Exhibit 7

considerable difficulties in succeeding in that cause of action, but its eventual fate is not for me to decide at this stage. What is noteworthy, however, is that very much the same issues and very much the same complaints will have to be dealt with in the defamation action as would be dealt with on a writ action for breach of contract for wrongful dismissal. Mr. Darkoh is alive to that possibility as he claims damages for "humiliation" in the defamation proceedings—that is to say damages for the manner of his dismissal. Such damages would not be available to him on an action for wrongful dismissal.

I mention those matters only because had I been satisfied that there was a sufficient public law interest to permit this application to proceed, I would in my discretion have refused it on the grounds that the real issues can only properly be determined in the defamation action and the potential wrongful dismissal action. In the defamation action the defendant alleges that the complaints were true, so that the truth of the allegations will have to be determined in those proceedings and/or in the proceedings for wrongful dismissal. It may be that those actions can conveniently be tried together although I express no final view on the matter. What is clear is that those matters could be not resolved in these proceedings.

I wish to emphasize that my primary reason for the dismissal of these proceedings is that no public law right arises out of the contractual relationship between the applicant and the Cayman Islands Government.

Finally, I have been asked by Mr. Hellman if I would permit the present proceedings for judicial review to be converted into a writ action, in the event that I were to dismiss the claim for judicial review. I declined to do so in view of the complex factual issues which will arise in that suit. Such matters will have to be pleaded in a proper manner, discovery effected and the relevant witnesses assembled. I therefore decline to give leave for an amendment in the form requested and I dismiss the application for judicial review, with costs to be taxed in default of agreement.

Application dismissed.

Attorneys: *Quin & Hampson* for the applicant; *Government Legal Dept.* for the respondents.

IN THE MATTER OF OMNI SECURITIES LIMITED (No. 3)

GRAND COURT (Smellie, C.J.): October 14th, 1998

Civil Procedure—judgments and orders—summary judgment—defendant's application—under Grand Court Rules, O.14, r.12, defendant to show plaintiff's claim unsustainable—no dismissal if plaintiff shows more than faint possibility of success in at least part of claim—some assessment of plaintiff's evidence filed under r.13 necessary

Companies—auditors—professional negligence—auditor liable for negligent misstatement if (a) issues report in knowledge recipient will rely on it, (b) recipient does so rely, and (c) economic loss results

The plaintiff company in liquidation brought an action for damages against the defendants for breach of contract and negligent misstatement.

The first defendant's predecessor firm, DH&S (Cayman), was responsible for issuing the plaintiff's audit reports. Its role was confined to signing financial statements and accounts which had been prepared on the basis of primary auditing and fieldwork by its affiliated firm, DH&S (Zurich), now D&T A.G., the eighth defendant. The other defendants were partners in DH&S (Cayman) and the existing Cayman firm, D&T (Cayman).

The plaintiff claimed that DH&S (Cayman) had failed to alert it to the fact that there were insufficient funds from which to meet payments made to its parent company as dividends, resulting eventually in its winding up.

All the defendants save D&T A.G. applied for the plaintiff's claims to be dismissed and judgment entered in their favour under, *inter alia*, O.14, r.12 of the Grand Court Rules, on the basis that these claims had no prospect of success.

They submitted that (a) the plaintiff was required to show that it had a realistic prospect of success in order to proceed with its claims; (b) the court would need to examine the evidence to assess whether such a prospect existed; (c) the plaintiff had no tenable claim in contract, since it had no agreement with DH&S (Cayman) that the local firm would conduct the audit, and it had liaised with the Swiss firm regarding the preparation of the accounts; and (d) nor would it succeed in tort, since there was no evidence that it had relied on the audit or that such reliance had ultimately caused the company to be wound up.

The plaintiff submitted in reply that (a) since the defendants had to prove that its claims had no prospect of success, it need only show that there was a triable issue and that it had a chance of recovering more than nominal damages to defeat their application; (b) there was no need, for

this purpose, for the court to examine the evidence in support of its claims; (c) its contractual relationship with DH&S (Cayman) was evidenced by minutes of its board meetings referring to that firm's appointment as auditor; and (d) having signed the unqualified audit report, DH&S (Cayman) had assumed professional responsibility for its contents and was liable to the plaintiff as the intended recipient who clearly intended to rely on the report.

Held, dismissing the application:

(1) Under O.14, r.12 of the Grand Court Rules, the defendants were required to show that the plaintiff's claims were unsustainable in order to obtain their dismissal. However, in common with the test applicable to a plaintiff's application under O.14, r.1, the qualification of reasonableness was implicit so that if the plaintiff could show more than a faint possibility of succeeding on at least part of its claim, the defendants' application would fail. To ascertain whether there was a fair and reasonable chance of success, and without usurping the function of the trial judge, the court would need to make some assessment of the evidence supporting the plaintiff's claims as it would do in respect of an alleged defence upon an O.14, r.1 application. Indeed, this was the purpose of filing such evidence under r.13 (page 279, line23 – page 280, line 40; page 291, lines 26–28).

(2) Whilst the evidence appeared to show no relationship of privity between DH&S (Cayman) and the plaintiff, the court could not conclude, on a summary basis, that this cause of action had no real prospect of success, since the plaintiff's claim in contract relied on evidence of its board meetings, the significance of which could not be assessed without full discovery and the examination of witnesses. Accordingly, this claim would not be dismissed (page 284, lines 16–34; page 284, line 42 – page 285, line 4).

(3) The defendants would be liable for economic loss suffered by the plaintiff if it could be shown that they had issued the report containing negligent misstatements in the knowledge that the plaintiff would rely on it in its business dealings, that the plaintiff did in fact rely on it and that it suffered consequential detriment. Other tests of liability, involving proof of "a relationship of proximity" or the "assumption of professional responsibility" were merely different ways of expressing the requirement of knowledge of the recipient's intended reliance. On a summary examination of the evidence, it seemed unlikely that the defendants, having issued an unqualified audit report on which the plaintiff would presumably wish to rely, would avoid liability because a sister firm had carried out the basic work. The inter-relationship of the firms would clearly be relevant to liability in tort, which could exist irrespective of liability in contract, and required further examination (page 281, line 25 – page 282, line 15; page 285, lines 21–37; page 286, lines 15–31; page 287, line 41 – page 288, line 28).

(4) The extent of this liability depended on the plaintiff's proving that the breach of contract or negligence was the dominant or effective cause of its loss, and could not be assessed on a summary basis. It was likely that even if the plaintiff's claim for losses resulting from continued trading in reliance on the audit did not succeed in full, it had a reasonable chance of obtaining damages for the alleged unlawful payment of dividends. Accordingly, the court would not dismiss this claim either (page 286, line 45 – page 287, line 13; page 290, lines 4–13; page 291, lines 9–24).

Cases cited:

(1) *Argentine Holdings (Cayman) Ltd.* v. *Buenos Aires Hotel Corp. S.A.*, 1997 CILR 90.

(2) *Bank of Credit & Commerce Intl. (Overseas) Ltd.* v. *Price Waterhouse*, [1997] BCC 584; [1997] T.L.R. 60, considered.

(3) *Banque de Paris et des Pays-Bas (Suisse) S.A.* v. *de Naray*, [1984] 1 Lloyd's Rep. 21, *dicta* of Ackner, L.J. applied.

(4) *Barings PLC* v. *Coopers & Lybrand*, [1997] 1 BCLC 427; [1997] BCC 498, considered.

(5) *Berg Sons & Co. Ltd.* v. *Adams*, [1993] BCLC 1045; [1992] BCC 661, considered.

(6) *Caparo Indus. PLC* v. *Dickman*, [1990] 2 A.C. 605; [1990] 1 All E.R. 568, applied.

(7) *Cribb* v. *Reed*, 1997 CILR *N–5*, *dicta* of Patterson, Ag. J. applied.

(8) *Deloitte Haskins & Sells* v. *National Mutual Life Nominees Ltd.*, [1993] A.C. 774; [1993] 2 All E.R. 1015, considered.

(9) *Drummond-Jackson* v. *British Medical Assn.*, [1970] 1 W.L.R. 688; [1970] 1 All E.R. 1094.

(10) *Galoo Ltd.* v. *Bright Grahame Murray*, [1994] 1 W.L.R. 1360; [1995] 1 All E.R. 16, applied.

(11) *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*, [1964] A.C. 465; [1963] 2 All E.R. 575.

(12) *Henderson* v. *Merrett Syndicates Ltd.*, [1995] 2 A.C. 145; [1994] 3 All E.R. 506, considered.

(13) *J.E.B. Fasteners Ltd.* v. *Marks Bloom & Co.*, [1983] 1 All E.R. 583, *dicta* of Donaldson, L.J. applied.

(14) *National Westminster Bank PLC* v. *Daniel*, [1993] 1 W.L.R. 1453; [1994] 1 All E.R. 156, followed.

(15) *Smith* v. *Eric S. Bush*, [1990] 1 A.C. 831; [1989] 2 All E.R. 514, *dicta* of Lord Griffiths applied.

(16) *Wenlock* v. *Moloney*, [1965] 1 W.L.R. 1238; [1965] 2 All E.R. 871, *dicta* of Danckwerts, L.J. applied.

Legislation construed:

Grand Court Rules, O.14, r.12:

"(1) Where in an action to which this rule applies a defence has been served by any defendant, that defendant may, on the ground that the plaintiff's claim has no prospect of success or that the

plaintiff has no prospect of recovering more than nominal damages, apply to the Court for the plaintiff's claim to be dismissed and judgment entered for that defendant.

(2) An application under this rule may not be made on the ground that part only of the plaintiff's claim has no prospect of success or that a plaintiff has no prospect of recovering more than nominal damages in respect of part only of his claim."

r.13(3): "A plaintiff may show cause against an application under rule 12 by—

(a) filing and serving a reply; or

(b) filing and serving an affidavit in reply."

O.18, r.19(1): "The Court may at any stage of the proceedings order to be struck out or amended any pleading or the indorsement of any writ in the action, or anything in any pleading or in the indorsement, on the ground that—

(a) it discloses no reasonable cause of action or defence, as the case may be . . . ."

R.H. Hildyard, Q.C. and *D.T.J. McCahill* for the plaintiff;
M.J. Brindle, Q.C. and *N.R.L. Clifford*, for the first to seventh, ninth and tenth defendants;
The eighth defendant did not appear and was not represented.

SMELLIE, C.J.: This is an application by the first to seventh, ninth and tenth defendants ("the applicants") to dismiss the claims of the plaintiffs. The individual applicants are, or were at material times, partners within the first applicant, DH&S (Cayman) or its predecessor firms. By a judgment delivered on August 16th, 1998 the application was dismissed. These are the reasons for that judgment.

The application was made pursuant to the Grand Court Rules, O.18, r.19 or alternatively O.14, r.12, but was based primarily upon O.14, r.12. It relied primarily upon O.14, r.12 because the test—as postulated by the applicants—which the plaintiff was required to meet under it was to show a case which had a *realistic prospect of success*. Under O.18, r.19, by contrast, the test to be met was said to be different and less onerous—the showing of a reasonable cause of action, which means a cause of action "*of some chance of success*" (*per* Lord Pearson in *Drummond-Jackson* v. *British Medical Assn.* (9) ([1970] 1 W.L.R. at 696)). A further important difference—assuming that a lesser standard is to be shown by the plaintiff under O.18, r.19—is the general prohibition it provides against the admission of evidence and the requirement instead that the pleadings be taken at face value.

Order 14, r.12 is expressed in terms of dismissing a plaintiff's case which shows "*no prospect of success*." Here the applicants urge the super-imposition of the word "*realistic*" as denoting the difference from the O.18, r.19 test and as recognizing that O.14, r.12 is the reverse of an

O.14, r.1 application by a plaintiff for summary judgment against a defendant, which is predicated upon the absence of a reasonable defence. The introduction of the test "*realistic*" would also imply an assessment of the evidence available in support of the plaintiff's case, to the same extent at least as is allowed upon an O.14, r.1 plaintiff's application. Mr. Brindle, Q.C. relied by analogy upon *National Westminster Bank PLC* v. *Daniel* (14), the leading case on the O.14, r.1 application, in support of these submissions.

Mr. Hildyard, Q.C. urged a different test, emphasizing the literal meaning of O.14, rr. 12 and 13, that the plaintiff need only show a prospect of success. This, he also submitted, would go without analysis of the evidence on the plaintiff's claim or on any part of its claim. He argued, moreover, that the plaintiff need only show that it has a prospect of recovering more than nominal damages in respect of its claim or any part of its claim. He submitted that whether an analogy is made with the principles of O.14, r.1 or those of O.18, r.19, it is plain that a party is only entitled to summary judgment in the clearest cases—*i.e.* when there is no triable issue.

While I accept this to be a generally sound proposition, it cannot displace what must be the primary objective of O.14—the timely disposition of cases which do not deserve to be allowed to go to trial either because there is no prospect of a defence (O.14, r.1) or of a claim (O.14, r.12) succeeding. This debate arises in this case I think only because O.14, r.12 is peculiar to the Cayman Grand Court Rules, having recently been introduced in 1996, and so there are no settled *dicta* defining its meaning. There is, however, the decision of this court in *Cribb* v. *Reed* (7) which is helpful. Patterson, Ag. J. observed:

> "In my view, as I have said earlier, the scope of O.14, r.12 appears to be very wide. It gives a defendant the right to terminate proceedings against him in a summary manner by showing that the plaintiff's claim has no prospect of success. If the defendant is able to show that the plaintiff's case is clearly unsustainable, then he will be entitled to judgment without the necessity of a possible long drawn out trial. If the issue raised by the defence is shown to be sufficient to finally determine the action in his favour without a full scale trial, then in my view, an O.14, r.12 application is appropriate. These are but examples of the scope of the rule and are by no means exhaustive. The application of the procedure not only saves costs but it saves the time of the court."

I agree with those statements. I think they properly emphasize the need to show that the plaintiff's case has no prospect of success. Indeed it is at some risk of pedantry that one would seek further to define the test but it is a risk worth taking, I believe, in order to emphasize that there should be rationalization between the test upon an application by a plaintiff with that upon an application by a defendant. I would therefore only add that

in any rational application of the rule, there must be implicit the tests of reasonableness and realness.

I agree with Mr. Brindle that the rule could not properly be predicated only upon a fanciful or improbable prospect of the plaintiff's claim succeeding. And the fact that the rule is engrafted upon O.14, allowing also for a defendant's application for summary dismissal, does to my mind imply the reverse of the test of O.14, r.1 which is applicable where a plaintiff applies for summary judgment. That test, as stated in the headnote to *National Westminster Bank PLC* v. *Daniel* (14) in *The All England Law Reports* ([1994] 1 All E.R. at 156) requires a defendant seeking unconditional leave to defend to "satisfy that court that there is *a fair or reasonable probability of having a credible defence and not merely that there is a faint possibility that he has a defence.*" [Emphasis supplied.] (See also *Argentine Holdings (Cayman) Ltd.* v. *Buenos Aires Hotel Corp. S.A.* (1) (1997 CILR at 97) where that test was applied by this court upon a plaintiff's application for summary judgment.)

In applying this test, while one must be mindful of the cautionary words of Danckwerts, L.J. in *Wenlock* v. *Moloney* (16) ([1965] 1 W.L.R. at 1244)—expressed upon an O.18, r.19 application—not to usurp the position of the trial judge by embarking upon "a trial of the case in chambers, on affidavits only, without discovery and without oral evidence tested by cross-examination. . ." there none the less has to be some assessment of the evidence presented in support of the plaintiff's case to see whether there is a fair and reasonable probability or more than a faint possibility of success. As was observed by Ackner, L.J. in *Banque de Paris et des Pays-Bas (Suisse) S.A.* v. *de Naray* (3) ([1984] 1 Lloyd's Rep. at 23):

> "It is of course trite law that O.14 proceedings are not decided by weighing the [opposing] affidavits. It is also trite that the mere assertion in an affidavit of a given situation which is to be the basis of a defence does not, ipso facto, provide leave to defend; the Court must look at the whole situation and ask itself whether the defendant has satisfied the Court that there is a fair or reasonable probability of the defendant's having a real or bona fide defence."

That, in reverse, is the standard I have adopted in considering whether the plaintiff has shown a fair or reasonable prospect of success. And, contrary to the express prohibition arising upon an O.18 application, I think O.14, r.13 by its terms implies some consideration of the evidence where it expressly invites a plaintiff to show cause against a defendant's application by filing and serving evidence in reply.

The claim

There are two distinct aspects to the plaintiff's claim: that in contract and that in tort. The claim is of that genre which has come to be referred to as an auditor's negligence claim. It is for very large sums of damages

alleged to have arisen from the applicants' breaches of their professional duties owed alternatively in contract or in tort. I will briefly consider the separate heads of damages when considering whether the plaintiff can recover more than nominal damages, which is an important factor in assessing the ultimate prospects of success.

The subject of this action is the audit conducted in respect of the financial affairs of the plaintiff for the year ended December 31st, 1989. The first issue is over who was contractually responsible for that audit. Was it the applicants or was it the eighth defendant, the applicants' affiliated firm of Deloitte Haskins & Sells Zurich ("DH&S Zurich")? Notwithstanding that the audit was signed and issued by DH&S (Cayman), privity of contract between DH&S (Cayman) and the plaintiff is denied.

Although in its arguments the plaintiff referred to the applicants' "assumption of liabilities in contract and/or in tort," liability in contract remains a question which must be answered by reference to whether or not there was privity of contract between the plaintiff and the applicants. Reference was also made to the expert evidence of Messrs. Bullmore and Dinan (experienced audit practitioners with other local firms) as to the industry standards and practices which would deem the firm which signed and issued the audit report (in this case DH&S (Cayman)) primarily liable for the representations contained therein and the signing and issuing as giving rise to a form of "implied contract." No particular authority was, however, cited for this proposition.

In my view, this is an issue which can only go to the question of liability in tort, *i.e.* whether in tort the applicants may be liable for economic loss due to negligent misstatements given to the plaintiff as the known recipient of the audit report for the specific purpose of reliance upon it for the management of its affairs and upon which the plaintiff in fact relied to its detriment. That is the tripartite test—knowledge, reliance, detriment—laid down by the House of Lords in *Caparo Indus. PLC* v. *Dickman* (6) in delineating the circumstances under which liability may be incurred by accountants or auditors to third parties in respect of negligence, especially that arising from the performance of the audit function. It is a delineation which narrows the scope of liability to third parties (which was first defined in *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.* (11)), by the requirement of proof of knowledge on the part of the auditor that his report will be received and relied upon by the third party, as distinct from the mere foreseeability that it might be so used.

In seeking to delineate the categories of third parties to whom liability for negligent misstatements might arise, the test has been described by a more unitary concept—those toward whom there has been an "assumption of responsibility" (see, *e.g. Henderson* v. *Merrett Syndicates Ltd.* (12) ([1995] 2 A.C. at 180–181)). "Assumption of responsibility" is a

test which has, however, been criticized as being "unlikely to be a helpful or realistic test in most case."See *Smith* v. *Eric S. Bush* (15) ([1990] 1 A.C. at 846, *per* Lord Griffiths) and *Caparo Indus. PLC* v. *Dickman* (6) ([1990] 2 A.C. at 628, *per* Lord Roskill):

> "I find considerable difficulty in phrases such as 'voluntary assumption of responsibility' unless they are to be explained as meaning no more than the existence of circumstances in which the law will impose a liability upon a person making the allegedly negligent statement to the person to whom that statement is made; in which case the phrase does not help to determine in what circumstances the law will impose that liability or indeed, its scope."

I share those reservations about the appropriateness of the phrase. I intend instead to be guided by the test as laid down in *Caparo Indus. PLC* v. *Dickman* as providing the definitive modern test in the context of an auditors' negligence claim.

There is a further marker worth laying down at this point by reference to the concept of "relationship of proximity" as a basis for liability in negligence. This is a phrase which was adopted and applied by the Judicial Committee of the Privy Council in the case of *Deloitte Haskins & Sells* v. *National Mutual Life Nominees Ltd.* (8) and in which such a relationship was deemed to have been created as between the auditors and their client by virtue of provisions (in a New Zealand statute) which defined the circumstances under which the audit was required and the purposes for which it would be relied upon by the client. There, although liability was found not to exist for other reasons, the relationship of proximity was found to exist because of the responsibilities created by the statutes.

No such statutory scheme exists in the Cayman Islands to govern the relationship between the plaintiff and the applicants here. Whether the factual context could be described as giving rise to such a relationship of proximity is a separate matter to be considered in what I think must be the only relevant context, *i.e.* whether the applicant had the requisite knowledge that the plaintiff would rely upon the audit report. With those distinctions in mind I go on to consider the plaintiff's case in contract and in tort.

Liability in contract

Apart from the opposing factual and expert testimony, there are objective factors already available from the evidence which may well come, in my view, to determine this issue. DH&S (Cayman) did not undertake to the plaintiff to conduct the audit. It undertook to DH&S (Zurich) to carry out certain limited work in Cayman with respect to the audit and ultimately to issue the report upon DH&S (Zurich)'s confirmation of the field work which was to be DH&S (Zurich)'s primary responsibility. This is unequivocally clear from the engagement

memorandum of October 5th (or 15th—alternatively so dated on different pages) 1989, addressed from DH&S (Zurich) to various of Deloitte's participating offices worldwide in setting the terms of reference for the worldwide audits of the various Omni enterprises. This included DH&S (Cayman). The engagement memorandum identifies DH&S (Zurich) as required "to audit the operations [of the plaintiff], DH&S Cayman Islands to issue the report." This was against the background by which it is established that DH&S (Zurich) had been the primary auditors of the plaintiff in previous years. A memorandum from Mr. Daniel Rotherfluh of Omni Holding AG ("OHAG"), the parent company and sole shareholder of the plaintiff, dated August 15th, 1989, places the historical context by referring to DH&S (Zurich) as "the auditors of Omni Securities Ltd.," the plaintiff.

DH&S (Zurich) was clearly responsible to perform the general audit of the consolidated financial statements of OHAG and of its subsidiaries, and the engagement memorandum expressly so states in respect of the year ending December 31st, 1989. It also expressly states that DH&S (Zurich) was to perform general audits of individual companies as required for local statutory or other purposes.

As already noted, Cayman statute does not require an independent audit. It requires only that proper accounts are kept. In respect of the plaintiff, its own articles require that accounts be kept but not that they be independently audited. There was therefore no statutory imposition of duties beyond those expressly or implicitly agreed by contract—such as for instance in the case of the New Zealand statute in *Deloitte Haskins & Sells* v. *National Mutual Life Nominees Ltd.* (8) or the UK Companies Act 1985, ss. 236(1) and (2) and 237(1). DH&S (Cayman) informed DH&S (Zurich) by a memorandum dated November 14th, 1989 (signed by one of the applicants, Mr. Adrian Hammond) of seven requirements to be met before the former might issue an audit report. These expressly included DH&S (Zurich)'s confirmation that it had done the general purpose examination of the financial statements of the plaintiff in accordance with Canadian General Accounting and Audit Standards and that the preparation of the financial statements by the plaintiff had been carried out in accordance with the generally accepted accounting principles. It was not surprising that the field work was to be done in Zurich, as the records of the plaintiff were maintained there.

Ultimately, DH&S (Zurich) was required to confirm to DH&S (Cayman) that in its opinion the audit report as drafted was appropriate and could be issued by DH&S (Cayman). By a standard representation letter dated March 16th, 1990, the plaintiff wrote to DH&S (Zurich):

> "In connection with your examination of the balance sheet of [the plaintiff] as of December 31st, 1989 and related statements of income and retained earnings and changes in financial position for the year then ended, for the purpose of expressing an opinion as to

whether the financial statements present fairly the financial position, results of operations and changes in financial position of [the plaintiff]—we confirm to the best of our knowledge and belief the following representations made to you during your examination. . . ."

There then followed a list of 14 matters confirmed by the plaintiff in relation to the financial statements. Eventually, after suggested amendments to the draft report by a Mr. Dettling on behalf of the plaintiff, DH&S (Zurich) sent DH&S (Cayman) a fax dated May 23rd, 1990 including the suggested amendments and giving the go-ahead to DH&S (Cayman) to issue the report accordingly. The report was issued by DH&S (Cayman) apparently on May 23rd, 1990, although there is some question over the exact date, as the minutes of the board meeting of the plaintiff dated May 22nd, 1990 show the report as having been presented and considered there on that date.

On the foregoing narrative of the evidence, there would appear, to my mind, to be no privity of contract as between the plaintiff and DH&S (Cayman) and therefore, by extension, none with the other applicants. But the resolution of this issue of contractual liability will be argued by the plaintiff as turning upon other factors the significance of which is yet to be determined. For each of the years 1988–1991 the minutes of the respective board meetings of the plaintiff show the appointment of "Deloitte Haskins & Sells" as its auditors without reference specifically either to DH&S (Zurich) or DH&S (Cayman). The reported recollection of Mr. Daniel Schwab—one of two directors of the plaintiff at material times—is that he understood those to be references to DH&S (Cayman). Apparent support for this view comes from the fact that DH&S (Cayman) did sign and issue the audit report for 1989.

In agreement with Mr. Hildyard, I felt obliged to conclude that in the absence of full discovery and the opportunity to examine and cross-examine the various witnesses (in particular Mr. Schwab and possibly Mr. Coleman, the other director of the plaintiff, now himself a defendant in a related cause of action), this court could not safely conclude that the plaintiff has no fair or reasonable prospect of showing a case in contract.

For the purposes of Swiss tax laws governing securities transactions, the plaintiff needed to show that its mind and management were in the Cayman Islands. As I understand it, it was for that primary reason of Swiss tax advantage that the plaintiff was established in the Cayman Islands as the offshore investment vehicle of the OHAG group. There were therefore good reasons for the plaintiff to arrange for its audit to be issued by Cayman auditors and to present itself as carrying on substantive business in the Cayman Islands audited by Cayman auditors. Whether, through its board of directors, it was privy to the arrangement as between DH&S (Zurich) and DH&S (Cayman) in relation to its own audit and whether all three parties regarded DH&S (Cayman) as assuming

contractual liabilities for the audit report (whether as primary or secondary auditor it matters not at this stage) are not matters which I regarded as amenable to safe resolution on the evidence as presented to me.

It will, I think, be a matter ultimately of determining what effect is to be given the resolutions passed by the plaintiff's board appointing its auditors vis-à-vis the effect of the terms of the engagement memorandum issued by DH&S (Zurich) on October 5th (or 15th), 1989 and the effect of the terms of the response to that of DH&S (Cayman) in its memorandum of November 14th, 1989 signed by Mr. Adrian Hammond.

We know from the record in the proceedings in Cause No. 93 of 1992 (in the court-supervised liquidation of the plaintiff) that DH&S (Cayman) acquiesced to the description of themselves by the liquidators of the plaintiff as "the plaintiff's auditors." Whether that acquiescence was the result of their actual understanding of their relationship with the plaintiff or whether it was simply a forensic slip—an assertion not refuted by oversight or for lack of appreciation of the implications—are all matters which I think should suitably be left for resolution at trial.

Liability in tort

Even if the plaintiff is unable to show a duty in contract, it maintains that the applicants are responsible for the contents and effect of the audit report which DH&S (Cayman) signed and issued and are therefore liable in tort to the plaintiff who was known to be the recipient of this report and would rely upon it for the conduct of its affairs. I consider that on the evidence and in the circumstances of this case, the plaintiff meets the O.14, r.12 strike-out test and more readily so in this regard. Even if, as asserted by the applicants, there is no contract, it would indeed be a novel proposition that professional auditors may deny and avoid all responsibility for an unqualified audit report which they issued, simply on the basis that the primary audit or field-work was done by someone else. Indeed, Mr. Brindle's argument was by no means as simplistic as that and all are agreed that the applicable legal standards are those stated by the House of Lords in *Caparo Indus. PLC* v. *Dickman* (6). And it is acknowledged that the duty in tort will exist irrespective of whether there is a duty in contract: see *Henderson* v. *Merrett Syndicates Ltd.* (12). Mr. Brindle's argument in the main was centred on what he said was "the absence of any evidence of reliance by the plaintiff" upon the report and the absence of proof of causation of any detriment suffered. In the light of the decision I have taken it would not be appropriate for me to examine these issues in detail at this stage. I will state my reasons only in brief.

Reliance

Prior to this hearing the statement of claim contained no averment that the plaintiff actually relied upon the audit report in any manner so as to

have affected the conduct or management of its affairs. There was, however, the evidence of the minutes of the meeting of the plaintiff's board of May 22nd, 1990 which showed the report as having been tabled and then decisions which followed to approve and confirm the financial statements (statement of income and retained earnings) for 1989 and a further decision ratifying and approving dividends of SFr.25m. which had earlier been declared. A significant portion of these are dividends alleged in the statement of claim to have been improperly paid out from capital to the sole shareholder—the parent OHAG—because the audited financial statements incorrectly reflected the plaintiff as having income and retained earnings from which to pay them. On the basis of that evidence and state of the pleadings, an amendment to the statement of claim was allowed (without opposition from the applicants) to aver the necessary claim of reliance.

In *Deloitte Haskins & Sells* v. *National Mutual Life Nominees Ltd.* (8) the Privy Council held that by virtue of the statutory duties placed upon auditors (in that case by the New Zealand statute) there was created a relationship of proximity between an auditor and its client and an auditor was therefore under a duty to exercise reasonable care in the preparation of its report, knowing the extent to which (as defined by the statute) it would be received and relied upon by the plaintiff. As no such statutory scheme exists in the Cayman Islands, any relationship of proximity can, in my view, only exist in the absence of contract if professional responsibility to the aggrieved third party has been assumed. And in this regard the limitations are clear from the *Caparo* case; there must first be knowledge that the third party will rely upon the audit report.

In the circumstances of this case, I conclude that the plaintiff may be able to show that in signing and issuing the report unqualified as to its terms, DH&S (Cayman) must have known that it would be received and relied upon to some extent by the plaintiff for the management of its affairs. And I think this must be arguable even if the contractual position was in fact such that the report was actually issued to DH&S (Zurich) at the behest of OHAG as the parent of the plaintiff. The plaintiff was known by DH&S (Cayman) to be an entity having a separate legal existence in the Cayman Islands and routinely, even if only formally, managed as to its financial affairs by its directors based in the Cayman Islands.

The scope of duty

Mr. Brindle also emphasized the scope of duty issue. Even if there was an assumption of responsibility to it, the plaintiff must have known throughout the real and limited extent to which DH&S (Cayman)—and by extension the other applicants—would be involved. It is therefore not open to the plaintiff to argue that it relied, to the extent claimed, upon DH&S (Cayman)'s representations. There are obvious difficulties in

seeking to consider this scope of duty issue on the summary basis upon which a strike-out application must proceed. First, and as already noted, the audit report was unqualified. DH&S (Cayman) therefore did nothing to signal to the plaintiff that reliance should be placed upon it only in so far as DH&S (Cayman) had itself conducted the necessary preparatory work. DH&S (Cayman) did not, in the report itself, seek to qualify the scope of its duty. Those issues have not yet been fully explored by discovery and exchange of witness statements. It therefore could not properly be determined at this summary stage and on the available evidence to what extent the plaintiff was aware of the real and limited extent of the involvement of DH&S (Cayman).

Liability, moreover, as a matter of the law governing reliance, can be a matter of degrees. As was stated by Donaldson, L.J. in *J.E.B. Fasteners Ltd.* v. *Marks Bloom & Co.* (13) ([1983] 1 All E.R. at 588):

> "The fallacy . . . lies in regarding the concept of 'reliance' as being both narrow and precise. Counsel for the plaintiffs interprets or defines 'reliance' as if it meant 'wholly dependent on'. In reality, while 'reliance' can bear this meaning, it does not necessarily do so. In real life decisions are made on the basis of a complex of assumptions of fact. Some of these may be fundamental to the validity of the decision. 'But for' that assumption, the decision would not be made. Others may be important factors in reaching the decision and collectively, but not individually, fundamental to its validity. Yet others may be subsidiary factors which support or encourage the taking of the decision. If these latter assumptions are falsified in the event, whether individually or collectively, this will be a cause for disappointment to the decision-taker, but will not affect the essential validity of his decision in the sense that if the truth had been known or suspected before the decision was taken, the same decision would still have been made."

The plaintiff denies the applicants' suggestion that there was ever any understanding that OHAG had commissioned the audit report for reliance on it solely for the purpose of satisfying Swiss tax requirements. The plaintiff asserts that DH&S (Cayman) knew—as distinct from having merely foreseen, which is not the test—that it was part of the purpose of the report that the plaintiff would itself generally rely upon it (through its directors) to the extent that it provided opinions as to the status of the financial affairs of the plaintiff. These—subject to the issue of causation—are issues which may properly be joined at common law by the test laid down by the House of Lords in the *Caparo* case (6).

In *Barings PLC* v. *Coopers & Lybrand* (4) the English Court of Appeal (applying the *Caparo* case) held ([1997] 1 BCLC at 435) that the accountants retained to audit the accounts of a subsidiary owed a duty of care to the plaintiff holding company because they knew that their work was required to enable the plaintiff to produce accounts which related to

the financial affairs of the whole group. A similar result was reached by the Court of Appeal in what were described as the exceptional circumstances of the case in *Bank of Credit & Commerce Intl. (Overseas) Ltd.* v. *Price Waterhouse* (2), where it was held that the auditors of the accounts of companies, all members of the large BCCI group, whose affairs had been conducted on the basis that they were a single bank, owed a duty of care to another company within the group which was audited by another firm. Emphasis was laid on the exceptional circumstances that as the companies operated in effect as a single bank and the barrier between the two firms of auditors was a "mere shadow," there having been a constant interchange of information between them, the defendant auditors owed a duty of care to the plaintiff group company.

It seems to me that there are arguable parallels to be drawn with the present case to meet the defence that DH&S (Cayman) (and so the other applicants) owed no duty of care to the plaintiff as the audit was engaged not by the plaintiff but by OHAG with DH&S (Zurich). Much may depend on what knowledge may be implied to DH&S (Cayman) about the intended reliance by the plaintiff from all the circumstances under which the audit work was to be done, including the interrelationships between the OHAG group and the audit firms.

In *Galoo Ltd.* v. *Bright Grahame Murray* (10) liability in tort to a third party turned upon the actual knowledge of the auditors that the audit report was required for the purpose of fixing the price for the purchase of shares in the client company and not just for the purpose of the audit itself. However routine and perfunctory the deliberations of the plaintiff's board may have been, reliance upon the audit report may well be found essential for certain purposes and therefore to have been anticipated by all parties engaged in the audit process.

Causation

An auditor is only liable for such loss as has been caused by his breach of duty. Much may therefore turn upon what the court finds at the trial was the specific relationship between the functions DH&S (Cayman) was engaged to perform or assumed responsibility to perform (knowing of the intended reliance in the sense of the tripartite test of *Caparo*) and any transaction in relation to which the plaintiff claims it relied upon the proper performance of that function. This is a modern restatement of the test of causation applicable to claims based on professional negligence. In *Berg Sons & Co. Ltd.* v. *Adams* (5) it was held that the plaintiff company was entitled only to nominal damages against its auditors since a Mr. Golechha (who was the dominant directing mind and will of the company and whose knowledge was therefore the company's knowledge) had not relied upon or been misled by the audit.

In the present case the applicants point to the dominance of Mr. Werner Rey, the notorious and archetypal shadow director of OHAG, over the

board of the plaintiff, and to the probability that he, and certainly OHAG, was aware of the limited scope of DH&S (Cayman)'s involvement in the audit process. The defence also cite the further inference to be drawn that neither Mr. Rey, OHAG itself, nor the board of the plaintiff could have been misled as to the true financial status of the plaintiff.

I agree that however one views the plaintiff's case, there are obvious difficulties with proving the causative link between the audit report (and any breach of duty involved in its issuance) and the losses claimed. The losses claimed can be described under four heads:

(a) "The Harpener loans"—loans obtained by the plaintiff in the order of DM628,357,862 in October 1989 from a syndicate of banks and from Inspectorate International A.G. (IIAG) and advanced to three German subsidiary companies of OHAG for the purpose of enabling them to purchase shares in Harpener A.G., a large and multi-faceted German conglomerate. The loans were booked to the plaintiff but secured by the pledge of the Harpener shares to the banks and by the guarantees of OHAG and by the further guarantees of the parent OHAG to IIAG.

As such no residual liability to the plaintiff is as yet alleged. The applicants say that at best only nominal damages could ever arise for the reason of the nature of the security to the bank and to IIAG and as the loans are no-recourse loans. The Harpener loans represent by far the single largest head of claim.

(b) Loans to other affiliates made in 1988 and in 1989 and, significantly therefore, prior to the audit report.

(c) Scheduled losses (as set out in Schedules 1–6 of the statement of claim) including:

(i) shares transferred to Mr. Rey in 1990–1991 valued at SFr.35m.;

(ii) loans to Mr. Rey in 1990–1991 of SFr.58m. and DM7.2m.;

(iii) advances in December 1990 to another affiliate, OBET, of DM2.5m.;

(iv) shares held in another company, ADIA, transferred to Space (another Rey company) in December 1990;

(v) other assets said to be worth DM35m. transferred to another affiliate, Omni International BV, in early 1991 (to Lloyds Bank PLC for the benefit of OIBV). Omni International BV is now in liquidation and a compromise has been reached with the liquidators of the plaintiff to treat 25% of the value of those assets as a loan to OIBV and 75% as capital injection.

(d) Dividends "unlawfully declared," *i.e.* those confirmed by resolution on May 22nd, 1990 by the directors of the plaintiff.

In relation to the Harpener loans and those to affiliates in 1988–1989 for instance, those pre-dated the audit and, in any event (as was found in *Galoo Ltd.* v. *Bright Grahame Murray* (10)), the mere entering into a loan

cannot be described as a loss giving rise to damages. Moreover, it may be difficult to show how the losses which might result from the use to which the loan was put could be attributed to the making of the loan.

As regards the claim that certain heads of loss resulted from the plaintiff's continuing to trade in the light of the audit report when otherwise it would not have done so, it may be difficult to prove that that loss was caused by any negligent conduct on the part of the auditors. Such a claim is regarded as notoriously difficult to prove: see *Jackson & Powell on Professional Negligence*, 4th ed., at 901–902 (1997). For a defendant to be liable in relation to a breach of duty imposed in contract or in tort in a situation analogous to a breach of contract, it must first be proved that the alleged wrong was the *effective* or *dominant* cause of the plaintiff's loss.

The nature of the causation necessary to establish liability for breach of duty in contract or in tort has been so described and also as "doubtless one of the most difficult areas of the law" in *Galoo* ([1995] 1 All E.R. at 24–25, *per* Glidewell, L.J.). There that judge went on to quote the following passage from 1 *Chitty on Contracts*, 26th ed., para. 1785, at 1128–1129 (1989) for guidance:

> "**Requirement of a causal connection.** The important issue in remoteness of damage in the law of contract is whether a particular loss was within the reasonable contemplation of the parties, but causation must also be proved: there must be a causal connection between the defendant's breach of contract and the plaintiff's loss. The courts have avoided laying down any formal tests for causation: they have relied on common sense to guide decisions as to whether a breach of contract is a sufficiently substantial cause of the plaintiff's loss. (It need not be the sole cause.)".

From all the material I have seen here, that seemingly arcane test which resorts to common sense will be no less appropriate in this case than in any other.

Much will depend upon what the court decides would have been the probable response of the directors of the plaintiff had the audit report reflected what the plaintiff asserts was the true position: its own impending insolvency. The plaintiff will need to show that the directors were lulled into a state of complacency by the report, a state they would not have occupied had they been made aware of the true financial position of the plaintiff. It will need to show that had the report been accurate, they would have been able to and would probably have taken some action to redeem the position of the plaintiff *vis-à-vis* OHAG and the three German companies in respect of the Harpener loans, that they would have taken some similar or other redemptive action in relation to the advances made to affiliates or in relation to advances made on behalf of Mr. Rey himself or to entities personally controlled by him, and that they would have decided not to confirm the earlier declaration of dividends eventually paid

out to OHAG on the fallacious basis of the plaintiff's own liquidity and profitability.

In the face of what Mr. Brindle described as the "internal tensions" in the plaintiff's case—averring as it does Mr. Rey's complete dominance over the directors while at the same time asserting that the directors would have taken action to oppose him—the plaintiff will doubtless need to satisfy the common sense scrutiny of the court in relation to those issues.

As a result and for the present purposes, it seemed to me that in the event that the duty and standard of care alleged to be owed by the applicants can be established, it would be a remarkable thing to suppose that had that duty of care been fulfilled, persons in the position of the directors—aware of their own fiduciary duties owed to the company and then confronted with the concomitant and inevitable accountability owed especially to creditors—would not have taken action to check Mr. Rey's abuses or to protect their own positions. That would require the attribution to them by the court of a rather unnatural state of sang-froid.

This will be a pivotal issue both in this and in the action separately brought against the directors. Whether, if the directors had acted, the losses would have been mitigated or avoided is the further element for proof in causation. *Ex facie*, and purely from the narrow view the present evidence affords, it seemed to me in that regard that the plaintiff could have an arguable case—a reasonable prospect of success—at least in relation to the alleged unlawful payment of dividends. This ultimately totalled some SFr.14.2m. according to the statement of claim and is therefore in and of itself no small matter. The rules (O.14, r.12(2)) enjoin me not to strike out a plaintiff's claim if it shows such a prospect of success even if only on one aspect of its claim.

In any event, I also concluded that it would have been inappropriate to seek to dispose of any of these involved issues on a summary basis without the benefit of full discovery and on the basis only of untested affidavit evidence. Notwithstanding the court's power to strike out which proceeds upon some analysis of the evidence, there can be no usurpation of the role of the trial judge and no abridgement of the parties' rights to full discovery and, if appropriate, to further particularization of the pleadings.

Application dismissed.

Attorneys: *W.S. Walker & Co.* for the plaintiff; *Hunter & Hunter* for the defendants.
