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SEMINAR

PROFESSIONAL RESPONSIBILITY

PART TWO

Paper presented by

The Honourable Mr Justice Rogers
A Judge of the Supreme Court of New South Wales

and Commentaries on Papers published in Part One

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FOREWORD

Volume 2 of the papers presented at the Professional Responsibility Seminar comprises the overview presented by Mr Justice Rogers and commentaries on the papers published in Volume 1.

Mr Justice Rogers' paper differs slightly from the text presented at the seminar. In the time between the seminar and publication the New South Wales Court of Appeal has delivered its decision on the appeal from the decision of Mr Justice Rogers in *Cambridge Credit Corporation Limited v Alexander* (1983) A.C.L.R. 123; (1983) A.C.L.R. 513. His Honour has very kindly expanded his paper slightly to include this decision.

The commentaries mirror the uniformly high standard of papers delivered to the seminar. They present interesting and often practical perspectives of the situations and principles which are the subject of the papers.

*B.D. Gray*
*Seminar Convener*
## CONTENTS

### PART 2

<table>
<thead>
<tr>
<th>Paper</th>
<th>Title</th>
<th>Author(s)</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td></td>
<td>Mr B.D. Gray</td>
<td>V</td>
</tr>
<tr>
<td>Paper</td>
<td>Professional Responsibility: An Overview</td>
<td>The Honourable Mr Justice Rogers</td>
<td>255</td>
</tr>
<tr>
<td>Commentaries on</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paper One</td>
<td>Conflicts of Interest and Professionals</td>
<td>Dr Paul Finn</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr John C. Hagen</td>
<td>291</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr A.A. Lusk</td>
<td>303</td>
</tr>
<tr>
<td>Paper Two</td>
<td>Insider Trading</td>
<td>Dr Barry Rider</td>
<td>49</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr William Wilson</td>
<td>315</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr Carl Peterson for Mr David Belcher</td>
<td>321</td>
</tr>
<tr>
<td>Paper Three</td>
<td>The Tax Adviser: Responsibilities and Liabilities of the Professions</td>
<td>Dr Anthony Molloy Q.C.</td>
<td>111</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr R.J. Hoare</td>
<td>329</td>
</tr>
<tr>
<td>Paper Four</td>
<td>Liability of Accountants and Providers of Financial Services and the Effect of Qualifications and Disclaimers</td>
<td>Dr Robert Chambers</td>
<td>141</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr A.N. Frankham</td>
<td>339</td>
</tr>
<tr>
<td>Paper Five</td>
<td>Liability and Immunity of Arbitrators, Engineers, Certifiers, Dispute Settlers</td>
<td>Associate Professor Ian Eagles</td>
<td>171</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mr R.P. Carter</td>
<td>359</td>
</tr>
<tr>
<td>Paper Six</td>
<td>Liabilities of Receivers, Liquidators, Investigators and Inspectors</td>
<td>Mr Peter Blanchard</td>
<td>229</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ms Elizabeth Hickey</td>
<td>367</td>
</tr>
</tbody>
</table>
PROFESSIONAL RESPONSIBILITY:
AN OVERVIEW

The Honourable Mr Justice Rogers

Mr Justice Rogers is President of the Commercial Causes Court, New South Wales.
INTRODUCTION
The last thirty years have witnessed an exponential increase in the width of liability of professionals. Only in this period did it become clear that a duty is owed by a professional not just to persons with whom there is a contractual relationship but also to some third parties. It is now accepted that liability may flow in respect of words negligently uttered causing purely economic loss. A cause of action may be located in contract or in tort and even for breach of fiduciary duty. The perception that concurrently a cause of action may be available to a client both in contract and in tort is a relatively recent arrival where the professional is not engaged in a common calling. A discussion of this evolution and the problems attending it may be a convenient central point around which an examination of some of the problems posed in this field of discourse may be treated. Since I wrote this paper there has been published a most perceptive analysis of many of these problems in an article by Mason QC, "Contract and Tort; Looking Across the Boundary from the Side of Contract" (61 ALJ 228).

CONCURRENT DUTY IN CONTRACT AND IN TORT
Until the last decade or so, it was generally accepted and, it would appear, mistakenly so, that, apart from the duty
owed by a professional person to a client arising from contract, there was no duty in tort (Groom v Crocker [1939] 1 KB 194). The contrary view was recognised in England in the judgment of Lord Denning MR in Esso Petroleum Co Limited v Marton [1976] QB 801 at 809. The validity of the earlier perception was then thought to be conclusively and finally exploded in England by Oliver J in Midland Bank Trust Co Limited v Hett Stubbs & Kemp [1979] 1 Ch 384. As his Lordship demonstrated, the decision in Groom v Crocker (supra) could not hope to survive the judgments in Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465. It defied logic and common sense that a professional person should be held liable in tort to persons with whom he had no contractual relationship, say a solicitor acting gratuitously, but not liable in tort for the self same act of negligence to a client with whom there is a contractual relationship.

The acceptance of the existence of a dual obligation has had a tortured history in countries drawing on English jurisprudence.

In New Zealand, in McLaren Raycroft & co v Fletcher Development Co Limited [1973] 2 NZLR 100 it was held that an action for professional negligence between client and solicitor lay only in contract. In Gartside v Sheffield [1981] 2 NZLR at 553, 554 Thorpe J was not entirely convinced and the decision was questioned in Rowe v Turner.
Hopkins & Partners [1982] 1 NZLR 178. The Court of Appeal referred to McLaren Raycroft as requiring reconsideration. In Allied Finance v Haddow & Co [1983] NZLR 22, the Court of Appeal seems to have accepted without expressly deciding that a solicitor owed a duty of care to his client in tort (see McMullen J at 34, 35). It would seem likely that when the time comes for the issue to be squarely faced that concurrent liability will be accepted.

By majority, the Full Court in Queensland in Aluminium Products (Qld) Pty Limited v Hill 1981 Qd R 33 accepted the reasoning of Oliver J. There was, however, a very penetrating and exhaustive review of the authorities by the dissentient, Connolly J. He rejected the statement by Denning MR in Esso Petroleum (supra) that decisions of the last century supported the notion of the existence of concurrent duties in contract and in tort. In Victoria, Oliver J's view was followed by the majority (Murphy J dissenting) in Macpherson Kelley v Kevin J Prunty & Associates [1983] 1 VR 573.

In the New South Wales Court of Appeal, in Simonius Vischer & Co v Holt & Thompson [1979] 2 NSWLR 322, Hutley JA expressed his preference for the rule in Groom v Crocker but Samuels JA concluded that the question was still open. In New South Wales it seemed that the battle was won after the decision of the Court of Appeal in Brickhill v Cooke [1984] 3 NSWLR 396. The judgment of the Court was delivered by
Glass JA and he was of the opinion that an engineer could be sued by his client both in contract and in tort. As Glass JA said at p 401:

"Since doctors and dentists have always been subject to a dual liability in tort and contract one would suppose that the ruling in Groom v Crocker was influenced by the belief that a plaintiff able to prove financial loss only could not succeed in negligence."

However, in Hawkins v Clayton [1986] 5 NSWLR 109 the Court of Appeal again left open the question whether there were concurrent duties in contract and in tort owed to the plaintiff. The High Court granted special leave to appeal and judgment has been reserved.

In South Australia, the Full Court adapted the modern view in Sacca v Adam & R Stuart Nominees Pty Limited (1983) 33 SASR 429.

The Supreme Court of Ireland accepted the new principle with the pungent comment: "For the same default there should be the same cause of action (Finlay v Murtagh 1979 IR 249 at 257).

In Canada, also, after a false start in J Nunes Diamonds Limited v Dominion Electric Protection Co (1972) 26 DLR (3d) 699 the Supreme Court has in Central Trust Co v Rafuse (1987) 31 DLR (4th) 481 decisively come down in favour of the existence of a concurrent liability. The summary of principle (supra p 521-522) deserves to be quoted at least
in part:

"What is undertaken by the contract will indicate the nature of the relationship that gives rise to the common law duty of care, but the nature and scope of the duty of care that is asserted as the foundation of the tortious liability must not depend on specific obligations or duties created by the express terms of the contract. It is in that sense that the common law duty of care must be independent of the contract. The distinction, in so far as the terms of the contract are concerned, is, broadly speaking, between what is to be done and how it is to be done. A claim cannot be said to be in tort if it depends for the nature and scope of the asserted duty of care on the manner in which an obligation or duty has been expressly and specifically defined by a contract. Where the common law duty of care is co-extensive with that which arises as an implied term of the contract it obviously does not depend on the terms of the contract, and there is nothing flowing from concurrent or alternative liability in tort. The same is also true of reliance on a common law duty of care that falls short of a specific obligation or duty imposed by the express terms of a contract.

A concurrent or alternative liability in tort will not be admitted if its effect would be to permit the plaintiff to circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort. Subject to this qualification, where concurrent liability in tort and contract exists the plaintiff has the right to assert the cause of action that appears to be most advantageous to him in respect of any particular legal consequence."

What courts have not yet resolved are the difficult questions which follow from such acceptance. The existence of a concurrent duty has been said to impact in a number of different areas. Differences can arise depending on whether the action is laid in contract or in tort in a number of respects.

There is great good sense in the words of the Supreme Court
of Canada in *Central Trust Co v Rafuse* (supra) where Le Dain J, delivering the judgment of the Court, said (p 489):

"The three most important areas in which these differences have been reflected in the decisions on the question of concurrent liability are limitation of actions, measure of damages and apportionment of liability. Although there has been an increasing judicial disposition to apply similar rules, or at least to reach similar results, with respect to these issues under the two kinds of liability, there are likely to remain differences of result in certain cases flowing from inherent differences between contract and tort. Although an assimilation of the rules or results under the two kinds of liability has been advocated as one response to the issue of concurrent liability, the question is unlikely to be rendered wholly academic by this clearly discernible development in the law. It has been the important difference of result, particularly in the three areas referred to, that has given the question of concurrent liability its policy focus and interest in the abundant judicial and academic opinion on the subject."

The most frequent question so far has probably been the easiest to accommodate. Plaintiffs have been permitted to sue their erstwhile professional advisers in tort thereby postponing the commencement of the limitation period. That question was the occasion for the seminal judgment of Oliver J in *Midland Bank* (supra). However, even in this relatively uncomplicated field the courts have not been comfortable.

**SCOPE OF DUTY**

The threshold problem confronting those accepting the notion of concurrent liability relates to the scope of duty in tort. As Le Dain J pointed out, a tortious duty of care will not spring from specific obligations created by express terms of a contract. A duty of care in tort might be co-
extensive with duty arising from an implied term of a contract. In theory, it is possible to imagine an express term of a contract for an audit that requires the auditor to discharge his duties with all due care and skill. In actual practice, the statement of principle by Le Dain J is accurate.

It would have been just as irrational to allow unrestricted liability in tort without reference to contractual obligations as it was to deny altogether the availability of a tortious remedy. This was clearly and emphatically recognised by Lord Goff, then still a member of the Court of Appeal, in *Leigh & Sullivan Limited v Aliakmon Shipping Co Limited* [1985] 1 QB 350. Indeed, as his Lordship made clear, rather than to permit a result which allowed for liability unrestricted by contract, he would prefer to reject altogether the notion of liability in tort. The facts were most unusual. The buyer of goods sued the owners of a vessel, that was under a time charter, for the loss caused by damage to the goods as the result of bad stowage. Lord Brandon explained in the House of Lords ([1986] 1 AC 785) that the parties had changed the ordinary c and f contract so that the sale was ex warehouse but the risk in the goods during their carriage by sea remained with the buyers as if the sale had a c and f basis. The Court of Appeal held that the buyers did not have a right of action in contract against the shipowners because ownership had not passed to the buyers as required by the Bills of Lading Act
and that there was no implied contract with the shipowners arising from the buyers having taken delivery of the goods upon presentation of the bill of lading because the buyers did so as the agents of the sellers under their agreement with the latter. A majority of the Court held that the buyers did not have a right of action in tort against the shipowners because they were not the owners and did not have a right to immediate possession of the goods at the time the damage occurred. The majority gave as a further consideration that to admit a liability in tort in such a case would be to impose on the shipowners a greater liability than they had under the Hague Rules in the contract of carriage. The majority were of the view that, as a matter of legal principle, a tortious duty of care in such a case could not be made subject to the contractual provisions limiting liability. I am not sure that I understand what principle it is that would be violated. Why may the duty not be imposed in tort subject to the restriction imposed by the parties? Tortious liability could still have an important role to play, eg with respect to the limitation of action.

Robert Goff LJ, who was the dissentient in the Court of Appeal, and whose approach to the problem was rejected by the House of Lords, sent out this warning (p 396):

"This is therefore a case where, if the buyers are to have a direct right of action against the shipowners, they will do so by reason of a breach of duty owed by the shipowners to the goods' owner in respect of the care of goods entrusted to them for carriage under a contract contained in or evidenced

264
by a bill of lading. Indeed the case can be simplified into one in which A breaks his duty to B, and the question is whether a third party, C, can proceed directly against A in respect of damage thereby suffered by him. In such circumstances (and in this I find myself differing from Lloyd J in *The Irene’s Success* [1982] QB 461) it seems to me unthinkable that, if C is to have a direct cause of action against A, that right of action should be uncontrolled by those provisions which regulate A’s liability to B. This is a reaction which, I consider, is felt particularly strongly in a case concerned with carriage of goods by sea. The vast majority of goods carried by sea are carried under bills of lading which incorporate, usually compulsorily, but if not compulsorily then by agreement, the Hague Rules; even in cases where the bill of lading remains a mere receipt, and the goods are carried under the terms of a charterparty, it is not unusual for the charterparty itself to incorporate the Hague Rules. It would be a most remarkable result if a shipowner were to contract to carry goods under a bill of lading incorporating the internationally accepted regimen embodied in the Hague Rules, and were then to find himself faced with a claim in tort for economic loss arising from damage to the goods in transit, brought by a receiver who was never party to the contract of carriage or owner of the goods while in transit, and who was able to prosecute his claim uninhibited by the provisions and exceptions in the bill of lading. If that were so, he could (for example) claim such damages on the basis of negligence of the master in the navigation of the ship; he could commence proceedings at any time up to six years after the date when the damage occurred; and he could assess his claim unrestricted by the limitation as to amount contained in the Hague Rules. If I were forced to conclude that the buyers in the present case, if able to proceed directly against the shipowners, could do so in that manner, I would unhesitatingly reject their argument."

However, Goff LJ took the view, and I suggest correctly, that there was no principle that stood in the way of his preferred approach. The same view was taken by Samuels JA in *Bright v Sampson & Duncan Pty Limited* [1985] 1 NSWLR 346 at 356.
Nonetheless, it is doubtful whether, at least in England, the law will develop along these lines. In *Tai Hing Cotton Mill Limited v Liu Chong Hing Bank Limited* [1986] 1 AC 80 the Privy Council said (p 107):

"Their Lordships do not believe that there is anything to the advantage of the law's development in searching for a liability in tort where the parties are in a contractual relationship. This is particularly so in a commercial relationship. Though it is possible as a matter of legal semantics to conduct an analysis of the rights and duties inherent in some contractual relationships including that of banker and customer either as a matter of contract law when the question will be what, if any, terms are to be implied or as a matter of tort law when the task will be to identify a duty arising from the proximity and character of the relationship between the parties, their Lordships believe it to be correct in principle and necessary for the avoidance of confusion in the law to adhere to the contractual analysis: on principle because it is a relationship in which the parties have, subject to a few exceptions, the right to determine their obligations to each other, and for the avoidance of confusion because different consequences do follow according to whether liability arises from contract or tort, eg in the limitation of action. Their Lordships respectfully agree with some wise words of Lord Radcliffe in his dissenting speech in *Lister v Romford Ice and Cold Storage Co Limited* [1957] AC 555. After indicating that there are cases in which a duty arising out of the relationship between employer and employee could be analysed as contractual or tortious Lord Radcliffe said, at p 587:

'Since, in any event, the duty in question is one which exists by imputation or implication of law and not by virtue of any express negotiation between the parties, I should be inclined to say that there is no real distinction between the two possible sources of obligation. But it is certainly, I think, as much contractual as tortious. Since in modern times the relationship between master and servant, between employer and employed, is inherently one of contract, it seems to me entirely correct to attribute the duties which arise from that relationship to implied contract.'"
Their Lordships do not, therefore, embark on an investigation as to whether in the relationship of banker and customer it is possible to identify tort as well as contract as a source of the obligations owed by the one to the other. Their Lordships do not, however, accept that the parties' mutual obligations in tort can be any greater than those to be found expressly or by necessary implication in their contract. If, therefore, as their Lordships have concluded, no duty wider than that recognised in Macmillan [1918] AC 777 and Greenwood [1933] AC 51 can be implied into the banking contract in the absence of express terms to that effect, the banks cannot rely on the law of tort to provide them with greater protection than that for which they have contracted."

It is indeed difficult to know how far their Lordships were intending to go. It seems unlikely in the extreme that they were intending to cast doubt on the correctness of the judgment of Oliver J in Midland Bank (supra) without ever addressing that decision in terms or indeed the decisions that followed it. The question of principle referred to does not generally arise because as a rule parties do not in their contract specifically advert to the particular obligation in question. The fact that different consequences may follow may improve the fairness of the result. The instance of limitation of actions is particularly unfortunate in that context as demonstrated by the facts of Midland Bank (supra) itself as well as Central Trust (supra) and numerous other decisions.

DISTRIBUTION OF LOSSES

The preponderance of judicial opinion favours the view that contributory negligence cannot be relied upon where the only action brought and the only cause of action is in contract
(cf Swanton, "Contributory Negligence as a Defence to Actions for Breach of Contract" (1983) 55 ALJ 278 p 283 et seq).

But what of the situation where the plaintiffs sue in both contract and in tort? The question has not been finally resolved. In England the answer at the present is thought to be in the negative (cf Basildon District Council v J E Lesser (Properties) Limited [1985] 1 QB 839; A B Marinetrans v Comet Shipping Co Limited [1985] 3 AER 442. Nonetheless, the argument to the contrary does not lack supporters.

Hobhouse J in Forsikring saktieselskapet Vesta v Butcher [1986] 2 AER 488 not only took the view that the defence is available but claimed to have the support of the English Court of Appeal in Sayers v Harlow UDC [1958] 2 AER 342 for his conclusion. Hobhouse J in turn was followed by Allicott J in Lipkin Gorman v Karpnale Limited (1986) 136 NLJ 659.

Each school has its academic supporters (cf 1986 CLJ 8 but contrast [1987] 1 LMCLQ 10). It would seem that textually the legislation will yield to either interpretation and ultimately the question will be resolved as a matter of policy. Indeed, that is how the question has been dealt with in Canada.

In Canadian Western Natural Gas Co v Pathfinder Surveys Ltd (1983) 12 Alta (2d) 135, the Alberta Court of Appeal held that the plaintiff could not frame an action in contract rather than in tort so as to avoid the application of
apportionment legislation. The Court took the view that, to avoid injustice in a case of concurrent liability, the action should be treated as an action in tort. Quite imaginatively, two other provincial Courts of Appeal in Canada have applied apportionment in contractual actions treating the principle of apportionment as part of the common law: Cosyns v Smith (1983) 146 DLR (3d) 622 and Doiron v La Caisse Populaire D'Inkerman Ltee (1985) 17 DLR (4th) 660. The judgment of the New Brunswick Court of Appeal in the last mentioned case was delivered by La Forest JA, then a member of that Court. He recognised that decisions supporting apportionment employed reasoning "sparse to the point of non-existence" (p 675) and that historically it was inappropriate to rely on the provisions of the contribution legislation. He also acknowledged (p 676) that the decisions relied upon by Professor Glanville Williams in "Joint Torts and Contributory Negligence" do not support the applicability of principles of contribution. He said (p 677) that equally there was neither authority nor underlying principle which required the extension into contract law of the absolutist tort theory for distribution of loss. He identified the origin of the rule in tort in the ethos of the 19th century. He went on (p 679):

"As 19th century judges responded to the ethos of their times, so must we to ours. Contribution is now consistent with prevailing theories of both the law and the market-place. And it meets our sense of fairness. In many situations, the fairest approach is to apply the now ordinary rules of contributory negligence. That is what the courts are asserting when they say that it is 'right'."

269
Fairness and justice are the concepts which ground the views of another division of the Court of Appeal of New Brunswick in Coopers & Lybrand v H E Kane Agencies Limited (1985) 17 DLR (4th) 695 in holding that apportionment applies. Of course, if this be a correct approach, then apportionment should be available across the field, even in actions purely in contract.

In Australia, in Meddick v Cotten (1984) 36 SASR 542, the trial judge held that contributory negligence had not been proved. However, White J went on to discuss the availability of the defence of contributory negligence and apportionment should his finding be disturbed.

Most recently, the authorities were reviewed by Bollen J in the Supreme Court of South Australia in Walker v Hungerfords (24 February 1986, unreported) and His Honour concluded that contributory negligence and apportionment were available. He also found that there was no negligence and, accordingly, his opinion was merely by way of obiter.

Probably the most that can be said is to echo the words of Samuels JA in Simonius Vischer & Co v Holt & Thompson [1979] 2 NSWLR 322 that the point remains open and arguable.

The question is discussed at length by Greig and Davis in their recent book "The Law of Contract" (1978) p 1403 et seq. The authors express the view (p 1405) that:
"The weight of authority favours the view that in these circumstances (that is where there are concurrent and co-extensive obligations in contract and in tort) the defendant may plead the apportionment legislation as a defence whichever way the plaintiff may have framed his cause of action".

This is certainly the view which most closely accords with fairness. In the same way that it would be unjust to allow an action in tort, unfettered by the limitations which would be encountered in an action in contract and based on the terms of the contract, it would be unjust to allow apportionment to be avoided by resort to an action in contract. It has been argued that, if the courts fail to give this result, there should be legislation (M B Taggart "Contributory Negligence; Is the Law of Contract Relevant" (1977) 3 Auck L Rev 1).

The foregoing discussion serves to introduce what, in my view, are the really difficult questions in this area. I may best commence by posing one of the most common manifestations. An auditor fails to discover defalcations of a company accountant and they continue for a number of years. The company sues the auditors who seek to rely on the contributory negligence of the company and, as well, claim contribution or indemnity from the directors who, it is said, failed to adequately supervise the accountant.

Generally, the courts have set their face against holding that there was contributory negligence in such
circumstances. As Samuels JA said in *Simonius Vischer* (supra p 348) when invited to find implied terms in the audit contract importing obligations on the part of the client:

"Such provisions would necessarily have as their primary effect the weakening of the obligations to supervise and examine and of the auditor's duty to make up his own mind all of which are central to the very notion of an audit contract."

Jacobs JA spoke to the same effect in *Dominion Freeholders Limited v Aird* [1966] 2 NSWLR 293, 298.

The contrary result was arrived at after a very thorough survey of United States, Canadian and Australian authorities by the Chief Justice of British Columbia in *Revelstoke Credit Union v Miller, Berry* [1984] 2 WWR 297. However, he drew the line where the directors were acting dishonestly. Surely the sentiments expressed by Samuels JA should prevail. Were it otherwise, the purpose and effect of the audit contract would be set at nought.

What then of the situation where the auditor seeks to join the directors as third parties? Putting aside the technical difficulties which may be posed by the form of the contribution legislation requiring liability in tort whereas the principal action may be framed in contract, why should there not be an entitlement to contribution? In *Leeds & Northrop Australia v Electricity Commission of NSW* (NSW Court of Appeal, 4 May 1973), the Court declined to dismiss summarily a cross claim seeking such contribution. The
Court said:

"This view, which is the one favoured by Glanville Williams, cannot be said to be clearly wrong. Indeed, in our opinion, it is a view which is well open, and it certainly produces a more just result than a construction, which, in the cases under consideration, leaves the right to contribution dependent upon the manner in which the plaintiff happens to have framed his cause of action."

The dispute was then settled.

The same course was taken by Sheppard J in Employers Corporate Investments v Cameron 1977 CLC 40-365. He refused to strike out the cross claim by the auditors against the directors. Indeed, he said that in his tentative view the cross claimants were entitled as a matter of law to contribution. Unfortunately for the development of the law, this dispute also was then settled. In some countries, legislation has been passed to put beyond doubt the entitlement to contribution in such circumstances (eg Civil Liability (Contribution) Act 1978 (UK), but for a criticism see (1979) 42 MLR 182). Take Cambridge Credit Corporation Limited v Alexander (infra). Why should the auditors, if they are ultimately liable, not be entitled to transfer most of the loss to the directors who brought about the financial downfall of the company?

I should like to diverge somewhat now to follow up the major policy issue which underlies the query just posed. In Cambridge Credit the auditor was required to certify that the prescribed ratio between assets and debentures was maintained. Due to some imaginative work on the part of the
directors, the value of assets was brought in at a grossly inflated figure. I found that the auditors were negligent in accepting what they were told by the directors with respect to assets and their values. As it happens, the directors were not worth suing and, no doubt in a large measure for that reason, no effort was made by the auditors to seek indemnity or contribution from them. Even if they had been sued and the auditors succeeded, victory would have tasted sour.

Is an order for indemnity or contribution against the actual or major wrongdoer a sufficient and proper remedy to professional persons? What prompts the enquiry is the inability of professionals to obtain liability insurance at all, much less at an affordable premium, in respect of the liability to which they are currently seen to be exposed. Concepts of fairness are hardly satisfied by the panaceas currently on offer of limited liability by incorporation or by capping of damages. Consideration should perhaps be given to legislation proposed for The Netherlands where the judge will have power to apportion the primary liability between auditor and company officers without entering judgment against the auditor for the full amount.

I should warn against regarding the type of claim in Cambridge as confined to auditors. Other examples of claims of this kind we are presently witnessing are the rash of litigation arising from two major areas of recent activity.
However, the breach of ratio went undetected, no receiver was appointed, further debentures were issued and other assets acquired. Only towards the conclusion of the defendants' evidence as to this confined area of the company's operations did it emerge that the major contention would be that it was the restriction on credit imposed by the Commonwealth Government in 1974 that brought about the collapse of the company. Indeed, it appeared on the defendants' evidence that, in the period intervening between the auditor's initial default in 1971 and the credit squeeze of 1974, the financial position of the company had strengthened. The plaintiff declined my invitation to adduce evidence in reply. It adopted this course because of the view which it formulated as to the applicable law and which it still maintains. The effect of that view is that, once the breach of duty occurred and, due to that breach, the company was permitted to remain in business, the auditors were in truth insurers. As Mahoney JA said:

"Thus, the breach allowed the company to continue in business. If its net worth had fallen because, eg, 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.

... To allow the company to continue in existence is, in a sense, to expose it to all of 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
First, the widespread marketing of taxation schemes which may even have been soundly based but were incompetently, or sometimes dishonestly, implemented. Second, the high interest rates which obtained led both borrowers and financial advisers into foreign currency transactions which both were incompetent to manage. The consequential losses in some cases have been quite catastrophic in their results. There are in the pipeline actions for hundreds of millions of dollars against accountants acting as tax advisers and financial consultants against banks and other financiers. This leads me conveniently to the next topic I should like to discuss.

CAUSATION AND REMOTENESS

The difficulties encapsulated by these two words are well illustrated by what happened in Cambridge Credit Corporation Limited v Hutcheson (1985) 9 ACLR 545 (on appeal, Court of Appeal, unreported, 25 June 1987). In an effort to make the hearing manageable, I focussed first on a relatively small segment of the company's assets and activities and on the first only of the audits, that for the year ended 30 June 1971. I came to the conclusion that the auditor's failures led to a breach of the prescribed ratio of assets to borrowings. I was satisfied that, had the auditor drawn attention to the breach, the Trustee for the debenture holders would have appointed a receiver then and there. It was agreed by the parties that, at that time, the assets would have all but satisfied the debenture holders' claims.
However, the breach of ratio went undetected, no receiver was appointed, further debentures were issued and other assets acquired. Only towards the conclusion of the defendants' evidence as to this confined area of the company's operations did it emerge that the major contention would be that it was the restriction on credit imposed by the Commonwealth Government in 1974 that brought about the collapse of the company. Indeed, it appeared on the defendants' evidence that, in the period intervening between the auditor's initial default in 1971 and the credit squeeze of 1974, the financial position of the company had strengthened. The plaintiff declined my invitation to adduce evidence in reply. It adopted this course because of the view which it formulated as to the applicable law and which it still maintains. The effect of that view is that, once the breach of duty occurred and, due to that breach, the company was permitted to remain in business, the auditors were in truth insurers. As Mahoney JA said:

"Thus, the breach allowed the company to continue in business. If its net worth had fallen because, eg, 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.

... To allow the company to continue in existence is, in a sense, to expose it to all of 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."

No matter what the company did, no matter how foolish the enterprise into which it may have ventured, any loss incurred would be to the account of the auditors. Counsel for the plaintiffs accepted that, in his argument, if the company had left the field of real estate completely and invested the whole of its assets in the futures market and lost the whole of its assets it would be entitled to be recompensed. I rejected this approach to causation and remoteness but the submissions were repeated in the Court of Appeal and suffered the same fate and no doubt in the fullness of time will be ventilated in the High Court. The rationale advanced by the plaintiffs is that what occurred was precisely what the defendants were engaged to safeguard against. The company was permitted to continue to trade in a financial condition which was prohibited by the Trust Deed. Any loss from whatever cause that was suffered due to the subsequent trading was caused by the initial negligence of the defendants and was not too remote. On a resumed hearing, the plaintiffs did call further evidence and demonstrated, at least to my satisfaction, that the breach in ratio subsisted right up to the time of the credit squeeze and the collapse of the company was simply a question of time. The credit squeeze was only the occasion for the collapse of the company and not its real cause.

It is this aspect of the decision which, to my mind, is
insufficiently understood by those who go into catatonic shock whenever Cambridge Credit is mentioned. The default in ratio was never rectified in the three years following the initial breach of duty. This led to an interesting submission from the defendants. They contended that the effect of their 1971 breach, if any, was spent when the accounts were audited for 1972 and subsequent years. It is an argument entitled to respect. Its force may best be illustrated by asking what would have happened had the defendants' retainer been terminated after the 1971 accounts were audited and the new auditors for the 1972 accounts also failed to detect the breach of notice? It was argued, therefore, that damages could be assessed in respect of the breach relating to the 1971 accounts by reference only to the financial position as it was in 1972. This, it was said, is for two reasons. First, because, at the time the contract was entered into, it was not reasonably foreseeable that the breaches of ratio would continue undetected or, alternatively, because damage in 1974 was not in the contemplation of the parties at the time of making of the contract. (As to other possible criteria, Koufos v Czarnikow Limited [1969] 1 AC 350.) It seemed to me that, if the breach escaped detection in 1971, there was no reason to think, or it was not unlikely, that history might repeat itself, as indeed it did, in subsequent years.

The plaintiffs did not seek to support the approach that I made to the case when it came before the Court of Appeal.
As a result, the Court dealt with the plaintiffs' loss theory I have already mentioned.

One of the principal features of the judgments of both Glass JA, the dissentient, and McHugh JA, one of the majority, is their acceptance of the "but for" test as the test of causation. One of the interesting features of the analysis by Glass JA is that every decision but one mentioned in relation to causation and remoteness was given in proceedings in tort.

Reverting to the earlier discussion, the House of Lords accepted in Koufos (supra) that the test of remoteness in contract was different from that in tort. What then is the test to be applied where there is a concurrent duty in contract and in tort. The decision in H Parsons (Livestock) Limited v Uttley Ingham & Co Limited [1978] QB 791 suggest that whatever way the plaintiff frames his case, the more favourable test will be applied.

FIDUCIARY DUTY

Actions against professionals have tended to be brought almost exclusively in contract, sometimes in tort, but hardly ever for breach of fiduciary duty. Yet fiduciary relationships exist where one person stands in a special relationship of trust, reliance and confidence to another person, based, inter alia, on inequality of experience. One would think that this is the badge of the usual relationship
of professional adviser and client. Today, one can detect signs of significant increase in the sheer number of actions against professionals for breach of fiduciary duty *(Farrington v Rowe McBridge & Partners* [1985] 1 NZLR 83; *Mid Northern Fertilizers Limited and anor v Connell Lamb Gerard & Co* (Thorpe J, 18 September 1986). One of the reasons, I would suggest, is the measure of damages available to a successful plaintiff. The other and even more significant advantage is the ability to obtain damages from other participants in the transaction involved in the breach of fiduciary duty. Let me illustrate with the facts of *Catt v Marac Australia Limited*. Mr Winter is an accountant. He had a practice which concentrated almost exclusively on marketing tax postponement schemes to persons with high incomes, usually doctors. One type of scheme involved a company, Wings, which had a number of aircraft on order from Short Bros in Northern Ireland. Winter was engaged for a commission of $A200,000 - 300,000 to form syndicates to acquire on lease individual aircraft. Winter marketed participation in the syndicate amongst his doctor clients. They trusted him and relied on his advice. Winter failed to inform members of the syndicate of his commission or that Wings was making a profit on the transaction running into hundreds of thousands of dollars. Thus, the total lease payments, being the whole of the price, even without interest payable by the syndicate, far exceeded the actual market value of the aircraft. It was proved that, at the time of acquisition of the aircraft, Marac and the other
financiers were aware that Winter was obtaining a commission without the knowledge of his clients, the members of the syndicate, and that he also concealed from them the difference in the purchase price payable by Wings to Short Bros and by the syndicate to Wings. It was found that Marac had actively participated in the transaction and made the breaches of fiduciary duty possible. Financially, it would have been unrewarding to sue either Winter or Wings.

However, the financiers were also made defendants in the various actions and equitable damages sought from them. Not only did the syndicates succeed at first instance in having the transaction with the financiers set aside, their guarantees of the lease payments rescinded, but they also recovered by way of equitable damages the moneys they had already paid under the lease agreements. The principle is clear enough: the beneficiary of the duty is entitled to be put back in the position he would have been in. That is unburdened by the lease. The financier finishes up with a second hand aircraft. Interestingly, in Marac, contributory negligence was not pleaded and, accordingly, the problem in Day v Mead (1987 NZ Recent Law 1) did not arise. In Banque Paribas, where it was pleaded, the defendant settled. The appeals in Marac have now also been settled.

LIABILITY FOR ECONOMIC LOSS SUFFERED BY THIRD PARTIES

There is universal agreement that in some cases there will be liability outside the law of contract for negligent statements causing economic loss. Negligently prepared
valuations and accounts are ready examples. We are the fascinated witnesses of the efforts of the House of Lords on the one hand and the High Court of Australia on the other to define the boundaries of liability. The topic of course is so large that one can merely skim the surface of the debate.

The High Court sees the relevant test for determining the existence of a duty of care entirely in the relationship of proximity (Sutherland Shire Council v Heyman (1985) 157 CLR 424; San Sebastian Pty Limited v Minister (1987) 61 ALJR 41). The joint judgment in the second case cited offered this assistance (p 45):

"When the economic loss results from negligent misstatement, the element of reliance plays a prominent part in the ascertainment of a relationship of proximity ... but when the economic loss results from a negligent act or omission outside the realm of negligent misstatement, the element of reliance may not be present."

The test of liability proffered by Lord Wilberforce in Anns v Merton London Borough Council [1978] AC 728 held sway in England, Canada and New Zealand. It works in two stages. First, one determines whether, as between wrongdoer and injured party, there is a sufficient proximity such that, in the reasonable contemplation of the wrongdoer, carelessness "may be likely to cause damage" to the injured person. If that requirement is satisfied then, secondly, regard is had to any considerations which ought to negative or limit liability. Not only is this test difficult to apply but it
has come under heavy challenge recently. Most recently, the Privy Council pointed out in *Yuen Kun Yeu v Attorney General of Hong Kong* (unreported, 10 June 1987) that "for the future it should be recognised that the two stage test in *Anns* was not to be regarded as in all circumstances a suitable guide to the existence of a duty of care".

In *Leigh & Sullivan Limited v Aliakmon Shipping Co Limited* [1985] 1 QB 350, Goff LJ returned to the concept that such duty was based on an "assumption of responsibility by the defendant to the plaintiff in circumstances which were equivalent to contract". It would seem that in *The Royal Bank Trust Co (Trinidad) Limited v Pampellone* [1987] 1 Ll Rep 218 Lord Goff, delivering the judgment of the majority of the Privy Council, again fixed on the principle of assumption of liability rather than imposition of a duty as a result of a relationship of proximity or foresight. The minority opinion of Lord Templeman and Sir Robin Cooke accepted the view that a duty of care arose when Mr Kennedy, a bank manager, supplied financial information to the respondent, an unsophisticated person with little, if any, financial knowledge. As they said:

"If Mr Kennedy failed to appreciate the significance of the enquiry nevertheless Mr Kennedy had no right to assume that Mr Pampellone would understand the relevance of information contained in, or omitted from, the Pinnock brochure".

The distinction drawn by the majority of the Privy Council between giving information on the one hand and advice on the
other is flatly denied by the High Court in Heyman (supra). More importantly, in that decision, and since, the High Court has firmly rejected the Wilberforce test in Anns. In Australia the future seems to lie in the test of proximity as it is continuously refined by Deane J. It embraces physical proximity, in the sense of space and time between the person or property of the plaintiff and the person or property of the defendant; circumstantial proximity such as relationships eg employer and employee; and causal proximity addressing the relationship between act or statement on the one hand and the loss or injury on the other. It may reflect an assumption of responsibility by one or reliance by the other that care would be taken where the other party knew or ought to have known of the reliance. Thus, Deane J seeks to couple both the notions of proximity and reliance in the one definition of duty. The statement of law in England seems to be in a much greater state of flux.

DISCLAIMERS

Even before the decision in Hedley Byrne (supra) and the more expansive view of concurrent liability in contract and in tort was adopted, it had been usual to insert in documents such as valuations, advice from banks and other professional and quasi-professional communications disclaimers of liability should the information turn out to be incorrect. However, with the ever increasing scope of liability on the part of the professional persons, obviously the function of disclaimers has become one of increasing importance.
In *Hedley Byrne* (supra), Lord Reid contrasted disclaimer clauses in contracts, where it was necessary to exclude liability for negligence, and the disclaimer in the case before him, where the question was whether an undertaking to assume a duty to take care could be inferred. That is clearly a very different matter. Lord Morris took the view (p 504) that the bank effectively disclaimed any assumption of a duty of care. As he said:

"They stated that they only responded to the enquiry on the basis that their reply was without responsibility. If the enquirers chose to receive and act upon the reply, they cannot disregard the definite terms upon which it was given."

Lord Devlin (p 533) agreed with Lord Reid that:

"A man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that in fact he is not. The problem of reconciling words of exemption with the existence of a duty arises only when a party is claiming exemption from a responsibility which he has already undertaken or which he is contracting to undertake."

Lord Pearce would have taken the view (p 540) that, even if the parties were already in contractual or other special relationship, the words would have given immunity to a negligent answer. In any event, in His Lordship's view, they clearly prevented a special relationship from arising:

"They are part of the material from which one deduces whether a duty of care and a liability for negligence was assumed. Both parties say expressly (in a case where neither is deliberately taking advantage of the other) that there shall be no liability. I do not find it possible to say that a liability was assumed."
In the interests of the development of the law it was unfortunate that the decision of Wootten J in *BT Australia Limited v Raine & Horne Pty Limited* [1983] 3 NSWLR 221 was not taken further. The defendant there prepared a valuation which contained a disclaimer clause in the following terms:

"This report is for the use of the party to whom it is addressed and for no other purpose and no responsibility is accepted to any third party for the whole or part of the contents of this report."

His Honour took the view that leaving aside the effect of the disclaimer, the valuer should be taken to have assumed responsibility to the plaintiff to take reasonable care in the valuation. So far as the disclaimer was concerned, His Honour's view was that (p 236):

"The disclaimer clause was unilaterally framed and inserted by Raine & Horne and if it was intended to disclaim responsibility for the consequences of its use for the very purpose for which it was obtained, it was reasonable to expect Raine & Horne to say so in clear words."

His Honour commented that he bore in mind the statement, particularly of Lord Reid in *Hedley Byrne* that no liability could be inferred but went on (p 237):

"While in the present case the contractual liability would not extend to third parties, the obligation to provide the valuation was being undertaken in a contractual context where responsibility to take care was being assumed to BT, and where, in my view, it would be reasonable to infer that the responsibility so assumed would extend in tort beyond the other party to the contract the third plaintiffs, and the discharge of duties towards which BT proposed to use the valuation. ... His Lordship (Lord Reid) was not making a general statement about all *Hedley Byrne* situations, but a statement about the particular case before him."
In the result, disclaimers may well be incorporated into a professional person's retainer. This is highly likely to occur, eg in the case of an engagement to give a valuation. However, that still leaves the question of disclaimers which are not contractually based. These raise a different and much more complex question. In BT, the third plaintiffs were not parties to the original contract between BT and Raine & Horne. In Wootten J's opinion Raine & Horne impliedly accepted responsibility for the use of the valuation by BT but not for any other purpose. The second part of the disclaimer sought to negative responsibility to any third party. The resulting question of construction the judge resolved in the third plaintiff's favour (p 237):

"I have also concluded that the present case is one in which although there was a contract with BT although the duties of Raine & Horne under the contract did not extend to the third plaintiffs the situation was such that in the absence of a disclaimer of liability the third plaintiffs Raine & Horne would be taken to be accepting such responsibility. Hence it was not merely a question of whether it said or did something more to assume responsibility. It was a question of whether it disclaimed responsibility which it would have taken to have assumed in the absence of a clear disclaimer."

In MLC v Evatt (1968) 122 CLR 556 Barwick CJ in a dictum noted that in relationships which give rise to a duty of care in the case of utterance a disclaimer will not always be effective. He said (p 570):

"The duty of care in my opinion is imposed by the law in the circumstances. Because it is so imposed I doubt whether the speaker may always except himself from performance of the duty by some express reservation at the time of his utterance but the fact of such reservation particularly if
acknowledged by the recipient will in many instances be one of the circumstances to be taken into consideration in deciding whether or not a duty of care has arisen and it may be sufficiently potent in some cases to prevent the creation of the necessary relationship. Whether it is so or not must in my opinion depend upon all of the circumstances of and surrounding the giving of the information or advice."

In the contractual setting it is interesting to note the recent judgment of the High Court in Darlington Futures Limited v Delco Australia Pty Limited 61 ALJR 76. The plaintiff entered into a contract with the defendant for the latter to enter into futures contracts on behalf of the plaintiff. Heavy losses were incurred in silver and coffee futures. The trial judge accepted the plaintiff's claim that the transactions were unauthorised. Nonetheless, he found for the broker on the basis of exclusion clauses in the contract. On appeal, the Full Court held that the broker was not protected by either of the two very extensive and detailed exemption clauses. The High Court agreed with the courts below that the failure to unlock the straddle was committing the respondent to a form of speculation quite beyond the ambit of the authority given to that broker. The Court agreed with the Full Court that cl 6 of the contract which disclaimed liability where losses arose in any way out of any trading activity undertaken on behalf of the client whether pursuant to the agreement or not would not extend to transactions undertaken without authority. However, it held that the client was limited to $100 because the claims did arise in connection with the relationship established by the
agreement. As they said:

"A claim in respect of an unauthorised transaction may nonetheless have a connection, indeed a substantial connection, with the relationship of broker and client established by the agreement. We are unable to discern any basis on which cl 7C can be construed so as not to apply to such a claim. The present case is one in which the respondents claim arises in connection with the relationship of broker and client established by the contract between the parties notwithstanding the finding that the relevant transactions were not authorised."

I mention this decision to show that limitation of liability provisions still have a great role to play.

Something more than an overview would be required to deal with certain important statutory obligations imposed on providers of services by the Trade Practices Act and Securities Industry Act and their local equivalents. As it is I do no more than draw attention to them.

* * *
CONFLICTS OF INTEREST AND PROFESSIONALS
by Dr Paul Finn

Commentary by Mr John C. Hagen
Chartered Accountant, Partner: Deloitte Haskins & Sells, Chairman of the New Zealand Society of Accounting Research and Standards Board of the New Zealand Society of Accountants
Introduction
By dint of circumstance I am forced to take a "lay" view on the contents of the excellent paper prepared by Dr. Paul Finn.

In today's competitive, and ever more deregulated environment the topic of conflict of interest needs to be constantly aired and brought to the attention of professional advisors.

In my opinion, ethical standards have fallen as the competitive element heats up, while at the same time the hierarchy of the professions are desperately trying to cling to past high standards of moral conduct.

Professionals today are advising clients to enter into transactions and deals of highly questionable standing, deals which would not have been contemplated by those professionals ten, or even five years ago.

As professional firms grow larger the potential for problems in the conflict of interest area increases at a geometric rate.
Also as professional firms are perceived by their partners to be more like any other profit oriented business and are managed accordingly, it becomes harder to maintain the higher ethical standards of the past. The profit motive and high ethical standards are not always totally in tune as most in depth reviews of business practice show.

Furthermore, as larger firms select progressive clients upon which to concentrate their limited resources and, target new clients for special attention, the competitive world runs into conflict with a general theme of high moral and ethical standards.

As a practical example I might add that, the standards by which professional men operate seem to change depending upon whereabouts they are located. We have as an instance in the political arena a prime example of a poacher turned game keeper and in the business arena, now we have examples of previously professional game keepers turning poachers.

Dr Finn has selected for us a number of areas falling within the general title of fiduciary relationships upon which he comments.
He has said that the problems facing the larger advisory firms, of which I have some knowledge, include:

firstly;

client conflict - that is where one has two clients on either side of the same problem. In a large professional firm one may not in fact be aware that there is a conflict. Do you know all the clients of your firm?

secondly,

the "information problem" - that is, where one gains knowledge in a confidential client dealing that may have relevance to other but separate client dealings. The prospect of use or disclosure raises problems.

thirdly,

- the problem of "institutional interests and loyalties" - where one set of clients may be favoured to the cost of others.

Certainly, from my own point of view as a partner in a large international accounting firm, I experience all three types of problem quite often and in fact we do resort to the so-called Chinese Wall as a device with which to overcome the problem.
It is commonly accepted that the basic purpose of fiduciary law is to protect the interests of a beneficiary and to require those in a fiduciary relationship to act only in the interests of that beneficiary.

In defiance of this basic axiom is the practice, quite common amongst smaller accounting firms, to take part, in a financial sense, in the activities of their clients. This, to my mind immediately brings into conflict their duty to the client as opposed to their own personal pecuniary interest.

All of the major firms prohibit the holding of financial interests in clients so as to avoid this patently obvious conflict.

Dr Finn also eludes to the role that fiduciary law plays in protecting public confidence in some institutions.

This aspect is particularly relevant to the accounting profession, with the perception of auditors in our commercial society being of real concern.

It is essential for the maintenance of credibility, that the auditor not only be independent, but be seen to be independent. This proposition has caused a number of problems, especially in the United States, where there has been a perceived conflict between a firm of chartered
accountants providing both audit and management advisory services to the one client. The roles are there perceived to be mutually exclusive due to the possibility of conflict of interest.

I guess the same objection could be levelled against persons from a firm of Chartered Accountants providing both audit services and advice to client companies on accounting policy matters. Perhaps not only assisting in the process of "creative accounting" but in some cases initiating it to the chagrin of ones audit partners.

Certainly for those of us who are involved in the accounting standards setting process this does cause some degree of conflict and in some cases a feeling of uneasiness.

After dealing with the rule in the 1912 Rakusen v Ellis case and finding for the irrebuttable presumption option Dr Finn turns his attention to the "consent based exceptions".

In this context, I believe that in the present commercial world a major problem arises where a director is appointed by a large corporate shareholder and then, in many cases, acts as though he is there as the representative, and only the representative, of that major shareholder. His larger directorial responsibility to the company as a whole often seems to be ignored and forgotten. This indefensible position is quite prevalent today and probably leads to a
great deal of insider trading about which we are later to hear.

Related to this issue also is the policy of some of the international accounting firms overseas to prohibit their partners from accepting directorships so as to avoid being tainted with commercialism.

In my opinion New Zealand is far too small a place for such policies to be realistic and indeed I believe that professional accountants can gain tremendously from having to face and take responsibility for commercial decisions. However directorial morality needs recharging every so often.

Dr Finn then turns to the "same matter conflict" where one professional advisor may be asked to act for both parties on either side of the transaction. In such circumstance one is between a rock and a hard place.

Many accountants have problems in this area in regard to say valuations where one is asked to act for both parties.

My experience is that if one acts for one party and not the other, then the party for whom you do not act will be upset and accuse you of favouring the other.

If you act for both and attempt to arbitrate, and do your job properly, then probably both will be upset. Quite possibly
the best solution is to not act for either in which case both will feel snubbed and you will have no work or fee.

With regard to litigation matters the same situation can arise and where one has clients on both sides of a dispute it is probably safer not to act for either.

Dr Finn also discusses the "separate matter conflict".

Chartered accountants, and in particular auditors, find themselves in this situation quite often, where they act say for a number of clients in the same industry, such as a number of finance houses, forestry companies, etc.

This is a real problem which arises automatically where firms or individuals wish to specialise.

In such situations as this is it is quite usual for Chartered Accountants to use the "Chinese Wall" as a defence against a conflict charge.

If however one's client perceives that there has been a breach of the Chinese Wall then it is particularly difficult to convince them that there has not been such a breach.

Obviously the validity of a conflict is in the eye of the beholder and in my experience there will certainly be no predictability of which of one's clients will see conflict.
Some are more commercial minded and understanding, than others.

The Chinese Wall is defined by Dr Finn as "an organisational contrivance within an enterprise designed to prevent the flow of confidential information to or from a part of parts of that enterprise".

Sometimes it is quite difficult to conceive of this wall really working. I recall recently seeing on television, a stockbroker explaining how information was kept contained within parts of his organisation by having people in different rooms i.e. Chinese Walls. Stockbrokers are notorious for spreading rumours and information and it does somewhat stretch creditability to suggest that walls in such situations will work.

If indeed they do exist, it is perhaps because many of these walls are so thin that a number of corporate clients have turned to offshore brokers and financial advisors in recent years so as to maintain confidentiality.

Where problems over conflict of interest situations arise one will often find that the use of hindsight is most useful in clarifying ones principles. Twenty-twenty vision with a rear view mirror is not uncommon. The difficulty is that the Courts always have this benefit when hearing conflict of interest matters.
Finally Dr Finn has quite clearly expressed his doubt as to whether the Chinese Wall defence will be very effective in a large professional advisory office and I believe that those of us who convince ourselves that the device works should perhaps look again from a more objective viewpoint. It should always be remembered that it suits us to think that the wall works. It may not suit others to see it our way.

Dr Finn

Thank you.
CONFLICTS OF INTEREST AND PROFESSIONALS
by Dr Paul Finn

Commentary by A.A. Lusk
Barrister and Solicitor, Litigation Partner in Bell Gully Buddle Weir (Auckland Office)
The perspective from which my comments are made is that of a lawyer with some experience of advising professionals and their underwriters in the defence of professional liability claims. If there is a bias in my experience, and in the remarks I later make, towards claims by clients against solicitors, it is for the obvious reason that it is that professional relationship that attracts the highest incidence of claims. It is also that relationship that best exemplifies the fiduciary relationship that is the subject of Dr. Finn's paper and it is not surprising that many of the authorities to which Dr. Finn refers are solicitor cases.

Before I pay tribute to Dr. Finn, as I must, for his very fine paper, I set the stage for my comments by referring to a remark made early in Dr. Finn's paper and I quote:

"It is well known that lawyers, like all professionals, are subject to a legal and not merely an ethical duty to maintain the secrecy of information acquired from or about their clients when acting in their professional capacity."

I hope, Dr. Finn will not think me quibbling if I disagree with that general observation. In my personal experience there is very limited knowledge in this country of the nature of the duty of confidentiality owed by professionals to their clients. Among lawyers I regret to say there is a lamentable lack of understanding of the fiduciary duty concept. Many lawyers and most accountants and bankers believe that the duty of confidentiality is an ethical one rather than a legal duty, with the inflexible characteristics and rigorous application so well described in Dr. Finn's paper.

It is well publicized by professional indemnity insurers that one of the categories of professional conduct of solicitors that most often gives rise to claims is where the same solicitor or firm has acted for multiple parties in a transaction. Those are the claims in which the informed Plaintiff's lawyer can best ensure a successful outcome by pleading breach of fiduciary duty. Before the Court of Appeal decision in Farrington v Rowe, McBride & Partners (1) I had seen only one proceeding involving a solicitor acting for multiple parties in which breach of fiduciary duty was even pleaded. That
was in the Mid-Northern matter referred to in Dr. Finn's paper and I have no doubt that senior Counsel for the Plaintiff in that case was alerted to the pleading by the decision at first instance in the Farrington case.

I assumed that the Farrington decision would be widely read and understood and that we could expect in the future that there would invariably be allegations of breach of fiduciary duty raised against solicitors who had chosen to act for both parties or more than one party in the same matter. That has not eventuated. Any careful consideration of Farrington and Mid-Northern (2) and Day v Mead (3) should leave Plaintiffs' advisers in no doubt that an allegation of breach of fiduciary duty, properly raised, makes life rather difficult for the defence. Some of these difficulties I will refer to later. An obvious example however is the question of limitations. I know of two occasions in the last year or so when Plaintiffs have been advised they cannot proceed against their former solicitors because their claim based on contract (as it still must be in this country) had fallen foul of the six year statutory time limit from the date of the alleged breach. In both cases in my opinion an allegation of breach of fiduciary duty could have been made and neither claim was properly statute barred so far as that cause of action was concerned.

The point of these observations as to the comparative ignorance of our professionals of the whole concept of breach of fiduciary duty in the context of their own relationships with their clients, is to say how timely it is that Dr. Finn should have taken up his interest in this subject, albeit if the consequences may be unwelcome to those for whom I sometimes act. Dr. Finn's book "Fiduciary Obligations" was a trail blazer in this difficult area. It says much for its author and the value of the work itself that in those New Zealand cases that have considered fiduciary obligations in recent years, the work has been embraced by the Courts and treated as authoritative.

Dr. Finn will I hope, forgive me after that unsolicited commercial if I sound a caveat. Faced with the formidable difficulty of resisting an allegation of breach of fiduciary duty in a solicitor/client duty and duty conflict matter, and finding a comparative absence of useful case authority, I once had resort to
Dr. Finn's text as the authority for the compelling submissions I was advancing. The trial Judge, Mr Justice Thorp who has demonstrated a close and learned interest in the law relating to professional responsibilities, proceeded to hold that two of the submissions were based on passages in the text that were not supported by the authorities cited in the footnote. The third submission failed on the facts (for which I can hardly blame Dr. Finn). The Lusk/Finn defensive ploy was lost three nil and a breach of fiduciary duty was found in that particular case. On the question of damages, as I shall mention, we were jointly despatched to the boundary again.

It is to be hoped notwithstanding my personal setback that the legal profession will read carefully Dr. Finn's paper and become more familiar with this well established extensive and stringent legal duty.

Dr. Finn's paper is really in three sections. The first considers the purposes of fiduciary law. He then goes on to consider how a client's informed consent can sometimes reduce or eliminate a breach of a fiduciary obligation and finally he looks at attempts to circumvent the rigours of the duty by artificial contrivances such as Chinese walls.

It would be presumptuous of me to take issue with Dr. Finn as to his examination of the principles that emerge from the cases and I think he correctly cautions that those studying his paper are unlikely to be pleased by what they learn to be the law in this area. I do feel free to take some issue with him as to what the law should be and there are some respects in which I think the law as it is now applied should be criticised although I do not anticipate the Courts will be quick to change.

It is easy to understand, and I think we can all probably accept that there is a breach of fiduciary duty in a duty/personal interest conflict. The law is and needs to be fairly inflexible and is certainly harsh in penalising such a breach. However it is much more difficult to understand why the Courts have been so inflexible in the duty/duty conflict area. The principles are not as easy to extract from the authorities and it is not surprising that a number of them such as the Rakusen case (4) to which Dr. Finn refers,
emphasize that these cases need to be considered on a case by case basis.

I think none of us has much difficulty in recognising a duty/duty conflict in a litigation context. A lawyer or firm can only act for one party where adverse interest are involved. In other legal transactions it is not too hard in most cases to identify a conflict and that the rule applies when an individual attempts to act for two parties with adverse interests in the same transaction. Where I find much more difficulty in accepting the rule should be applied rigorously is where different lawyers or departments of the same firm or fiduciary organisation are involved in acting for the different interested parties.

In his first section dealing with the principles and purposes of fiduciary law Dr Finn refers to the English Court of Appeal decision in Rakusen. He extracts from that decision what he says to be a rule laid down by the English Court of Appeal in that case that solicitors may be able to act in the same matter for a new client without having to disclose confidences reposed in them by their first client. The Courts will only interfere if the first client can show a likelihood that there will be a breach of confidence. Dr. Finn advances four criticisms of that rule, but I suggest with respect that he shows a personal lack of sympathy with it and the general, almost philosophical arguments, with which he criticises the rule are unimpressive.

The Rakusen decision is of importance as being one of the few decisions of authority that have attempted to confine the rigorous application of the breach of confidentiality and loyalty duties to cases where the breach is not just theoretical but actual. It is also important in the context of my remarks as one of the few cases where the alleged conflict arose because different solicitors in the same firm acted for the different clients.

I quote from the judgment of Cozens-Hardy M.R. at page 835:
"I do not doubt for a moment that the circumstances may be such that a solicitor ought not to be allowed to put himself in such a position that, human nature being what it is, he cannot clear his mind from the information which he has confidentially obtained from his former client; but in my view we must treat each of these cases, not as a matter of form, not as a matter to be decided on the mere proof of a former acting for a client, but as a matter of substance, before we allow the special jurisdiction over solicitors to be invoked, we must be satisfied that real mischief and real prejudice will in all human probability result if the solicitor is allowed to act."

The facts of that case were that a member of a firm of solicitors accepted instructions to act in an arbitration for one party, he being completely unaware at the time that at an earlier stage, before he accepted instructions, his partner had been advising the other party to the same dispute. There was no question of the same firm acting for more than one party at the same time. There was no doubt that the second solicitor was not the repository of any confidence which his partner had obtained from the first client. The Court of Appeal declined to restrain the second solicitor from acting for the second client. With respect to Dr. Finn's criticism of the case it seems to me that it was undoubtedly correct on its facts and that the principle or rule that was the basis of the decision involves no inherent mischief and introduces a note of realism in an area of law where some other decisions fail so to do.

Rakusen has stood as a leading authority in the Commonwealth on this subject for 75 years. It was adverted to in passing in the Court of Appeal in Farrington v Rowe and escaped criticism. I submit it represents the law in this country. Although it was a successive engagement case rather than a contemporaneous dual engagement case it should stand as some encouragement to those who seek by the device of the Chinese wall, or other proper separation of interests, to avoid the harshness with which the fiduciary duty obligations have been imposed on the profession in the past to preclude multiple engagements.

There are three criticisms I would make of the current application of the law in the area of duty and duty conflicts of interest. I mention them, but time precludes me arguing them.

1. Why should not different partners in the same law firm act for different parties to the same transaction if they do so in a
manner that preserves the confidentiality of each client and each client receives the wholehearted loyalty of the solicitor who is acting for him? I am not concerned with adversary litigation, but refer to other common transactions in the property, financing and some commercial fields. Why should it be that firms taking on a multiple engagement in this type of transaction should "do so at their peril" to adopt the phraseology of certain English Judges who probably themselves never practiced in a firm and never assisted in any way in the conduct of a conveyancing or commercial property transaction. I find it artificial and unrealistic to suggest that the knowledge of one partner must be imputed to the other and that client A is entitled to be given by the firm all of the information that is known to the partner acting for client B and failure of the firm to do so is a breach of fiduciary duty. Yet that seems to be the way the Courts approach the matter at the present time. I prefer the Rakusen approach.

2. It is offensive to me that a technical breach of duty can sound in damages where a fiduciary is held to have failed to impart to the beneficiary all material information known to him or his firm, even though it is clear on the facts that the beneficiary would have acted no differently had the material facts been disclosed to him. The authorities are all one way to the effect that speculation as to the course the beneficiary might have taken on disclosure, is irrelevant. Brickenden v London Loan & Savings Co, (5) Farrington v Rowe McBride, Mid-Northern Fertilizers Limited v Connell. I do not presume to suggest that the judgment of Thorp J. in the Mid-Northern case was wrong in law. The single issue of breach of fiduciary duty that gave rise to a finding of liability was earlier pleaded as an allegation of negligence. The allegation was a failure to give a client material information about a lender's security. Like all other allegations of negligence in that case it was rejected under that head. His Honour found as a fact that while there was an obligation on the solicitor concerned to give his client the material information, the beneficiary in that case would have proceeded with the transaction even with the benefit of the appropriate advice. The same allegation when considered by His Honour as a breach of fiduciary duty was held to sound
in damages because the solicitor concerned was not able to argue that factually his failure to give the advice would have made no difference. If the judgment accords with legal authority, it departs from common sense and fairness in my respectful submission. To award damages to a person for non-disclosure of information which clearly would have made no difference to him in any event, does not seem to make good sense. Those were windfall damages for that plaintiff.

3. The damages or compensation that have been awarded can be unduly favourable to the beneficiary. Generally, the approach is that the beneficiary is entitled to be put back in the position he would have been in if the transaction had not proceeded at all.

Dr. Finn does not develop this theme in his paper, so nor should I except to say that if equity is to be even handed there should be a proper relationship in a causative sense between the losses suffered and the damages awarded. Yet the authorities clearly suggest the beneficiary need not show such causation. See the review of this by Thorp J. in Mid-Northern. His Honour rejected a submission by the Defendants relying on a passage in Dr. Finn's book that the Plaintiff must show that loss was caused by the breach of duty before he could recover. The same was said in the Court of Appeal in Farrington. Further, because equitable damages are involved, common law restrictions arising from the concepts of foreseeability and remoteness, are not taken into account.

It is my hope, probably not shared enthusiastically by Dr. Finn that our Courts will realise that in the duty/duty conflict area the Court's rigid application of the strict fiduciary principles have been carried to an extreme. By a proper application of the Rakusen rule the Courts can ensure the purposes of the fiduciary duty concept are not circumvented and that high standards of professional behaviour maintained, while at the same time recognising that in the real world of professional practice multiple engagements will continue to be accepted and men of integrity will ensure their respective clients rights of confidence and of undivided loyalty are maintained.
I do not advocate total abrogation of the rule, but its relaxation on a case by case basis. The Chinese wall is not a defence, but a very good evidential indication in the context of a Rakusen argument, that as a matter of substance, rather than form, the law firm or organisation, has not caused and will be unlikely to cause real prejudice or real mischief.

Thank you Dr. Finn for a stimulating and scholarly paper.
FOOTNOTES


2. Mid-Northern Fertilizers Ltd and Anor v Connell Lamb Gerard & Co; N.Z. High Court, 18 September 1986, Thorp J.

3. Day v Mead; N.Z. High Court, 19 March 1986, Gal len J.


INSIDER TRADING
by Dr Barry Rider

Commentary by Mr William Wilson
Company Director
At the outset I reflect what, no doubt will be the mood of this seminar, and acknowledge the contribution which Dr Rider has made to our understanding of this difficult and vexed topic.

He remarks that "it is perhaps surprising that so little concern has been felt in New Zealand". I will attempt to put the topic within my knowledge of the New Zealand marketplace.

I notice that at times Dr Rider uses the terms insider dealing and insider trading as being interchangeable. We tend to use the term insider trading in New Zealand. From my earlier professional background in income tax I know that there can be a connotation of repeated transactions when referring to dealing or trading. But, as Dr Rider's paper makes clear, these terms in this context can refer to a once only purchase or sale of securities. Unfortunately the terms insider trading and dealing have acquired an unsavoury ring now and we need another description for the above-board straightforward purchase or sale of securities by a director or officer of a company.

Traditionally we have regarded insiders in New Zealand primarily as a director, his spouse, minor children and family trusts and as senior executives. I should mention that in these days of women's liberation it is difficult even for directors to influence their wives investment decisions.

But, as Dr Rider's paper points out, the definition of an insider can be much wider and can include financial intermediaries and advisers who act for the company.

A concern which I have is the growing trend here for senior management to have private briefings for major institutional shareholders and for investment analysts. These briefings are often fairly detailed expositions of the company's operating position and while they fall short of forecasting profits, often they enable the audience to make very sophisticated forecasts. For example, the leading sharebrokers letters can now forecast a company's profit with an uncanny accuracy.

The depth of information given at these briefings, and more particularly the body language of the management team gives the audience a quality of information which is not available generally to all shareholders.

To what extent does possession of this information make the audience insiders? To borrow from George Orwell does it mean
that all shareholders are equal but some shareholders are more equal than others! From the corporate viewpoint it is desirable to maintain the confidence and support of this audience but it is a trend which we should examine before it gives rise to abuse.

Turning to the New Zealand scene generally, what is the scope of insider trading? I do not think that it is very widespread. We live in a financial village by world standards and it is difficult for an insider to conceal his actions. I don't say it is not happening but we have a feel for who may be involved. Every insider who deals has to take someone into his confidence. He has to instruct a broker or an agent who instructs a broker. Herein lies one of the key points which I took from Dr Rider's paper; these intermediaries probably more than anybody else possess the knowledge of who is doing what to whom.

The Stock Exchange as a self regulating body is in difficulty position because its members, the brokers, ultimately possess the crucial information about share deals. Who checks the gamekeeper?

And yet this whole group of financial intermediaries tend to be self policing the market because they are all acting in their own interest. So that the abuse of information by any of them tends to become known to others who take appropriate action which can range from a complaint to the Stock Exchange to inspired comments in the financial press.

Personally I experience very little difficulty with directors dealing in shares. A good point in the paper is that few of us have sufficiently large holdings to shake the tree but in any event most boards have adequate checks. A simple rule is that all board members should always tell the chairman when they are buying or selling, even in the "open season", and the chairman should always tell his deputy or the managing director.

In New Zealand and Australia there are a group of directors who hold very substantial shareholdings in their companies. In this respect I do not agree with Dr Rider's comment that in "a modern corporation it would be extremely difficult to identify any single person....who might be regarded as an entrepreneur in the traditional sense of the word".

Here we have several companies where the founder and family still hold significant holdings. Because the shares may represent the family's main wealth, their sale and timing of the sale raise difficult questions in the context of insider trading. This aspect is one which still requires more consideration.
A danger in New Zealand is that we take a sledgehammer to crack a nut. I have had limited exposure to raising capital through the London and North American securities markets and really it is far too detailed and nit picking; a dream for the professional advisers fees!

Conclusion

I favour for New Zealand:

1. A recognition that insiders include financial intermediaries and advisers

2. The continuation of a company's board employing its own disciplines for directors and management; any transgressor should be fired

3. The adoption of Dr Rider's proposal to make an insider liable to the corporate issuer for his profit

4. A law which debars any person found liable under 3 from participating in any corporation, financial intermediary or professional practice for stipulated periods. This law would be administered by the Securities Commission.
INSIDER TRADING
by Dr Barry Rider

Commentator: Mr Carl Peterson
Director, Paine Belcher Limited

standing in for

Mr David Belcher
Executive Chairman, Paine Belcher Limited
While I am not David Belcher I am perfectly comfortable with this address
and have worked with David on the content.

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Given the breadth of the specific issues raised in the lengthy paper
presented by Dr Rider, I wish to confine my remarks to the fundamentals
which I believe need to be addressed in framing any laws or rules which
are to operate in the New Zealand commercial environment.

It must be remembered that New Zealand is not Great Britain, the United
States or even Australia. To put this in perspective, Australia and New
Zealand stockmarkets represent only 2% of the total world markets. In
commercial terms we are still very much a small town and therefor to
introduce here the level of regulation which may be required in some
larger markets would, in the New Zealand context, be equivalent to
driving in a tack with a sledgehammer.

In Dr Rider’s paper, one particularly salient comment appears in the last
paragraph of his conclusion where he states that ‘‘No jurisdiction has
succeeded in significantly combatting this form of market abuse and
perhaps given the nature of markets and men, none will’’.

I believe that insider trading as defined by Dr Rider is not
significantly widespread in New Zealand, and the question perhaps needs
to be asked whether it is not more a hobby horse of business writers and
television commentators than a commercial reality.

But it is fair to assume that in New Zealand, as in other markets, insider
trading does occur. The question becomes, what effect does this have?

The sharemarket has always been accepted as a place of risk investment.
The public is aware of these risks and participates in the market on a
best information basis. As part of this I do not believe that investors
expect to insure themselves totally against decisions or actions over
which they themselves have no control.
I do not subscribe to the theory that in a country our size, either New Zealand or overseas investors lose confidence in our sharemarket as a result of any perceived insider trading. Given my small town business argument, I do not believe that detection of serious insider trading is very difficult.

I do not believe that corporates need to be overly protected from insider trading, in one another's shares, nor do I subscribe to the arguments of lost opportunity nor that insider trading is prevalent enough to provide any form of market price averaging.

I readily accept that the practice of insider trading is undesirable, but what steps should we take to combat it?

I was taken with the phrase used by Dr Rider, 'hinder and impede', and I am comfortable with this as the initial approach to our attacking insider trading, particularly in the areas of education and self-regulatory constraints.

Firstly, I believe in education through increased awareness as being of prime importance for both the professional players and the investing public in general in the New Zealand market, that the problems and inherent dangers of insider trading should be better understood.

Secondly, I believe that professional bodies such as the Accountants' Society, the Law Society and the Stock Exchange should each include, within their code of ethics, strong anti-insider trading provisions with necessary punitive measures for breaking those rules. As professional advisors, members of these groups will often become party to confidential information in respect of which temptations may arise. The pressure of threat to livelihood which professional groups can exert could indeed be a significant deterrent, to those who might otherwise succumb.

Thirdly, rules imposed within specific organisations themselves such as the Auckland Regional Stock Exchange, individual sharebroking or accounting firms, or financial institutions, can also act in a self-
policing capacity over their own staff.

One specific matter that I would take issue with and which has been raised in the paper, is the suggestion that brokers should act as a watchdog or a pseudo policeman on insider trading. I do not believe that it is a broker's role to make such judgments for his client. It is his role only to transact business as instructed provided that in so doing he follows the regulations of the New Zealand Stock Exchange and the requirements of the law in general. Apart from placing the broker in an impossible position I believe the total onus on whether or not the individual or corporate should be dealing in a particular company's shares rests with that client.

I am a firm believer in maintaining business and individual freedoms and while I am in no way suggesting that these freedoms should include licence to trade as an insider, laws and powers for investigation which restrict normal business almost down to watching with whom you are lunching, in my opinion are draconian and counter-productive to commercial realism and the greater balance we are trying to achieve in our society.

Dr Rider suggests most cases of insider trading surround acquisition, mergers and takeovers and I'd like to comment specifically on this area. Partial acquisitions and takeovers are a normal business activity, the process of which frequently involves the purchasing of shares to acquire perhaps up to 4.9% of a company (before the general market has knowledge of corporate intentions). I see this purely as a normal procedure in a free market where, quite often a decision to proceed or not to proceed, or how far to proceed in acquiring shares, is made during this initial acquisition process. To interrupt this process, by requiring disclosure to be made, would inhibit greatly the potential to complete the transaction in many cases.

As far as legislation is concerned, there are three points.

Firstly, the cost-benefit of a New Zealand legislative watchdog would need to be questioned, given the level and seriousness of any insider
trading which may occur. I believe that such an institution would need to have identifiable benefits to the community before the cost of its existence could be justified. Dr Rider records that in the seven years since the British law has been in place, only seven cases have come to Court. I do not believe that a hit list at that level would justify the expenditure of resources in New Zealand.

I am sure that there are many other areas of commercial law where funds and scarce professional resources could be better utilised.

Secondly, I believe there should be provision for the primary aggrieved party to take civil action to recover any direct damage it has suffered so that takeovers, acquisitions and mergers do not become as in some Commonwealth jurisdictions, nothing more than a barristers' benefit match. I believe it should be possible for the aggrieved party, ONLY, to seek compensation, for example, if company A was to takeover company B and persons in the latter with inside information purchased shares which moved the market up thus forcing A to pay more to acquire the company then A should have the right to recover the additional cost it incurred in obtaining its objective.

Moreover if people with inside knowledge of the transaction actively coerced holders to sell these shares then any sales should be reversible. However, I do not believe that individuals who sell shares to the acquiring company, where no coercion or advice has been used to purchase these shares from the vendor, have any case for compensation.

Thirdly, legislative action, over and above that already available, can always be reserved as a further course of action if the problem proliferates and if the principle of impede and hinder is unsuccessful.

In New Zealand the overwhelming influence on the whole issue of insider trading is that we are a small country and a small market place. Companies and individuals need to deal and have continuing contact with one another. Until a larger population or business community exists, there is insufficient space for malpractices of any significant consequences to occur. With greater size, sub-cultures can emerge. When that stage is
reached, and if the problem is widely apparent, the New Zealand situation can be reviewed, probably with more sophisticated and effective overseas experience than currently exists, available to help us.

In summary I believe:

- That through investor education and internal regulation of professional bodies steps should be taken to make all players aware of their responsibilities.

- That the New Zealand sharemarket has not experienced or suffered from widespread insider trading.

- That given the size and nature of our market any major abuse of this kind would be obvious.

- That market self-regulation would ensure that the entrepreneurs who were guilty of insider trading to the detriment of other investors would be brought into line by the treatment of their company in the market.

- That other regulations would only serve to stifle a healthy business environment.

- That companies or individuals concerned should be able to seek civil compensation to recover losses suffered.
THE TAX ADVISER: RESPONSIBILITIES AND LIABILITIES OF THE PROFESSIONS
by Dr Anthony Molloy Q.C.

Commentary by Mr R.J. Hoare
Chartered Accountant and Director of First Corp. Capital Limited
THE DIFFERENT ROLES OF THE LEGAL AND ACCOUNTING PROFESSIONS

Both professions have skills the other lacks, and must recognise this.

The best tax advice in my experience occurs when the CLIENT, his LAWYER and his ACCOUNTANT all participate and co-operate. It is also the most enjoyable.

A well informed client appreciates your efforts, understands and accepts the risks inherent in tax planning, and does not underestimate the importance of his role as implementor. Most importantly, this client sees tax in the wider context as part of his business and strategic planning rather than as a 'stand-alone' issue.

It is vital to remember that tax advice is rarely given in isolation from commercial advice. If you are only consulted in a pure tax issue, remember that the tax is a CONSEQUENCE of some commercial transaction. Often you are actually being consulted on a commercial issue which even the client often fails to realise.

Pure tax advice as such is the field of few, it is usually part of a wider advisory role.

Apart from determing the tax consequences of past transactions most tax practice deals with future commercial activity.

In reality the question is 'How do I achieve this end result?' It is not always apparent what the commercial objective is. The answer MIGHT lie in pure tax knowledge, but often it lies in finding an alternative means to achieve the commercial objective which eliminates the tax hurdle previously in the way.

This requires what Dr Molloy so aptly describes as 'Commercial imagination'.

Lawyers typically are involved on a one-off basis, either as draftsman or as advocate.
Accountants are usually, because of their ongoing contact, better placed to identify problems or opportunities.

The client expects his lawyer to solve problems he has identified. He expects his accountant to FIND problems he has NOT yet identified.

Whilst it is easy to identify the need to include tax skills in your practice, make no mistake tax practice is HARD.

It is constantly changing, in part based on un-codified policy in N.Z. often inadequately policed and yet of continuous importance to taxpayers. When I started it really only involved absorbing the annual Amendment Act. It now involves monitoring overseas developments and anticipating changes in attitudes and policies of the Commissioner, the Government, Treasury, and the Opposition as well as attempting to unravel three or more annual Amendment Acts. You are expected to know whether new proposals (such as imputation) are a good thing, how they work overseas, and when they will be introduced in N.Z.

**Privilege**

Unlike lawyers, accountants do not have privilege. I have not found this a particular difficulty although it is always a risk, particularly if Revenue/Taxpayer relations become strained. Australians will tell you of visits by inspectors accompanied by police, and of prosecutions against Q.C.'s etc.

Although the power is sparingly used, the Revenue in N.Z. and overseas do have power to access audit files and from time to time the issue rears its head. Proper co-operation between the professions however enables sensitive documents to be collectively designed but generated from and stored on lawyers' premises.

The nearest thing in N.Z. is the 'Section 17 letter' which the Revenue now use more frequently. A quick browse through the Inland Revenue Act will remind you of the extent of the Revenue's powers. Loss of your personal credibility with the Revenue is much more serious than a loss of credibility with one particular client.
The Auditor as Tax Advisor

There is an obvious potential conflict between audit and tax advice.

The client thinks the tax advice will be constrained by an audit mentality and the accountant thinks of the prospect of being both the first and second defendant if anything goes wrong. The same is true of insolvency and accounting services. It is one thing to give advice which the client can take or leave (and Dr Molloy quite rightly stresses the obligation to give such advice however sensitive the subject).

The accountant however is left to file the tax return or sign the audited accounts so that he must not only give the advice but later decide himself whether the client's response to that advice was or was not correct. I can assure you this is harder than giving the advice.

From time to time, attempts are made to have separate tax advisors and auditors. In my experience this rarely works. It leaves the auditor to ferret out all advice and re-check it and if (as is likely) the tax advisor has a reputation for being aggressive the auditor will be VERY careful.

Tax advice which is going to be unacceptable to your auditors will not help you unless you hide it from them with all that that entails.

Responsibility to the CLIENT

In an academic sense one can define the role as based on current law and practice and most importantly duty to the client.

The N.Z. Society of Accountants have recently published a "Guideline on Ethics in Tax Practice (GU8). This Statement which is based on a similar international Standard, makes (among others) the following points:-

One may put forward the best position in favour of a client provided it is in your opinion consistent with the law.

One may resolve doubt in favour of a client if in their judgment there is reasonable support for their position.
One should not hold out that one's advice is beyond challenge and ensure the client does not misinterpret an expression of opinion as an assertion of fact.

One should not associate with any return or communication which:

(a) contains a false or misleading statement

(b) contains statements or information furnished recklessly by the client without any real knowledge of whether they are true or false

(c) omits or obscures information required to be submitted and such omission or obscurity would mislead the Revenue.

I do not see any reason why you should not tell a client that in your experience the Revenue are unlikely to find out. One difficulty is whether you should advise him to rely on that. More difficult still is whether you then condone the returns it is necessary to file. I wonder how long it will be before the professional advisor will be obliged to also sign a declaration on the client's return form.

These professional obligations are easily spelt out within the professions where they are understood.

Your fellow professionals may understand your role but the client WILL NOT and (if things go awry neither will the media or the public).

The true role of an auditor is almost universally misunderstood. How many people still think that an audit report means that the company is solvent or even well managed?

Client perception of professional responsibility is different.

In the client's eyes, the benchmark is simply whether you are 'right' in the end event. He sees tax as a simple (albeit technical) matter which, like death, is certain.
If you tell a client that something is not deductible, it is quite likely that it will be allowed and he thinks you are wrong.

Conversely, if you tell him something is not taxable, and it is assessed, unless the case is heard in Court (and for every one that is there are hundreds that are not pursued for economic reasons) the client thinks you are wrong.

The client will also blame you for failing to correctly predict Government or Revenue initiatives.

The client also thinks that:

If you can't match the tales he hears at the club you are no good. If you can't match the opposition’s schemes you are no good (whether those schemes actually work or not).

It is, as I have often said, easy to pay no tax – you just have to have no income.

This state of affairs is true of many proud non-taxpayers, for example the lawyer who spent his income on a farm which then decreased in value, or who paid $40,000 to buy a plastic die worth $400.

Such taxpayers, either through pride or ignorance NEVER boast of their lack of income, only of the tax they did not pay.

**Responsibility to the PROFESSION**

Almost all discussion on responsibility of the professions focuses on the DUTY to the CLIENT.

I believe that the professions also have a wider duty to THEMSELVES. It is, I suggest, trite to say that the professions’ ONLY role is as an advocate or as a sort of encyclopedia of factual information and imply that responsibility to the client is all that matters.

Whether they like it or not the professions also have responsibilities to
their country, and particularly to the long-term credibility of their own profession. This is not to say that they are to be self-appointed protectors of the tax base.

The professions are increasingly marketing themselves and their involvement in matters which the "ordinary man" views as a bit "naughty" will affect the reputation of the profession. We may know that the "ordinary man" is un-informed, or even mis-informed but if the professions wish to retain their present exalted image in the marketplace they need to keep one eye on the potential consequences of blindly following the "service to the client" ethic.

The time-honoured sentiments about every man's right to avoid taxes are not shared by most of today's judiciary. Those quotes were made at a time when few paid tax and the Revenue were required to prove beyond doubt a liability to tax. Today, paying your share of the national tax burden is seen as a responsibility of every citizen.

In recent years tax avoidance promoters have thrived on: -

The Revenue's inability to find avoidance;
The Revenue's propensity to confuse questions of deductibility and assessability with avoidance;
The Revenue's inability to successfully prosecute;
The Revenue's snail-like pace in prosecuting.

In the excitement of the last few years it is easy to get swept along in this "beat the taxman" competition.

It has been fuelled by incompetence on the part of both Government and the Revenue.

However, overseas experience clearly indicates that such periods have occurred in all western countries in the past. They are followed firstly by draconian legislation as a reaction. Secondly, when this doesn't work, by a more aggressive and competent defence of the national purse. And thirdly, a change in taxpayer morality away from the "sharp" scheme
which has become too risky.

We should remember that tax avoidance is almost exclusively available only to the wealthy, and the majority of the population would rejoice at hearing stories of the rich being hammered.

I believe that within the near future a major company will be assessed for millions of dollars, perhaps as a result of one of the hairier financing transactions which have been popular, or perhaps just because they didn’t implement an arrangement properly. Make no mistake, the press will have a field day. The other corporates will try and disown this company, and the man in the street will howl for blood. Unfortunately, the directors will turn on their advisors and you will all pay increased negligence premiums in consequence.

One has to overlay a strictly professional definition of morality in tax practice with a commercial view based on the market position of YOUR practice and YOUR profession in the long run. It is therefore necessary for each of you to ask yourself:

WHAT SORT OF PRACTICE DO I WANT?

If you go deeply into the avoidance areas, you may make market gains in the short term, but trading that close to the edge has risks. If you don’t go into areas in which you feel uncomfortable (notwithstanding pressure from partners and clients to provide a competitive edge) will you be better off in the long term?

I believe that a useful rule of thumb is to imagine you are summoned to the Commissioner’s office. On his desk is the letter you wrote years earlier (which you are now about to sign). How would you feel? If you would feel uncomfortable or embarrassed then don’t sign it.

However much he may DISLIKE the letter doesn’t matter. The issue is whether your personal professional self-image would still be intact.
Conclusion
I believe it is dangerous to view tax practice in a narrow sense as a field of professional specialisation.

Tax is always at the forefront of economic management and as such the role of the participants in tax practice will be subjected to public scrutiny. These days it has become fashionable to question the professions' 'elitist' position and it is important that we all remember the importance of maintaining the credibility of the profession.

There will be tax-based claims against advisors, and probably also against promoters of tax schemes in the not too distant future. Make no mistake, everyone's negligence premiums go up as a result.

At the end of the day, we all have the choice of refusing to act although I suspect it is used less frequently than it should be. The worst mistake you can make with a client you don't really like or want is to do the job you dislike half-heartedly rather than declining it altogether.
LIABILITY OF ACCOUNTANTS AND PROVIDERS OF FINANCIAL SERVICES AND THE EFFECT OF QUALIFICATIONS AND DISCLAIMERS

by Dr Robert Chambers

Commentary by Mr A.N. Frankham
Chartered Accountant, Partner of Lawrence Anderson Buddle, Vice-President of New Zealand Society of Accountants
1. INTRODUCTION

1.1 I congratulate Dr Chambers on his erudite paper and his excellent analysis of the legal principles of the current law. Whilst the subject is wide and there is much that can be added to Dr Chambers' argument I shall endeavour to perform in the manner I have been requested - that is as a commentator on the learned paper and not as author of an alternative treatise.

1.2 Dr Chambers' paper does not deal in depth with 'the effect of qualifications and disclaimers'. I am neither concerned nor critical about that. He has devoted his attention, quite properly, to the major issue which is clearly of considerable concern to the professions and a matter of high public interest. It is indeed timely that a learned gathering under the auspices of the Legal Research Foundation should consider and debate this important issue.

1.3 Dr Chambers states that the purpose of his paper is to investigate whether the existing law is imposing too onerous responsibilities on accountants and if it is what the most appropriate response is. With the greatest of respect, I do
not agree with his conclusions. My commentary endeavours to put an alternative viewpoint.

1.4 My viewpoint is signalled by the following quotations:

(a) "(the ever increasing exposure of the professions to civil liability) militates against society because there is a temptation for the professional to drop the level of his responsibility ... Professionals are being driven into giving defensive advice ... Some are even starting to abandon their practices because of the civil liability risks involved."

Lord Hacking

(House of Lords debate - March 1987)

(b) "We have extended the liability for negligence to an altogether excessive degree ... It has come to the situation where, even if there has been an error of judgment or any little mistake or mischance the law holds the professional man negligent."

Lord Denning

(House of Lords debate - March 1987)

(c) "What the judgment demonstrates, if sustained on appeal, is that the financial consequences of auditors' negligence may not emerge for some years, and that when
they do they may far exceed any amount contemplated at the time of the negligent act. This makes the task of insuring against loss one of immense difficulty for the auditor and the underwriter ... How can the accountant adequately insure when the amount of possible liability is so speculative."

Rogers J
(the Judge in the Cambridge Credit case commenting on the case in an ex curial publication)

(d) "In modern times the damages that may be awarded when an auditor's breach of duty may be so high as to financially destroy the auditor and the firm without there being any realistic insurance cover. This trend, if not addressed may make insurance practically unattainable, engender unwillingness by some people to serve as auditors, fearful of crushing personal liability and ultimately undermine sufficiently the integrity of the audit system envisaged by the legislation. There needs to be a redressing of the seeming imbalance between the extraordinary extent of liability and the auditors ability to pay."

(The Report of the Australian Companies and Securities Law Review Committee to the Ministerial Council - September 1986)
2. DR CHAMBERS' CONCLUSIONS

2.1 Duty of care to too many?

Dr Chambers says -

"(Many accountants) complain that they owe a duty of care to too many people ... It is difficult to accept that (this complaint) has any validity in the auditing sphere."

"I believe most accountants would have no objection in principle to their being liable to the company and its members ... the principle behind S204 of the Companies Act seems not merely reasonable but absolutely vital for the protection of shareholders."

"So far as liability to others is concerned the position is more complicated ... they may be able to claim millions of dollars ... should they rely upon accounts which turn out to have been negligently prepared ... I do not believe that this aspect of the law requires any change ... all that is required is that (the auditor) be careful in carrying out the audit ... "

344
Dr Chambers' conclusions are quite clear under this head and I support them in principle.

2.2 Damages too high?

"The award of large sums of damages ... is not really the result of any recent change in the law ... all that has happened is that people ... have become more litigation conscious"

Dr Chambers does not reach a clear conclusion under this head.

2.3 The remedies

Dr Chambers dismisses, on both philosophical and practical grounds, the solution of statutory capping and mandatory insurance. This approach is the one most favoured by the accounting professions in the United Kingdom, Australia and New Zealand and is the system in operation in Western Germany.

Dr Chambers sees the remedy as being in the hands of the profession and suggests incorporation of practices and the right to practice accountancy as a limited liability company as sufficient to deal with the problem in that it would "remove one's personal prospective liability for the actions of one's colleagues and employees".
3. THE ACCOUNTING PROFESSION'S POSITION

3.1 In summary the views of the accounting profession (in the United Kingdom, Australia and New Zealand at least - if not worldwide) include the following:

(a) people who rely on the work of accountants and subsequently suffer loss, should continue to have the right to compensation

(b) the current exposure of accountants for unlimited liability gives an exposure where penalties are not commensurate with fault

(c) accountants who carry out the audit function are increasingly being asked to insure against corporate failure. With unlimited liability and the lack of available insurance cover auditors face the very real and serious risk of bankruptcy

(d) permitting incorporation alone will not deal with the problem

(e) some form of statutory capping with mandatory insurance is the preferred and fairest form of protection
3.2 The New Zealand Society of Accountants will shortly be making a case to Government for legislation to alter the present unlimited liability of chartered accountancy firms for damages arising from their audit responsibilities.

3.3 There is a public interest to be protected and some change in the present law is required

"There is a primary and anterior consideration of public policy which should be the starting point. That is that where there is a breach of duty causing damage to the other person, public policy in general demands that such damage should be made good to the party to whom the duty is owed by the person owing the duty. There may be a supervening and secondary public policy which demands nevertheless immunity from suit in the particular circumstances. (emphasis added)

Simon, L J
Arenson v Arenson [1977] AC 405

4. THE PROBLEM

The following summarises the problem in general. Each of the issues can be argued in depth.

4.1 Aggrieved parties in commercial failures should have the right and will seek recompense.
4.2 With dramatic growth in the size of corporate enterprises the potential for loss by creditors and investors is very significant (and is becoming more so).

4.3 Although directors have primary responsibility, aggrieved parties look increasingly to auditors for recompense. No doubt this is because auditors are perceived to have financial resources (and insurance cover).

4.4 Although auditors may be held to be responsible for a small percentage of loss suffered they can be liable for the full quantum of loss. Opportunities for recovery from directors are often minimal. Although the law may recognise culpability the effect of joint and several liability means the party with assets faces full liability.

4.5 The dramatic increase in potential liability has coincided with an equally dramatic reduction in the availability of insurance and an adverse judgment may well result in the personal bankruptcy of all partners and the demise of the firm.

4.6 In all areas where chartered accountants compete with other entities (services other than audit) liability may be limited by contract. Auditors are prohibited by statute from contracting out of liability.
4.7 Auditors may be liable both in contract and in tort for failure to exercise reasonable care and skill. It is the right of action under tort and the inability to contract out of liability that exposes the accountant most.

4.8 An auditor, in reporting adversely on financial statements runs the risk of an action for defamation and consequent potential liability for financial damage flowing from the effects of such a report. An adverse report may become a self-fulfilling prophecy. In this regard the auditor cannot limit exposure to liability by an abundance of caution.

4.9 In the event of a corporate failure every decision made by an auditor during the conduct of his work will be scrutinised using the great benefit of hindsight. The auditor will be conscious of the need for a high degree of professionalism to discharge his public interest obligation but he must have regard for the commercial reality of his role. Business and the community cannot afford the cost of an audit of a scope sufficient to provide absolute assurance. Furthermore the time delays inherent in a report providing such assurance would be of questionable value to end users.
4.10 The auditor has a statutory duty to report without limitation of liability

"given the nature of the auditing task, the amount of money, considered as a multiple of the fees received, for which auditors may be held liable greatly exceeds that of other professions. Auditors appear to carry an excessively high monetary risk"

Australian Companies & Securities Law Review Committee (para 1.4(d) supra)

4.11 Whilst available insurance cover has provided reasonably adequate protection to the auditor in the past, this is no longer the case. The accountants' professional indemnity insurance market worldwide is facing severe difficulties and there has been a drastic reduction in the capacity of the market to provide cover and very substantial premium increases are being sought for the cover that can be obtained.

5. THE CONSEQUENCES - EFFECT ON THE PUBLIC INTEREST

5.1 It is apparent that a continuation of the current exposure of accounting firms to unquantified potential liabilities and an inability to obtain adequate professional indemnity cover will have particularly adverse effects on the public interest. It is essential for the protection of the
investing public and the maintenance of commercial
credibility that auditing firms attract and retain highly
competent independent professionals. However, it is evident
that failure to provide some effective limitation on the
liability of professional firms will result in some or all
of the following consequences:

(a) partners in accounting firms undertaking auditing work
will run high risks of bankruptcy

(b) skilled partners are already and will continue to
retire prematurely to protect themselves from
intolerable potential liabilities

(c) talented professionals are being deterred from entering
a profession where the personal risks are perceived to
be unreasonable

(d) active steps will be taken by professionals to protect
themselves from the consequences of exposure by
divestment of personal assets

(e) the possibility of increased use of audit
qualifications to protect the auditing firms from
exposure to liability. As the consequences of an audit
qualification can be extremely serious for the company
being reported on, the use of qualifications to protect
against liability should be of extreme concern to the

351
commercial community and the profession

(f) the breaking up of professional partnerships and the signing of audit reports in individual names of practitioners

(g) the withdrawal from providing audit services by many accounting firms

(h) very significant increases in audit fees to recoup the insurance premium costs of available professional liability insurance

6. INCORPORATION

6.1 Dr Chambers concludes that the solution is to permit accountants and other professionals to incorporate and assume the cloak of limited liability. "While it would not reduce one's liability for one's own negligence - and that is no bad thing - it would remove one's personal prospective liability for the actions of one's colleagues and employees". Although I support limitation of liability through incorporation as far as it goes I cannot accept Dr Chambers' thesis that it is the full answer to the present problem.
6.2 Limited liability does not address at least two major problems.

(a) While limited liability may protect some partners from personal bankruptcy, a director of an auditing corporation who participates in the auditing activities of the corporation may be personally liable in tort concurrently with the corporation in the event of a breach of duty by the audit corporation (C Evans & Sons v Spritebrand Ltd, [1985], 1 WLR 317).

(b) There is a strong argument that in terms of Sections 320 and 321 of the Companies Act an officer of an audit corporation could be personally liable for the debts of the corporation in the event of the audit corporation becoming insolvent as a result of a successful action for negligence.

6.3 The enormous potential liability from a successful claim against the firm, where adequate insurance cover is not available, may well result in the demise of the firm even through many of the partners avoid personal bankruptcy.

6.4 Further, notwithstanding Dr Chambers' comments, this alternative does not lie solely within the profession's own hands. For the accounting profession a significant change in the Companies Act would be required to permit corporations to undertake auditor, liquidator and receiver
positions.

6.5 If the individual is to remain liable, the problem of insurance cover availability and cost is not likely to be ameliorated. The most dangerous of all consequences however is that unless all of the shareholders of an incorporated accounting firm were prepared to indemnify the directors providing the auditing function (thereby sharing exposure to potential personal liability) only the foolhardy or ignorant would be prepared to specialise in that field. This would in effect destroy the very foundation of a successful professional entity which provides a wide range of financial services of the highest standards to the business community. Such an indemnity would negate all of the benefits Dr Chambers perceives as all that are necessary.

7. **THE OPTIONS**

7.1 To address the problems there are a number of options. These are fully documented in the Australian Companies and Securities Law Review Committee report to the Ministerial Council on the Civil Liability of Company Auditors, September 1986.

7.2 In summary these options include:

Option 1 Require that a plaintiff exhaust all remedies available against the defaulting directors or
other parties before having recourse to the auditors.

Option 2 Enable the amount of loss for which an auditor is liable to be ascertained in a manner different from that by which any loss attributable to directors or other relevant persons is determined.

Option 3 Courts be given the discretion to apportion liability between directors, other relevant parties and the auditors, having regard to their differing degrees of culpability.

Option 4 Legislate to limit the life of an audit so that losses arising subsequently could not be attributed to it.

Option 5 Legislate to limit the potential amount of an auditor's liability (the statutory cap).

7.3 The first four options were rejected for the following reasons:

- Option 1, assessing awards to reflect the degree of responsibility represents a fundamental philosophical move away from the principle of joint and several liability. Such a move was not felt to be in the public interest.
Options 2, 3 and 4 were rejected for public policy considerations set out in the Australian Companies and Securities Law Review Committee pages 15 to 19.

7.4 The Committee supported the fifth option of a statutory cap as being "the most direct and suitable means of translating into practice the principle of limited liability for company auditors."

7.5 The New Zealand Society of Accountants supports the contention that a statutory cap on auditors liability is the most appropriate means of dealing with the problem.

8. CONCLUSIONS

8.1 By reason of the fact that this paper is only a commentary on a major paper and the time for preparation has been only a few days I have not fully developed all of the arguments in favour of my profession's case. Neither have I endeavoured to answer all of Dr Chambers' detailed objections. For those who have a serious interest in developing the very much needed solution to a serious problem I do urge a close study of the September 1986 Report of the Australian Companies and Securities Law Review Committee to the Ministerial Council on the Civil Liability of Company Auditors.
8.2 Again I compliment Dr Chambers on his well prepared and logically argued case which is admirably supported by legal precedent. With respect I do not believe Dr Chambers adequately addresses the seriousness of the problem and its effect on the public interest.

8.3 I conclude my commentary with a summary of the best way I believe the public interest can reasonably be protected.

(a) That there be a specified limit on the amount of damages that can be awarded against an auditor, once negligence is established.

This "statutory cap" could, for example, be based on a multiple of the audit fees for assignment to which the loss relates.

(b) That auditors be required to carry a minimum prescribed level of professional indemnity cover, being at least the amount of the statutory cap.

(c) That auditors be permitted, at their option, to incorporate through limited liability companies.
LIABILITY AND IMMUNITY OF ARBITRATORS, ENGINEERS, CERTIFIERS, DISPUTE SETTLERS
by Associate Professor Ian Eagles

Commentary by Mr R.P. Carter
Consulting Engineer, Partner in Beca Carter Hollings & Ferner
Dr Eagles' thoroughly researched paper traces the development - through the examination of legal precedent - of the current status of immunity for those involved in the functions of arbitration, valuation and certification.

The relevance of this paper extends well beyond one of the common processes of settling disputes, namely arbitration - it gives guidance to the status of immunity that may apply to a range of persons - many of them professionals - that are involved in the administration of business in the widest context, ie whenever a third party is called upon to interpret, certify or value an aspect of a contractual relationship.

The quasijudicial function, as Dr Eagle points out, is often only a part of a broader task undertaken by many professional advisers. Situations in which I am frequently involved as "Engineer-to-the-Contract" require the engineer, on the one hand, to represent the owner's interests in the contract (and the engineer's success with this task often depends upon the respect that he enjoys with both parties for making a reasonable interpretation of the intention of the agreement between the parties). At other times, the engineer, as with the architect, the valuer and the auditor, must discharge a quasijudicial role, frequently, but not exclusively, relating to the issuance of certificates. Confusion between these two roles has lead to misconceptions of an adviser's liability and sometimes to misconceptions of his power under the contract.
And so I read Dr Eagles' paper with much more than academic interest.

The paper is presented in three sections entitled

- Immunity in context
- Competing tests of immunity
- Future developments and solutions

The author develops the complex and often contradictory background through the first two of these sections prior to postulating in the third the alternative courses of direction that may be taken. His advice, to those exposed to liability for their actions, is contained in the last section - it is both clear and practicable.

The earliest case history, right through to the prediction of future trends, shows a continual reduction in the extent of immunity even to the point made late in the paper that legal counsel - when acting in arbitration - may be denied immunity!

As the paper points out, so long as the definition as to whom immunity will apply remains obscure, there will be challenges to the protection that any person involved in arbitration can enjoy. However, some of the more likely definitions seem to draw the line between a "real arbitrator" and a lesser qualified mortal in an inappropriate position; whilst other definitions serve more to help in clarifying situations that would certainly deny claims to immunity. None of the definitions appear entirely suited. The view I arrived at in following Dr Eagles' argument is that a more specific definition of what constitutes a real arbitrator is just as likely to create fertile ground in which to sow seeds of doubt as it is to clarify the matter. Such definitions could well lead to yet more legal argument.
It seems that the more judicial the manner in which the arbitration is performed the more likely that immunity would be conferred. However, to prevent too many technical experts feeling that they are protected so long as they carry out their quasijudicial duties in an adversarial way, the paper warns that when exercising technical skills in the investigatory phase, immunity is unlikely to apply.

Unlike many of your other commentators, it is not for me to debate or even discuss the various views referred to in the paper or to draw differing conclusions on the extent of immunity and to whom it may apply. For me, as I guess for most of the laymen and perhaps even some of the judiciary who read this paper, is its relevance to the application of professional advice in general; ie with respect to both the routine advice given to clients as well as the more special case of the process of arbitration itself.

From my position the paper has signalled three issues.

The first is that no one can safely assume, when acting in any professional capacity as arbitrator, certifier or valuer, that he or she will not be held liable for their actions - unless they take steps in their commissioning to ensure otherwise.

My second concern goes, in part, beyond the subject of this paper. Dr Eagles, in his chapter on Policy Arguments for Arbitral Immunity, asserts that there appears to be no shortage of architects, auditors and so forth, offering themselves for work in this subject area, and that professional indemnity insurance is available for those who act. I fear that these views are optimistic and while this is the present case in countries whose legal processes are founded on British law, it is no longer so certain in the USA. In that country the relentless pursuit of absolute liability
has reached the stage that the public is being disadvantaged by unavailability, or difficulty in obtaining insurance and also by professional services being withheld for fear of the extreme consequences of the liability for error. This "hot topic" can be expected to have ramifications beyond the USA; it is already seriously affecting insurance premiums worldwide. Notwithstanding this alarming trend, I believe that engineers will still come forward to serve as arbitrators - they should not regard the associated liabilities any greater than those they must carry in their other activities.

My third concern also relates to the responsibility rather than the liability for giving professional advice; ie whose job should it be - and the answer to that question clearly is dependant upon the subject concerned. I would like you to consider the situation in which a construction contract provides for arbitration, an arbitration is held and due to a failure to have due regard for some process of law, the award is set aside. This has happened on a number of occasions as we are all well aware. I have heard said by a number of disenchanted engineers that the process of arbitration is no longer appropriate and that disputes on building contracts should be settled in the courts. Now, as I can see from the paper, the arbitrator himself is likely to be held liable for the cost consequences of his decision. This is yet another circumstance which can reduce the acceptability of the arbitration process. I therefore think it is relevant to dwell for a moment on the possible outcome of this trend. When the court system is already overloaded I can hardly believe the judiciary want to see the full range of matters currently very adequately decided by practitioners in the construction industry suddenly come before the courts.
Construction contracts, by their very nature, present a continual barrage of issues which for the most part the managers of construction companies and architects, engineers, quantity surveyors resolve. I believe all the professionals involved in this process are all becoming painfully aware of the potential for liability which surrounds their day-by-day work. Nonetheless, the questions are usually of a technical nature and are dealt with in a satisfactory manner by the persons involved. Some cannot and go to arbitration and for the majority of these the decisions arrived at in arbitration are accepted. It would seem to me that the pragmatism which pervades this system is the right way to handle disputes on a building site.

I believe it would be a retrograde step if it becomes the vogue for one party or the other to be readily able to get issues referred to the courts. Handled well arbitration can achieve a speedy and cost effective resolution to disputes. Emphasis should be on developing better arbitrators.

As I see it, any contract which stipulates arbitration in terms of the Act has been knowingly entered into by the parties and each of them is afforded an equal opportunity to select arbitrators who are judged competent to decide upon the issues. There is much to be commended in making the parties responsible for the quality of arbitrator they choose. It is also reasonable to presume that the procedure of arbitration was selected not only because it has been in customary use but also because it was considered appropriate. In these circumstances I think there is much to be said for not tampering with decisions so reached. Clearly this can only be achieved if arbitration proves to be just
and hence I believe we should put effort into achieving this end. As a corrollary if we are successful in improving the quality of arbitration, the question of liability of the arbitrator will not arise.

Dr Eagles, I compliment you on an exhaustive and lucid presentation of the issues relating to immunity and liability of the arbitrator. I am sure it will clarify these considerably for all those who study your paper.

May 1987
LIABILITY OF RECEIVERS, LIQUIDATORS, INVESTIGATORS AND INSPECTORS

by Mr Peter Blanchard

Commentary by Ms Elizabeth Hickey
Technical Director Arthur Young, Co-Author “Liquidations — A Practical Guide”
In preparing this commentary we bring to the task not a legal background but rather our combined practical experience in receivership, liquidation, investigation and inspection assignments.

INVESTIGATIONS

This aspect was not discussed in Mr Blanchard's paper; perhaps because an investigator is not appointed in terms of a statute nor usually in terms of a document such as a debenture. In the context of the topic we confine our comments to what accountants term "pre-insolvency investigations". Such appointments need to be delicately handled. Typically a debenture holder (the trading bank) has some considerable concern about the debtor company, but may as yet be reluctant to appoint a receiver. The bank requires both information and an independent source to weigh the evidence in a business sense. The company through its officers may be helpful or uncooperative. The bankers have no wish to incur a professional fee. The often unwilling company appoints an investigator of the bank's choosing who reports to the company, with the clear understanding that the bank is to receive a copy of that report. The investigator is looking to the company for his or her fee.

In contrast to a section 9A inspector who has a narrow function, the investigator's brief tends to be open ended, and is often unwritten. The investigator, unlike an auditor, does not have the relative security of a standard form report to fall back on. These matters increase an investigator's possible liability.
We know of no reported cases, but surmise the investigator's liability might include:

- a duty to the debtor company with consequent potential liability to it in contract.

- a potential liability in the tort of defamation

- potential liability to the bank in negligence; it being plainly clear to the investigator from the start of the assignment that the bank may rely on the investigation report.

- a potential liability in negligence to other third parties, who might reasonably be contemplated to read and rely on the report. The company may be endeavouring to attract further equity investment to relieve its liquidity problems with the bank.

The liability in negligence encompasses a failure to detect and report on matters amiss in the affairs of the debtor company. The investigator does not have the same luxury of time afforded even an auditor. Neither does he or she possess the same background knowledge of the company and its industry.

Attempts by an investigator to lessen such liabilities will usually include:

1. The inclusion of some form of disclaimer in the investigation report to limit both the purposes for which the report is used and the parties to whom it is presented. Such disclaimers are at best a partial defence mechanism.
2. Discussion of the report contents in draft with officers of the company in order to clear any misunderstandings which may have arisen from the investigator's brief consideration of the company and its business. In reviewing the draft report with officers of the company, the investigator must remember that one of the purposes of the report is to provide an independent assessment of the company.

3. The investigation report will usually contain a clear identification of the basis of the engagement, mentioning particularly that it is not an audit, and indicating where reliance has been placed on explanations given by the company's staff and officers.

RECEIVERSHIPS

Receivers are remunerated on the basis of the time spent on an assignment, and not on the basis of the risks taken. It is important that they are aware of their exposure to liability. We highlight below some liabilities receivers may face.

1. Liability in trespass

The rights, powers and duties of a receiver are determined by two documents, the debenture itself and the instrument of appointment. A receiver must be satisfied that both documents have been properly drawn, executed and are valid in all respects. The receiver must be acquainted with his or her powers and duties set out in the documentation.

If either the Deed of Appointment or the debenture is unsound, the receiver may be regarded as a trespasser and become personally liable on contracts undertaken in the name of the company or for assets converted into cash.
The Court is empowered to relieve a receiver from liability due to a defect in his or her appointment. Section 345A states, inter alia,

"(1) Where the court is satisfied that a person who has acted as receiver... has incurred liability solely by reason of some defect in his appointment ... and that in all the circumstances the person ought fairly to be excused, the Court may relieve the person, either wholly or in part, from his liability on such terms and conditions as the Court thinks fit.

(2) Where the Court grants relief from liability pursuant to subsection (1) ... then, subject to such terms and conditions as the Court thinks fit, the liability shall be that of the person who appointed the receiver ..."

This in effect empowers the Court to impose any liability arising from a defect in the debenture or the appointment on the debenture holder. However, a receiver 'elect' would be most unwise to rely on section 345A as an alternative to taking all reasonable precautions to ensure that the appointment is in order before it is accepted.

A somewhat related issue arises with regard to assets located overseas. Receivers appointed to companies with assets and liabilities overseas must take special care. They must ensure that the debenture under which they are appointed has been registered in the jurisdiction in which the assets are situated, and must seek appropriate local legal advice. Failure by a debenture holder to register a debenture in another jurisdiction means that the debenture will be void as against other creditors in that jurisdiction in respect of assets situated there.
2. **Liability - selling goods without title**

If the debtor company has purchased goods and the goods have been delivered and title has passed, then the receiver is entitled to retain such goods on behalf of the company and the vendor will rank simply as an unsecured creditor. If, on the other hand, title to the goods is not passed to the debtor company, or alternatively will pass only on payment, then the receiver, if he or she does not wish to use the goods, should return them to the supplier without payment.

Some suppliers purport to retain title until such time as the goods are paid for. This condition of sale is commonly known as "reservation of title" or a "Romalpa clause". On appointment, a receiver should enquire as to whether any stock held by the company is held subject to an alleged reservation of title. Where this is so, the receiver should seek legal advice concerning the effectiveness of the purported reservation of title. Often, however, the debtor company's staff will have no clear idea as to whether any stock held by the company is subject to alleged reservation of title.

Aside from the "Romalpa clause" situation, the receiver must ensure that the company otherwise has good title to goods offered for sale. It would be embarrassing and costly to find, after a sale was consummated, and the receivership terminated, that the goods sold were subject to a hire purchase or lease agreement.

When selling assets or the business as a going concern, the receiver should insist on excluding his or her personal liability as permitted by section 345 of the Companies Act 1955 by inserting in all agreements a clause which makes it quite clear that the receiver is entering the agreement as receiver and shall not be personally liable pursuant to the agreement.
3. Liabilities of continuing to trade

Usually the powers conferred on a receiver by a debenture include an authority to carry on the business of the company. Although the receiver is less likely to incur personal liability by closing the business down and selling the assets piecemeal, the assets may not be realised to the best advantage.

 Receivers tread a very thin line. They are unlikely to trade profitably in the initial stages of a receivership and must balance the additional funds they expect to realise from a going concern sale against the cash loss from unprofitable trading. Receivers must operate for only a limited time unless they can achieve profitable trading. A simple, efficient and accurate reporting system is vital.

The carrying on of a business necessarily will involve borrowing even if it is only by way of normal credit terms extended by suppliers. When receivers obtain credit by way of countersigning approval on a purchase order they borrow in their personal capacity. This is true of any borrowing unless the receiver specifically states in writing prior to actually incurring the liability that he or she is borrowing only as an agent and is excluding any personal liability. Usually such an exclusion of liability, while highly desirable, will be very difficult to obtain in practice.

However, when borrowing, other than by obtaining usual monthly credit, receivers should discuss with their solicitor the possibility of excluding their personal liability. There must be no doubt about the receiver's authority to borrow or to pledge assets in support of borrowings.
Where a construction company is trading in receivership and the receiver tenders for a new contract, he or she will be faced with having to arrange a performance bond. There will be full recourse back to the receiver for any amount the surety has to pay under the bond, unless and it is most unlikely, the receiver is able to exclude personal liability.

Often a receiver continuing to trade a company will be making sales on hire purchase. All hire purchase sales agreements entered into after receivership should be appropriately endorsed by the receivers to exclude personal liability. Similarly where a hire purchase agreement is discounted, the assignment should exclude the receiver's personal liability. This might be achieved by the following clause:

'This agreement/assignment is made by the receiver as agent for the vendor and the receiver shall be under no personal liability whatsoever to the purchaser/company.'

It is not uncommon for a liquidator to be appointed while the receiver is still in office. In these circumstances the receiver must immediately cease trading as the liquidation automatically cancels the receiver's right of agency, and he or she becomes personally liable in respect of any contract entered. The receiver is not entitled to create debts which would be provable in liquidation. While the receiver can no longer carry on the business, his or her power to realise assets continues, subject of course to the debenture being enforceable against the liquidator.
4. Coping with liabilities after termination

Before the receiver terminates the receivership he or she must be satisfied that all claims and outstanding liabilities have been satisfied. If the receiver has been trading advice should be sent to all parties with whom he or she has had transactions. That advice should indicate that the receivership is being terminated and ask for a final statement of account. As a precaution the receiver should obtain, if this is not already held, a suitable indemnity from the debenture holder against any contingent liabilities.

It is possible that the receiver's appointment may be withdrawn by the debenture holder prior to the completion of the receivership. Under these circumstances the receiver must ensure that the following liabilities are discharged:

a) Costs of realisation of the company's property

b) Outgoings and costs incurred by the receiver in carrying on the business and in collecting and recovering the company's assets

c) Receiver's remuneration

d) Preferential creditors.

The receiver is entitled to retain assets in order to meet those liabilities. If a receiver appointed under a floating charge debenture neglects to discharge the preferential creditors, he or she will become personally liable.

The judgment of Goff J in Commissioners of Inland Revenue v. Goldblatt (1972) 47TC 483, is of interest. The Judge said, inter alia,
"It would follow that, if a receiver be not merely removed but another appointed, the first cannot safely account to the second, nor can the second demand the assets from the first, without the preferential debts of which the first receiver has notice being paid or provided for ..., but in any judgement, once the receiver has collected assets, he is liable to the extent of those assets for any preferential debts of which he has notice."

5. Attempts to lessen a receiver's liabilities

Indemnities

As already noted above, the receiver is personally liable for all contracts into which he or she enters and for any losses sustained while carrying on the business. Receivers have a right of indemnity out of the assets, but if the assets are insufficient they could be faced with personal loss.

There is often a large element of risk in continuing to trade a company in receivership, particularly in the early days. Often there is no accounting information system or, alternatively, it is inadequate. Often it is well behind, and, together with the general administration, is in a state of poor repair. The receiver often has to make significant decisions on the basis of inadequate facts.

Receivers who continue to trade a company in receivership should first insist upon a full indemnity from the debenture holder.
Competent independent legal advice

It is important for receivers to have a basic understanding of the law which will enable them to recognise legal problems as they arise. It is of even greater importance to have the assistance and guidance of a solicitor who is a specialist in commercial and corporate law and who is prepared to be readily accessible to the receiver. Not only must the legal advice sought be highly competent, but the solicitor or solicitors advising receivers should be independent of both the debenture holder and the company.

File notes

It may become necessary for the receiver to defend his or her position, possibly in Court. It is thus important that receivers maintain proper and adequate working paper files. Notes and/or minutes should be kept of each meeting, telephone call, or other discussion of any significance. Both the minutes and notes are an important documentary record, and should be written clearly and concisely and be initialled and dated.

LIQUIDATIONS

1. Carrying on business - a contrast

A liquidator has the statutory power to carry on the business of the company, so far as necessary to beneficially wind the company up. A liquidator carrying on the business of the company does so as the company's agent and is not personally liable on contracts entered into as liquidator. Creditors for the liquidator's period of trading are entitled to be paid in priority to the creditors at the commencement of the winding up.
The liquidator also has a statutory power to raise money on the security of the assets of the company.

2. **Statutory Duties**

As indicated in Mr Blanchard's paper the liquidator has certain statutory powers and statutory duties. If the liquidator exceeds those powers or fails to carry out those duties he or she will be liable to anyone who thereby suffers loss.

Creditors or shareholders, who may have lost a considerable amount of money through the debtor company, will often look to what recovery they might make from the liquidator. The liquidator is not liable for debts of the company incurred before the liquidation, neither, as Mr Blanchard points out, is the liquidator an insurer against all the hazards of a liquidation. The major areas of practical concern are:

a) negligence in realising the assets
b) not meeting a valid claim against the company
c) paying out a claim which is not due by the company.

The liquidator cannot use the Companies (Winding Up) Rules 1956 as a shield for protection in calling for proofs of debt. He or she must consider, in the light of all the information available from the records of the company, the areas from which claims may come, and must then seek out creditors. Liquidators often interpret their power to make a compromise or arrangement with creditors or persons having a claim against the company, as a licence to take a "commercial approach" in admitting and rejecting proofs of debt. A "commercial approach" is inappropriate for a statutory duty and, however difficult that may be, liquidators must make sure that they pay no creditor who should not have been paid, that they seek
proofs of debt from all possible creditors, and that they pay any creditor who has proved and who should have been paid. The power to compromise applies only where the creditor has a claim against the company, but the amount of that claim is unable to be ascertained or is contingent.

3. Attempts to lessen a liquidator's liabilities

Competent independent legal advice

As for receivers, it is equally important for liquidators to have a basic understanding of the law, and to have the assistance and guidance of a solicitor specialising in commercial and corporate law who is independent of both the major creditors and the company. However, as Mr Blanchard points out, "legal advisors, unfortunately, are fallible." The liquidator may well be personally liable notwithstanding the fact that he or she has received legal advice and acted on it.

Directions from the Court

The best available solution to resolve a question arising in a liquidation is the liquidator's power to apply to the Court for directions. Having a dispute determined by the Court is time consuming and expensive. We have yet to see what impact the new Commercial List may have on the time and cost of such actions. Delays lessen the value of any ultimate distribution to creditors. Yet the best advice is for a liquidator to apply to the Court in cases of doubt, especially where considerable amounts of money are involved.
Can receivers or liquidators be held liable as officers to maintain proper accounting records for the company in terms of section 151(7) of the Companies Act 1955; and if so are they exposed to potential liability in terms of section 319(1)?

The term "officer of a company" is generally regarded in a narrow sense as including only the director(s) and secretary. Section 2(1) of the Companies Act 1955 states that the term officer "includes a director, manager or secretary". The same sub-section states that the term director "includes any person occupying the position of director by whatever name called". The definitions are not exhaustive.

A receiver, per se, does not come within the definition of an officer of a company. The obligation to maintain accounting records still remains with the directors of the company. (Refer Smiths Ltd v. Middleton (1979) 3 All E.R. 842, at 847.) But a receiver may take over the management functions of a company. So long as a receiver merely takes control of particular assets and takes receipt of revenue from those assets for the benefit of the debenture holder, the receiver is not acting in the management of the company. But should the receiver's powers extend to those of a manager, then we believe that the receiver/manager could incur liability under ss.157 and 319.

When a company is in liquidation the directors no longer have authority to act for the company. The liquidator however, has power to trade the company so far as is necessary for a beneficial winding up. In Australia, there has been a reported instance of a liquidator being held personally liable for the debts of the company. (Refer Re Timberlands Ltd (In Liquidation) (1979) 4 A.C.L.R. 259). The court enquired into the liquidator's failure to perform his statutory duties, and his failure to keep proper accounting records. As a
consequence of the investigation, the court ordered his removal as liquidator, disallowed his remuneration and ordered the liquidator to make good losses totalling nearly $367,000.