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that the failure of the defendants to discover the discrepancy was due to negligence. In the Supreme Court of New Zealand, Quilliam J. dismissed the plaintiffs' claim on the ground that the appellants, though careless, owed them no duty of care. An appeal to the Court of Appeal failed but the court was divided as to the reasons. Richmond P. held that the appeal failed for the same reason as that stated by the trial judge. Woodhouse J. would have allowed the appeal. Cooke J., on the other hand, whilst concurring with Woodhouse J. that the respondents did in fact owe a duty of care to the appellants, held that the appeal failed because they had failed to show any recoverable loss.

The more restrictive view was expressed by Richmond P. in the following terms, at pp. 566–567:

> "The question in any given case is whether the nature of the relationship is such that one party can fairly be held to have assumed a responsibility to the other as regards the reliability of the advice or information. I do not think that such a relationship should be found to exist unless, at least, the maker of the statement was, or ought to have been, aware that his advice or information would in fact be made available to and be relied on by a particular person or class of persons for the purposes of a particular transaction or type of transaction. I would especially emphasise that to my mind it does not seem reasonable to attribute an assumption of responsibility unless the maker of the statement ought in all the circumstances, both in preparing himself for what he said and in saying it, to have directed his mind, and to have been able to direct his mind, to some particular and specific purpose for which he was aware that his advice or information would be relied on. In many situations that purpose will be obvious. But the annual accounts of a company can be relied on in all sorts of ways and for many purposes. It would be going too far to treat accountants as assuming a responsibility towards all persons dealing with the company or its members, in reliance to some greater or lesser degree on the accuracy of the accounts, merely because it was reasonably foreseeable, in a general way, that a transaction of the kind in which the plaintiff happened to become involved might indeed take place. The relationship between the parties would, I think, be too general and not sufficiently 'special' to come within the principles underlying the decision in *Hedley Byrne*. As I have said, I believe it to be essential to the existence of a 'special relationship' that the maker of the statement was or should have been aware that his advice was required for use in a specific type of contemplated transaction. This requirement has not always required emphasis in the course of judicial discussion as to the nature of a special relationship. Probably this is because in most cases the purpose for which the information was required was, on the facts, quite obvious. But certainly this particular point was made very clear indeed in Denning L.J.'s judgment in *Candler v. Crane, Christmas & Co*. I would think that it must almost inevitably follow, once the maker of the statement is aware of a specific purpose for which his information will be used, that he will also

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A have in direct contemplation a specific person or class of persons, even though unidentified by name."

The New Zealand Companies Act 1955 contained provisions relating to the auditors' report which is similar in substance to those contained in the United Kingdom legislation but with this variation, that the "true and fair view" which group accounts are certified to give are qualified by B the words "so far as concerns members of the company." In relation to these provisions, Richmond P. observed, at p. 568:

"The provisions of the Act to which I have just referred are aimed essentially at the protection of the members of the company and of course the auditors, whose contract of employment is with the company itself, are under a contractual duty of care to the C company. These provisions do not encourage me to take the view that there is any reason why the auditors of a public company should thereby come under a common law duty of care to third persons dealing with the company or its members on the faith of their audit certificate, such liability being in some way based on a much wider principle than would apply, for example, in the case of auditors certifying the accounts of a private company. Like Quilliam D J., I can also see no reason to differentiate between auditors as such and a firm of chartered accountants employed to prepare the accounts of the company. The only point which has given me some concern, so far as the statutory provisions are concerned, is the requirement of section 133(1) whereby a copy of the balance sheet and auditors' report is required to be annexed to the annual return E and thus becomes available to the public under section 9(1) of the Act. But on reflection, this only means that the auditor of the accounts of a public company knows that the accounts and his report will become available to the public generally and, consequently, may be relied on by one or more members of the public, to some greater or lesser degree, as the basis of some business transaction. It is not suggested, however, that the F Companies Act imposes any statutory duty of care as between auditors and members of the public who rely on the accounts. In the case of a company whose shares are listed on the Stock Exchange the auditor will also know that under the Stock Exchange rules a copy of the accounts must be made available. He knows, too, that shareholders will receive copies of the accounts and that G the company itself may well make copies available to business institutions and individuals for various purposes. In the end all these matters merely add up to the fact that the auditor of a public company will necessarily have in his contemplation the possibility that the accounts may be relied on in all sorts of ways by persons other than the company and its members. This, as I have said, is not sufficient to bring about a 'special relationship.'"

H Both Woodhouse and Cooke JJ., who favoured a wider view of responsibility, based themselves upon an interpretation of the speech of Lord Wilberforce in the *Anns* case [1978] A.C. 728 which required, as the first stage of the two-stage inquiry to which he there referred, no

more than a consideration of whether harm was foreseeable, thus equating the "proximate relationship" as comprehending foresight and nothing more. This is made quite clear from the following passage in the judgment of Woodhouse J., at p. 574:

> "In this regard it will be noticed that although the first part of the inquiry outlined by Lord Wilberforce is to ask whether 'there is a sufficient relationship of proximity' in order to decide whether there is a prima facie duty of care, he would test the sufficiency of proximity simply by the reasonable contemplation of likely harm. And, with respect, I do not think that there is any need for or any sound reason in favour of a more restrictive approach. The issue has been made increasingly complex by the successive and varying formulas that have been used in an effort to confine the general area of responsibility, in particular for negligent words or in respect of purely economic losses. At this initial stage at least it should be possible to remove some degree of uncertainty—in my opinion it is done by the comprehensible and straightforward test of foreseeability."

Woodhouse J., again emphasised foreseeability as the relevant test for the creation of the relationship of proximity in his judgment where he said, at p. 575:

> "Although an audit is undertaken on behalf of the members of a public company it must be within the reasonable contemplation of any auditor that confidence in its ability to handle its commercial arrangements would depend upon the authenticity of its accounts—a confidence that would disappear if reliance could not be put upon the audit report. So I think that when auditors deliberately undertake to provide their formal report upon the accounts of a public company they must be taken to have accepted not merely a direct responsbility to the shareholders but a further duty to those persons whom they can reasonably foresee will need to use and rely upon them when dealing with the company or its members in significant matters affecting the company assets and business. An example, no doubt, would be the banker asked to make substantial advances on the security of the company undertaking. On the other hand, there would seem to be formidable difficulties for a plaintiff who attempted to prove that an auditor should have foreseen the plaintiff's likely reliance upon some newspaper or a Stock Exchange reference to a company's accounts. However, it is sufficient for present purposes to restrict consideration to a take over offer related, as so frequently is the position, to the value of shareholders' funds. In such a situation the need to rely upon audited accounts is, I think, quite obvious. As a matter of commercial reality I think the auditor and offeror are in a relationship of close proximity."

Cooke J. was to the same effect. At p. 583 he adopted, as the first step of Lord Wilberforce's two-stage approach, the formulation which equates the relationship of proximity with foreseeability, although at an earlier stage of his judgment he seemed to be disposed to regard the essential

A relationship as arising not simply from the foreseeability that a member of the public might rely on the accounts as a basis of some transaction but, for a reason which I confess I do not fully understand, from the foreseeability that some member of the public might rely on the accounts for the making of a take-over bid. He said, at p. 581:

> "The learned judge in the Supreme Court was disposed to B regard the requirement of filing audited accounts, which are available for public inspection, as not imposed by Parliament for the purpose of enabling people to deal confidently in reliance on the accuracy of the accounts. He thought it much more likely that the purpose was to enable a proper supervision to be exercised over the activities of companies, and to enable those concerned to ensure that the companies were not trading illegally or dishonestly. With respect, I C am unable to agree with him on that point. The statutory requirements regarding the filing of financial information stem, I think, from the view that those *dealing with* or *investing in* a limited liability company have a legitimate interest in being afforded reasonable access to relevant information; and that this interest has to be balanced against the wish for confidentiality naturally D entertained by family companies and the like which do not appeal to the public for funds. . . . I would agree, though, that the provisions are probably not aimed, or at least not primarily, at protecting purchasers of shares in the market."

Thus the majority of the Court of Appeal favoured a more extensive view of the circumstances from which the essential relationship between E plaintiff and defendant may be inferred in a negligent statement case than had yet emerged from any decision in the United Kingdom.

Now, of course, any decision of the Court of Appeal of New Zealand is entitled to the very greatest respect, but it has to be observed that the majority view was based upon an interpretation of Lord Wilberforce's observations in the *Anns* case [1978] A.C. 728, 751–752 which has since been severely qualified by subsequent decisions of this F House.

The *Scott Group* case [1978] N.Z.L.R. 553 has, however, since been referred to and accepted in two cases decided in the United Kingdom. In *JEB Fasteners Ltd. v. Marks Bloom & Co.* [1981] 3 All E.R. 289, the plaintiffs who had acquired the shares of the company as a result of a take-over, claimed damages against the company's auditors who, it was G claimed, had been negligent in certifying the accounts. Woolf J. dismissed the claim on the ground that the plaintiffs failed to show the causative connection between reliance on the erroneous accounts and the take-over and his decision was subsequently affirmed by the Court of Appeal [1983] 1 All E.R. 583. In the course of his judgment, however, Woolf J. made the following observation with regard to the auditors' liability [1981] 3 All E.R. 289, 296–297:

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> "Without laying down any principle which is intended to be of general application, on the basis of the authorities which I have cited, the appropriate test for establishing whether a duty of care exists appears in this case to be whether the defendants knew or

> reasonably should have foreseen at the time the accounts were audited that a person might rely on those accounts for the purpose of deciding whether or not to take over the company and therefore could suffer loss if the accounts were inaccurate. Such an approach does place a limitation on those entitled to contend that there has been a breach of duty owed to them. First of all, they must have relied on the accounts and, second, they must have done so in circumstances where the auditors either knew that they would or ought to have known that they might. If the situation is one where it would not be reasonable for the accounts to be relied on, then, in the absence of express knowledge, the auditor would be under no duty. This places a limit on the circumstances in which the audited accounts can be relied on and the period for which they can be relied on. The longer the period which elapses prior to the accounts being relied on, from the date on which the auditor gave his certificate, the more difficult it will be to establish that the auditor ought to have foreseen that his certificate would, in those circumstances, be relied on."

Now although he disclaimed any intention of laying down a general principle, it is clear that Woolf J., like Woodhouse and Cooke JJ., was interpreting Lord Wilberforce's two-stage approach in the *Anns* case as establishing a test of proximity which depended on the foreseeability of harm alone and that he regarded the limits of liability as being set not by the need for any relationship other than such as might be inferred from such foreseeability but by the factual difficulties likely to be encountered in establishing foreseeability in cases in which the reliance essential to the cause of action was separated in time from the statement or advice relied upon. In the light, therefore, of the observations of Lord Keith of Kinkel in the *Peabody* case [1985] A.C. 210 and in the *Yuen Kun Yeu* case [1988] A.C. 175, this case provides no very convincing authority for the respondents' proposition, although, as Bingham L.J. observed in the instant case, the facts were such as to justify a finding of a relationship of proximity without any extension of the criteria suggested by Denning L.J. in his judgment in *Candler's* case [1951] 2 K.B. 164.

The third case upon which the respondents rely is the decision of the Outer House of the Court of Session in *Twomax Ltd. v. Dickson, McFarlane & Robinson*, 1982 S.C. 113, the facts in which have a broad similarity to those in the *JEB Fasteners* case and in the instant case. The court was concerned with three separate claims from investors (one of whom was a company and two of whom were individuals) who had acquired shares in a private company which, shortly after the investments were made, went into receivership and was subsequently wound up. All three investors claimed that their respective investments were made on the faith of the company's audited accounts which had been negligently prepared and certified by the defenders, the company's auditors, in the course of their statutory audit. The Lord Ordinary (Lord Stewart), at pp. 122–124, having contrasted the limitations appearing from the speeches of Lord Morris and Lord Hodson in the *Hedley Byrne* case

A with the broader formulation of general principle in the speech of Lord Wilberforce in the *Anns* case, accepted the latter as governing the proper approach to the question of whether or not the essential relationship between pursuers and defenders was established in a negligent statement case and followed the guidance of the majority judgments of the New Zealand Court of Appeal in the *Scott Group* case, save that he could not draw any sensible distinction between the B case of the corporate pursuer, which had acquired the controlling interest, and that of the individual minority investors. He thus, by implication, rejected the suggestion that a potential bidder in the market is in some special position as compared with other investors such as to create between him and the auditors carrying out their statutory duties, a special relationship which does not arise in the case of an investor C concerned to acquire only a minority interest. And this, with respect, must be correct, for there can be no logical distinction according to whether an investor is likely to acquire many shares or only a few. Such distinction as there is lies only in the scale of the potential loss which may be little or great according to the magnitude of the investment. Indeed, as he pointed out, it could legitimately be said that the smaller the investment the greater the likelihood of the investor accepting the D audited accounts as the basis for his action without making any independent investigation. In the result, Lord Stewart held that the knowledge to be imputed to the defenders that there would or might well be potential investors in the market who would be interested in purchasing existing shares or subscribing for new shares and who might be influenced by the accounts was sufficient to create between them and E such investors the relationship of proximity which gave rise to an enforceable duty of care.

This case, therefore, falls into the same category as the other two cases. All three were based upon the view of Lord Wilberforce's exposition in the *Anns* case [1978] A.C. 728 which would result in foreseeability and proximity being treated as synonymous—a view which this House (and, indeed, Lord Wilberforce himself in *McLoughlin v.* F *O'Brian* [1983] 1 A.C. 410) has now decisively rejected. That, of course, does not conclude the question for it would still be open to your Lordships to find in the circumstances of this case that a special relationship existed between the auditor conducting an annual audit in pursuance of his statutory duty and every potential investor in the market or, indeed, any other person who might do business with the G company without relying solely upon the foreseeability of potential damage to such person. Just as, for instance, in *Smith v. Eric S. Bush* [1990] 1 A.C. 831, one of the factors giving rise to the relationship in that case was the circumstance that the plaintiff was the person who paid for the report upon which the reliance was placed, so here it might be said that a special relationship was to be found in the nature and extent of the statutory duties which the auditor is called upon to fulfil.

H For my part, however, I can see nothing in the statutory duties of a company's auditor to suggest that they were intended by Parliament to protect the interests of investors in the market and I see no reason in policy or in principle why it should be either desirable or appropriate

that the ambit of the special relationship required to give rise to liability in cases such as the present should be extended beyond those limits which are deducible from the cases of *Hedley Byrne* and *Smith v. Eric S. Bush*. Those limits appear to me to be correctly and admirably stated in the passages from the judgment of Richmond P. in the *Scott Group* case to which I have already referred. In particular, I see no reason why any special relationship should be held to arise simply from the circumstance that the affairs of the company are such as to render it susceptible to the attention of predators in the market who may be interested in acquiring all or the majority of the shares rather than merely a parcel of shares by way of addition to a portfolio. It follows that I would dismiss the respondents' cross-appeal.

I turn, therefore, to the question raised by the appellants' appeal. The Court of Appeal, whilst rejecting unanimously the respondents' contention that the appellants owed them a duty of care simply as potential investors in the market, nevertheless by a majority allowed their claim that a similar duty was owed to them in their capacity as shareholders from the date when they first became registered in respect of shares which they had purchased. Now it cannot be nor is it claimed that this event created for the appellants any new or greater risk of harm in relation to a certification which had already taken place; nor can it be claimed that it brought about some change in the quality or extent of the respondents' reliance upon the (ex hypothesi) inaccurate information which they had previously received and digested. The only difference in their position before registration and their position afterwards was that, as registered shareholders, they now had the statutory right to receive the accounts on which they had already relied in acquiring their original shares and to receive notice of and attend the annual general meeting of Fidelity at which the accounts were to be read and, if thought fit, approved and passed. This change of position seems, on the face of it, less than momentous and in fact they did not trouble to appoint a representative to attend the meeting on their behalf. If a distinction is to be found at all, therefore, it can only be that the nature and purpose of the statutory provisions governing the appointment and duties of auditors and the certification and publication to shareholders and others of the accounts have the effect of creating, between the auditors and individual shareholders, as potential investors in that capacity, that special relationship of proximity which is required to give rise to the duty of care and which does not exist between the auditors and the investing public generally.

Now if it be right, as, for my part, I believe that it is and as the Court of Appeal has held, that no relationship of proximity and thus no duty of care exists between auditors and the investing public generally in relation to the statutory audit—I say nothing, of course, about a case where accounts are audited specifically for the purpose of submission to a potential investor—the attribution of such a duty arising from the receipt of exactly the same information by a person who happens to be the registered holder of a share in the company whose accounts are in question produces entirely capricious results. O'Connor L.J. [1989] Q.B. 653, 715, in his dissenting judgment, instanced the case of a

A shareholder who, having purchased further shares at an overvalue on the basis of the accounts, shows the accounts to a friend who has no existing shareholding but proceeds to make a similar purchase. Each receives exactly the same information; each relies upon it in exactly the same way and for the same purpose; and the loss sustained in both cases is identical and is equally foreseeable. Yet liability is said to exist in the one case but not in the other. One has indeed only to consider the B circumstances of the instant case which must ultimately result in drawing a distinction between the loss sustained as a result of the initial purchase of shares (irrecoverable) and that sustained as a result of purchases made after the first registration (recoverable) although all purchases were made in reliance upon exactly the same information.

So unreasonable a distinction must call in question the analysis which C leads to it. The majority in the Court of Appeal deduced the relationship from what Bingham L.J. described, at p. 684D, as "the degree of closeness between the parties." It was pointed out that although the auditors are appointed and paid by the company that is the result of the vote of the shareholders in general meeting and their remuneration is paid out of funds which might otherwise be available for distribution to shareholders by way of dividend. Their duty is to report D to the shareholders whether the accounts give a true and fair view of the company's financial position and their report is sent to each shareholder as an identifiable individual. Thus, it was said, the relationship, although not a contractual one, was very close to being contractual and was moreover one in which a lack of care would be likely directly to affect the very person whose interest the auditor is engaged to protect, should E that person choose to rely upon the accounts for the purpose of making or disposing of an investment. My Lords, of course I see the force of this, but, as I have already suggested, "proximity" in cases such as this is an expression used not necessarily as indicating literally "closeness" in a physical or metaphorical sense but merely as a convenient label to describe circumstances from which the law will attribute a duty of care. It has to be borne in mind that the duty of care is inseparable from the F damage which the plaintiff claims to have suffered from its breach. It is not a duty to take care in the abstract but a duty to avoid causing to the particular plaintiff damage of the particular kind which he has in fact sustained. I cannot improve on the analysis which is to be found in the judgment of Brennan J. in the High Court of Australia in the *Shire of Sutherland* case, 60 A.L.R. 1 to which I have already referred. After G citing the speech of Viscount Simonds in *The Wagon Mound* [1961] A.C. 388, 425, where he observed that it was vain to isolate the liability from its context and to say that B is or is not liable and then to ask for what damage he is liable, Brennan J. continued, at p. 48:

> "The corollary is that a postulated duty of care must be stated in reference to the kind of damage that a plaintiff has suffered and in H reference to the plaintiff or a class of which the plaintiff is a member. I venture to repeat what I said in *John Pfeiffer Pty. Ltd. v. Canny* (1981) 148 C.L.R. 218, 241–242: 'His duty of care is a thing written on the wind unless damage is caused by the breach of that duty; there is no actionable negligence unless duty, breach and

consequential damage coincide . . . for the purposes of determining liability in a given case, each element can be defined only in terms of the others.' It is impermissible to postulate a duty of care to avoid one kind of damage—say, personal injury—and, finding the defendant guilty of failing to discharge that duty, to hold him liable for the damage actually suffered that is of another independent kind—say, economic loss. Not only may the respective duties differ in what is required to discharge them; the duties may be owed to different persons or classes of persons. That is not to say that a plaintiff who suffers damage of some kind will succeed or fail in an action to recover damages according to his classification of the damage he suffered. The question is always whether the defendant was under a duty to avoid or prevent that damage, but the actual nature of the damage suffered is relevant to the existence and extent of any duty to avoid or prevent it."

In seeking to ascertain whether there should be imposed on the adviser a duty to avoid the occurrence of the kind of damage which the advisee claims to have suffered it is not, I think, sufficient to ask simply whether there existed a "closeness" between them in the sense that the advisee had a legal entitlement to receive the information upon the basis of which he has acted or in the sense that the information was intended to serve his interest or to protect him. One must, I think, go further and ask, in what capacity was his interest to be served and from what was he intended to be protected? A company's annual accounts are capable of being utilised for a number of purposes and if one thinks about it it is entirely foreseeable that they may be so employed. But many of such purposes have absolutely no connection with the recipient's status or capacity, whether as a shareholder, voting or non-voting, or as a debenture-holder. Before it can be concluded that the duty is imposed to protect the recipient against harm which he suffers by reason of the particular use that he chooses to make of the information which he receives, one must, I think, first ascertain the purpose for which the information is required to be given. Indeed the paradigmatic *Donoghue v. Stevenson* case of a manufactured article requires, as an essential ingredient of liability, that the article has been used by the consumer in the manner in which it was intended to be used: see *Grant v. Australian Knitting Mills Ltd.* [1936] A.C. 85, 104 and *Junior Books Ltd. v. Veitchi Co. Ltd.* [1983] 1 A.C. 520, 549, 552. I entirely follow that if the conclusion is reached that the very purpose of providing the information is to serve as the basis for making investment decisions or giving investment advice, it is not difficult then to conclude also that the duty imposed upon the adviser extends to protecting the recipient against loss occasioned by an unfortunate investment decision which is based on carelessly inaccurate information. Bingham L.J. did, indeed, conclude that the provision of guidance for the making of investment decisions was one of the purposes to be discerned in the statutory provisions. He observed [1989] Q.B. 653, 681–682:

" . . . I think these provisions also reflect a wider and more commercial intention. The growth and development of limited

A liability companies over a relatively very short period have been phenomenal. Their proliferation and expansion have depended on their acceptance by the investing public as an advantageous and (on the whole) reliable medium of investment. The statutory requirements that companies account to their members and that auditors express an independent opinion to shareholders on the truth and accuracy of company accounts are in my view designed (in B part at least) to fortify confidence in the holding of shares as a medium of investment by enabling shareholders to make informed investment decisions. There are obvious reasons, both economic and social, why this end should be regarded as desirable."

How far he regarded this as an essential feature of the relationship of C proximity which he held to exist between the appellants and the respondents as shareholders is not, however, entirely clear, for he attributed the same intention to the legislature in relation to investors generally. He said, at p. 682:

"The publication of accounts must limit, if it cannot eliminate, the scope for rumour-inspired speculation and thus promote an informed and orderly market. It enables prospective investors, like D shareholders, to make informed decisions. For such prospective investors the independent opinion of the auditor has the same significance as for existing shareholders."

As I have already indicated, I am not, for my part, able to share this view of the intention of the legislature. I do not believe and I see no E grounds for believing that, in enacting the statutory provisions, Parliament had in mind the provision of information for the assistance of purchasers of shares or debentures in the market, whether they be already the holders of shares or other securities or persons having no previous proprietary interest in the company. It is unnecessary to decide the point on this appeal, but I can see more force in the contention that one purpose of providing the statutory information might be to enable the F recipient to exercise whatever rights he has in relation to his proprietary interest by virtue of which he receives it, by way, for instance, of disposing of that interest. I can, however, see no ground for supposing that the legislature was intending to foster a market for the existing holders of shares or debentures by providing information for the purpose of enabling them to acquire such securities from other holders who G might be minded to sell.

For my part, I think that the position as regards the auditor's statutory duty was correctly summarised by O'Connor L.J. in his dissenting judgment when he said, at p. 714:

"The statutory duty owed by auditors to shareholders is, I think, a duty owed to them as a body. I appreciate that it is difficult to see how the over-statement of the accounts can cause damage to the H shareholders as a body; it will be the underlying reasons for the over-statement which cause damage, for example fraudulent abstraction of assets by directors or servants, but such loss is recoverable by the company. I am anxious to limit the present case

to deciding whether the statutory duty operates to protect the individual shareholder as a potential buyer of further shares. If I am wrong in thinking that under the statute no duty is owed to shareholders as individuals, then I think the duty must be confined to transactions in which the shareholder can only participate because he is a shareholder. The Companies Act 1985 imposes a duty to shareholders as a class and the duty should not extend to an individual save as a member of the class in respect of some class activity. Buying shares in a company is not such an activity."

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In my judgment, accordingly, the purpose for which the auditors' certificate is made and published is that of providing those entitled to receive the report with information to enable them to exercise in conjunction those powers which their respective proprietary interests confer upon them and not for the purposes of individual speculation with a view to profit. The same considerations as limit the existence of a duty of care also, in my judgment, limit the scope of the duty and I agree with O'Connor L.J. that the duty of care is one owed to the shareholders as a body and not to individual shareholders.

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To widen the scope of the duty to include loss caused to an individual by reliance upon the accounts for a purpose for which they were not supplied and were not intended would be to extend it beyond the limits which are so far deducible from the decisions of this House. It is not, as I think, an extension which either logic requires or policy dictates and I, for my part, am not prepared to follow the majority of the Court of Appeal in making it. In relation to the purchase of shares of other shareholders in a company, whether in the open market or as a result of an offer made to all or a majority of the existing shareholders, I can see no sensible distinction, so far as a duty of care is concerned, between a potential purchaser who is, vis-à-vis the company, a total outsider and one who is already the holder of one or more shares. I accordingly agree with what has already fallen from my noble and learned friend, Lord Bridge of Harwich, and with the speech to be delivered by my noble and learned friend, Lord Jauncey of Tullichettle, which I have had the advantage of reading, and I, too, would allow the appeal and dismiss the cross-appeal.

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LORD JAUNCEY OF TULLICHETTLE. My Lords, it no longer requires a detailed citation of authority to vouch the well-established proposition that a negligent statement may, in certain circumstances, render the maker thereof liable for economic loss occasioned thereby to another. It is sufficient to mention *Cann v. Willson* (1888) 39 Ch.D. 39, the dissenting judgment of Denning L.J. in *Candler v. Crane, Christmas & Co.* [1951] 2 K.B. 164, and two cases in this House, *Hedley Byrne & Co. Ltd v. Heller & Partners Ltd.* [1964] A.C. 465 and *Smith v. Eric S. Bush* [1990] 1 A.C. 831. Whether liability exists in any particular case will depend upon whether the maker of the statement owes a duty of care to the person who has suffered loss. In this connection I cannot do better than quote the words of Lord Keith of Kinkel in *Governors of Peabody Donation Fund v. Sir Lindsay Parkinson & Co. Ltd.* [1985] A.C. 210, 240–241:

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A "The true question in each case is whether the particular defendant owed to the particular plaintiff a duty of care having the scope which is contended for, and whether he was in breach of that duty with consequent loss to the plaintiff. A relationship of proximity in Lord Atkin's sense must exist before any duty of care can arise, but the scope of the duty must depend on all the circumstances of the case. . . . So in determining whether or not a B duty of care of particular scope was incumbent upon a defendant it is material to take into consideration whether it is just and reasonable that it should be so."

The relationship of proximity to which Lord Keith referred is not one which is created solely by the foreseeability of harm resulting from carelessness in the statement, but is one in which some further ingredient C importing proximity is present. Thus in *Hill v. Chief Constable of West Yorkshire* [1989] A.C. 53, 60 Lord Keith said:

"It has been said almost too frequently to require repetition that foreseeability of likely harm is not in itself a sufficient test of liability in negligence. Some further ingredient is invariably needed to establish the requisite proximity of relationship between plaintiff D and defendant, and all the circumstances of the case must be carefully considered and analysed in order to ascertain whether such ingredient is present."

Once foreseeability of likely harm from a careless statement has been established, it becomes necessary to examine the circumstances in and the purposes for which the statement was made in order to determine E whether there are also present the further ingredients necessary to establish the requisite proximity of relationship between the maker of the statement and the person who has acted upon it. As Bingham L.J. observed in the present case, the concept of proximity is somewhat elusive, extending as it does beyond mere physical proximity. It might be described as the circumstances in which the law considers it proper F that a duty of care should be imposed on one person towards another. If in any given circumstances a relation of proximity is found to exist, consideration must still be given to the scope of the duty which arises therefrom. In the case of physical proximity, few problems will arise, but where there exists a duty of care in relation to the making of statements, written or oral, problems may arise if those statements are capable of being used for more than one purpose. It is not disputed in G the present case that economic loss to the plaintiff as a shareholder was foreseeable by the auditors as a result of any failure on their part to exercise reasonable care in the conduct of the audit. What is disputed is whether the auditors owed any duty to individual shareholders, and if so, what was the scope of that duty.

Before examining the circumstances in this case which may be relevant to the existence of a relationship of proximity, it is helpful to H look in a little more detail at the four cases dealing with negligent statements to which I have already referred. In *Cann v. Willson*, 39 Ch.D. 39, valuers instructed by an intending mortgagor sent the valuation to solicitors acting for an intending mortgagee knowing that it

was hoped thereby to induce the mortgagee to make a loan. Chitty J. held that in the circumstances the valuers owed a duty of care to the mortgagee. In *Candler v. Crane, Christmas & Co.* [1951] 2 K.B. 164, the accountants were aware that the accounts were to be shown by their employer to the plaintiff who was a potential investor, and indeed their clerk discussed those accounts with him. Denning L.J., in suggesting the circumstances in which a duty to use care in a statement by professional persons would exist apart from contract, posed three questions: first, what persons are under such duty? Secondly, to whom do those professional people owe this duty? And thirdly, to what transactions does the duty of care extend? In relation to the second question, he said, at pp. 180–181:

> "I will take accountants, but the same reasoning applies to the others. They owe the duty, of course, to their employer or client; and also I think to any third person to whom they themselves show the accounts, or to whom they know their employer is going to show the accounts, so as to induce him to invest money or take some other action on them. But I do not think the duty can be extended still further so as to include strangers of whom they have heard nothing and to whom their employer without their knowledge may choose to show their accounts. Once the accountants have handed their accounts to their employer they are not, as a rule, responsible for what he does with them without their knowledge or consent. . . . But excluding such cases as those, there are some cases—of which the present is one—where the accountants know all the time, even before they present their accounts, that their employer requires the accounts to show to a third person so as to induce him to act on them: and then they themselves, or their employers, present the accounts to him for the purpose. In such cases I am of opinion that the accountants owe a duty of care to the third person. The test of proximity in these cases is: did the accountants know that the accounts were required for submission to the plaintiff and use by him?"

In relation to the third question, he said, at pp. 182–183, 183–184:

> "[The duty of care] extends, I think, only to those transactions for which the accountants knew their accounts were required. For instance, in the present case it extends to the original investment of £2,000 which the plaintiff made in reliance on the accounts, because the accountants knew that the accounts were required for his guidance in making that investment; but it does not extend to the subsequent £200 which he made after he had been two months with the company. This distinction, that the duty only extends to the very transaction in mind at the time, is implicit in the decided cases"
>
> "It will be noticed that I have confined the duty to cases where the accountant prepares his accounts and makes his report for the guidance of the very person in the very transaction in question. That is sufficient for the decision of this case. I can well understand that it would be going too far to make an accountant liable to any

A person in the land who chooses to rely on the accounts in matters of business, for that would expose him to 'liability in an indeterminate amount for an indeterminate time to an indeterminate class': see *Ultramares Corporation v. Touche*, *per* Cardozo C.J. Whether he would be liable if he prepared his accounts for the guidance of a specific class of persons in a specific class of transactions, I do not say."

B

Denning L.J. clearly considered that the scope of any duty of care was limited to the precise transaction for which the accountants knew that the accounts were to be used. In *Hedley Byrne* [1964] A.C. 465, a company's bankers were asked by the plaintiffs' bankers whether the company "would be good for an advertising contract of £8,000 to

C £9,000." The company's bankers answered the question in the affirmative but, "without responsibility on the part of the bank." When the company failed, the plaintiffs sought to recover damages from the bankers for negligence in making the statement. The action failed because of the express disclaimer of responsibility, but this House, after detailed review of authority, held that a negligent statement, oral or

D written, could give rise to an action of damages for economic loss apart from any contractual or fiduciary relationship subsisting between the parties. In the context of this case, *Hedley Byrne* is perhaps most important for its approval of the dissenting judgment of Denning L.J. in *Candler v. Crane, Christmas & Co.* After setting out the facts in *Candler*, Lord Reid said [1964] A.C. 465, 487:

E "This seems to me to be a typical case of agreeing to assume a responsibility: [the accountants] knew why the plaintiff wanted to see the accounts and why their employers, the company, wanted them to be shown to him, and agreed to show them to him without even a suggestion that he should not rely on them."

Lord Reid is again there emphasising the fact that the maker of the

F statement was aware of the purpose for which the accounts were required to be seen. Finally, in *Smith v. Eric S. Bush* [1990] 1 A.C. 831, the plaintiff applied for a mortgage to a building society which in pursuance of its statutory duty under the Building Societies Act 1962 instructed independent surveyors to prepare a written report as to the value of the house in question. The plaintiff paid to the building society a fee in respect of this report, and subsequently a copy thereof was

G provided to her. Without obtaining an independent valuation, the plaintiff bought the house which later turned out to be structurally defective. The surveyor was found to have been negligent in failing to discover the defect. This House held that, notwithstanding the presence of an exclusion clause in his report, he was thereby in breach of a duty of care owed to the plaintiff. It is clear from the speeches which were delivered that the facts which created the proximate relationship between

H the surveyor and the plaintiff were that the former knew that the valuation had been paid for by the plaintiff and would be shown to and probably relied upon by her in deciding whether or not to buy the house. Thus, Lord Templeman said, at p. 847:

"I agree that by obtaining and disclosing a valuation, a mortgagee does not assume responsibility to the purchaser for that valuation. But in my opinion the valuer assumes responsibility to both mortgagee and purchaser by agreeing to carry out a valuation for mortgage purposes knowing that the valuation fee has been paid by the purchaser and knowing that the valuation will probably be relied upon by the purchaser in order to decide whether or not to enter into a contract to purchase the house."

Lord Templeman undoubtedly considered that one of the necessary ingredients of the relationship of proximity was the fact that the valuer knew of the particular transaction for the purposes of which reliance would probably be placed on his report.

Lord Griffiths, after setting out three criteria for the imposition of a duty of care on an adviser, namely, foreseeability of damage, proximity of relationship and reasonableness continued, at p. 865:

"The necessary proximity arises from the surveyor's knowledge that the overwhelming probability is that the purchaser will rely upon his valuation, the evidence was that surveyors knew that approximately 90 per cent. of purchasers did so, and the fact that the surveyor only obtains the work because the purchaser is willing to pay his fee. It is just and reasonable that the duty should be imposed for the advice is given in a professional as opposed to a social context and liability for breach of the duty will be limited both as to its extent and amount. The extent of the liability is limited to the purchaser of the house—I would not extend it to subsequent purchasers."

Here Lord Griffiths is limiting the existence and scope of the duty of care to the very person and the very transaction which were in the contemplation of the surveyor at the material time.

My Lords, in each of these cases where a duty of care has been held to exist, the statement in question has, to the knowledge of its maker, been made available to the plaintiff for a particular purpose upon which he has relied. In the present case, the auditors, by accepting office, came under a statutory duty to make their report to the members of the company. The crucial issue is the purpose for which the report was made. To quote the words of Denning L.J. in the *Candler* case [1951] 2 K.B. 164, 183, what was the "very transaction" for which it was provided? To answer this question, it is necessary to look at the relevant provisions of Part VII of the Companies Act 1985.

Section 221 requires every company to cause accounting records to be kept which should be sufficient to show and explain the company's transactions, and should be such as (a) to disclose with reasonable accuracy the financial position of the company at the time, and (b) to enable the directors to ensure that any profit and loss account complies with the requirements of the Act. If a company's business involves dealing in goods, the accounting records require to contain statements of stock at the end of each financial year and all statements of stocktaking from which such statements of stock derive. Section

A 227 requires that the directors, by subsection (1) prepare a profit and loss account for the financial year in respect of each accounting reference period of the company and, by subsection (3), prepare a balance sheet as at the last day of the financial year. Section 228(2) is in the following terms:

> "The balance sheet shall give a true and fair view of the state of affairs of the company as at the end of the financial year; and the profit and loss account shall give a true and fair view of the profit or loss of the company for the financial year."

B

In terms of section 235 the directors are required to prepare a report "containing a fair review of the development of the business of the company and its subsidiaries during the financial year and of their position at the end of it," and giving particulars of, inter alia, changes in asset values, directors' shareholdings and other interests and contributions for political and charitable purposes. Section 236 makes provision for an auditors' report in the following, inter alia, terms:

C

> "(1) A company's auditors shall make a report to its members on the accounts examined by them, and on every balance sheet and profit and loss account, and on all group accounts, copies of which are to be laid before the company in general meeting during the auditors' tenure of office. (2) The auditors' report shall state—(*a*) whether in the auditors' opinion the balance sheet and profit and loss account and (if it is a holding company submitting group accounts) the group accounts have been properly prepared in accordance with this Act; and (*b*) without prejudice to the foregoing, whether in their opinion a true and fair view is given—(i) in the balance sheet, of the state of the company's affairs at the end of the financial year; (ii) in the profit and loss account (if not framed as a consolidated account), of the company's profit or loss for the financial year. . . ."

D

E

Section 237(1) defines auditors' duties as follows:

F

> "It is the duty of the company's auditors, in preparing their report, to carry out such investigations as will enable them to form an opinion as to the following matters—(*a*) whether proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them, (*b*) whether the company's balance sheet and (if not consolidated) its profit and loss account are in agreement with the accounting records and returns."

G

Section 241 provides, inter alia:

> "(1) In respect of each financial year of a company the directors shall lay before the company in general meeting copies of the accounts of the company for that year. (2) The auditors' report shall be read before the company in general meeting, and be open to the inspection of any member of the company. (3) In respect of each financial year the directors—(*a*) shall deliver to the registrar of companies a copy of the accounts for the year. . . ."

H

The accounts of a company are defined by section 239 to include, inter alia, the company's profit and loss account and balance sheet, and the directors' and auditors' reports. In terms of section 240, a copy of the company's accounts must be sent to every member not less than 21 days before the date of the meeting referred to in section 241(1). Finally, section 245 imposes penalties on directors whose defective accounts are laid before the company or delivered to the Registrar of Companies.

Three matters emerge from the statutory provisions, namely: (1) that the responsibility for the preparation of accounts giving a true and fair view of the company's financial state is placed fairly and squarely on the shoulders of the directors; (2) that the role of the auditors is to provide an independent report to the members on the proper preparation of the balance sheet and profit and loss account, and as to whether those documents give a true and fair view respectively of the state of the company's affairs at the end of the financial year and of the company's profit and loss for that year. Their role is thus purely investigative rather than creative; (3) that the company's accounts, including the auditors' report, will be furnished to all members of the company as well as to debenture holders and any other persons entitled to receive notice of general meeting. The accounts will, of course, also be available to any member of the public who chooses to examine the company file in the office of the Registrar of Companies.

So much for the circumstances in which company accounts reach the members. Circumstances which render it inevitable that auditors will be aware that their reports will be seen and relied upon by the members. However, that does not answer the fundamental question of the purpose, and hence the very transactions, for which the annual accounts of a company are prepared and distributed to its members. Mr. Goldsmith, for the auditors, submitted that the principal purpose was to provide an account of the stewardship of the directors to the shareholders as a body, and not to provide individual investors, whether shareholders or members of the public, with comparative information. Mr. Bathurst, for Caparo, on the other hand, argued that the purpose was to enable shareholders to make such individual decisions as they wished in relation to the company, including decisions as to investment, they already being investors, and decisions as to voting in general meetings.

In the Court of Appeal [1989] Q.B. 653, 685D–690F Bingham L.J. concluded that the auditors had voluntarily assumed direct responsibility to individual shareholders to whom they owed a duty to exercise reasonable care in carrying out their audit. He further concluded that such duty was owed to a shareholder in respect of any loss sustained by him in selling, retaining, or buying shares in the company. Bingham L.J. referred to the approval by Cardozo C.J. in *Ultramares Corporation v. Touche*, 174 N.E. 441, 447 of an earlier statement that:

"'negligent words are not actionable unless they are uttered directly, with knowledge or notice that they will be acted on, to

A one to whom the speaker is bound by some relation of duty, arising out of public calling, contract or otherwise, to act with care if he acts at all.' "

He then said, at p. 686:

"This formulation would not exclude the finding of a sufficiently proximate relationship in the present case if the words 'will be B acted upon' are replaced, as in English law I think they should be, by 'may be acted upon.' "

Taylor L.J. said, at p. 703G:

"once proximity to the shareholder is established, the auditor ought prima facie to be liable for any loss suffered in foreseeable C reliance upon the report; . . ."

In my view these observations go too far. Possibility of reliance on a statement for an unspecified purpose will not impose a duty of care on the maker to the addressee. More is required. In *Smith v. Eric S. Bush* [1990] 1 A.C. 831 it was probable, if not highly probable, that the potential purchaser would rely on the valuer's report. This D probable reliance was an essential ingredient in establishing proximity. Had it merely been a possibility that the purchaser would rely on the report I very much doubt whether this House would have decided that the valuer owed a duty of care to the purchaser. Furthermore, reliance, even if probable, thereby establishing proximity, does not establish a duty of care of unlimited scope. Regard must be had to the transaction or transactions for the purpose of which the statement E was made. It is loss arising from such transaction or transactions rather than "any loss" to which the duty of care extends.

I do not understand that either Bingham L.J. or Taylor L.J., in reaching their conclusions, relied to any material extent upon the purpose for which accounts of a company, including the auditors' report, are provided to members or consequentially upon the F transactions for which the members were expected to use them. O'Connor L.J., in a dissenting judgment, considered that the statutory duty owed by auditors to shareholders was owed to them as a body and not as individuals.

My Lords, Part VII of the Companies Act 1985 provides that the accounts of a company for each financial year shall be laid before the company's general meeting, that is to say before the members in G general meeting. Copies of the accounts must be sent to the members at least 21 days in advance, and it is obvious that the reason for this is to enable the members to prepare themselves for attendance at and participation in the meeting. The annual general meeting provides the opportunity for members to question the stewardship of the company during the preceding year, to vote for or against election or H re-election of directors, to approve or disapprove the appointment or re-appointment of auditors and to take other decisions affecting the company as a whole or themselves as members of a particular class of shareholders. There is nothing in Part VII which suggests that the accounts are prepared and sent to members for any purpose other

than to enable them to exercise class rights in general meeting. I therefore conclude that the purpose of annual accounts, so far as members are concerned, is to enable them to question the past management of the company, to exercise their voting rights, if so advised, and to influence future policy and management. Advice to individual shareholders in relation to present or future investment in the company is no part of the statutory purpose of the preparation and distribution of the accounts. It follows that I am in agreement with the views of O'Connor L.J. as to the nature of the statutory duty owed by auditors to shareholders.

If the statutory accounts are prepared and distributed for certain limited purposes, can there nevertheless be imposed upon auditors an additional common law duty to individual shareholders who choose to use them for another purpose without the prior knowledge of the auditors? The answer must be no. Use for that other purpose would no longer be use for the "very transaction" which Denning L.J. in the *Candler* case [1951] 2 K.B. 164, 183 regarded as determinative of the scope of any duty of care. Only where the auditor was aware that the individual shareholder was likely to rely on the accounts for a particular purpose such as his present or future investment in or lending to the company would a duty of care arise. Such a situation does not obtain in the present case.

The Court of Appeal unanimously rejected a submission by Caparo that an auditor owed a duty to a potential investor who held no shares. In this House it was argued that the relationship of the unwelcome bidder in a potential takeover situation was nearly as proximate to the auditor as was the relationship of a shareholder to whom the report was directed. Since I have concluded that the auditor owed no duty to an individual shareholder, it follows that this argument must also fail. The fact that a company may at a time when the auditor is preparing his report be vulnerable to a take-over bid cannot per se create a relationship of proximity between the auditor and the ultimate successful bidder. Not only is the auditor under no statutory duty to such a bidder but he will have reason at the material time to know neither of his identity nor of the terms of his bid. In this context the recent case of *Al Saudi Banque v. Clarke Pixley* [1990] Ch. 313 is in point. There Millett J. held that the auditors of a company owed no duty of care to a bank which lent money to the company, regardless of whether the bank was an existing creditor or a potential one, because no sufficient proximity of relationship existed in either case between the auditor and the bank. I have no doubt that this case was correctly decided and I would only add that I am in entire agreement with the careful process of reasoning whereby the judge reached his decision.

It only remains to mention *Twomax Ltd. v. Dickson, McFarlane & Robinson*, 1982 S.C. 113 to which your Lordships were referred. The Lord Ordinary (Lord Stewart) held that auditors owed a duty of care to potential investors who were not shareholders by applying the test of whether the defenders knew or reasonably should have foreseen at the time the accounts were audited that a person might rely on those

A accounts for the purpose of deciding whether or not to take over the company, and therefore would suffer loss if the accounts were inaccurate. There were in that case no such findings in fact as would support the existence of a relationship of proximity between the auditor and the unknown potential investor. I therefore consider that the reasoning of the Lord Ordinary was unsound and that the decision cannot be supported.

B For the foregoing reasons, I would allow the appeal.

Appeal allowed with costs.
Cross-appeal dismissed with costs.

Solicitors: Freshfields; Berwin Leighton.

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C. T. B.

D

[HOUSE OF LORDS]

GUINNESS PLC. . . . . RESPONDENTS

E AND

SAUNDERS . . . . APPELLANT

1989 Oct. 30, 31; Nov. 1, 2, 6, 7;
F 1990 Feb. 8

Lord Keith of Kinkel, Lord Brandon of Oakbrook, Lord Templeman, Lord Griffiths and Lord Goff of Chieveley

Company—Director—Fiduciary duty—Accounting for profits to company—Committee of board of directors agreeing to pay director sum in connection with company's take-over bid—Whether power in committee to grant special remuneration—Whether director entitled to retain sum paid or part on quantum G *meruit basis or as equitable allowance—Conflict of personal interest and duty—Whether company entitled to repayment of sum paid—Companies Act 1985 (c. 6), ss. 317(1), 727(1)*

The two defendants and another director of the plaintiff company, as a committee of the board of directors, agreed to pay the second defendant £5.2m. for his services in connection with a take-over bid being made by the plaintiffs. Following H the successful completion of the bid, the plaintiffs paid the money. They claimed recovery of the money on the ground that the second defendant had received the payment in breach of his fiduciary duty as a director in that he had not disclosed his interest in the agreement to the plaintiffs' directors as required