Controlling Liability To Passive Sufferers Of Negligent Misstatements

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Passive sufferer cases in the area of negligent misstatement are anomalous and, as Lord Oliver commented in *Caparo*, "do not readily fit into easily definable categories".[1] This latter statement was a reference to the fact that the existing categories of duty situations had developed from situations where the plaintiff either as intended or unintended recipient, had ultimately used and relied on the negligent advice or information and thereby suffered damage. However, the passive sufferer of a negligent statement has not used or relied on that statement. The reliance has been by a third party with resultant damage to the passive sufferer. Instances of plaintiff passive sufferers of negligent statements are found in Great Britain,[2] Australia[3] and New Zealand.[4] The "disappointed legatee" cases such as *White v. Jones*[5] and *Gartside v. Sheffield Young and Ellis*[6] (failure to prepare and execute a will within a reasonable time), *Hill v. Van Erp*[7] and *Seale v. Perry*[8] (failure to ensure proper execution of a will) and *Ross v. Caunters*[9] (failure to give warning concerning proper execution of the will) are examples of passive sufferers and raise similar difficulties but are not discussed here since they do not involve negligent misstatements. A

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1 [1990] 2 AC 605 at 635; see also the difficulty Wootten J had in defining the category of passive sufferers in *B.T. Australia Ltd and another v. Raine and Horne Pty Ltd* [1983] 3 NSWLR 221.

2 *Ministry of Housing v. Sharp* [1970] 2 QB 223; *Spring v. Guardian Assurance plc.* [1994] 3 All ER 129.

3 *B.T. Australia and another v. Raine and Horne Pty Ltd* [1983] 3 NSWLR 21.

4 *South Pacific Manufacturing Co Ltd v. New Zealand Security Consultants and Investigations Ltd* [1992] 2 NZLR 282; *Balfour v. Attorney-General* [1991] 1 NZLR 51; *Wild v. National Bank of New Zealand Ltd* [1991] 2 NZLR 454.

5 [1995] 2 AC 207.

6 [1983] NZLR 37.

7 (1997) 71 ALJR 487.

8 [1982] VR 193.

9 [1980] 1 Ch. 297.

more recent example of a situation analogous to the "disappointed legatee" cases is found in the court of appeal in New Zealand in *Connell v. Odlum*[10] where a solicitor was held to owe a duty of care not to his client but to the spouse of his client for failure to give full instructions to the client concerning the implications of a matrimonial property agreement thereby resulting in the agreement being declared void.

The passive sufferer cases in negligent misstatement have posed particular difficulties for application of an incremental approach to duty of care. An incremental step "being a small amount by which a variable quantity increases"[11] cannot describe the step required for courts to move from the existing categories of "reliance" cases, where the plaintiff was the user of the negligent statement, to situations where the user was a third party with resultant economic loss to the passive plaintiff. To find a duty of care owed to the passive plaintiff has presented the court with a choice to open either an entirely new category, or confine liability to the existing categories. The incremental approach to the duty question, has generally provided no yardstick or starting point in the passive sufferer cases and the courts have searched elsewhere for determinants of the duty issue. Salmon LJ in *Ministry of Housing v. Sharp* adverted to this difficulty in the "passive sufferer" case before him:

> The present case does not precisely fit into any category of negligence yet considered by the courts. The plaintiff has not been misled by any careless statement made to him by the defendant or made by the defendant to someone else who the defendant knew would be likely to pass it on to a third party such as the plaintiff, in circumstances in which the third party might reasonably be expected to rely upon it: see, for example, Denning LJ's dissenting judgment in *Candler v. Crane Christmas and Co* [1951] 2 KB 164, 174, which was adopted and approved by the House of Lords in *Hedley Byrne* [1964] AC 465. I am not, however, troubled by the fact that the present case is, in many respects, unique. I rely on the celebrated dictum of Lord Macmillan that 'the categories of negligence are never closed', *Donoghue v. Stevenson* [1932] AC 562, 619.[12]

Ministry of Housing v. Sharp involved the following facts. The Ministry of Housing and Local Government registered a planning charge with the local land registry. The charge was on a piece of land at King's Langley owned by a Mr Neale. Subsequently a company which intended to purchase the land requisitioned an official search at the local land registry. The clerk in the registry, who made the search, was negligent. He failed to notice the Ministry's charge; or to include it in the official certificate. He issued a clear certificate to the purchasers. They completed the purchase on that footing. The Ministry as a consequence of the clear certificate issued to the purchasers lost the benefit of their charge. The Ministry sued the clerk and the local Council for negligence. The Ministry was a passive sufferer of economic loss due to the clerk's negligent misstatement in the certificate supplied

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10 [1993] 2 NZLR 257.

11 *South Pacific Manufacturing Co Ltd v. New Zealand Security Consultants Investigations Ltd* [1992] 2 NZLR 282 at 325.

12 [1970] 2 QB 223 at 278.

to and relied upon by the purchaser. In *Sharp* the Court of Appeal applied proximity as the control on duty of care. Cross LJ stated:

> The question is whether there was sufficient 'proximity' between the Ministry and the searcher — whether he was sufficiently their 'neighbour' — to render him liable to be sued under the modern developments of the law of tort which were initiated by *Donoghue v. Stevenson* [1932] AC 562 and extended to negligent statements in *Hedley Byrne and Co Ltd v. Heller and Partners Ltd* [1964] AC 465.[13]

Salmon LJ in the same case relied on proximity:

> The servant and certainly the Council must or should have known that unless the search was conducted and the certificate prepared with reasonable care, any chargee or encumbrancer whose registered charge or quasi charge was carelessly omitted from the certificate would lose it and be likely to suffer damage. In my view, this factor certainly creates as close a degree of proximity between the Council and the encumbrancer as existed between the appellant and respondent in *Donoghue v. Stevenson* [1932] AC 562.[14]

The House of Lords more recently in *Spring v. Guardian Assurance plc*[15] dealt with a passive sufferer situation involving an employee who failed to obtain employment as a result of a negligent reference supplied by his former employer to a prospective future employer. The employee sued his former employer for the economic loss resulting from the negligent reference supplied by the defendant. This case fell outside the facts of *Hedley Byrne* since in Hedley Byrne the plaintiff was the intended recipient of the negligent credit reference, whereas the plaintiff in *Spring* was not the intended recipient of the reference but the passive sufferer of its use by the intended recipient. There was significant reliance in *Spring* on the proximity of relationship (or its indicators) between the employer supplying the reference and the plaintiff employee the subject of the reference.[16] As part of the foundation for duty of care it was stated that "there was as obvious a proximity of relationship in this context as can be imagined".[17]

In New Zealand proximity has been used as the starting point for gauging whether a prima facie duty of care is owed to passive sufferers of negligent advice or information relied upon by a third party. The most recent incidence of passive sufferers of negligent advice or information in New Zealand occurred in *South Pacific Manufacturing Co Ltd v. New Zealand Security Consultants Investigations Ltd*[18]. This litigation involved claims for economic loss by an insured and by a shareholder and

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13 [1970] 2 QB 223.
14 *Ibid* at 278.
15 [1994] 3 All ER 129.
16 *Ibid* at 143 ff, 152, 161, 170-171.
17 *Ibid* at 161.
18 [1992] 2 NZLR 282.

creditor in an insured company. As a result of negligent reports by defendant insurance investigators, supplied to and relied upon by an insurance company, insurance claims by the insured parties were rejected. Actions in negligence were commenced not only by the insured against the insurance investigators, but in the case of the insured company, by a shareholder and creditor in that company. The Court of Appeal applied proximity in this litigation to determine whether a prima facie duty of care was owed by the insurance investigators. Cooke P stated that:

> What is plainly at the forefront of the factors telling in favour of the duty is the close proximity between the investigators and the insured. True the contract of the investigators is only with the insurer, but by entering into the contract of insurance the insured has placed himself in a position where he must submit to investigation by the insurer's representatives in the event of a claim. Further, that close proximity means that neither the fact that the alleged loss is economic nor the preference of judges for proceeding step by step or incrementally creates any obstacle to a decision in favour of the duty of care. Still, by accepting by their contract with the insurer the responsibility of investigation, the investigators have brought themselves into immediate proximity to the insured whose actions they have agreed to investigate. The relationship between the persons investigated and the investigators is at least as close as, if not closer than, the various relationships hither to held to give rise to a duty of reasonable care to avoid economic loss.[19]

The claims by the shareholder and creditor of the insured company failed for lack of a sufficiently proximate relationship between insurance investigators and parties having such interests in the insured company. Cooke P commented that even if the investigators owed a duty of care to the insured, such a duty would not extend to persons financially interested in the insured.[20] Richardson J referred to the indirectness of relationship between the creditor and shareholder in the insured company, and the insurance investigators.[21]

Two further passive sufferer cases in New Zealand involving negligent misstatements are *Balfour v. the Attorney-General*[22] and *Wild v. National Bank of New Zealand Ltd*[23]. *Balfour* concerned a memo from one inspector to another indicating that the plaintiff, a teacher, was homosexual. This memo was placed on the plaintiff's file. The allegation in the memo had not been properly investigated before being recorded and was prejudicial to the plaintiff's career as a teacher. The Court of Appeal considered the issue of proximity on the duty question but ultimately found against a duty on policy grounds.

In *Wild v. National Bank of New Zealand Ltd*, Smellie J in the High Court found a bank owed a duty of care for negligent statements made by a branch manager to a

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19 *Ibid* at 300.
20 *Ibid* at 299.
21 *Ibid* at 310.
22 [1991] 1 NZLR 519.
23 [1991] 2 NZLR 454.

trustee for a proposed company yet to be incorporated. The court found that the bank owed a duty of care for its statements to the company even though it was the trustee and not the company which had relied on the negligent advice and despite the company not being incorporated at the time of the advice and reliance of the trustee. The court found a proximate relationship sufficient for duty existed between the bank and the plaintiff company. This proximity was established by the fact that the bank was aware that the trustee was seeking information as a basis to make a decision whether to buy a business on behalf of the company yet to be incorporated. These facts alone pointed to a relationship of proximity.

In Australia the plaintiff in *BT Australia Ltd and Another v. Raine and Horne Pty Ltd*[24] was a passive sufferer of a negligent misstatement supplied by a valuer to a trustee for unit holders. The trustee of a trust used as an investment fund for the assets of superannuation funds of which the trustee was the investment manager sought from a professional valuer the value to be attributed to certain units in the trust fund. The valuation was to be used and relied on by the trustee in the carrying out of its duties as investment manager of the fund and in ascertaining the value of certain trust property. The valuer, with this knowledge of the use to which the valuation would be put, supplied a valuation which contained an error attributable to its negligence. As a result of the error in the valuation individual unit holders as clients of the trust's superannuation fund suffered economic loss. Wootten J referred to the following passage from Glass JA:

> When the nature of the risk presented to the plaintiff by the defendant's carelessness is allotted to the appropriate sphere of human conduct, the situation linking plaintiff and defendant is to be measured to determine whether the evidence discloses the appropriate relationship (proximate or special) productive of the relevant duty of care. If so, a prima facie duty of care is owed which may for policy reasons be displaced. But policy considerations have no role to play in determining whether the plaintiff and defendant are so placed in relation to each other that a prima facie duty of care is owed.[25]

Wootten J found a duty of care owed by the valuer to the unit holders. This duty of care arose from a proximate relationship based on an assumption of responsibility[26] by the valuer. The valuer was aware that the trustee would himself act on the information in the execution of a duty which he owed to the plaintiff unit holder in a way which might cause economic loss to that plaintiff.

Conclusion

The passive sufferer cases indicate a use of proximity as a prima facie yardstick for duty of care in the supply of advice or information. It would seem that where the

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24 [1983] 3 NSWLR 221.
25 *Ibid* at 227, 228.
26 *Ibid* at 229, 235.

incremental approach cannot bridge the gap from the existing category of the plaintiff user of negligent advice or information to the category of the plaintiff passive sufferer of a third party's use of a negligent misstatement, the courts have turned to other controls such as proximity of relationship as the yardstick of duty. This use of proximity may result from the fact that whether the plaintiff was the user of the negligent advice or merely the passive sufferer, does not prevent the court from examining a range of indicators measuring proximity between plaintiff and defendant. The degree of proximity between plaintiff and defendant may be examined in any given circumstance and its usefulness does not cease or depend on the type or novelty of category of plaintiff. This flexibility and adaptability of proximity to any circumstance suggests a significant advantage over the incremental approach. The weakness of the incremental approach on duty of care found in the passive sufferer cases, is that in some circumstances the courts simply cannot work incrementally. When this occurs, it is necessary for the court to adopt some other device by which to gauge the duty of care question, otherwise the court is left without any yardstick. The "passive sufferer" cases indicate that proximity can be applied in circumstances where it is difficult or impossible to work incrementally from established categories of duty situations. Proximity can provide a starting point from which to gauge or predict the likely outcome of the duty question in any circumstance whether novel or not. The same cannot be postulated for the incremental approach.

While proximity provides a yardstick for duty across disparate circumstances of negligently supplied information or advice, it also prevents an exposure of defendants to an indeterminate liability. This was particularly evident in *South Pacific Manufacturing Ltd v. New Zealand Security Consultants and Investigations Ltd*[27] where a proximate relationship was found between insurance investigators who reported to the insurance company and the insured, but not between the insurance investigators and a creditor and shareholder in the insured company. This latter relationship was too indirect.[28] A finding that the insurance investigators owed a duty of care to shareholders and creditors in the insured company would have meant that a sufficiently close relationship could exist at two removes from the direct effect or detriment of the defendant's negligence. The defendants supplied their report to the insurance company and the shareholder and creditor were at two removes from the insurance company.

In the cases of *Ministry of Housing v. Sharp*[29], *BT Australia Ltd v. Raine and Horne Pty Ltd*[30] and *Wild v. National Bank of New Zealand Ltd*[31] where the application of proximity resulted in a duty of care owed to the passive sufferer, there was a close circumstantial relationship between the third party user of the negligent misstatement and the passive sufferer. The passive sufferer in each instance incurred

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27 [1992] 2 NZLR 282.
28 *Ibid* at 310.
29 [1970] 2 QB 223.
30 [1983] 3 NSWLR 221.
31 [1991] 2 NZLR 454.

economic loss at one remove from the third party user. In the cases of *BT Australia* and *Wild* the trustee in each case was the recipient and user of the negligent misstatement and the beneficiaries in each instance were the passive sufferers of economic loss. A finding of duty in these cases did not therefore expose the defendants to an indeterminate liability to an unascertained class for an indeterminate amount of time. It would seem that justice was served by recovery by the plaintiffs in *Sharp*, *BT Australia* and *Wild*, since in each instance it was not unreasonable that the defendants should compensate plaintiffs who were so obviously to be directly and immediately affected because of the latter's close circumstantial relationship to the party supplied with the negligent misstatement.