the House of Lords in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.* [1964] A.C. 465, consideration has been given in a number of cases in the appellate courts to the circumstances in which a duty of care exists giving rise to liability in negligence where the loss suffered by the plaintiff is a purely economic loss. At the same time the courts have been concerned with the wider problem of trying to isolate and define the essential ingredients of the tort of negligence in all its manifestations. In the earlier part of this period attempts were made to seek a general principle which, subject to any necessary modification to meet the facts of a particular case, could be applied in all circumstances. This quest for a general principle led finally to the well known passage in the speech of Lord Wilberforce in *Anns v. Merton London Borough Council* [1978] A.C. 728, 751:

"the position has now been reached that in order to establish that a duty of care arises in a particular situation, it is not necessary to bring the facts of that situation within those of previous situations in which a duty of care has been held to exist. Rather the question has to be approached in two stages. First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter—in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise."

In the last 10 years, however, there has been a change of direction. In a series of decisions of the Privy Council and the House of Lords it has been emphasised that no single general principle is able to provide a practical test which can be applied to every situation to determine whether a duty of care is owed and, if so, what is its scope. This series of cases was recently referred to by Lord Bridge of Harwich in his speech in *Caparo Industries Plc. v. Dickman* [1990] 2 A.C. 605, 617–618, when he said:

"What emerges is that, in addition to the forseeability of damage, necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the party to whom it is owed a relationship characterised by the law as one of 'proximity' or 'neighbourhood' and that the situation should be one in which the court considers it fair, just and reasonable that the law

should impose a duty of a given scope upon the one party for the benefit of the other. But it is implicit in the passages referred to that the concepts of proximity and fairness embodied in these additional ingredients are not susceptible of any such precise definition as would be necessary to give them utility as practical tests, but amount in effect to little more than convenient labels to attach to the features of different specific situations which, on a detailed examination of all the circumstances, the law recognises pragmatically as giving rise to a duty of care of a given scope. Whilst recognising, of course, the importance of the underlying general principles common to the whole field of negligence, I think the law has now moved in the direction of attaching greater significance to the more traditional categorisation of distinct and recognisable situations as guides to the existence, the scope and the limits of the varied duties of care which the law imposes."

Moreover, a similar restatement of the present state of the law was given by Lord Goff of Chieveley in *Davis v. Radcliffe* [1990] 1 W.L.R. 821, 826, where he said:

"It is now clear that foreseeability of loss or damage provides of itself no sufficient criterion of liability, even when qualified by a recognition that liability for such loss or damage may be excluded on grounds of policy. On the contrary, as appears in particular from the speech of Lord Keith of Kinkel in *Governors of the Peabody Donation Fund v. Sir Lindsay Parkinson & Co. Ltd.* [1985] A.C. 210, 240–241, it is also necessary to establish what has long been given the label of 'proximity'—an expression which refers to such a relation between the parties as renders it just and reasonable that liability in negligence may be imposed on the defendant for loss or damage suffered by the plaintiff by reason of the act or omission of the defendant of which complaint is made. Furthermore it has also been reasserted that it is not desirable, at least in the present stage of development of the law, to attempt to state in broad general propositions the circumstances in which such proximity may or may not be held to exist."

It therefore seems probable that, at any rate at this stage, the common law of England will develop step by step and in accordance with the views expressed by Brennan J. in the High Court of Australia in *Sutherland Shire Council v. Heyman* (1985) 157 C.L.R. 424, 481, where he said:

"It is preferable, in my view, that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care restrained only by indefinable 'considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed.' "

It therefore becomes necessary, in the absence of some general principle, to examine each individual case in the light of the concepts of foreseeability, proximity and fairness. The last of these concepts, however, is elusive and may indeed be no more than one of the criteria by which proximity is to

be judged. It is perhaps sufficient to underline that in every case the court must not only consider the foreseeability of the damage and whether the relationship between the parties is sufficiently proximate but must also pose and answer the question: in this situation is it fair, just and reasonable that the law should impose on the defendant a duty of the scope suggested for the benefit of the plaintiff?

I turn next to consider what guidance can be obtained from the modern authorities as to how these general concepts are to be applied

> "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:" *per* Lord Bridge in the *Caparo* case [1990] 2 A.C. 605, 619.

The natural starting point for this search for guidance is, of course, the *Hedley Byrne* case [1964] A.C. 465, but I do not propose to make any detailed reference to it for at least three reasons. In the first place, as Lord Oliver of Aylmerton observed in the *Caparo* case, at p. 629, it is not easy to cull from the speeches in the *Hedley Byrne* case any clear attempt to define or classify the circumstances which give rise to the relationship of proximity. In the second place, the test which was suggested in some of the speeches in the *Hedley Byrne* case, the test of "a voluntary assumption of responsibility" by the defendant, has been found to be unhelpful in more recent authorities: see, for example, *per* Lord Griffiths in *Smith v. Eric S. Bush* [1990] 1 A.C. 831, 862 and *per* Lord Roskill in the *Caparo* case [1990] 2 A.C. 605, 627. My third and most compelling reason for not making any detailed reference to the *Hedley Byrne* case is the fact that Lord Oliver himself in the *Caparo* case, at p. 638, set out, in words which I would gratefully adopt, the guidance which can be obtained from the *Hedley Byrne* case:

> "What can be deduced from the *Hedley Byrne* case, therefore, is that the necessary relationship between the maker of a statement or giver of advice ('the adviser') and the recipient who acts in reliance upon it ('the advisee') may typically be held to exist where (1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given; (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose; (3) it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry; and (4) it is so acted upon by the advisee to his detriment. That is not, of course, to suggest that these conditions are either conclusive or exclusive, but merely that the actual decision in the case does not warrant any broader propositions."

I shall return later to refer to some aspects of these propositions in more detail and to consider their importance in the context of the present

A case. First, however, I should make one further reference to the speech of Lord Bridge in the *Caparo* case, in which he summed up the recent authorities in England on this branch of the law, at pp. 620-621:

> "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. 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."

I have considered the four propositions which have been distilled by Lord Oliver [1990] 2 A.C. 605, 638, from the speeches in the *Hedley Byrne* case. I have also considered the more recent authorities and, in particular, the speeches in the House of Lords in *Smith v. Eric S. Bush* [1990] 1 A.C. 831 and the *Caparo* case. From this scrutiny it seems to me to be clear (a) that in contrast to developments in the law in New Zealand, of which the decision in *Scott Group Ltd. v. McFarlane* [1978] 1 N.Z.L.R. 553 provides an important illustration, in England a restrictive approach is now adopted to any extension of the scope of the duty of care beyond the person directly intended by the maker of the statement to act upon it; and (b) that in deciding whether a duty of care exists in any particular case it is necessary to take all the circumstances into account; but (c) that, notwithstanding (b), it is possible to identify certain matters which are likely to be of importance in most cases in reaching a decision as to whether or not a duty exists. I propose to examine these matters under a series of headings, though the headings involve a substantial measure of overlap.

(1) *The purpose for which the statement was made*

In some cases the statement will have been prepared or made by the "adviser" for the express purpose of being communicated to the "advisee," to adopt the labels used by Lord Oliver. In such a case it may often be right to conclude that the advisee was within the scope of the duty of care. In many cases, however, the statement will have been prepared or made, or primarily prepared or made, for a different purpose and for the benefit of someone other than the advisee. In such cases it will be necessary to look carefully at the precise purpose for which the statement was communicated to the advisee.

(2) *The purpose for which the statement was communicated*

Under this heading it will be necessary to consider the purpose of, and the circumstances surrounding, the communication. Was the communication

made for information only? Was it made for some action to be taken and, if so, what action and by whom? Who requested the communication to be made? These are some of the questions which may have to be addressed.

(3) *The relationship between the adviser, the advisee and any relevant third party*

Where the statement was made or prepared in the first instance to or for the benefit of someone other than the advisee it will be necessary to consider the relationship between the parties. Thus it may be that the advisee is likely to look to the third party and through him to the adviser for advice or guidance. Or the advisee may be wholly independent and in a position to make any necessary judgments himself.

(4) *The size of any class to which the advisee belongs*

Where there is a single advisee or he is a member of only a small class it may sometimes be simple to infer that a duty of care was owed to him. Membership of a large class, however, may make such an inference more difficult, particularly where the statement was made in the first instance for someone outside the class.

(5) *The state of knowledge of the adviser*

The precise state of knowledge of the adviser is one of the most important matters to examine. Thus it will be necessary to consider his knowledge of the purpose for which the statement was made or required in the first place and also his knowledge of the purpose for which the statement was communicated to the advisee. In this context knowledge includes not only actual knowledge but also such knowledge as would be attributed to a reasonable person in the circumstances in which the adviser was placed. On the other hand any duty of care will be limited to transactions or types of transactions of which the adviser had knowledge and will only arise where

> "the adviser knows or ought to know that [the statement or advice] will be relied upon by a particular person or class of persons in connection with that transaction:" *per* Lord Oliver in the *Caparo* case [1990] 2 A.C. 605, 641.

It is also necessary to consider whether the adviser knew that the advisee would rely on the statement without obtaining independent advice.

(6) *Reliance by the advisee*

In cases where the existence of a duty of care is in issue it is always useful to examine the matter from the point of view of the plaintiff. As I have ventured to say elsewhere* the question "Who is my neighbour?" prompts the response "Consider first those who would consider you to be their neighbour." One should therefore consider whether and to what extent the advisee was entitled to rely on the statement to take the action that he did take. It is also necessary to consider whether he did in fact rely

* *Reporter's note.* See *Aswan Engineering v. Lupdine Ltd.* [1987] 1 W.L.R. 1, 19.

A on the statement, whether he did use or should have used his own judgment and whether he did seek or should have sought independent advice. In business transactions conducted at arms' length it may sometimes be difficult for an advisee to prove that he was entitled to act on a statement without taking any independent advice or to prove that the adviser knew, actually or inferentially, that he would act without taking such advice.

B I return now to the facts of the present case. It was argued on behalf of McNaughton that the judge was fully entitled to conclude that a duty of care existed. It was important, it was submitted, to look at the whole sequence of events between the beginning of July 1982 and the meeting on 9 September when the price for the shares was agreed. It was right to infer that Mr. Pritchard would have been kept informed of what was happening C between Mr. Topsom and Mr. McNaughton. He had known from earlier in the year that the future of M.K. was in doubt and that the accounts for the period ended 30 June 1982 were likely to form the basis for any decision as to what was to be done. By the end of August he must have known that the draft accounts which he had produced were to be shown to Mr. McNaughton. Moreover, by the time of the meeting on 7 September he knew that McNaughton were likely purchasers of M.K. and that Mr. D McNaughton was placing reliance on the draft accounts and on the answer which he gave to the question: "Would I be right in saying that because of rationalisation M.K. Papers Group is now breaking even or doing marginally worse?" It was further argued that the judge had examined the facts with great care and had reached a conclusion with which the Court of Appeal could not safely interfere. The judge was in a much better position E to assess the probabilities of the case. It was also stressed that the fact that the accounts were draft accounts was in no way conclusive; we were reminded that the accounts which were considered by Denning L.J. in *Candler v. Crane, Christmas & Co.* [1951] 2 K.B. 164 were only draft accounts. In addition it was submitted that Mr. Pritchard had an opportunity to disclaim and to warn Mr. McNaughton, if he wished to do so, of the provisional nature of the accounts.

F These arguments are persuasive. In addition due weight must be given to the fact that the judge saw Mr. Topsom and Mr. Pritchard in the witness box. In the end, however, I have come to the conclusion that, if one applies the tests which have been established in the recent authorities, the existence of a duty of care has not been made out. In reaching this conclusion I have taken into account the four propositions set out in Lord G Oliver's speech in the *Caparo* case [1990] 2 A.C. 605, 638, and have examined the facts by reference to the headings which I have mentioned earlier. I have also had regard to the concepts of forseeability, proximity and fairness. The following matters in particular have impressed me.

(a) It is clear that in about July 1982 Mr. Topsom asked Mr. Pritchard to prepare the audited accounts as quickly as possible. At that stage, though the future of M.K. was in the melting pot, the accounts were to be H produced for Mr. Topsom.

(b) The accounts, when produced, were merely draft accounts. In the context of this case this was an important point because the term "draft" showed that further work would be required before the accounts became

final accounts. Accordingly Mr. McNaughton was not entitled to treat them as though they were final accounts and Mr. Pritchard could not be expected to foresee that Mr. McNaughton would so treat them.

(c) Mr. Pritchard attended the meeting on 7 September 1982 and wrote the letter on that date to Mr. McNaughton. There is no evidence that he took any other part in the negotiations leading to the take-over.

(d) As was pointed out during the course of the hearing of the appeal, it would appear that the judge did not appreciate that the accounts showed that there was a loss for the year ended 30 June 1982 of about £48,000. M.K. were plainly in a poor state and Mr. McNaughton can have been in no doubt about the matter.

(e) This was a transaction between experienced business men. It was to be anticipated that Mr. McNaughton would have access to and would consult with his own accountancy advisers. Mr. Pritchard and H.A. were the accountants to M.K.

(f) Great reliance was placed by McNaughton on the answer given by Mr. Pritchard to Mr. McNaughton's question at the meeting on 7 September. It seems to me, however, that it was a very general answer and that it did not affect any of the specific figures in the draft accounts. Moreover, it is not possible in my view to attribute to Mr. Pritchard the knowledge that Mr. McNaughton would rely on this answer *without any further inquiry or advice* for the purpose of reaching a concluded agreement with Mr. Topsom.

Since preparing this judgment I have had the opportunity of reading the speeches of the House of Lords in *Murphy v. Brentwood District Council* [1991] 1 A.C. 398. There is nothing in any of these speeches which alters what was said earlier this year in the *Caparo* case. Indeed it may be noted (a) that Lord Keith of Kinkel referred again, at p. 461, to the judgment of Brennan J. in the *Shire of Sutherland* case, 157 C.L.R. 424, where Brennan J. emphasised that the question is always whether the defendant was under a duty to avoid or prevent the kind of damage which the plaintiff in fact suffered; (b) that Lord Oliver underlined the same point where, having referred to the *Shire of Sutherland* case and to the *Caparo* case, he continued, at p. 486:

> "The essential question which has to be asked in every case, given that damage which is the essential ingredient of the action has occurred, is whether the relationship between the plaintiff and the defendant is such—or, to use the favoured expression, whether it is of sufficient 'proximity'—that it imposes upon the latter a duty to take care to avoid or prevent that loss which has in fact been sustained."

I have not found this to be an easy case. Having looked at length at the documents and the transcripts of the evidence, I have been driven to the conclusion that, as the law stands at present, McNaughton have not been able to establish the existence of a duty of care owed to them by Mr. Pritchard or H.A. at any material time. I would allow the appeal.

NOURSE L.J. I have had the advantage of reading in draft the judgment of Neill L.J. and, for the reasons which he has given, I too would allow this appeal.

A BALCOMBE L.J. I have had the advantage of reading in draft the judgment of Neill L.J. and I agree with him that, for the reasons which he gives, this appeal should be allowed. It is only because we are differing from the judge below that I add a few words of my own.

At the time of the hearing before Judge Lipfriend the hearing by the House of Lords of the appeal in *Caparo Industries Plc. v. Dickman* [1990] 2 A.C. 605 had not taken place and the speeches had not been delivered, B let alone reported. If the judge had had the advantage of reading the speeches in that case, I think it is highly improbable that he would have reached the conclusion that a duty of care existed on the facts of the present case. That case decided that in general there was no reason in policy or principle why the auditors of a company should be deemed to have a special relationship, giving rise to a duty of care, with non- C shareholders contemplating investment in the company in reliance on the published accounts. It also decided that such a duty of care did not even extend to the shareholders in the company when they relied on the accounts, not so as to exercise their class rights in general meeting, but to make decisions as to future investment in the company. To hold that in the circumstances of the present case Mr. Pritchard and H.A. owed a duty of care to McNaughton would require us to distinguish the facts of the D present case from those of the *Caparo* case when, in my judgment, no such valid distinction exists.

Like Neill L.J. I have also considered the facts of the present case in the light of the four propositions set out by Lord Oliver of Aylmerton in the *Caparo* case, at p. 638. Neill L.J. has set out the relevant matters in lettered paragraphs (a) to (f) towards the end of his judgment and I need E not repeat them here. It is sufficient to say that the facts that these were draft accounts and that there was no reason for Mr. Pritchard to suppose that Mr. McNaughton would not consult his own accountants are most material factors in considering the existence of a duty of care in relation to the accounts. Again, the answer to the question at the meeting of 7 September 1982 must be considered in the light of the fact that Mr. Pritchard knew that Mr. McNaughton had seen the draft accounts showing F a loss of some £48,000 for the year ended 30 June 1982. Accordingly I agree with Neill L.J. that it is impossible in these circumstances to attribute to Mr. Pritchard the knowledge that Mr. McNaughton would rely on this answer without any further inquiry or advice.

Appeal allowed with costs in Court of Appeal and below.
G *Interest to be on commercial rate.*
Leave to appeal refused.

Solicitors: Herbert Smith; Cameron Markby Hewitt.

[Reported by CHRISTOPHER CHAMPNESS ESQ., Barrister]

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