UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PASHA S. ANWAR, *et al.*, Plaintiffs, v. FAIRFIELD GREENWICH LIMITED, *et al.*, Defendant. This Document Relates To: All Actions	Master File No. 09-cv-118 (VM)

AFFIDAVIT OF ROBERT MILES, Q.C.

Exhibit 7

BRITISH COMPANY CASES 1998

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Coulthard & Ors v Neville Russell (a Firm).

Court of Appeal (Civil Division)
Kennedy, Judge and Chadwick L JJ.
Judgment delivered 27 November 1997

Auditors' liability – Financial assistance by company for purchase of shares – Directors disqualified – Action by directors against auditors in negligent misstatement – Application by auditors to strike out action – Application refused – Appeal – Companies Act 1985, s. 151, Rules of the Supreme Court O. 18, r. 19(1), (2)

This was an appeal by the auditors of a company in insolvent liquidation against a decision of Judge Mart-Johnson, sitting as a judge of the High Court, refusing to strike out the statement of claim against the auditors by the directors (now disqualified) of the company that the auditors were in breach of duty of care to the directors and to dismiss the action.

The former directors had acquired a company ('H') which acquired the whole of the issued share capital of another company which they had been in control of ('D & H'). The costs of the acquisition had been borne by loans to H by D & H. D & H went into liquidation and the disqualification orders against the directors were made on the grounds that, amongst other things, the loans made by D & H to H constituted a breach of s. 151 of the Companies Act 1985 (prohibition on financial assistance for purchase of shares).

Before the making of the disqualification orders, the former directors had instituted proceedings against the auditors claiming that the auditors owed a duty of care to them as directors of D & H to warn them that the loans to H might be in breach of s. 151. They claimed damages for the loss suffered as a result of the disqualification orders against them. The auditors sought an order to have the statement of claim of the directors struck out on the grounds that it disclosed no reasonable cause of action and to have the action dismissed.

The judge refused the application and the auditors appealed against that decision.

In order to make a striking-out order the question to be answered was whether the statement of claim disclosed a cause of action which had a reasonable prospect of success at law.

Held, dismissing the appeal:

1. The auditors had cited the principle enunciated by Lord Oliver in Caparo Industries v Dickman [1990] BCC 164; [1990] 2 AC 605 that it was no part of the auditor's statutory duties to protect directors personally from the consequences of their mistakes. That principle was correct but breach of statutory duty was not alleged in the present case. The directors were basing their claim on a duty of care at common law.

2. The law relating to the liability of professional advisers, including auditors, was in a state of transition or development and the legal result depended on the facts of the individual case. The striking-out application was brought under RSC, O. 18, r. 19(1)(a); under r. 19(2) no evidence was admissible on such an application. The evidence could be established at a full trial. Within the reasonable confines of the pleaded case, whatever the facts turned out to be, it could not be said that the claim was bound to fail. This was not one of those plain and obvious cases in which it would be right to deny the plaintiffs the opportunity to establish their claim at a trial.

The following cases were referred to in the judgment of Chadwick LJ:

Anns v Merton London Borough Council [1978] AC 728.
Banque Bruxelles Lambert SA v Eagle Star Insurance Co [1997] AC 191; [1996] CLC 1,179.
Belmont Finance Corporation Ltd v Williams Furniture Ltd [1979] Ch 250.
Caparo Industries plc v Dickman [1990] BCC 164; [1990] 2 AC 605.
E (a minor) v Dorset County Council [1995] 2 AC 685.

Henderson v Merrett Syndicates Ltd [1995] 2 AC 145; [1994] CLC 918.
Selangor United Rubber Estates v Cradock (No. 3) [1968] 1 WLR 1555.
Wallersteiner v Moir [1974] 1 WLR 991
White v Jones [1995] 2 AC 207

Richard Southwell QC and Simon Barker (instructed by Rowe & Maw) for the appellants.

Rupert Jackson QC and Graeme McPherson (instructed by Titmuss Sainer Dechert) for the respondents.

JUDGMENT

Chadwick LJ: This is an appeal against the refusal of His Honour Judge Marr-Johnson, sitting as a judge of the High Court in the Queen's Bench division, to strike out the statement of claim in these proceedings and to dismiss the action.

The facts which give rise to these proceedings, as they appear from the statement of claim, may be stated shortly. Dawes and Henderson (Agencies) Ltd, to which I shall refer as 'D & H', carried on business as a members' agent for names at Lloyd's. The third named plaintiff, Mr Dawes, was a director and shareholder of D & H. Under the terms of a sale and purchase agreement dated 19 May 1989 the whole of the issued share capital of D & H was acquired by Hendal Ltd ('Hendal'), a shell company which had been acquired for that purpose. At the time of the acquisition Hendal was owned as to 70 per cent by Cox Tudsbery & Wills Limited ('CTW'). Following the acquisition Mr Dawes remained a director of D & H. He was joined on the board of that company by the first named plaintiff, Mr Coulthard, who had been and who remained a director of CTW, and by the second named plaintiff, Mr Shuttleworth. The defendants, Neville Russell, a firm of accountants with long experience in the insurance market at Lloyd's and the existing auditors of CTW, were appointed to be auditors of D & H and of Hendal.

The acquisition of the D & H shares by Hendal was funded, in part, by a loan made to Hendal by National Westminster Bank plc. It appears to have been the intention, at the time of acquisition, that that loan would be repaid – and (no doubt) serviced in the interim – from dividends declared by D & H out of profits generated by the business which that company would continue to carry on. In that sense the acquisition was intended to be self funding. Later in 1989, in order to present an appearance of capital adequacy in the accounts of D & H, the original intention of distributing profits by way of dividend was partially abandoned in favour of a new arrangement under which Hendal was enabled to meet its commitments out of funds provided by D & H by way of loan. If funds were provided by way of loan by D & H to Hendal for the purpose of enabling Hendal to service its loan with National Westminster Bank and to make payments due to the former shareholders of D & H under the sale and purchase agreement of 19 May 1989, then, prima facie at least, there was a clear breach of the provisions of s. 151 of the *Companies Act* 1985

D & H went into an insolvent liquidation on 30 March 1993. Following the liquidation of D & H the Secretary of State for Trade and Industry brought proceedings against Mr Coulthard, Mr Shuttleworth and Mr Dawes, as directors of D & H, seeking orders for disqualification pursuant to s. 6 of the *Company Directors Disqualification Act* 1986. Disqualification orders were made in those proceedings on 4 February 1997 by Sir Richard Scott, Vice-Chancellor, on the grounds, inter alia, that the loans made by D & H to Hendal in the circumstances which I have described did constitute a breach of s. 151 of the *Companies Act* 1985; and that their participation in that breach justified a finding that they were each unfit to be concerned in the management of a company.

The present proceedings were commenced by a writ issued on 5 February 1996, before the disqualification orders had been made but at a time when it was known that the

Secretary of State had commenced disqualification proceedings against the plaintiffs. It is alleged in the current proceedings that Neville Russell owed a duty of care to the plaintiffs, as directors of D & H, to warn them that the loans to be made by D & H to Hendal would or might be in breach of s 151 of the 1985 Act; and that (as a consequence of the illegality of the loans) the accounts of D & H would not show a true and fair view of that company's financial position if those loans were included as assets in its balance sheet. The plaintiffs claim damages for the loss (including loss of reputation and the costs of defending the disqualification proceedings) which they have suffered as a result of the Secretary of State's decision to seek disqualification orders against them.

By a summons issued on 19 September 1996 the defendants sought an order striking out the statement of claim in the current proceedings on the grounds that it disclosed no reasonable cause of action; and for an order that the action be dismissed. That application was dismissed by Judge Mair-Johnson on 19 December 1996. The appeal against that order is brought with the leave of this court, granted on 14 February 1997.

The application to strike out is brought under O. 18, r. 19(1)(a) of the *Rules of the Supreme Court* 1965. No evidence is admissible on an application under that paragraph – see r 19(2). Accordingly, the application has to be approached on the basis that the factual allegations made in the statement of claim will be established at trial. The question for the court below, as the judge recognised, was whether, on that basis, the statement of claim disclosed a cause of action which had a reasonable prospect of success at law. Those propositions are, of course, trite; but I mention them in order to make it clear that the court is not required to form any view as to the ability of the plaintiffs to establish the factual allegations which they make. It is right to record, in fairness to the defendants, that material allegations made against them in the statement of claim are strenuously denied. Nothing in this judgment is to be taken as an indication that I have formed any view whether or not the plaintiffs will establish the factual allegations which they make.

With those considerations in bind it is appropriate to set out the relevant allegations made in the statement of claim. The statement of claim as originally served was amended to reflect the disqualification orders made on 4 February 1997. It is common ground that those amendments do not affect the question whether or not the statement of claim discloses a cause of action; and so it is convenient to set out the allegations in the amended form; notwithstanding that the amendments were made after the date of the order under appeal. First, the relevant introductory allegations in para. 5–11:

> '5 In order to acquire D & H a new company Hendal ('Hendal') was incorporated ...
>
> 6. Hendal's only purpose was to act as a holding company for D & H, and it was envisaged that its only income would be from dividends declared by D & H, from which it would repay the loans referred to below.
>
> 7. On 19 May 1989 the Sale and Purchase Agreement was executed between the shareholders of D & H, Hendal and D & H itself, pursuant to which Hendal acquired the shares and D & H. The acquisition of the shares was financed by loans to Hendal from CTW and National Westminster Bank ("the Bank")
>
> 8. At the time of the said acquisition it was intended that the purchase of D & H would be self-financing, in that the sums borrowed by Hendal would be repaid from the profits generated by the business of D & H, which would be distributed as dividends.
>
> 9. Following the said acquisition Mr Dawes remained and Messrs Coulthard and Shuttleworth became, directors of D & H. Neville Russell became the accountants and auditors of D & H and Hendal, and continued to act as the accountants and auditors of CTW

10. During the period following the acquisition until 31 December 1992 after the payment of one dividend, D & H, instead of paying further dividends, made loans in excess of £500,000 to Hendal which enabled Hendal inter alia to service its loan with the bank. The residue was used by Hendal to make payments due to the former shareholders of D&M under the Sale & Purchase Agreement and to meet Hendal's running expenses.

11. The loans by D & H to Hendal were in breach of s. 151 of the *Companies Act* 1985 in that D & H was giving financial assistance directly or indirectly for the purpose of enabling Hendal to reduce or discharge the liability incurred for the purpose of the acquisition of D & H's shares'

Next, the allegations of duty of care:

'13 During the relevant period Neville Russell were appointed and acted as accountants and auditors for D & H. They were also accountants and auditors for Cox Group Ltd the ultimate parent company, and all subsidiaries including Hendal

14. It is averred that in fulfilling their duties as accountants and auditors Neville Russell owed a duty of care to Messrs Coulthard, Shuttleworth and Dawes inter alia, to advise and warn them:

(a) that the loans by D & H to Hendal would be in breach of s 151 of the *Companies Act* 1985 and the meaning, effect and consequences of that breach;

(c) that the accounts for D & H did not give a true and fair view of the company's financial position in that the loans by D & H to Hendal were irrecoverable having been made in breach of s. 151

15 In support of the contention that such a duty arose the plaintiffs will contend:

(a) that it was foreseeable that they could suffer damage;

(b) there was a close proximity between them and Neville Russell in particular by reason of the matters set out above and below. Neville Russell knew that the plaintiffs were relying on them to advise in relation to the making of the loans (as opposed to the payments of dividend) to Hendal;

(c) it is reasonable to impose such a duty of care.'

There then follows, in para. 16–23 of the statement of claim, allegations of the advice which Neville Russell are said to have given in connection with the proposal to fund Hendal by way of loans from D & H rather than, as originally intended, by the distribution of dividends. I shall return to those allegations shortly Paragraph 24 alleges that Neville Russell were negligent during the period that they acted for D & H and advised the plaintiffs as directors of D & H in relation to the affairs of the company. Put shortly, the negligence alleged is failure to appreciate that the loans by D & H to Hendal would be in contravention of s. 151 of the *Companies Act* 1985; failure to advise that the inclusion of the loans as assets in the balance sheet of D & H would have the effect that the statutory accounts would not show a true and fair view of that company's affairs; and failure to advise the plaintiffs of the possible consequences to them, personally, as directors if they were party to a breach of the section Paragraph 25, under the heading 'Reliance', contains the averment that, had Neville Russell advised or warned the plaintiffs that loans by D & H to Hendal could be in breach of s. 151, the plaintiffs would not have permitted the same; and para. 27 contains the averment that, had Neville Russell advised or warned the plaintiffs that the accounts for D & H did not give a true and fair view of the company's financial position, the plaintiffs would not have signed those accounts

A Paragraph 28 sets out, with extensive particulars, the loss and damage which the plaintiffs are said to have suffered by reason of the failure to appreciate that the loans were in breach of s. 151 of the Companies Act. It is, I think, sufficient to note that those particulars are a catalogue of the sort of consequences that might be expected to result from a breach of s. 151 once that had become the subject of proceedings under the *Company Directors Disqualification Act* 1986

B I return now to the advice said to have been given by Neville Russell. The allegations pleaded in para. 16–23 of the statement of claim may be summarised as follows:

(a) At a meeting on 26 September 1989 between Mr Shuttleworth, Mr Dawes and, Mr Robin Oakes of Neville Russell consideration was given to the way in which the purchase price payable by Hendal for the D & H shares was to be settled. At that time the profit and loss figures for D & H for the year ended 31 December 1989 were not known. In particular it is alleged that:

C 'Mr Shuttleworth and Mr Dawes sought the advice of Mr Oakes as to whether there were any problems in making loan payments to Hendal rather than dividend payments . . . Mr Oakes advised that money could be lent by D & H to Hendal in October 1989 until the year end distributable profit position was known'

D (b) On 16 February 1990, at a meeting between Mr Oakes and Mr Shuttleworth at which the year end accounts for D & H and Hendal were discussed, consideration was given to the possibility of Hendal waiving the dividends which it might otherwise receive from D & H and treating the payment to Hendal of such sums as a loan by D & H.

(c) On 28 February 1990 Mr Oakes, Mr Shuttleworth and Mr Dawes again discussed the accounts of Hendal and D & H Consideration was given to the Lloyd's

E solvency requirements to be fulfilled by D & H and the possibility of a waiver of dividend by Hendal

(d) At a meeting on 5 March 1990 it was agreed between Sian Evans of Neville Russell and Mr Shuttleworth that:

'. . . although Hendal was entitled to a dividend of £156,109 from D & H, it should receive only £85,100 as dividend and treat the balance of £71,009 as an

F unsecured loan by D & H to Hendal.'

(e) The auditors' report in respect of the D & H financial statements for the year ended 31 December 1989 was signed by Neville Russell on 25 April 1990 It was unqualified. The D & H accounts recorded the waiver by Hendal of its entitlement to £71,009 dividend and 'an indebtedness of £71,009 due from a Group Company'. In context that group company was clearly Hendal.

G (f) The pattern was repeated in the 1990 accounts and in the 1991 accounts. In each of those annual accounts it was recorded that Hendal had waived its entitlement to dividend and that there was an inter-company debt owed to D & H. The amount of the debt was increasing. Paragraph 23 is in these terms:

'23. It is averred that throughout the period up to 1 December 1992 the plaintiffs, in particular Mr Shuttleworth, liaised closely with Neville Russell

H who:

(a) carried out regular reviews of D & H's budget, profit commissions, cash flows and tax position;

(b) audited and signed the auditors' report for the members of D & H in respect of the statutory accounts of D & H as aforesaid;

(c) considered the recoverability of the loan by D & H to Hendal;

(d) reported each year that accounts had been properly prepared in accordance with the *Companies Act* 1985; and

(e) made the necessary annual financial return to Lloyd's recording the loan to Hendal as recoverable in full'

Section 151 of the *Companies Act* 1985 is in these terms, so far as material:

'151(2) . . where a person has acquired shares in a company and any liability has been incurred (by that or any other person), for the purpose of that acquisition, it is not lawful for the company or any of its subsidiaries to give financial assistance directly or indirectly for the purpose of reducing or discharging the liability so incurred.

(3) If a company acts in contravention of this section, it is liable to a fine, and every officer of it who is in default is liable to imprisonment or a fine, or both.'

Section 152(1)(a)(iii) defines financial assistance in terms which include financial assistance given by way of loan. It is accepted, for the purposes of the present appeal, that the loans made by D & H to Hendal were made in contravention of s. 151(2) of the *Companies Act* 1985. It is also accepted, for the purposes of the present appeal, that a loan made for the purpose of giving financial assistance contrary to the prohibition in s 151 of the 1985 Act is illegal and unenforceable against the borrower. Accordingly it is unnecessary for this court to consider whether the decision of Ungoed-Thomas J in *Selangor United Rubber Estates v Cradock (No. 3)* [1968] 1 WLR 1555 at p. 1659F – on the comparable provisions in s. 54 of the *Companies Act* 1948 – has survived the observations of Lord Denning MR and Scarman LJ in *Wallersteiner v Moir* [1974] 1 WLR 991 at pp 1014 and 1033 and of Buckley LJ and Goff LJ in *Belmont Finance Corporation Ltd v Williams Furniture Ltd* [1979] Ch 250 at pp. 261 and 271. It follows, of course, that it is accepted that loans made in contravention of the section cannot, properly, be treated as assets of the lending company; and that a balance sheet in which such a loan is shown as an asset of the company will fail to show a true and fair view of its financial affairs.

Section 226(1) of the 1985 Act requires the directors of a company to prepare, for each financial year of the company, (inter alia) a balance sheet as at the last day of that year. Subsection (2) of that section is in these terms:

'226(2) 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 . . .'

Section 233(1) of the 1985 Act requires that the company's annual accounts, prepared in accordance with s 226(1) of the Act, be approved by the board of directors. If annual accounts are approved which do not comply with requirements of the Act – including the requirement in s 226(2) that the balance sheet shall give a true and fair view of the state of affairs of the company at the end of the financial year – every director of the company who is party to their approval and who knows that they do not comply or is reckless as to whether they comply is guilty of an offence and liable to a fine – see s. 233(5).

Section 235(1) of the 1985 Act requires the company's auditors to make a report to the company's members on the annual accounts. Section 235(2) requires that the auditors' report shall state whether in the auditors' opinion (inter alia) the balance sheet of the company does show a true and fair view of the company's affairs at the end of the financial year.

Although it might appear from s 226, 233 and 235 of the *Companies Act* 1985 that the preparation, approval and audit of annual accounts are a series of distinct and sequential steps – as, indeed, they are as a matter of law – that would not reflect the ordinary practice. It would, for example, be most unusual for directors to approve annual accounts without having first satisfied themselves, by consultation with the auditors, as to the form

of report which the auditors would expect to make in relation to those accounts. It would, save in exceptional circumstances, be unwise for the directors of a company to approve a balance sheet in a form which gave the auditors concern; so that the auditors would find themselves unable to express the opinion that the balance sheet, in that form, showed a true and fair view of the state of affairs of the company as at the end of the financial year. A fortiori, if that balance sheet was to be used to demonstrate solvency in some regulatory context. It is for this reason that discussions between directors and auditors as to the proper treatment in the balance sheet of any item likely to be controversial will, almost invariably, take place before the accounts are approved and the audit report signed. That is not to say that the directors are bound to adopt the auditors' view, or vice versa. The purpose of the discussions is not to absolve the directors, or the auditors, from their own independent duties under s. 226 and 235 respectively but rather to recognise that it is in the interests of both – and of the company – that any issue as to the proper treatment of an item should be identified, and if possible resolved, before the accounts are finalised.

It is to this process of consultation, as it seems to me, that the allegations made in para. 17, 18 and 19 of the statement of claim relate. Those paragraph contain allegations that there were discussions, on three separate occasions in February and March 1990, of the proposed treatment in the 1989 accounts of the moneys which had been paid by D & H to Hendal; in particular, discussions as to whether the whole of such payments should be declared by way of dividend or whether some part could be treated as a loan. The apparent attraction of treating some part of the payments as a loan was that that would inflate the assets in the balance sheet and so make it easier to satisfy the Lloyd's solvency requirements. That, as it seems to me, is the significance of the allegation that solvency requirements were discussed in this context on 28 February 1990.

The role of auditors – and, in particular, their statutory duties – was considered by the House of Lords in *Caparo Industries plc v Dickman* [1990] BCC 164; [1990] 2 AC 605 – see in particular the analyses in the speech of Lord Oliver at pp. 178F–179H; 630A–631F and of Lord Jauncey at pp. 200H–203H; 658F–662B. In reliance on those passages the appellants submit that it is no part of the auditors' statutory duties to protect directors personally from the consequences of their mistakes or wrongdoing: the work done by auditors is not done for the benefit of directors personally, but solely for the company of which they are the directors (and through the company for the benefit of the shareholders collectively).

For my part I would be inclined to accept the proposition that it is no part of the auditors' statutory duties to protect directors personally from the consequences of their mistakes and wrongdoing. But breach of statutory duty is not alleged in the present case. The plaintiffs put their claim on the basis of a duty of care at common law. Properly understood, the plaintiffs' claim is that in the course of the discussions leading to the approval of the 1989 annual accounts by them as directors the defendants ought to have told them that the proposed treatment of the payments to Hendal would lead to a qualified audit report and so was not a path down which responsible directors could sensibly go – at least without first obtaining clear and authoritative legal advice as to the position under s. 151 of the *Companies Act* 1985. The duty at common law arose, if at all, because, in advance of the audit report in respect of the 1989 accounts, the defendants had, quite properly, entered into discussion with the directors as to the way in which they, as directors, were to perform their duties in relation to the preparation and approval of accounts. In the course of those discussions, so it is alleged, the defendants advised that the proposed treatment of the payments to Hendal was unexceptional; or, at the least, said nothing to suggest that it would give rise to any difficulty when they, as auditors, came to give their audit report.

The plaintiffs allege, in para. 13 of the statement of claim, that defendants acted as 'accountants and auditors' for D & H; and, in para. 14, that the defendants owed a duty

of care to them 'in fulfilling their duties as accountants and auditors'. There is, in my view, a true dichotomy, between that which the defendants were doing as accountants and that which they were doing as auditors; although I doubt whether, in the present case, the distinction is material. Advice to the directors as to the way in which they should, in fulfilling their own duties under s. 226 of the 1985 Act, treat an item in the year-end accounts is, commonly, within the role of a company's accountants – although whether the accountants have accepted responsibility for that particular task will, of course, depend on the facts of any given case. The auditors, on the other hand, are not engaged, as auditors, to advise the directors as to the way in which the directors should fulfil the director's duties; but they may properly be expected to inform the directors, in advance of the approval of the accounts, how they, as auditors, will regard the treatment of any controversial item in the accounts when performing their own duties under s. 235 of the Act. The distinction, although real, is unlikely to be material; for the reason that, in deciding how they should treat an item which has been identified as potentially controversial, the directors are likely (save in exceptional cases) to adopt a course which the auditors will accept and reject a course which will bring them into conflict with the auditors. This, as it seems to me, is the thrust of the allegation in para. 15(b) of the statement of claim that:

> 'by reason of the matters set out above and below Neville Russell knew that the plaintiffs were relying on them to advise in relation to the making of the loans (as opposed to the payments of dividend) to Hendal'

It is against that background that I examine the authorities to which we were referred by Mr Southwell QC on behalf of the appellants. We were taken to three recent decisions of the House of Lords – *Caparo Industries plc v Dickman* [1990] BCC 164; [1990] 2 AC 605, *White v Jones* [1995] 2 AC 207 and *Banque Bruxelles SA v Eagle Star Insurance Co* [1997] AC 191; [1996] CLC 1,179.

I start with the well-known passage in the speech of Lord Bridge in *Caparo*, at pp 169C–D; 617H–618C. After citing from the speech of Lord Wilberforce in *Anns v Merton London Borough Council* [1978] AC 728 at pp. 751–752 and referring to the series of decisions of the Privy Council and the House of Lords which followed that case, Lord Bridge went on to say this:

> 'What emerges is that, in addition to the foreseeability of damage, necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the party to whom it is owed a relationship characterised by the law as one of "proximity" or "neighbourhood" and that the situation should be one which the court considers it fair, just and reasonable that the law should impose a duty of a given scope upon the one party for the benefit of the other. But it is implicit in the passages referred to that the concepts of proximity and fairness embodied in these additional ingredients are not susceptible of any such precise definition as would be necessary to give them utility as practical tests, but amount in effect to little more than convenient labels to attach to the features of different specific situations which, on a detailed examination of all the circumstances, the law recognises pragmatically as giving rise to a duty of care of a given scope'

There is a passage to the like effect in the speech of Lord Roskill, at p. 177C–D; 628C–E:

> 'I agree with your Lordships that it has now to be accepted that there is no simple formula or touchstone to which recourse can be had in order to provide in every case a ready answer to the questions whether, given certain facts, the law will or will not impose liability for negligence or in cases where such liability can be shown to exist, determine the extent of that liability. Phrases such as "foreseeability" "proximity", "neighbourhood", "just and reasonable," "fairness", "voluntary

acceptance of risk" or "voluntary assumption of responsibility" will be found used from time to time in different cases. But, as your Lordships have said, such phrases are not precise definitions. At best they are but labels or phrases descriptive of the very different factual situations which can exist in particular cases and which must be carefully examined in each case before it can be pragmatically determined whether a duty of care exists and, if so, what is the scope and extent of that duty.'

Lord Oliver expressed a similar view at pp 180H–181C; 633A–D:

'Thus the postulate of a simple duty to avoid any harm that is, with hindsight, reasonably capable of being foreseen becomes untenable without the imposition of some intelligible limits to keep the law of negligence within the bounds of common sense and practicality. Those limits have been found by the requirement of what has been called a "relationship of proximity" between plaintiff and defendant and by the imposition of a further requirement that the attachment of liability for harm which has occurred be "just and reasonable". But although the cases in which the courts have imposed or withheld liability are capable of an approximate categorization, one looks in vain for some common denominator by which the existence of the central relationship can be tested. Indeed it is difficult to resist a conclusion that what have been treated as three separate requirements are, at least in most cases, in fact merely facets of the same thing. For in some cases the degree of foreseeability is such that it is from that alone that the requisite proximity can be deduced, whilst in others the absence of that essential relationship can most rationally be attributed to the court's view that it would not be fair and reasonable to hold the defendant responsible. "Proximity" is, no doubt, a convenient expression so long as it is realised that it is no more than a label which embraces not a definable concept but merely a description of circumstances from which, pragmatically, the courts conclude that a duty of care exists.'

Both Lord Oliver at p 181D; 633F and Lord Roskill at p 178A; 629C cautioned against an approach based on the premise that because different cases may display certain common features, they are necessarily all cases in which the same consequences regarding liability or the scope of liability will follow.

Some five years later in *White v Jones* [1995] 2 AC 207 Lord Browne-Wilkinson reviewed the position established in *Caparo* in the light of the decision of the House of Lords in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; [1994] CLC 918. He said this at pp 274F–275A:

'The law of England does not impose any general duty of care to avoid negligent misstatements or to avoid causing pure economic loss even if economic damage to the plaintiff was foreseeable. However, such a duty of care will arise if there is a special relationship between the parties. Although the categories of cases in which such special relationship can be held to exist are not closed, as yet only two categories have been identified, viz. (1) where there is a fiduciary relationship and (2) where the defendant has voluntarily answered a question or tenders skilled advice or services in circumstances where he knows or ought to know that an identified plaintiff will rely on his answers or advice. In both these categories the special relationship is created by the defendant voluntarily assuming to act in the matter by involving himself in the plaintiff's affairs or by choosing to speak. If he does so assume to act or speak he is said to have assumed responsibility for carrying through the matter he has entered upon. In the words of Lord Reid in *Hedley Byrne* [1964] AC 465, 486 he has "accepted a relationship . . . which requires him to exercise such care as the circumstances require" i.e. although the extent of the duty will vary from category to category, *some* duty of care arises from the special relationship. Such relationship can arise even though the

defendant has acted in the plaintiff's affairs pursuant to a contract with a third party'

In *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1997] AC 191; [1996] CLC 1,179 Lord Hoffmann emphasised the importance of considering the scope of the duty alleged to exist. He said, at pp. 211H–212C; 1,182C–E:

'A plaintiff who sues for breach of a duty imposed by the law (whether in contract or tort or under statute) must do more than prove that the defendant has failed to comply. He must show that the duty was owed to him and that it was a duty in respect of the kind of loss which he has suffered. Both of these requirements are illustrated by *Caparo Industries plc v Dickman* [1990] BCC 164; [1990] 2 AC 605. The auditors' failure to use reasonable care in auditing the company's statutory accounts was a breach of their duty of care. But they were not liable to an outside take-over bidder because the duty was not owed to him. Nor were they liable to shareholders who had bought more shares in reliance on the accounts because, although they were owed a duty of care, it was in their capacity as members of the company and not in the capacity (which they shared with everyone else) of potential buyers of its shares. Accordingly, the duty which they were owed was not in respect of loss which they might suffer by buying its shares. As Lord Bridge of Harwich said, at p. 176E; 627D:

"It is never sufficient to ask simply whether A owes B a duty of care. It is always necessary to determine the scope of the duty by reference to the kind of damage from which A must take care to save B harmless."'

In the light of these authorities the defendants submit that the plaintiffs' claim is bound to fail in law

I remind myself that this is an application to strike out. The principles which govern the approach on an application of this nature were explained by Sir Thomas Bingham MR in *E (a minor) v Dorset County Council* [1995] 2 AC 685. In a passage which begins at p. 693E the Master of the Rolls said this:

'It is clear that a statement of claim should not be struck out under RSC, Ord. 18, r. 19 as disclosing no reasonable cause of action save in clear and obvious cases, where the legal basis of the claim is unarguable or almost incontestably bad. It was argued by Mr Ter Haar, for Richard, that this procedure was inappropriate in a case such as his, raising issues which were novel and difficult. Relying in particular on *Lonrho plc v Fayed* [1992] 1 AC 448, 469–470, he urged the undesirability of courts attempting to formulate legal rules against a background of hypothetical facts and pointed to the potential unfairness to plaintiffs if their cases were finally ruled upon before they were able, with the benefit of discovery, to refine their factual allegations. If a summary procedure for determination of legal issues were to be adopted at all, it should (he submitted) follow joinder of issues on the pleadings and discovery, and should be by decision of an issue of law suitable for determination without a full trial under RSC, Ord. 14A. The defendants answered that their applications do in effect raise an issue of law for decision by the court: if they cannot show the plaintiffs' claims to be plainly bad, then their applications must fail; but if they can show that, then it is preferable in the interests of all concerned that the claims should be dismissed now before the costs of a full trial are incurred.

There is great force in both these arguments. I share the unease many judges have expressed at deciding questions of legal principle without knowing the full facts. But applications of this kind are fought on ground of a plaintiff's choosing, since he may generally be assumed to plead his best case, and there should be no risk of injustice to plaintiffs if orders to strike out are indeed made only in plain and

obvious cases. This must mean that where the legal viability of a cause of action is unclear (perhaps because the law is in a state of transition), or in any way sensitive to the facts, an order to strike out should not be made. But if after argument the court can be properly persuaded that no matter what (within the reasonable bounds of pleading) the actual facts the claim is bound to fail for want of a cause of action, I can see no reason why the parties should be required to prolong the proceedings before that decision is reached.'

In my view the liability of professional advisers, including auditors, for failure to provide accurate information or correct advice can, truly, be said to be in a state of transition or development. As the House of Lords has pointed out, repeatedly, this is an area in which the law is developing pragmatically and incrementally. It is pre-eminently an area in which the legal result is sensitive to the facts. I am very far from persuaded that the claim in the present case is bound to fail whatever, within the reasonable confines of the pleaded case, the facts turn out to be. That is not to be taken as an expression of view that the claim will succeed; only as an expression of my conviction that this is not one of those plain and obvious cases in which it could be right to deny the plaintiffs the opportunity to attempt to establish their claim at a trial.

For these reasons I would dismiss this appeal.

Judge LJ: I agree.

Kennedy LJ: I also agree.

(*Appeal dismissed with costs*)