*1360 Galoo Ltd. (in liquidation) and Others v Bright Grahame Murray (a firm) and Another

Positive/Neutral Judicial Consideration

Court
Court of Appeal (Civil Division)

Judgment Date
21 December 1993

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[1994] 1 W.L.R. 1360

Court of Appeal

Glidewell , Evans and Waite L.JJ.

1993 Nov. 3, 4, 5; Dec. 21

Negligence—Foreseeability of risk—Causation—Negligent auditing—Consequential continued trading by companies resulting in losses—Whether auditor's negligence causative of companies' losses

Negligence—Duty of care to whom?—Auditor—Purchase of companies' shares—Accounts supplied to purchaser by companies' auditors to fix purchase consideration—Purchaser subsequently making loans to companies—Further purchase of shares under supplemental agreement—Whether auditors owing duty of care to purchaser—Whether sufficient proximity to found action in tort

In February 1987, by a written agreement, the third plaintiff, a public limited company, purchased 51 per cent. of the shares in the second plaintiff, a limited company owning all the shares in the first plaintiff. The defendants were the auditors of the first and second plaintiffs from 1981 and 1984 respectively until 1991. The agreement set out the method of calculation of the purchase consideration of the shares, namely 5.2 times the net profits of the first plaintiff in the completion accounts, defined as including the audited accounts of the first and second plaintiffs for the year ending 31 December 1986. The defendants were required under the agreement to calculate the net profits and to deliver copies of the completion accounts to the third plaintiff. Between March 1987 and January 1993 the third plaintiffs made loans to the first and second plaintiffs exceeding £30m. and in May 1991, pursuant to a supplementary share purchase agreement, purchased a further 44.3 per cent. of the shares in the second plaintiff. In October 1992 the plaintiffs brought an action claiming that the audited accounts of the first and second plaintiffs for 1985 to 1989 and the draft audited accounts for 1990 contained substantial inaccuracies and that the defendants had been negligent in failing to discover and report them. They alleged that if the defendants had performed their duties with reasonable care and skill the insolvency of the companies would have been shown and they would have ceased to trade immediately and subsequent losses would not have occurred. The defendants applied to strike out the statement of claim on the grounds that it disclosed no reasonable cause of action. The deputy judge struck out claims by the first and second plaintiffs for damages for breach of contract or in tort. In respect of claims by the third plaintiff in tort he held that a claim for loss resulting from the original purchase of shares by the third plaintiff disclosed a reasonable cause of action, but struck out further claims for loss resulting from the loans to the second plaintiff and for amounts paid under the supplementary agreement for the purchase of the further 44.3 per cent. of shares and for payments made to a director of the first and second plaintiffs for loss of office.

On appeals by the plaintiffs and cross-appeal by the defendants: —

Held, (1) dismissing the appeals, that the mere acceptance of a loan could not amount to a loss causing damage, and the acceptance by the first and second plaintiffs of loans from the third plaintiff in reliance on the defendants' statements therefore gave rise to no cause of action; that a breach of contract would sound in damages only if it were the dominant or effective cause ***1361** of the plaintiff's loss and not if had merely given the opportunity for the loss to be sustained, and in determining whether a breach of duty (in contract or in tort in situations analogous to breach of contract) was the cause of a loss or merely the occasion of it the court would apply common sense to the facts of each case; and that, applying that test, the defendants' alleged breach had provided an opportunity for the trading losses of the first and second plaintiffs to be incurred but had not caused them and those claims had rightly been struck out (post, pp. 1369C–E , 1374G–1375B , 1387C–E , 1389D).

Monarch Steamship Co. Ltd. v. Karlshamns Oljefabriker (A/B) [1949] A.C. 196, H.L.(Sc.) ; *Quinn v. Burch Bros. (Builders) Ltd. [1966] 2 Q.B. 370, C.A.* ; *Alexander v. Cambridge Credit Corporation Ltd. (1987) 9 N.S.W.L.R. 310* and *March v. E. & M.H. Stramare Pty. Ltd. (1991) 171 C.L.R. 506 applied* .

(2) That, although mere foreseeability that a potential bidder for shares in, or lender to, a company might rely on the company's audited accounts did not impose on the auditor a duty of care to the bidder or lender, such a duty would arise if the auditor were expressly made aware that a particular bidder or lender might rely on them or other statements approved by the auditor without independent inquiry and intended that he should so rely; that since it was not alleged that the defendants knew or intended that the third plaintiff would rely on their accounts for the purpose of making loans or for the purpose of calculating the purchase price under the supplemental share purchase agreement the pleaded facts disclosed no cause of action against the defendants on those issues (post, pp. 1382B–D , 1385F–1386A , 1387C–E , 1389D).

But (3), dismissing the cross-appeal, that, since the acquisition agreement as pleaded provided that the accounts submitted to the third plaintiff were to be the completion accounts on which the calculation of the purchase price of the shares was to be based and it was common ground that the defendants knew of the terms of that agreement, the statement of claim did disclose a cause of action on that issue (post, pp. 1384F–1385A , 1387C–E , 1389D).

Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605, H.L.(E.) and *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295, C.A. applied* .

Decision of Mr. Ronald Walker Q.C. sitting as a deputy judge of the Queen's Bench Division affirmed.

The following cases are referred to in the judgments:

Al-Nakib Investments (Jersey) Ltd. v. Longcroft [1990] 1 W.L.R. 1390; [1990] 3 All E.R. 321
Al Saudi Banque v. Clark Pixley (a firm) [1990] Ch. 313; [1990] 2 W.L.R. 344; [1989] 3 All E.R. 361
Alexander v. Cambridge Credit Corporation Ltd. (1987) 9 N.S.W.L.R. 310
Candler v. Crane, Christmas & Co. [1951] 2 K.B. 164; [1951] 1 All E.R. 426, C.A.
Caparo Industries Plc. v. Dickman [1989] Q.B. 653; [1989] 2 W.L.R. 316; [1989] 1 All E.R. 798, C.A. ; *[1990] 2 A.C. 605; [1990] 2 W.L.R. 358; [1990] 1 All E.R. 568, H.L.(E.)*
Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465; [1963] 3 W.L.R. 101; [1963] 2 All E.R. 575, H.L.(E.)
March v. E. & M.H. Stramare Pty. Ltd. (1991) 171 C.L.R. 506
Monarch Steamship Co. Ltd. v. Karlshamns Oljefabriker (A/B) [1949] A.C. 196; [1949] 1 All E.R. 1, H.L.(Sc.)

Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295; [1991] 2 W.L.R. 655 ; *[1990] 3 All E.R. 330* ; *[1991] Ch. 295; [1991] 2 W.L.R. 655; [1991] 1 All E.R. 148, C.A.* ***1362***
Quinn v. Burch Bros. (Builders) Ltd. [1966] 2 Q.B. 370 ; *[1966] 2 W.L.R. 430; [1965] 3 All E.R. 801* ; *[1966] 2 Q.B. 370; [1966] 2 W.L.R. 1017; [1966] 2 All E.R. 283, C.A.*
Smith v. Eric S. Bush [1990] 1 A.C. 831; [1989] 2 W.L.R. 790; [1989] 2 All E.R. 514, H.L.(E.)
Ultramares Corporation v. Touche (1931) 174 N.E. 441

The following additional cases were cited in argument:

Banque Keyser Ullmann S.A. v. Skandia (U.K.) Insurance Co. Ltd. [1990] 1 Q.B. 665 ; *[1987] 2 W.L.R. 1300; [1987] 2 All E.R. 923* ; *[1990] 1 Q.B. 665; [1989] 3 W.L.R. 25; [1989] 2 All E.R. 952, C.A.* ; *[1991] 2 A.C. 249; [1990] 3 W.L.R. 364; [1990] 2 All E.R. 947, H.L.(E.)*
Berg Sons & Co. Ltd. v. Adams [1993] B.C.L.C. 1045
Deloitte Haskins & Sells v. National Mutual Life Nominees Ltd. [1993] A.C. 774; [1993] 3 W.L.R. 347; [1993] 2 All E.R. 1015, P.C.
Donoghue v. Stevenson [1932] A.C. 562, H.L.(Sc.)
Gerrard (Thomas) & Son Ltd., In re [1968] Ch. 455; [1967] 3 W.L.R. 84; [1967] 2 All E.R. 525
Grant v. Australian Knitting Mills Ltd. [1936] A.C. 85, P.C.
Heskell v. Continental Express Ltd. [1950] 1 All E.R. 1033; 83 Ll.L.R. 438
JEB Fasteners Ltd. v. Marks, Bloom & Co. [1981] 3 All E.R. 289 ; *[1983] 1 All E.R. 583, C.A.*
Kingston Cotton Mill Co. (No. 2), In re [1896] 1 Ch. 331
Leeds Estate, Building and Investment Co. v. Shepherd (1887) 36 Ch. D. 787
London and General Bank (No. 2), In re [1895] 2 Ch. 673, C.A.
McNaughton (James) Paper Group Ltd. v. Hicks Anderson & Co. [1991] 2 Q.B. 113; [1991] 2 W.L.R. 641; [1991] 1 All E.R. 134, C.A.
Murphy v. Brentwood District Council [1991] 1 A.C. 398; [1990] 3 W.L.R. 414; [1990] 2 All E.R. 908, H.L.(E.)
Smith v. Littlewoods Organisation Ltd. [1987] A.C. 241; [1987] 2 W.L.R. 480; [1987] 1 All E.R. 710, H.L.(Sc.)
Sutherland Shire Council v. Heyman (1985) 157 C.L.R. 424

The following additional cases, although not cited, were referred to in the skeleton arguments:

Anns v. Merton London Borough Council [1978] A.C. 778; [1977] 2 W.L.R. 1024; [1977] 2 All E.R. 492, H.L.(E.)
Candlewood Navigation Corporation Ltd. v. Mitsui O.S.K. Lines Ltd. [1986] A.C. 1; [1985] 3 W.L.R. 381; [1985] 2 All E.R. 935, P.C.
Dorset Yacht Co. Ltd. v. Home Office [1970] A.C. 1004; [1970] 2 W.L.R. 1140; [1970] 2 All E.R. 294, H.L.(E.)
Le Lievre v. Gould [1893] 1 Q.B. 491, C.A.
Yorkshire Dale Steamship Co. Ltd. v. Minister of War Transport [1942] A.C. 691; [1942] 2 All E.R. 6, H.L.(E.)

Appeals and Cross-Appeal from Mr. Ronald Walker Q.C. sitting as a deputy judge of the Queen's Bench Division.

By a writ dated 6 October 1992 the plaintiffs, Galoo Ltd. (“Galoo”), Gamine Ltd. (“Gamine”) and Hillsdown Holdings Plc. (“Hillsdown”), brought an action for damages against the defendants, Bright Grahame Murray (a firm of accountants), for negligence and breach of duties, owed in contract and tort to Galoo and Gamine and in tort to Hillsdown, in the preparation of the accounts of Galoo and Gamine for the years 1985 to 1990; claiming that if the defendants had prepared their accounts with reasonable professional care and skill those accounts would have shown that the companies, instead of being profitable and having substantial assets, were unprofitable and worthless; that in these circumstances (a) the ***1363*** insolvency of Galoo and Gamine would have been revealed and they would have ceased to trade immediately, (b) Galoo and Gamine would not have accepted or continued to accept advances from Hillsdown or incurred any other liabilities, (c) Hillsdown would not have entered into an acquisition agreement in February 1987 to purchase 51 per cent. of the shares in Gamine, the owners of all the shares in Galoo, and/or would not have made any of the payments under the agreement, (d) Hillsdown would not have made or continued to make the advances to Galoo and Gamine which they made between March 1987 and January 1993 totalling £30,649,943, and (e) Hillsdown would not have entered into a supplemental agreement on 21 May 1991 and/or would not have paid the sum of £967,000 thereunder or any part of it and would not have paid the sum of £30,000 to a director of Galoo and Gamine as compensation for loss of office. The defendants applied to strike out the statement of claim as disclosing no reasonable cause of action and on 17 May 1993 the deputy judge dismissed the claims of Galoo and Gamine

but refused to strike out that part of the claim made by Hillsdown relating to the purchase of the original shares in Gamine. He granted leave to appeal to the plaintiffs and the defendants.

By notices of appeal dated 9 June 1993 the plaintiffs appealed on the grounds, inter alia, that the deputy judge had erred in law (1) in striking out the claim by Hillsdown under the supplementary agreement because he had interpreted the decision in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* to mean that the transaction of which the defendants were aware must be precisely that which was carried out subsequently, the nature of the subsequent transaction contemplated by the acquisition agreement was the sale and purchase of shares and the deputy judge should have held that that was what had occurred, as it was sufficient for the test of proximity for the auditors to be aware of the nature or type of transaction which the plaintiff had in mind; (2) in finding that the accounts subsequent to 1986 had been audited simply for the purpose of statutory audits and that there was no suggestion that they had been audited for the purpose of consideration by Hillsdown of a further purchase of shares, or that they had been submitted to Hillsdown; he should have found that (i) the accounts had been submitted to Hillsdown, inter alia, for the purpose of a transaction the nature or type of which the defendants had known, (ii) the defendants had known that Hillsdown would rely on their advice because it was impossible under the agreement between the vendors and Hillsdown to replace the defendants as company auditors before the sale to Hillsdown of all the vendors' remaining shares in Gamine; (3) in identifying an allegation that the accounts "were used for the wider purpose of deciding upon the wisdom of the transaction which Hillsdown had entered into," that was not Hillsdown's case as under the terms of the acquisition agreement Hillsdown could be compelled by the vendors to purchase the further shares and the role of the audited accounts was to determine the price to be paid; (4) in finding that there was an absence of proximity between the defendants and Hillsdown in respect of the advances, as the defendants had known that the audit reports would be submitted to Hillsdown in connection with the advances which the defendants had known were being made and that Hillsdown would be very likely to rely on them and, therefore, there had been direct communication between the defendants and Hillsdown concerning the advances; (5) in finding that an obligation to repay a loan can never amount to damage or alternatively in describing such a claim as ***1364** obviously unsustainable; and (6) in concluding that trading losses were necessarily remote from an auditor's negligence.

By a respondents' notice and cross-appeal dated 30 June 1993 the defendants sought to affirm the deputy judge's decision on those issues on which the plaintiffs sought leave to appeal on the additional grounds, inter alia, that the contractual claims of Galoo and Gamine were too remote, as it was not within the reasonable contemplation of auditors that any failure on their part to detect inaccurate and excessive stock figures would result in the company suffering trading losses; that in claiming in respect of losses resulting from the advances, Hillsdown were in no different position from that of the bankers in *Al Saudi Banque v. Clark Pixley [1990] Ch. 313* , whose claim in tort had failed on the ground that no duty of care was owed; and that no duty of care existed in respect of the payments made in 1991, as Hillsdown did not allege that they had in mind to rely on any accounts audited by the defendants for the purpose of making those payments, nor that the defendants were otherwise so aware. By way of cross-appeal the defendants contended that the deputy judge had been wrong to refuse to strike out Hillsdown's claim in respect of their initial investment in Gamine on the grounds, inter alia, that the acquisition agreement provided that the balance of the purchase price was to be calculated by reference to the "completion accounts" and these were defined as *audited* accounts; that Hillsdown's auditors had under the agreement the rights of access to the company's books and records and the right to review the accounts; that the opportunity for intermediate review was incompatible with the existence of a duty of care; and that the accounts submitted were merely draft *unaudited* accounts and no duty of care arose on the facts and/or as a matter of law in relation to such accounts.

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

Representation

Hugh Bennett Q.C. and Jonathan Acton Davis for the plaintiffs.
Ian Hunter Q.C. and Graham Dunning for the defendants.
The third party, K.P.M.G. Peat Marwick, did not appear and was not represented.

Cur. adv. vult.
Glidewell L.J.

21 December. The following judgments were handed down.

The first plaintiff, Galoo Ltd. (“Galoo”), which is now in liquidation, formerly traded in animal health products. The second plaintiff, Gamine Ltd. (“Gamine”), owned all the shares in Galoo. Both the first and second plaintiffs have changed their names. Galoo was formerly Peter Hand (G.B.) Ltd., and Gamine was Peter Hand Holdings Ltd.

The defendants, Bright Grahame Murray (“B.G.M.”), are a firm of chartered accountants. From 1981 until 1991 they were the auditors of the accounts of Galoo, and from 1984 until 1991 of the accounts of Gamine.

In 1987 the third plaintiff, Hillsdown Holdings Plc. (“Hillsdown”), purchased 51 per cent. of the shares in Gamine from the holders of those shares. Between March 1987 and January 1993 Hillsdown made loans to Galoo and Gamine which amounted in total to over £30m. In May 1991 Hillsdown purchased a further 44.3 per cent. of the shares in Gamine.

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By a specially endorsed writ issued on 6 October 1992, the plaintiffs claim that the audited accounts of Galoo and Gamine for the years 1985 to 1989 and the draft audited accounts for the year 1990 contained substantial inaccuracies; that in auditing the accounts without discovering or reporting such inaccuracies B.G.M. were negligent and in breach of duties owed in contract and tort to Galoo and Gamine and in tort to Hillsdown, and that as a result the plaintiffs have all suffered loss and damage.

B.G.M. applied to strike out the statement of claim endorsed on the writ on the ground that it disclosed no reasonable cause of action. We have not been supplied with a copy of the application but it seems that it was made under R.S.C., Ord. 18, r. 19(1)(a) and under the inherent jurisdiction of the court.

The application was heard by Mr. Ronald Walker Q.C., sitting as a deputy High Court judge in the Queen's Bench Division, who gave judgment on 17 May 1993. He ordered (a) that the claims of the first and second plaintiffs should be struck out and that the action by them should be dismissed pursuant to R.S.C., Ord. 18, r. 19 and/or the inherent jurisdiction of the court, (b) that part of the third plaintiff's claims should be struck out, as indicated in his judgment, and that the third plaintiff should amend its statement of claim so as to reflect the decision and to pursue only that part of the claim not struck out. The deputy judge granted leave to all the plaintiffs to appeal against his order, and for the defendants to cross-appeal against his refusal to strike out the whole of the claims of the third plaintiffs.

The plaintiffs now appeal against the decision to strike out, and the defendants cross-appeal against the decision not to strike out part of the claim by Hillsdown.

The nature of these proceedings

Although the application was more widely framed, in this appeal it has properly been treated as an application under Ord. 18, r. 19(1)(a) only, with one exception to which I shall refer later. On such an application, no evidence is admissible by virtue of Ord. 18, r. 19(2) . I therefore do not understand why the papers before the judge, and before this court, included and include a number of affidavits. As the deputy judge correctly said: “For the purposes of the applications, all the allegations in the statement of claim must be assumed to be true.”

The issue for the court is therefore, making that assumption, is the plaintiffs' claim nevertheless bound to fail? Only if the answer in relation to any claim is “Yes” should that claim be struck out. On the other hand I agree with the deputy judge that if the statement of claim does not disclose a reasonable cause of action on a particular claim, that claim should be struck out

at this stage, thus saving an unnecessary trial, perhaps lengthy, on that claim. I also take the view that, since the court at this stage is concerned only with the allegations in the statement of claim and not with evidence, the court hearing the application was and is in as good a position to decide the issue now as it would have been at the conclusion of a trial.

Ord. 18, r. 19(1) expressly provides that the court, as an alternative to striking out a pleading, may order that it be amended. Obviously if, after an amendment properly made, the statement of claim does disclose a reasonable cause of action, it should not be struck out. So the deputy *1366 judge, without objection by Mr. Hunter on behalf of the defendants, made his decision in relation to a draft amended statement of claim which was before him. With some further amendment to which reference was made in the hearing before the deputy judge, this document has been submitted to us. For the purposes of this appeal I shall treat the statement of claim so amended as the effective statement of claim. When I come to consider the claims in detail I shall do so by reference to the paragraph numbers in the draft amended statement of claim.

The issues and the judge's decision

Issue 1. Claims by Galoo and Gamine for damages for breach of contract or in tort. It was accepted before the judge that the same principles apply to damages under both heads. No different argument has been presented to us. The facts which would establish a breach of contract by the defendants have been pleaded. Thus these plaintiffs are entitled at least to nominal damages. The deputy judge however said in his judgment:

> "I was not, however, invited to refuse to strike out the claims on the basis that they could properly proceed with a view to obtaining nominal damages, and it appears to have been accepted that even if Ord. 18, r. 19(1)(a) would not be satisfied in those circumstances, then the claim would be demurrable by reason of the further provisions of that sub-rule."

I agree that this was a proper approach for the deputy judge to adopt.

The deputy judge then considered whether the first and second plaintiffs would be entitled to substantial damages for the pleaded loss under two heads: (a) by incurring an obligation to repay the sums advanced by Hillsdown; and (b) by incurring trading losses as a result of relying on the negligent auditing by the defendants and thus continuing to trade. The deputy judge decided that neither Galoo nor Gamine could recover damages under either head, and he therefore struck out their claims.

The other issues all relate to claims by Hillsdown in tort. They are claims for damages under the following heads.

Issue 2. For loss resulting from the original purchase by Hillsdown of the shares in Gamine. The deputy judge decided that the statement of claim did disclose a reasonable cause of action on this head and therefore declined to strike it out. This is the subject of the cross-appeal.

Issue 3. For loss resulting from making the loans to Gamine. The deputy judge struck out this claim.

Issue 4. For amounts paid under a supplementary agreement for the purchase of the further 44.3 per cent. of the shares in Gamine, and for payments made to a Mr. Sanders at the same time for loss of office. These claims were also struck out.

I shall deal with each of these issues in turn, in that order. Before I do so, however, it is necessary to refer to the statement of claim in more detail.

Facts alleged common to all issues

I have already described the parties briefly. By paragraph 4 of the statement of claim, it is alleged that by a written agreement dated 25 February 1987 Hillsdown purchased 51 per cent. of the issued £1 shares in the capital of Gamine. The vendors of the shares were Mr. Michael **1367* Sanders, the chairman and managing director of both Galoo and Gamine, together with members of his immediate family, and also Mr. Roger Tabakin, a partner in the defendant firm and trustee of the Sanders family settlement. This agreement is described as "the acquisition agreement."

Paragraph 10 sets out the method of calculation of the shares purchased under the acquisition agreement. It was to be 5.2 times the net profits of Gamine as set out in the completion accounts, which were defined as including the audited accounts of Galoo and Gamine for the year ending 31 December 1986. The agreement provided that the parties should jointly procure as soon as practicable and in any event within 90 days of the date of completion the preparation of the completion accounts, which "shall be audited" by B.G.M. B.G.M. were required to calculate the net profits from the completion accounts, and deliver to the vendors and to Hillsdown copies of the completion accounts and a statement setting out the net profits and the shareholders' funds.

Paragraph 11 sets out a further provision of the acquisition agreement, that, if the vendors so elected, Hillsdown would be required to purchase the remaining shares in Gamine in annual tranches, and that the price payable for each such tranche of shares should be calculated by reference to the pre-tax earnings of Gamine for the relevant year as shown by the accounts for that year, which were to be prepared and audited by B.G.M. Paragraph 5 pleads that by a supplemental written agreement made between Hillsdown and the vendors dated 21 May 1991, Hillsdown purchased further shares in Gamine from the vendors for a sum of £967,000. Moreover, by an agreement made on the same day between Gamine and Mr. Michael Sanders, Hillsdown made a termination payment of £30,000 to Mr. Sanders as compensation for loss of office.

By paragraph 8:

> "In the premises [B.G.M.] owed duties to [Galoo and Gamine] as implied terms of each of the annual contracts under which they acted as auditors of [Galoo and Gamine] and also in tort:
>
> (i) to perform the functions prescribed by the relevant provisions of the Companies Act in force at the material time, which functions included a duty to report to the company's members on the annual accounts of the company and to state in each report whether in [B.G.M.'s] opinion the annual accounts had been properly prepared in accordance with the Companies' Act ;
>
> (ii) to do all such work and carry out all such investigations as would enable [B.G.M.] properly to discharge the above functions; and
>
> (iii) in performing the above functions and work to comply with the requirements set out in the auditing standards and guidelines of the Institute of Chartered Accountants in England and

> Wales and to exercise reasonable professional care and skill in performing the above functions and work."

Paragraph 9 pleads that B.G.M. owed duties in tort, equivalent to those pleaded in paragraph 8, to Gamine as shareholders in Galoo, in auditing the accounts of Galoo for each of the years 1981 to 1990 and to Hillsdown as shareholders of Gamine in auditing the accounts of Gamine for each of the years 1986–90.

It is alleged that in respect of each of the years 1985–90 Mr. Sanders and/or the company secretary of Galoo falsely overstated the stock held by Galoo for the purpose of preparing the annual accounts of Galoo and Gamine. By the time the accounts for the year 1990 were drawn the value of the fictitious quantities of stock was approximately £15,300,000. ***1368** Further, the value of the stock of Galoo included in the accounts of Galoo and Gamine for the year 1990 included finished products to a value of £1,818,335 and work in progress totalling £1,391,000, neither of which ever existed. By reason of these matters, the audited accounts for each of the years 1985–89 and the draft audited accounts for the year ended 31 December 1990 of Galoo and Gamine were materially misstated and not properly prepared in accordance with the Companies Acts. Particulars are given year by year of the estimated actual stock contrasted with the stock shown in the accounts for each year, which shows the estimated margin of falsity as £2.5m. in the 1985 accounts, rising to £11.8m. in the 1989 accounts and £15,361,000 in the 1990 accounts.

Allegations relevant to Galoo and Gamine

Paragraph 19 alleges that in auditing the accounts of Galoo and Gamine for each of the years 1985 to 1990 B.G.M. acted negligently and in breach of their duties in contract and in tort as set out earlier. Particulars of the alleged negligence and breach of duty are given.

Paragraph 20 pleads:

> "If [B.G.M.] had performed their duties properly and with reasonable professional care and skill the accounts of [Galoo and Gamine] for each of the years 1985–1990 and/or its [B.G.M.'s] report on those accounts would have shown that those companies instead of being profitable and having substantial assets, were in fact unprofitable and worthless. In these circumstances:
>
> (i) the insolvency of [Galoo and Gamine] would have been revealed and those companies would have ceased to trade immediately;
>
> (ii) [Galoo and Gamine] would not have accepted or continued to accept the advances or further advances from [Hillsdown] referred to in sub-paragraph (iii) below and/or incurred any other liabilities."

The advances referred to in (iii) are pleaded as advances by Hillsdown to Galoo and Gamine between March 1987 and January 1993 in the total amount of £30,649,943.

Paragraph 21 pleads that Galoo and Gamine have suffered loss and damage "as a result of continuing to trade after they would otherwise have done" of which particulars would be provided in due course. Such particulars have now been provided in the following form:

> "The nature of the case is that had [B.G.M.] detected the fraud during their audit of the 1985 accounts, the steps preliminary to liquidation of the companies would have been commenced in early 1986 leading to their liquidation in approximately mid-1986. In the case of [Galoo] the loss can be quantified as follows."

The particulars then plead that in mid-1986 Galoo's net liabilities were approximately £2m. Galoo was put into liquidation upon discovery of the fraud. The current best estimate is that it has net liabilities of approximately £27m. The difference between these two estimates of net liabilities, i.e. £25m., was a loss caused by Galoo continuing to trade after mid-1986 and thus represents both its loss and a consequential fall in its net assets. Moreover, during 1988 Galoo made a dividend payment of £500,000 which would not have been made had B.G.M. detected the fraud. Galoo was essentially the only subsidiary of Gamine, and thus the fall in the net asset value of Galoo had a direct effect on the net asset value of Gamine. Further, Galoo and Gamine accepted the loans from ***1369** Hillsdown in the total sum of £30,649,943 which "were necessary only because of the stock overstatements and which masked the over-statements."

Issue 1: claims by Galoo and Gamine for damages for breach of contract or in tort

As I have said, this claim is for damages which are pleaded under two heads, which it is necessary to consider separately.

The first part of this claim is for damages for the loss allegedly incurred by Galoo and Gamine as a result of accepting and continuing to accept the loans from Hillsdown totalling over £30m. This part of the claim is added by the amendment to the statement of claim.

The deputy judge dealt with this matter shortly but clearly. He said:

> "As a matter of fact, I do not accept that accepting loans involving an obligation simpliciter to repay them can be described as damage. At the moment of accepting the loan, the company which accepts the loan has available that amount of money and the obligation to repay that amount of money, and I simply fail to see how that can amount to damage. If there is damage, it must consist of parting with those moneys in certain circumstances."

I entirely agree with the deputy judge on this issue. Like him, I do not understand how the acceptance of a loan can, of itself, be described as a loss causing damage. If anything it is a benefit to the borrower. Of course, a loss may result from the use to which the loan moneys are put, but no such resultant loss is pleaded, and even if it were it might very well be difficult to attribute it to B.G.M. I therefore agree with the deputy judge on this issue.

The second head of damage claimed by Galoo and Gamine is that they incurred trading losses as a result of relying on the negligent auditing by B.G.M. and thus continued to trade when they would otherwise not have done. The claim under this head is for damages for trading losses of approximately £25m. incurred in and between 1986 and 1990 and for making a dividend payment of £500,000 in 1988, as set out in the particulars to which I have referred. This claim requires more detailed consideration.

It can be expressed as follows: (a) if they had not acted in breach of their duty in contract or tort, B.G.M. would have detected the fraud during their audit of the 1985 accounts; (b) in that case, Galoo and Gamine would have been put into liquidation in mid-1986 and thus ceased to trade at that date; (c) if the companies had ceased to trade, they would neither have incurred

any further trading losses nor paid the dividend in 1988; (d) therefore the trading losses and the loss caused by the dividend payment were caused by the breach of duty by B.G.M.

This argument depends upon the nature of the causation necessary to establish liability for breach of duty, whether in contract or in tort. There is no doubt that this is one of the most difficult areas of the law. Both counsel are agreed that, at least in the context of this case, the principles applicable to liability in either contract or tort are the same.

Mr. Hunter, for the defendants, submits that the plaintiff's case depends upon the adoption of the "but for" test of causation which, at least in contract, is not the proper test in English law. This is causation of the kind which has sometimes been referred to as a "causa sine qua non."

***1370**

In *Chitty on Contracts* , 26th ed. (1989), vol. 2, pp. 1128–1129, para. 1785, the editors say:

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

For these propositions the editors quote three authorities, including the decision of the *House of Lords in Monarch Steamship Co. Ltd. v. Karlshamns Oljefabriker (A/B) [1949] A.C. 196* and *Quinn v. Burch Bros. (Builders) Ltd. [1966] 2 Q.B. 370* .

In the *Monarch Steamship case [1949] A.C. 196* , the defendants' ship was chartered to carry a cargo from Manchuria to Sweden. The ship should have reached Sweden in July 1939 but the boilers were defective, which resulted in the defendants breaking their contractual duty to provide a seaworthy ship. She was delayed and did not leave Port Said, at the north end of the Suez canal, until 24 September 1939. By that date the Second World War had broken out. The British Admiralty prohibited the ship from proceeding to Sweden and ordered her to proceed to and discharge at Glasgow. The cargo was eventually transshipped and delivered to Sweden at extra cost. The purchasers of the cargo sued the ship owners for damages. The ship owners by their defence claimed that the cause of the additional expense was the order from the Admiralty, not their breach of contract in failing to provide a seaworthy ship. The House of Lords rejected this argument, and held that the damages were recoverable.

However, in the course of the speeches in the House of Lords, their Lordships considered what test to apply in order to decide whether the defendants' breach of contract was causative of the plaintiffs' loss. In particular Lord Porter said, at p. 212, that it had to be determined whether the breach of contract was "the effective cause." Lord Wright said, at pp. 227–228:

> "There is, however, in this case a contention of a more general nature, which is that the delay which resulted from the defective boilers did not in any legal sense cause the diversion of the vessel. It is said that the relation of cause and effect cannot be postulated here between the unseaworthiness and the restraints of princes or the delay. As to such a contention it may be said at once that all the judges below have rejected it …. If a man is too late to catch a train, because his car broke down on the way to the station, we should all naturally say, that he lost the train because of the car breaking down. We recognise that the two things or events are causally connected. Causation is a mental concept, generally based on inference or induction from uniformity of sequence as between two events that there is a causal connection between them …. The common law however is not concerned with philosophic speculation, but is only concerned with ordinary everyday life and thoughts and expressions, and would not hesitate to think and say that, because it caused the delay, unseaworthiness caused the Admiralty order diverting the ***1371** vessel. I think the common

> law would be right in picking out unseaworthiness from the whole complex of circumstances as the dominant cause."

In *Quinn v. Burch Bros. (Builders) Ltd. [1966] 2 Q.B. 370* the defendants were main contractors on a building project. The plaintiff was an independent subcontractor carrying out plastering and similar work. Under the contract between them, the defendants were to supply any equipment reasonably necessary for the plaintiff's work. On the day in question, the plaintiff required a step-ladder in order to carry out work to ceilings, but despite his request the defendants did not supply one. The plaintiff found a folded trestle, which he propped against the wall and used as if it were a ladder to allow him to reach the ceiling. While he was standing on the trestle the foot of it slipped and he fell and broke his heel. He claimed that his injuries and resultant loss were the result of the defendants' breach of contract.

Paull J. held that the defendants were in breach of contract in failing to supply a step-ladder, but that the breach did not cause the plaintiff's accident. The Court of Appeal unanimously dismissed the plaintiff's appeal. Danckwerts L.J., in a short judgment, expressed his reasoning, at p. 391, in four propositions, of which the third and fourth were:

> "(3) The cause of the plaintiff's accident was the choice by the plaintiff to use the unsuitable equipment.
>
> (4) The failure of the defendants to provide the equipment required may have been the occasion of the accident but was not the cause of the accident."

Salmon L.J said, at pp. 394–395:

> "the defendants realised that, if there were a breach of contract on their part to supply the step-ladder, that breach would afford the plaintiff the opportunity of acting negligently, and that he might take it and thereby suffer injury. But it seems to me quite impossible to say that in reality the plaintiff's injury was caused by the breach of contract. The breach of contract merely gave the plaintiff the opportunity to injure himself and was the occasion of the injury. There is always a temptation to fall into the fallacy of post hoc ergo propter hoc; and that is no less a fallacy even if what happens afterwards could have been foreseen before it occurred."

We have been referred by counsel to two Australian cases. *Alexander v. Cambridge Credit Corporation Ltd. (1987) 9 N.S.W.L.R. 310 was a decision of the Court of Appeal* of New South Wales. The facts were very similar to those of the present case. In 1971 the auditors of the Cambridge Credit Corporation, in their annual audit certificates, failed to note that the balance sheet and other accounts did not show provisions which should have been made. If the appropriate note had been made it was highly probable that a receiver would have been appointed. The company eventually was put into receivership in 1974. The company claimed damages for negligent breach of contract against the auditors. The judge at first instance found that, but for the breach of contract by the auditors, the company would have gone into receivership in 1971, and it had suffered damage in the sum of A$145m., the increase over the period 1971 and 1974 in the deficiency of the company's assets. By a majority, the Court of Appeal allowed the appeal, holding that there was no causal connection between the breach of contract and the damage. The judges expressed their opinions as to the proper principle of causation in different ***1372*** language, although in the event the dissent by Glass J.A. was as to the application of the facts to the law rather than as to the principle, on which he was in a majority. He said, at p. 316:

> "the evidence here in my view supports the commonsense conclusion that but for this company's continuance in trade in the same line of business, under the same management in breach of the same ratios it would not have run down its assets. Being in trade when it should have been in receivership was a cause of the $57m. loss it suffered. If an unseaworthy vessel puts to sea because marine

> surveyors have negligently certified it, its loss will also be due to the marine hazards which cause it to founder. But it is equally true that its loss could not have occurred but for the fact that it put to sea as a result of a negligent survey."

The fact that Glass J.A. did not agree with his colleagues in the result shows that, inevitably, not all judges regard common sense as driving them to the same conclusion.

In his judgment, Mahoney J.A. said, at pp. 333–335:

> "In the broadest sense, that loss was a result of the defendants' breach. If a defendant promises to direct me where I should go and, at a cross-roads, directs me to the left road rather than the right road, what happens to me on the left road is, in a sense, the result of what the defendant has done. If I slip on that road, if it collapses under me, or if, because I am there, a car driving down that road and not down the right road strikes me, my loss is, in a sense, the result of the fact that I have been directed to the left road and not the right road. But, in my opinion, it is not everything which is a result in this broad sense which is accepted as a result for this purpose in the law. Thus, if, being on the left road, I slip and fall, the fact alone that it was the defendant's direction, in breach of contract, which put me there will not, without more, make the defendant liable for my broken leg. I say 'without more:' if there be added to the breach the fact that, for example, the left road was known to be dangerous in that respect I may, of course, be liable. But, in relation to losses of that kind, the fact that the breach has initiated one train of events rather than another is not, or at least may not, be sufficient in itself. It is necessary, to determine whether there is a causal relationship, to look more closely at the breach and what (to use a neutral term) flowed from it. In the present case, the company's loss resulted from the defendants' breach in the sense that the course of events vis-a-vis the company would have gone in a different direction had it not been for that breach. But that, I think, is not, or is not necessarily, sufficient. Thus, the breach allowed the company to continue in business. If its net worth had fallen because, for example, the main buildings it owned had been destroyed by an earthquake, I do not think that that loss would have been causally related to the breach which let the company continue in business. …
>
> "It may sometimes be argued that a breach exposes the plaintiff to particular dangers and that if what happens subsequent to the breach is loss from a danger of that kind, the loss may be seen as a result of the breach: see, for example, the reference to arguments of this kind in the preface to the second edition of Hart & Honore [Causation in the Law, 2nd ed. (1985), p. lviii]. But, again, I do not think that this argument is open to the company. To allow the ***1373** company to continue in existence is, in a sense, to expose it to all the dangers of being in existence. But allowing the company to remain in existence does not, without more, cause losses from anything which is, in that sense, a danger incident to existing. There are some dangers loss from which will raise causal considerations and some will not. But the company's case has been conducted on the basis that there is not to be — and there has in fact not been — a detailed examination of what particular things caused the fall in net value of the company between 1971 and 1974 and the nature for this purpose of them. In the end, the company's case has been that the loss it claims was caused by the breach because, and because alone, the breach allowed the company to continue in existence. Some of the incidents flowing from its existence during 1971–1974 may be the results of the breach; some, for example, those flowing from earthquakes or the like, will not be. But the basis of the plaintiffs' claim has been such that no inquiry is to be or has been pursued, for this purpose, into what in fact happened, why and the relationship of what happened to the breach. I do not think that that is enough to establish a causal relationship."

McHugh J.A. said, at p. 359:

> "In the proved circumstances of this case, I do not think that the issue of the certificates by the auditors constituted a cause of Cambridge's loss of $145m. The existence of a company, as counsel for Cambridge conceded, cannot be a cause of its trading losses or profits. Yet that is what the case for Cambridge comes to. Except in the sense that the issue of the certificates induced the trustee not to take action against Cambridge and thereby permitted Cambridge to exist as a trader, the issuing of the certificates was not one of the conditions which were jointly necessary to produce the loss of $145m. To assert in these circumstances that the issue of the certificates was a cause of the loss in my opinion is to depart from the common sense notion of causation which the common law champions."

It will be seen that all the judges considered that the "but for" test was not enough, and that two of them expressly relied on the application of common sense.

The recent decision of the High Court of Australia in *March v. E. & M.H. Stramare Pty. Ltd. (1991) 171 C.L.R. 506* was in an action in tort. The plaintiff claimed damages for injuries sustained when, driving his car at night, he ran into the back of a truck owned by the defendants which their driver had parked at a position where it straddled the centre line of a six-lane road. The defendants alleged that their driver's negligence did not cause the accident. A majority in the Supreme Court of South Australia had held that the defendants were not liable. The High Court allowed the appeal. Four of the five members of the court took the view that the "but for" test was not a definitive test of causation in tort.

In his judgment, Mason C.J. said, at p. 515:

> "The common law tradition is that what was the cause of a particular occurrence is a question of fact which 'must be determined by applying common sense to the facts of each particular case,' in the words of Lord Reid: *Stapley v. Gypsum Mines Ltd. [1953] A.C. 663* , 681 …. It is beyond question that in many situations the question whether Y is a consequence of X is a question of fact. And, prior to the introduction of the legislation providing for apportionment of ***1374*** liability, the need to identify what was the 'effective cause' of the relevant damage reinforced the notion that a question of causation was one of fact and, as such, to be resolved by the application of common sense. Commentators subdivide the issue of causation in a given case into two questions: the question of causation in fact — to be determined by the application of the 'but for' test — and the further question whether a defendant is in law responsible for damage which his or her negligence has played some part in producing: see, e.g.Fleming, Law of Torts, 7th ed. (1987), pp. 172–173; Hart & Honore, Causation in the Law, 2nd ed. (1985), p. 110. It is said that, in determining this second question, considerations of policy have a prominent part to play, as do accepted value judgments: see Fleming, p. 173. However, this approach to the issue of causation (a) places rather too much weight on the 'but for' test to the exclusion of the 'common sense' approach which the common law has always favoured; and (b) implies, or seems to imply, that value judgment has, or should have, no part to play in resolving causation as an issue of fact. As Dixon C.J., Fullagar and Kitto JJ. remarked in *Fitzgerald v. Penn (1954) 91 C.L.R. 268* , 277 'it is all ultimately a matter of common sense' and 'in truth the conception in question (i.e. causation) is not susceptible of reduction to a satisfactory formula.'"

In the court below, only one authority was cited to the deputy judge on this issue, and that was more concerned with remoteness of damage than with causation. Without the benefit of reference to the authorities to which we have been referred, he concluded:

> "Trading losses … are losses which by their nature do not flow from whatever statement appears in the accounts as to the state of the company's assets or profits; they flow from trading. If a company

> trades, it may suffer losses or it may enjoy profits, and those losses or gains depend upon a number of factors such as the prudence of the trading, market conditions, and so on. It does not seem to me that trading losses as such can possibly be attributed to statements as to the status of the company before that trading ever takes place … it seems to me that, for the reasons I have given … trading losses as such cannot arguably be said to be damages which flow from the auditors' negligence."

For those reasons he found for the defendants on this issue.

The passages which I have cited from the speeches in *Monarch Steamship Co. Ltd. v. Karlshamns Oljefabriker A/B [1949] A.C. 196* make it clear that if a breach of contract by a defendant is to be held to entitle the plaintiff to claim damages, it must first be held to have been an "effective" or "dominant" cause of his loss. The test in *Quinn v. Burch Bros. (Builders) Ltd. [1966] 2 Q.B. 370* that it is necessary to distinguish between a breach of contract which causes a loss to the plaintiff and one which merely gives the opportunity for him to sustain the loss, is helpful but still leaves the question to be answered "How does the court decide whether the breach of duty was the cause of the loss or merely the occasion for the loss?"

The answer in my judgment is supplied by the Australian decisions to which I have referred, which I hold to represent the law of England as well as of Australia, in relation to a breach of a duty imposed on a ***1375** defendant whether by contract or in tort in a situation analogous to breach of contract. The answer in the end is "By the application of the court's common sense."

Doing my best to apply this test, I have no doubt that the deputy judge arrived at a correct conclusion on this issue. The breach of duty by the defendants gave the opportunity to Galoo and Gamine to incur and to continue to incur trading losses; it did not cause those trading losses, in the sense in which the word "cause" is used in law.

For these reasons I would dismiss the appeals by the first plaintiff, Galoo, and the second plaintiff, Gamine.

Facts alleged relevant to Hillsdown

I go on to consider the cross-appeal and the appeal by Hillsdown under the remaining heads. This requires further reference to the proposed amended statement of claim.

In paragraphs 12 and 13, Hillsdown plead that the defendants sent a copy of the accounts of Gamine to Hillsdown accompanied by a letter dated 25 March 1987, which said, as did the audited accounts, that the net profits for the year ended 31 December 1988 were £650,944 and the shareholders' funds, £1,809,004. The shareholders' funds of Galoo at 31 December 1986 were said to be £3,486,518. It is then pleaded that at the time of making the representations in the letter and when they audited the accounts of Galoo and Gamine for the year ended 31 December 1986, B.G.M. knew of the existence and terms of the acquisition agreement. They accordingly knew that the purchase price under that agreement was to be calculated by reference to the accounts of Galoo and Gamine for the year ended 31 December 1986 as a multiple of the net profits of Gamine for that year, and that if the shareholders' funds in Galoo were less than £2,150,000 the vendors would be in breach of warranty towards Hillsdown. The pleading alleges that B.G.M. owed duties in tort to Hillsdown in making the representations referred to in the letter, and in auditing the accounts of Galoo and Gamine for the years 1986 to 1990, to exercise reasonable skill and care. It is further alleged that the defendants owed duties in tort to Hillsdown in auditing the accounts of Gamine for each of the years 1986 to 1990 as shareholders in Gamine, after Hillsdown acquired the 51 per cent. shareholding.

Paragraph 9A of the draft amended statement of claim amplifies this last pleading as follows:

> "Further (and in amplification of paragraph 9(ii) hereof) the defendants knew or ought to have known from the date of the acquisition agreement onwards that:
>
> (i) the third plaintiffs were the owners of and the source of support for the first and second plaintiffs:

> (ii) the third plaintiffs by virtue of the provisions of the shareholders' agreement made on 25 February 1987 could neither replace the defendants as auditors of the second plaintiffs nor sell the assets of the second plaintiffs other than at full market value nor wind-up the second plaintiffs until after the acquisition by the third plaintiffs of the remainder of the shares in the second plaintiffs:
>
> (iii) the third plaintiffs were obliged, at the option of the remaining shareholders in the second plaintiffs, to acquire their shares in the second plaintiffs at a price to be fixed by reference to accounts which could be audited only by the defendants:
>
> (iv) that the third plaintiffs were year by year to the knowledge of the defendants advancing substantial sums to the ***1376** second plaintiffs and supporting that company in reliance on the defendants' work … the third plaintiffs will say that such knowledge is shown by, inter alia:
>
> (a) in each of the years 1987 to 1990 the defendants requested and obtained from the third plaintiffs letters of comfort in respect of the third plaintiffs support of and continued lending to the second plaintiffs:
>
> (b) the accounts packs for each of the years 1987–1990 contained details of the said support and lending which details were supplied by the defendants, and in the premises that:
>
> (v) the third plaintiffs were using the defendants' accounts and audit work in their consideration of the existing lending to, and or the making of, further advances to the first and second plaintiffs."

There is a further alternative pleading that if the defendants were not in breach in relation to the auditing of the accounts when they sent the letter of 25 March 1987, they were in breach after 6 August 1987 and 16 September 1987 when the accounts of Galoo and Gamine were respectively signed.

Paragraph 18 pleads that the representations made by B.G.M. in their letter of 25 March 1987 were false in that Gamine made a net loss, not a net profit, in the year ended 3*l* December 1986, that at that date the shareholders' funds of Gamine were in deficit and that the shareholders' funds of Galoo were a mere £10,000 not the £3,486,518 shown in the accounts and referred to in the letter.

Paragraph 19 gives particulars of the alleged negligence of B.G.M. in auditing the accounts of Galoo and Gamine for each of the years 1985–1990.

Paragraph 20 reads:

> "If the defendants had performed their duties properly and with reasonable care and skill the accounts of the first and second plaintiffs for each of the years 1985–1990 and/or the defendants' reports of those accounts would have shown that those companies, instead of being profitable and having substantial assets, were in fact unprofitable and worthless. In these circumstances:
>
> (i) the insolvency of the first and second plaintiffs would have been revealed and those companies would have ceased to trade immediately; …

> (ii) the third plaintiffs would not have entered into the acquisition agreement and/or would not have made any of the payments which they in fact made thereunder;
>
> (iii) the third plaintiffs would not have made or continued to make the advances to the first and second plaintiffs which they in fact made between March 1987 and January 1993 in the total amount of £30,649,943;
>
> (iv) the third plaintiffs would not have entered into the supplemental agreement and/or would not have paid the sum of £967,000 thereunder or any part thereof and would not have paid Michael Sanders the sum of £30,000."

The loss and damage sustained by Hillsdown is alleged to be the total of (i) the purchase consideration under the acquisition agreement, approximately £1,726,000; (ii) advances made totalling £30,649,943, against which credit will be given for the price received on the sale of Gamine; and (iii) the amounts paid under the supplemental agreement and to Mr. Sanders, of £997,000, of which £910,000 has been recovered, leaving a loss of £87,000.

Economic loss in tort

Before turning to the issues raised in the appeal by Hillsdown and the cross-appeal by the defendants, it is necessary to consider the effect of ***1377** recent authorities on the circumstances in which a plaintiff may recover damages for purely economic loss in tort. The two major decisions are those of the House of Lords in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* and of this court in *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295* .

In the *Caparo Industries case [1990] 2 A.C. 605* the plaintiffs, who already owned some shares in another company, Fidelity Plc., bought further shares after the publication to them as shareholders of, and in reliance upon, the audited accounts of Fidelity for the year ending 31 March 1984. The defendants had audited the accounts. The issue was whether the defendants owed the plaintiffs a duty of care in tort the breach of which entitled the plaintiffs to sue for damages. The Court of Appeal by a majority found in favour of the plaintiffs, but the House of Lords unanimously allowed the defendants' appeal. Giving the judgment of the *Court of Appeal in the Morgan Crucible case [1991] Ch. 295* , 313 Slade L.J. described the effect of the decision in the *Caparo Industries* case:

> "The House of Lords reversed this decision, holding in effect that in certifying a company's accounts for the purpose of the Companies Act 1985 , an auditor owes no duty of care to a potential take-over bidder, whether or not he is already a shareholder of the company. It was held that foreseeability, no matter how high, that a potential bidder might rely on the audited accounts did not suffice to found a duty of care, since there was no sufficient relationship of proximity between auditor and potential bidder."

In his speech in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* , Lord Bridge of Harwich referred to *Candler v. Crane, Christmas & Co. [1951] 2 K.B. 164* , *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465* , in which Denning L.J.'s dissenting judgment in *Candler v. Crane, Christmas & Co. [1951] 2 K.B. 164 was approved* , and *Smith v. Eric S. Bush [1990] l A.C. 831* . Lord Bridge continued, at pp. 620–621:

> "The salient feature of all these cases is that the defendant giving advice or information was fully aware of the nature of the transaction which the plaintiff had in contemplation, knew that the advice or information would be communicated to him directly or indirectly and knew that it was very likely that the plaintiff would rely on that advice or information in deciding whether or not to engage in the transaction in contemplation. In these circumstances the defendant could clearly be expected, subject always to the effect of any disclaimer of responsibility, specifically to anticipate that the plaintiff would rely on the advice or information given by the defendant for the very purpose for which he did in the event rely on it. So also the plaintiff, subject again to the effect of any disclaimer, would in that situation reasonably suppose that he was entitled to rely on the advice or information communicated to him for the very purpose for which he required it. The situation is entirely different where a statement is put into more or less general circulation and may foreseeably be relied on by strangers to the maker of the statement for any one of a variety of different purposes which the maker of the statement has no specific reason to anticipate. To hold the maker of the statement to be under a duty of care in respect of the accuracy of the statement to all and sundry for any purpose for which they may choose to rely on it is not only to subject him, in the classic words of Cardozo C.J. to ***1378** 'liability in an indeterminate amount for an indeterminate time to an indeterminate class:' see *Ultramares Corporation v. Touche (1931) 174 N.E. 441* , 444; it is also to confer on the world at large a quite unwarranted entitlement to appropriate for their own purposes the benefit of the expert knowledge or professional expertise attributed to the maker of the statement. Hence, looking only at the circumstances of these decided cases where a duty of care in respect of negligent statements has been held to exist, I should expect to find that the 'limit or control mechanism … imposed upon the liability of a wrongdoer towards those who have suffered economic damage in consequence of his negligence' rested in the necessity to prove, in this category of the tort of negligence, as an essential ingredient of the 'proximity' between the plaintiff and the defendant, that the defendant knew that his statement would be communicated to the plaintiff, either as an individual or as a member of an identifiable class, specifically in connection with a particular transaction or transactions of a particular kind (e.g. in a prospectus inviting investment) and that the plaintiff would be very likely to rely on it for the purpose of deciding whether or not to enter upon that transaction or upon a transaction of that kind."

Lord Bridge then quoted a passage from the dissenting judgment of Denning L.J. in *Candler v. Crane, Christmas & Co. [1951] 2 K.B. 164* , starting at p.180. I repeat this classic statement, familiar though it is:

> "Let me now be constructive and suggest the circumstances in which I say that a duty to use care in statement does exist apart from a contract in that behalf. First, what persons are under such duty? My answer is those persons such as accountants, surveyors, valuers and analysts, whose profession and occupation it is to examine books, accounts, and other things, and to make reports on which other people — other than their clients — rely in the ordinary course of business …
>
> "Secondly, to whom do these professional people owe this duty? 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 …. 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? …

> "Thirdly, to what transactions does the duty of care extend? It 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 ***1379*** 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 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 (1931) 174 N.E. 441* , 444, 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 transaction, I do not say. I should have thought he might be, just as the analyst and lift inspector would be liable in the instances I have given earlier. It is perhaps worth mentioning that Parliament has intervened to make the professional man liable for negligent reports given for the purposes of a prospectus: see sections 40 and 43 of the Companies Act 1948 . That is an instance of liability for reports made for the guidance of a specific class of persons — investors, in a specific class of transactions — applying for shares. That enactment does not help, one way or the other, to show what result the common law would have reached in the absence of such provisions; but it does show what result it ought to reach. My conclusion is that a duty to use care in statement is recognised by English law, and that its recognition does not create any dangerous precedent when it is remembered that it is limited in respect of the persons by whom and to whom it is owed and the transactions to which it applies."

Lord Bridge commented, at p. 623:

> "It seems to me that this masterly analysis, if I may say so with respect, requires little, if any, amplification or modification in the light of later authority and is particularly apt to point the way to the right conclusion in the present appeal."

Lord Oliver of Aylmerton said, at p. 638:

> "Furthermore, it is clear that 'knowledge' on the part of the respondents embraced not only actual knowledge but such knowledge as would be attributed to a reasonable person placed as the respondents were placed. What can be deduced from the *Hedley Byrne case [1964] A.C. 465* , therefore, is that the necessary relationship between the maker of a statement or giver of advice ('the adviser') and the recipient who acts in reliance upon it ('the advisee') may typically be held to exist where (1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given; (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose; (3) it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry, and (4) it is so acted upon by the advisee to his ***1380*** detriment. That is not, of course, to

> suggest that these conditions are either conclusive or exclusive, but merely that the actual decision in the case does not warrant any broader propositions."

Lord Jauncey of Tullichettle said, at p. 662:

> "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."

A different conclusion was reached in *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295* . The plaintiffs in that action made a bid for another company, F.C.E. The initial bid was made in reliance upon the accounts of F.C.E. which had been audited by the second defendant, Judkins. Further statements were made by F.C.E. and its advisers in defence documents seeking to defeat the plaintiffs' take-over bid. The plaintiffs increased their bid and succeeded in purchasing F.C.E. Thereafter the plaintiffs began the action alleging that the audited accounts and the post-bid statements which in part referred to those accounts were all misleading, and that F.C.E. was worth much less than they had paid for its shares. Hoffmann J., following the decision in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* , held that the claim, whether as originally pleaded or as proposed to be amended, was bound to fail. He therefore disallowed the amendment.

The *Court of Appeal [1991] Ch. 295* allowed the plaintiffs' appeal, so far as the post-bid statements were concerned. I quote three passages from the judgment of the court delivered by Slade L.J., beginning at p. 318:

> "As we read the decision in *Caparo's* case, what their Lordships regarded as the crucial, fatal weakness in the plaintiffs' case, which negatived the existence of a relationship of proximity, was the fact that the relevant statement by the auditors *had not been given for the purpose for which the plaintiff had relied on it* ."

In a passage dealing with the case against F.C.E.'s directors Slade L.J. said, at pp. 319–320:

> "Their Lordships in *Caparo's* case regarded the purpose of the statutory requirement for an audit of public companies under the Companies Act 1985 as the making of a report to enable shareholders to exercise their class rights in general meeting — not as extending to the provision of information to assist shareholders or others as to the making of decisions as to the future investment in the company. These, as we read the decision in *Caparo's* case, were the essential elements of its ratio by which the plaintiffs' claim on the facts of that case were held to be untenable. In these circumstances, we are of the opinion that it is at least arguable that the present case can be ***1381*** distinguished from *Caparo's* case on its assumed facts. On such facts, each of the directors, in making the relevant representations, was aware that Morgan Crucible would rely on them for the purpose of deciding

> whether or not to make an increased bid, and intended that they should; this was one of the purposes of the defence documents and the representations contained therein. Morgan Crucible duly did rely on them for this purpose. In these circumstances, subject to questions of justice and reasonableness, we think it plainly arguable that there was a relationship of proximity between the directors and Morgan Crucible sufficient to give rise to a duty of care — particularly bearing in mind that, while Morgan Crucible had their own independent advisers, much of the information on which the accounts and profit forecast was based was presumably available to the defendants alone."

Dealing with the case against Judkins, the auditors, Slade L.J. said, at p. 324:

> "Once again, it may be of critical importance for the trial judge to consider in the context of duty of care and proximity whether Morgan Crucible could reasonably have regarded themselves as persons to whom the relevant representations were directly or indirectly addressed. For present purposes, however, we think it will suffice to say that in our judgment Morgan Crucible, on their proposed pleadings and the assumed facts, have established an arguable case as to duty of care for the same reasons (mutatis mutandis) as those relating to the directors in the case of the financial statements and the same reasons (mutatis mutandis) in [relation] to the directors and Hill Samuel in the case of the profit forecast."

It follows from that decision that an accountant and auditor of a company may owe a duty of care to a take-over bidder if he approves a statement which confirms the accuracy of accounts which he has previously audited or which contains a forecast of future profits, when he has expressly been informed that the bidder will rely on the accounts and forecast for the purpose of deciding whether to make an increased bid, and intends that the bidder should so rely.

We were also referred to decisions of Millett J. in *Al Saudi Banque v. Clark Pixley [1990] Ch. 313* and of Mervyn Davies J. in *Al-Nakib Investments (Jersey) Ltd. v. Longcroft [1990] 1 W.L.R. 1390* .

In the *Al Saudi Banque case [1990] Ch. 313* the judgment was given on 28 July 1989, after the decision of the *Court of Appeal in Caparo Industries Plc. v. Dickman [1989] Q.B. 653* but more than six months before the *House of Lords gave its decision in that case [1990] 2 A.C. 605* . Al Saudi was one of 10 banks which made loans to a company. The defendants were the company's auditors, who had audited the annual accounts for three years before the company was compulsorily wound up, with an estimated deficiency of £8,600,000. The banks, in the action, alleged that the defendants ought reasonably to have foreseen that the banks would rely on the accuracy of the auditors' reports in deciding whether to continue, renew or increase their advances to the company, and thus that the defendants owed the banks duties of care of which they were in breach. The breach was that the reports did not give a full and accurate account of the company's affairs.

Millett J. held that the banks were not in the position of shareholders, to whom the auditors owed a statutory duty to report; and that since the ***1382** auditors did not know that the company intended to supply the audited accounts to the banks they were under no such duty of care. *Lord Bridge inCaparo Industries Plc. v. Dickman [1990] 2 A.C. 605* , 623E described Millett J.'s rejection of the bank's claim as emphatic and convincing, Lord Oliver referred to Millett J.'s judgment with approval and Lord Jauncey said he had no doubt it was correctly decided.

Al-Nakib Investments (Jersey) Ltd. v. Longcroft [1990] 1 W.L.R. 1390 , which was decided after the House of Lords had given the decision in the *Caparo Industries case [1990] 2 A.C. 605* , was an application of the principles derived from that decision, and I therefore do not find it necessary to make more detailed reference to it.

The distinction between the set of facts which it was held in *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295* would suffice to establish a duty of care owed by auditors from those facts which it was held in the *Caparo Industries case [1990] 2 A.C. 605* would not have this effect is inevitably a fine one. In my judgment that distinction may be expressed as follows. Mere foreseeability that a potential bidder may rely on the audited accounts does not impose on the auditor a duty of care to the bidder, but if the auditor is expressly made aware that a particular identified bidder will rely on the audited accounts or other statements approved by the auditor, and intends that the bidder should so rely, the auditor will be under a duty of care to the bidder for the breach of which he may be liable.

I therefore turn to apply these principles to the issues in Hillsdown's appeal and B.G.M.'s cross-appeal.

Issue 2: Loss resulting from the original purchase by Hillsdown of the shares in Gamine.

This is the subject of the defendants' cross-appeal. In his judgment, the deputy judge referred to the terms of the acquisition agreement, which was permissible even though he was not entitled to refer to evidence, because that agreement was specifically referred to (though the whole of it was not included by reference) in the statement of claim. The deputy judge also referred to, but apparently did not rely upon, some correspondence. The statement of claim referred to (though did not quote in full) all or almost all the relevant terms of the acquisition agreement. Paragraph 10 summarised inter alia the following clauses in the agreement:

> "3.1. The purchase consideration … shall be such sum as equals 5.2 times the net profits of [Gamine] as reflected in the completion accounts, which term includes the audited accounts of Galoo and Gamine for the year ended 31 December 1986.
>
> 4.1. The parties shall jointly procure as soon as practicable and in any event within 90 days of the date of completion the preparation of the completion accounts which shall be … audited by [B.G.M.].
>
> 4.3. [B.G.M.] shall circulate the net profits and the shareholders' funds from the completion accounts and shall deliver to the vendors and [Hillsdown] copies of the completion accounts and a statement setting out the net profits and shareholders' funds."

In addition the statement of claim sets out the terms of a letter written by B.G.M. to Hillsdown dated 25 March 1987 which accompanied what were described as "A copy of the consolidated accounts of the above company for the year ended 31 December 1986." As I have already said, this was the letter in which B.G.M. informed Hillsdown that the net ***1383** profits of Gamine for the year ended 31 December 1986 were £650,944 and the shareholders' funds £1,809,004, and that the shareholders' funds of Galoo at the same date were £3,486,518. It is clear that the letter constituted a representation that not merely what was said in the letter itself but also the audited accounts gave an accurate account of the state of the company's affairs.

Paragraph 13 of the statement of claim expressly pleads:

> "At the time of making the above representations and when they audited the accounts of [Galoo and Gamine] for the year ended 31 December 1986, the defendants knew of the existence and terms of the acquisition agreement. They accordingly knew that:
>
> (i) the amount of the purchase consideration payable by [Hillsdown] to the vendors under the acquisition agreement was to be calculated by reference to the accounts of [Galoo and Gamine] for the year ended 31 December 1986 and as a multiple of the net profits of [Gamine] for that year as calculated and stated by B.G.M.; and
>
> (ii) if the net profits as shown by the completion assets were less than £500,000 and/or if the shareholders' funds in [Galoo] were less than £2,150,000 and if the capital and reserves in Gamine were less than £1,080,000 the vendors would be in breach of warranty towards [Hillsdown]."

When dealing with this issue in his judgment, the deputy judge said:

> "It is therefore plain that the 1986 audited accounts were to be prepared not only for the purposes of the audit but also for the purpose of fixing the purchase consideration under this agreement. It is common ground that the defendants knew of the terms of this agreement and that the accounts that they were to submit to the purchasers were to be for the purposes of those provisions. In those circumstances, the case is immediately, on its face, taken outside the *Caparo* principles by reason of those matters."

In my view that reasoning is entirely correct.

However, two further arguments were advanced to the deputy judge and are now advanced to us by Mr. Hunter for B.G.M. as to why nevertheless this part of the plaintiffs' claim should also be struck out.

The first point made by Mr. Hunter is that the accounts submitted to Hillsdown by B.G.M. with their letter of 25 March 1987 were no more than draft accounts. The final accounts were not approved or signed on behalf of the respective companies until after Hillsdown's purchase of the shares in Gamine had been completed. The deputy judge said of this point:

> "True it is that they were or may have been draft accounts, but it is plain to me that they were being treated as the accounts submitted for the purposes of clause 4 of the agreement … and it has not been suggested that any subsequent accounts were supplied for that purpose. Therefore, to put it no higher, it is plainly arguable (and indeed it appears to me to be the case as I have said) that those accounts were treated as completion accounts, whether they were, in fact, draft accounts or not."

I note that the statement of claim does not say that these accounts were draft accounts. The letter of 25 March 1987 describes them as "The consolidated accounts of the above company for year ended 31 December 1986." It would thus be necessary to introduce evidence to show that they ***1384*** were draft accounts. But quite apart from that, it is to my mind clearly arguable that the accounts submitted with the letter of 25 March 1987 were intended to be the completion accounts upon which the calculation of the purchase price of the shares then being purchased by Hillsdown was to be made. I entirely agree with the deputy judge's conclusion on this issue.

The second point made by Mr. Hunter is that clause 4.1 of the acquisition agreement specifically gave to Hillsdown's accountants the right to have full access to the books of the companies and to receive full information, together with the right

to review the completion accounts within 28 days of them being delivered to Hillsdown. Moreover clause 4.6 provided a mechanism for resolving any dispute with respect to the completion accounts or the statement referred to in clause 4.3 by a nominated firm of chartered accountants.

The statement of claim does not set out the full wording of these clauses of the acquisition agreement, but clearly it would not be right to allow a pleading which had not set out the full terms of a clause in an agreement to stand if, once the full terms were taken into account, the pleading should be struck out.

In dealing with this submission, the deputy judge quoted the passage from the speech of Lord Oliver in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* , 638 which I have quoted above, in which Lord Oliver set out the principles to be deduced from *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465* . To recapitulate, the third principle Lord Oliver described was *[1990] 2 A.C. 605* , 638: "it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose *without independent inquiry* ." (Emphasis added.)

Mr. Hunter relied on this passage for the proposition that the opportunity provided by clause 4.1 of the acquisition agreement for Hillsdown's accountants to make such independent inquiry meant that there could be no duty of care on B.G.M.

The deputy judge said of this submission:

> "Although that may be right and may prove to be right, it seems to me that the completion accounts were being prepared specifically for the purpose of determining the amount of the purchase consideration. The function of the purchasers' accountants was not necessarily precisely similar to that of the defendants'. It may require evidence as to what was the contemplated function of the purchasers' accountants and what the contemplated 'review' would have involved, but it seems to me, to put it no higher, well arguable that the review which the purchasers' accountants were to carry out would not be the same exercise as the preparation of the completion accounts which the defendants were to carry out. Clearly the purchasers' accountants would not, for example, be in as good a position as the defendants would have been to calculate the value of the stock as at 31 December 1986, which date by then would, of course, necessarily have passed. It may be that the evidence will reveal that matters which would or should have been discovered by the defendants on an audit close to that date could not have been apparent to the reviewing accountants some time later. This is, I think, a matter which requires evidence and, in those circumstances, I am not prepared to strike out the claims so far as they are based upon losses flowing from the payment of the consideration under the acquisition agreement."

1385 I entirely agree with that reasoning. For those reasons I would dismiss the cross-appeal.

Issue 3: The loss to Hillsdown resulting from making the loans to Gamine

It will be remembered that paragraph 9A of the amended statement of claim specifically pleads:

> "The defendants knew or ought to have known from the date of the acquisition agreement onwards that …
>
> (iii) [Hillsdown] were obliged, at the option of the remaining shareholders in [Gamine] to acquire their shares in [Gamine] at a price to be fixed by reference to accounts which could be audited only by [B.G.M.] …

> (v) [Hillsdown] were using [B.G.M.'s] accounts and audit work in their consideration of the existing lending to and/or the making of further advances to [Galoo and Gamine].”

It will be seen that the statement of claim does not plead that B.G.M. knew that Hillsdown would rely on the audited accounts for the purpose of making further loans, nor that B.G.M. intended that Hillsdown should so rely.

The deputy judge said that in his view the situation pleaded was indistinguishable from that contemplated in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* and which was before Millett J. in *Al Saudi Banque v. Clarke Pixley [1990] Ch. 313* . He set out the argument advanced to him by Mr. Bennett, for the plaintiffs, that B.G.M. knew that the purpose of the acquisition by Hillsdown of the first tranche of shares was the advancement of the business of Galoo and Gamine, that loans and advances were likely to be made, and that as auditors they would know in any particular year that loans had been made in the preceding years. He therefore argued that one of the purposes of auditing the accounts was the vouching of the fact that the companies were solvent.

The deputy judge said of that argument:

> “Those matters as it seems to me, go to foreseeability and only to foreseeability and they do not establish the degree of proximity that is, on the authorities, required. At the end of the day, it seems to me that it is not shown to be pleaded that any particular loan was made in reliance upon a particular set of accounts or that the defendants promulgated any set of accounts for the purpose of any specific loan or indeed for the purpose of loans at all, and the mere fact of the knowledge that loans would or might be made is not sufficient to create that degree of proximity. Accordingly, the cause of action in respect of the loans is in my judgment obviously unsustainable.”

On this issue also I agree with the deputy judge. As I have said, the statement of claim does not plead the facts which in *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295* were held to be those necessary in order to establish a duty of care, namely that the auditor knew that the intending lender would rely on the accounts approved by the auditors for the purpose of deciding whether to make the loans or increase loans already made, and intended that the intending lender should so rely. In other words I agree with the deputy judge that the statement of claim does not set out facts which establish a duty of care in this respect on the principles derived from *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* , *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295* and the earlier decision of Millett J. in *Al Saudi Banque v. Clark Pixley [1990] Ch. 313* .

Issue 4: The amounts paid under the supplemental agreement for the further 44.3 per cent. of the shares in Gamine and the £30,000 paid to Mr. Sanders for loss of office

So far as is relevant to this claim, the statement of claim pleads in paragraph 9(ii) that B.G.M. owed duties in tort to Hillsdown, as shareholders of Gamine, in auditing Gamine's accounts for each of the years 1986–90. The same duty of care is again pleaded in paragraph 14. Paragraph 11 reads:

> “The acquisition agreement further provided … that, if the vendors so elected, [Hillsdown] would be required to purchase the remaining shares in [Gamine] in annual tranches and that the price payable for each such tranche of shares was to be calculated by reference to the pre-tax earnings of [Gamine] for the relevant year as shown by the accounts in that year, which accounts were to be prepared and audited by the defendants.”

The same point is made in paragraph 9A(iii) which I have set out above.

Finally, in paragraph 20(iv) it is pleaded that Hillsdown would not have entered into the supplemental agreement and would not have paid the sum of £967,000 thereunder or any part thereof and would not have paid Mr. Michael Sanders the sum of £30,000 if B.G.M. had performed their duties properly and with reasonable professional care and skill.

It should be noted that the purchase by Hillsdown of 44.3 per cent. of the shares in Gamine under the supplemental agreement was a purchase under a new agreement, not in accordance with the provision in the acquisition agreement under which Hillsdown could be required to purchase the remaining shares in Gamine in annual tranches. If the original terms of the acquisition agreement had been followed, the price for the annual tranches would specifically have been calculated by reference to the earnings of Gamine for relevant years, as shown by the audited accounts. If that had been the case, then the purchase of the remaining shares would probably have been in precisely the same position as the purchase of the original 51 per cent. of the shares. In other words, it might then well be arguable that the statement of claim did disclose a duty of care owed by B.G.M. to Hillsdown, which at least would be dependent upon the determination of facts. Thus had the original agreement been followed, it would probably not have been right to strike out this part of the claim.

But it is not pleaded that B.G.M. knew when auditing the accounts or supplying them that Hillsdown would rely upon those accounts, nor that B.G.M. intended that they should so rely, for the purpose of calculating the purchase price under the supplemental agreement. Thus again in my view the pleaded facts do not establish a duty of care on B.G.M. in relation to this issue.

In his judgment on this issue, the deputy judge said:

> "Had further purchases of shares taken place in accordance with those provisions, then it is clear to me that, subject to an argument which might flow from the fact of the audit being carried out both by the company's accountants and the purchasers' auditors, the same considerations as applied in the case of the original acquisition would ***1387** here obtain, because the defendants would be aware that the accounts were being relied upon for the purpose of fixing the price of the shares under this agreement; not, it should be said, for the purpose of determining the wisdom of an acquisition of shares under this agreement, but simply for the purpose of determining the price. However, it is common ground, and it emerges from the pleadings, that the subsequent purchase of shares took place in 1991 was not a purchase in accordance with the provisions of this agreement. What happened was that in 1991 there was a different agreement entered into in relation to the sale of 44.3 per cent. of the shares in the second plaintiff. The consideration for the sale of those shares was, I was told, £967,000 and it is not alleged that that sum was fixed by reference to any formula or by reference to any set of accounts."

I agree with the deputy judge on this issue also, and for the reasons I have briefly explained I would therefore uphold his judgment in relation to this issue.

Conclusion

In summary therefore I conclude that the deputy judge's decision on each of the issues before him was correct. I would therefore dismiss both the appeal and the cross-appeal.

Evans L.J.

I agree entirely with the judgment of Glidewell L.J. that both the appeal and the cross-appeal should be dismissed. With regard to the cross-appeal, I add my express agreement with the passage from the judgment of the deputy judge which Glidewell L.J. has quoted, in which he stated his reasons for holding that the claim in tort, for losses caused by reliance (as is alleged) upon representations made in or by reference to the completion accounts, at the time of the original purchase, should not be struck out. What he emphasised, rightly in my view, is that this allegation is one which should proceed to trial. It cannot be said as a matter of law at this interlocutory stage that the pleaded facts are necessarily insufficient to give rise to a cause of action. To this extent, the claim may be one which has more in common with the one which was allowed to proceed to

trial in *Morgan Crucible Co. Plc. v. Hill Samuel & Co. Ltd. [1991] Ch. 295* than with the allegation of reliance on audited accounts, prepared by a company statutory auditors and published by them to shareholders, which was struck out in *Caparo Industries Plc. v. Dickman [1990] 2 A.C. 605* .

Permitting this allegation to proceed to trial does not mean that the duty of care, which is alleged to have been broken, will necessarily be held to have arisen from whatever facts are established by evidence at the trial. A distinction between the *Morgan Crucible* and the *Caparo* situations has to be drawn, and the line of demarcation is unclear. Whether the claim succeeds or not will depend upon not only the plaintiff proving the facts which it alleged, but also the extent to which Hillsdown's right to review the completion accounts negatives the duty of care which they allege.

The plaintiffs do not refer to that aspect of the matter in the amended statement of claim, and rightly so. But if the evidence shows that this "right of intermediate examination" excludes any duty of care which might otherwise arise, the claim will fail. That is why evidence is necessary. If it were necessary to decide this issue on the basis of the plaintiffs' pleaded facts, then I would be inclined to the view that Hillsdown, who were ***1388** known to be advised by an international firm of accountants and auditors and who would have full access to the company's books, would not be likely to rely upon statutory accounts, draft or otherwise, prepared by the defendants, when deciding whether or not to bid for the company, and if so at what price. But no conclusion can be reached without drawing inferences in the defendants' favour, and that in my judgment it would be wrong to do at this interlocutory stage.

It is tempting to distinguish between the *Caparo case [1990] 2 A.C. 605* and the *Morgan Crucible case [1991] Ch. 295* on the basis that in the latter, though not the former case, the identity of a particular purchaser of shares in the company was known to the defendants when they represented that the company's accounts which they had prepared were fair and true. This excludes individual members of the body of existing shareholders to whom the statutory accounts are published (the *Caparo* case), whilst including an identified take-over bidder, as in the *Morgan Crucible* case. But there could be intervening situations, for example, where an existing shareholder is known to be a potential purchaser of more shares, with a view to acquiring the whole or a majority of the shares. The identification test would not provide the answer in such a case. No duty of care would be owed to such a person, in my judgment, on those facts alone, because the third of the four propositions listed by Lord Oliver in the *Caparo case [1990] 2 A.C. 605* , 638D, already quoted by Glidewell L.J., as it was by Slade L.J. in the *Morgan Crucible case [1991] Ch. 295* , 318, would not be satisfied: "(3) it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry," and, vitally, it could not be said that the auditors in such a case "intended that they should act" upon it, for that purpose": *per* Slade L.J. in the *Morgan Crucible case [1991] Ch. 295* , 320A.

If it is right to confine the duty of care, meaning, to restrict the class of persons who can recover damages if the adviser/representor is negligent, to cases where the defendant is shown not merely to have known that the individual plaintiff would or might rely upon the representation but to have intended that it should be relied upon, by him and for the particular purpose and without intermediate examination, then the resulting analysis comes close to the "voluntary assumption of responsibility" which has been referred to in many of the authorities but which was discounted as a test of liability in *Smith v. Eric S. Bush [1990] 1 A.C. 831* , 862, *per* Lord Griffiths:

> "…. I do not think that voluntary assumption of responsibility is a helpful or realistic test for liability. It is true that reference is made in a number of the speeches in *Hedley Byrne [1964] A.C. 465* to the assumption of responsibility as a test of liability but it must be remembered that those speeches were made in the context of a case in which the central issue was whether a duty of care could arise when there had been an express disclaimer of responsibility for the accuracy of the advice …. The phrase 'assumption of responsibility' can only have any real meaning if it is understood as referring to the

> circumstances in which the law will deem the maker of the statement to have assumed responsibility to the person who acts upon the advice."

Lord Devlin referred in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C. 465* , 530 to "a relationship equivalent to contract" and it is ***1389*** clear from Lord Griffiths's speech in *Smith's case [1990] 1 A.C. 831* , 862 that the contractual analogy cannot serve as a definition of the cases where the duty of care may arise. But if the statement is made to an identifiable person and the maker not only knows that it will or is likely to be acted upon but also intended that it should be acted upon for a particular purpose, then these may well exemplify "circumstances in which the law will deem the maker of the statement to have assumed responsibility" to the person who acts upon it: per Lord Griffiths, at p. 862E. The "indeterminate class" of persons referred to by Cardozo C.J. in *Ultramares Corporation v. Touche (1931) 174 N.E. 441* , 444 is thus reduced to an inter-personal relationship where liability may be imposed, and it would seem unreasonable and even unjust to do so, in my view, if the defendant could not be said to have assumed responsibility towards the plaintiff, not necessarily as an individual, in the circumstances of the case. It is sufficient for present purposes to note that the relationship by definition must be "voluntary" in the sense that no consideration proceeds from the plaintiff for the defendant's advice.

Nor is it necessary to decide finally whether the facts alleged in the amended statement of claim are sufficient of themselves to establish liability, because that will depend also on the significance of the plaintiffs' right to review the completion accounts, which as already stated in my judgment is an issue fit for trial.

WAITE L.J.

I agree that the appeal and the cross-appeal should be dismissed for the reasons given in both judgments.

23 May 1994. The Appeal Committee of the House of Lords (Lord Goff of Chieveley, Lord Browne-Wilkinson and Lord Mustill) dismissed a petition by the first and second plaintiffs for leave to appeal.

J. K.

Representation

Solicitors: Biddle & Co.; Squire & Co.

Appeals of first and second plaintiffs dismissed with costs, to be taxed and paid forthwith. Appeal of third plaintiff and cross-appeal dismissed with costs. Leave to appeal refused.