IMPLICATIONS FOR AUDITORS OF THE HIGH COURT DECISION IN *PERRE V APAND*

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The recent decision of the High Court of Australia in *Perre v Apand Pty Ltd*[1] examines the current status and conceptual underpinnings of the law of negligence in relation to pure economic loss, which Kirby J describes as presently disordered and uncertain.[2] While the case itself concerns loss suffered by having to quarantine potatoes to avoid the spread of a disease called "bacterial wilt", the Court looked at many factors in the law, such as indeterminacy of class, vulnerability to risk, proximity and fairness, which are also relevant to auditors' liability for negligence to third parties.

Although the High Court was unanimous in finding in favour of the plaintiff, the seven justices[3] all gave separate judgments. This paper will ask, firstly, what, if any, is the ratio of *Perre v Apand*, which will govern the direction and determination of future cases of pure economic loss. Secondly, since the High Court has recently considered the liability of auditors[4], the paper will question whether the *Perre* decision will, or should, affect future cases involving auditors.

THE DECISION IN *PERRE V APAND*

The facts of the case are briefly as follows. The appellants grew potatoes on a farm close to land on which a potato disease was found to be present. It was alleged that the respondents had negligently introduced this disease to that land. The appellants

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1 (1999) 73 ALJR 1190.

2 (1999) 73 ALJR 1190 at para 233.

3 Gleeson CJ, Gaudron, McHugh, Gummow, Kirby, Hayne and Callinan JJ.

4 *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241.

suffered financial loss, not from their potatoes contracting the disease, but from the effects of a quarantine order imposed by the State of Western Australia to which they intended to export their produce.

The judgments looked at three different matters. The point most extensively covered was the current state of the law in relation to pure economic loss and its application to the facts of the present case. Several justices also addressed the issue of how the law developed. Some of the judgments also considered policy matters, such as indeterminacy of liability, disproportionate liability and economic freedoms.

The Duty of Care for Pure Economic Loss

It was accepted by the Court that the "exclusionary rule" (which denied any liability for negligence causing only pure economic loss) had now developed a number of exceptions, following the House of Lords' decision in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*[5] in 1963. But those exceptions, according to McHugh J, "have been developed in a haphazard and ad hoc fashion with no single principle underlying them".[6]

McHugh J went on to sound a small note of regret in the passing of the exclusionary rule:

> Bright line rules may be less than perfect because they are under-inclusive, but my impression is that most people who have been or are engaged in day-to-day practice of the law at the trial or advising stage prefer rules to indeterminate standards.[7]

Kirby J, on the other hand, spoke of the rule's "injustice and apparently capricious illogicality"[8] in approving the dissenting

[5] [1964] AC 465.
[6] (1999) 73 ALJR 1190 at para 71. Gaudron J could also not see any governing rule for the exceptions to the exclusionary rule at para 25.
[7] (1999) 73 ALJR 1190 at para 81.
[8] (1999) 73 ALJR 1190 at para 246.

judgment of Denning LJ in *Candler v Crane Christmas & Co* [9] where his Lordship said:

> I can understand that in some cases of financial loss there may not be a sufficiently proximate relationship to give rise to a duty of care; but, if once the duty exists, I cannot think that liability depends on the nature of the damage.[10]

Similarly, it was generally accepted that the test of reasonable foreseeability of loss was not sufficient in cases of pure economic loss.[11]

Finding principles of general application to replace the exclusionary rule was not as easy as accepting the latter's demise.[12] Various members of the Court expressed agreement[13] with *Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad"* [14], itself a decision notorious for the differences between the judgements and the lack of a firm ratio.[15]

The three-point test of foreseeability, proximity and policy propounded by Lord Bridge of Harwich in the House of Lords' decision in *Caparo Industries Plc v Dickman*[16] found favour only

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[9] [1951] 2 KB 164.
[10] *Id* at 179, cited by Kirby J in *Perre v Apand* (1999) 73 ALJR 1190 at para 245.
[11] (1999) 73 ALJR 1190, at para 4, per Gleeson CJ, at para 27, per Gaudron J, and at para 278, per Kirby J.
[12] Indeed, Keeler argues that such a task is not possible: "Cases involving liability for economic loss cover many kinds of fact situation[s]. It may be a matter of important general principle as to whether the law of negligence should be concerned with the consequences of poor bargains, or as to whether hirers of property should be able to sue people who damage or destroy it if the loss of the use of the property causes them economic loss. But they are different questions, and the reasons that will support answers to them cannot plausibly be expressed in terms of generalisations about economic loss, proximity or undertaking and reliance." J F Keeler, "The Proximity of Past and Future Australian and British Approaches to Analysing the Duty of Care" (1989) 12 *Adel L Rev* 93 at 123.
[13] (1999) 73 ALJR 1190 at paras 50, 87 and 113, per McHugh J; at para 201, per Gummow J; at para 278, per Kirby J; at para 341, per Hayne J; and at para 410, per Callinan J.
[14] (1976) 136 CLR 529.
[15] It was criticised on this point by the Judicial Committee of the Privy Council in *Candlewood Navigation Corporation Ltd v Mitsui OSK Lines Ltd* [1986] AC 1 at 22.
[16] [1990] 2 AC 605 at 617-618, per Lord Bridge of Harwich.

with Kirby J.[17] Chief Justice Gleeson[18], in dismissing the test, relied on the words of Lord Bridge that:

> the concepts of proximity and fairness…are not susceptible of any such precise definition as would be necessary to give them utility as practical tests, but amount in effect to little more than convenient labels to attach to the features of different specific situations which, on a detailed examination of all the circumstances, the law recognises pragmatically as giving rise to a duty of care of a given scope.[19]

Some members of the Court attacked the test of proximity itself. Gaudron J in particular noted that:

> the notion of proximity…has been criticised as being incapable of constituting a universal criterion of liability[20] and also as having only limited utility in determining whether there exists a duty of care in a particular case.[21] It may well be that, at this stage, the notion of proximity can serve no purpose beyond signifying that it is necessary to identify a factor or factors of special significance in addition to the foreseeability of harm before the law will impose liability for the negligent infliction of economic loss.[22]

McHugh J echoed the sentiments of Dawson J in *Hill v Van Erp*[23], a case concerning pure economic loss from a negligently prepared will, by saying "proximity is neither a necessary nor a

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[17] (1999) 73 ALJR 1190 at paras 259, 269, and 288. Kirby had earlier endorsed the *Caparo* test in *Pyrenees Shire Council v Day* (1998) 192 CLR 330 at 419-420.
[18] (1999) 73 ALJR 1190 at para 9. The *Caparo* tests were also disapproved of by McHugh J at paras 77-81 and Hayne J at para 332.
[19] [1990] 2 AC 605 at 617-618.
[20] See, e.g., *San Sebastian Pty Limited v The Minister* (1986) 162 CLR 340 at 368-369, per Brennan J; *Hawkins v Clayton* (1988) 164 CLR 539 at 555-556, per Brennan J; *Gala v Preston* (1991) 172 CLR 243 at 260-263, per Brennan J; at 276-278, per Dawson J; *Bryan v Maloney* (1995) 182 CLR 609 at 652-655, per Brennan J. See also McHugh, "Neighbourhood, Proximity and Reliance", in Finn (ed), *Essays on Torts,* (1989) 5 at 36-39.
[21] See, e.g., *Hill v Van Erp* (1997) 188 CLR 159 at 177-178, per Dawson J; at 189, per Toohey; at 192, per Gaudron J.
[22] (1999) 73 ALJR 1190 at para 27.
[23] (1997) 188 CLR 159 at 176-177.

sufficient criterion for the existence of a duty of care. Furthermore, proximity in the sense of nearness or closeness is hardly a useful concept in most cases of pure economic loss".[24]

Hayne J went further by stating "To search, in these circumstances, for a single unifying principle lying behind what is described as a relationship of proximity is, then, to search for something that is not to be found".[25]

Given that neither reasonable foreseeability, the exclusionary rule nor proximity alone were considered sufficient to determine questions of liability for pure economic loss, the High Court was then faced with the task of deciding what rules should apply. Gleeson CJ identified a number of relevant factors, such as knowledge of a reliant, and therefore vulnerable, individual or ascertainable class, physical propinquity, degree of foreseeability, and the control over the relevant activity by the defendant.[26]

McHugh J also considered the issues of vulnerability and knowledge of an ascertainable class. He said:

> What is likely to be decisive, and always of relevance, … is the answer to the question, "How vulnerable was the plaintiff to incurring loss by reason of the defendant's conduct?" So also is the actual knowledge of the defendant concerning that risk and its magnitude.[27]

McHugh J, however, was at pains to stress that the issue of vulnerability should only be decisive in the absence of indeterminate liability. In addition, he believed that the law should not compensate a plaintiff for pure economic loss caused

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[24] (1999) 73 ALJR 1190 at para 78.

[25] (1999) 73 ALJR 1190, para 330. See also Prof. J A Smillie, "The Foundation of the Duty of Care in Negligence" (1989) 15 *Mon U L Rev* 302 at 314 " … the extended concept of proximity provides no assistance in identifying the critical elements of the relationships that will attract a duty in controversial developing areas of the law of negligence. As a unifying 'touchstone' of negligence it has proved spectacularly unsuccessful: not only has it failed to produce agreement between members of the High Court at the level of practical doctrine; it has also proved incapable of consistent interpretation and application by individual members of the Court."

[26] (1999) 73 ALJR 1190 at paras 11, 13 and 15.

[27] *Id* at para 104.

by a defendant, if the plaintiff could have taken steps to protect itself from the effects of the defendant's conduct.[28] He considered that the concepts of "reasonable reliance" and "assumption of responsibility", which were discussed in *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords*[29], "are merely indicators of the plaintiff's vulnerability to harm from the defendant's conduct".[30]

Kirby J, on the other hand, considered that vulnerability to risk, *inter alia*, should not be elevated

> … so that they are legal preconditions to the existence of a duty of care in negligence or "principles" to be applied in deciding whether the duty of care exists in the particular case. They are not even essential or relevant to every case framed in negligence where the damage claimed is purely of an economic character, without physical injury to the plaintiff's property or person.[31]

According to Hayne J[32], policy issues were influential in the development of the law. His Honour was anxious to avoid indeterminate liability and therefore considered the plaintiff's knowledge of the class to be a most important factor.[33]

As a relatively new area of the law, Gaudron J accepted that pure economic loss did not yet have "a governing principle applicable in all cases".[34] Her Honour observed that in cases of negligent misstatement, a duty of care will exist in circumstances of "known reliance (or dependence) or the assumption of responsibility or a combination of the two, the word 'known' including circumstances in which reliance or dependence ought to be known".[35]

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[28] *Id* at para 118.
[29] (1997) 188 CLR 241 at 263-264, per Toohey and Gaudron JJ; at 298-299 per Gummow J.
[30] (1999) 73 ALJR 1190 at para 125.
[31] *Id* at para 286.
[32] *Id* at paras 329 and 336.
[33] *Id* at para 241.
[34] *Id* at para 25.
[35] (1999) 73 ALJR 1190 at para 30, her Honour quoting from the previous High Court judgments of *Bryan v Maloney* (1995) 182 CLR 609 at 619, per Mason CJ, Deane and Gaudron JJ, referring to *Sutherland Shire Council v Heyman* (1985) 157 CLR 424 at 466-468,

A second category identified by Gaudron J as the "protection of legal rights"[36] was considered by her Honour to be analogous to the present case.[37] Relying on earlier High Court decisions such as *Bennett v Minister of Community Welfare*[38], *Hawkins v Clayton*[39] and *Hill v Van Erp*[40] her Honour stated:

> Where a person is in a position to control the exercise or enjoyment by another of a legal right, that position of control and, by corollary, the other's dependence on the person with control are, in my view, special factors or, which is the same thing, give rise to a special relationship of "proximity" or "neighbourhood" such that the law will impose liability upon the person with control if his or her negligent act or omission results in the loss or impairment of that right and is, thereby, productive of economic loss.[41]

Gummow J favoured the approach adopted by Stephen J in *Caltex*[42], as he had also done in *Hill*[43] and *Pyrenees Shire Council v Day*[44]. This approach identified the "'salient features' which combined to constitute a sufficiently close relationship to give rise to a duty of care…[but] with allowance for the operation of appropriate 'control mechanisms'".[45] Gummow J considered the facts of the present case in order to bring the plaintiff and defendant "into such close and direct relations as to give rise to a duty of care".[46]

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per Mason J; at 501-502, per Deane J and *Hawkins v Clayton* (1988) 164 CLR 539 at 545, per Mason CJ and Wilson J; at 576, per Deane J and at 593, per Gaudron J.

[36] (1999) 73 ALJR 1190 at para 34.

[37] *Id* at para 39.

[38] (1992) 176 CLR 408 at 427, per McHugh J.

[39] (1988) 164 CLR 539.

[40] (1997) 188 CLR 159 at 234, per Gummow J and 198-199, per Dawson J.

[41] (1999) 73 ALJR 1190 at para 38.

[42] (1976) 136 CLR 529 at 576-577.

[43] (1997) 188 CLR 159 at 233-234.

[44] (1998) CLR 330 at 389.

[45] (1999) 73 ALJR 1190 at para 201.

[46] *Id* at para 217.

Callinan J sought guidance from many previous High Court decisions[47] and from the opinions of learned commentators. He commended the view of Professor Stapleton[48] in "Duty of Care Factors: a Selection from the Judicial Menus"[49] when she said:

> while the listing of these judicial menus of sound factors relevant to the duty issue helps unmask the substantive determinations being made by judges in this field, they cannot operate as some sort of mechanical guide as to how a novel case will be decided in the future …[A]t the end of the day, even if judges agree on the relevant factors to be weighed in the individual case, different judges may well place different weight on competing factors and do so quite reasonably.[50]

Ultimately, he concluded that:

> It should be made clear…that the determination of a claim for pure economic loss is not a merely discretionary matter: it requires the application of the principles stated in *Caltex* and the subsequent cases in this Court to the various factual situations as they arise in the courts.[51]

Policy Considerations

Cases dealing with liability for pure economic loss are always faced with the task of balancing the claims of the plaintiff with policy considerations that usually favour the defendant.[52]

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[47] *Id* at para 387-391 (*Caltex)*, para 393 (*Bryan v Maloney)*, para 394-5 *(Hill v Van Erp)*, para 396-400 *(Esanda)*.
[48] (1999) 73 ALJR 1190 at para 404.
[49] In Cane and Stapleton (eds), *The Law of Obligations: Essays in Celebration of John Fleming,* New York, Oxford University Press, 1998 at 59.
[50] *Id* at 88.
[51] (1999) 73 ALJR 1190 at para 404.
[52] See Symmons, C R, "The Function and Effect of Public Policy in Contemporary Common Law", 1977 51 *ALJ* 185. He states "The essential function, therefore, of public policy in the Common Law is to bring into judicial consideration the broader social interest of the public at large." (at 189) However, later he points out "When public policy considerations are explicitly covered by the courts… the predominant effect of the application of the doctrine is a negative one" (at 194) "It deprives the plaintiff of a 'right' rather than giving him one" (at 197).

Common policy considerations are fear of indeterminacy of liability, unproportionate liability and interference with the legitimate economic and commercial freedoms which businesses ought to be able to enjoy.

Each of the justices in *Perre* addressed the issue of indeterminacy. Gleeson CJ spoke of constraining a duty to avoid financial harm by "some intelligible limits to keep the law of negligence within the bounds of common sense and practicality".[53] Gaudron J cited[54] a long line of High Court decisions which had adopted the fearful words of Cardozo CJ in *Ultramares Corporation v Touche*[55], about the avoidance of liability "in an indeterminate amount for an indeterminate time to an indeterminate class".[56]

McHugh J was concerned to distinguish the idea of indeterminacy from the size of the class. He stated that "it is not the size or the number of claims that is decisive in determining whether potential liability is so indeterminate that no duty of care is owed.[57] Liability is indeterminate only when it cannot be realistically calculated.

And further adding that "indeterminacy depends upon what the defendant knew or ought to have known of the number of claimants and the nature of their likely claims, not the number or size of those claims"[58].

McHugh J also discussed the concept of constructive knowledge, finding that "… liability can be determinate even when the duty is owed to those members of a specific class whose identity could have been ascertained by the defendant".[59] He rejected however, the notion that a duty could be owed to

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[53] (1999) 73 ALJR 1190 at para 5, per Gleeson CJ, citing *Caparo Industries Plc v Dickman* [1990] 2 AC 605 at 633, per Lord Oliver of Aylmerton.
[54] (1999) 73 ALJR 1190 at para 36.
[55] 174 NE 441 (1931).
[56] *Id* at 444.
[57] *Canadian National Railway Co v Norsk Pacific Steamship Co* [1992] 1 SCR 1021 at 1105, per La Forest J.
[58] (1999) 73 ALJR 1190 at paras 107 and 108. His Honour reiterated this point at para 139.
[59] *Id* at para 111.

those who suffered loss as a result of loss negligently caused to another person, whom he described as the "first line victims".[60]

Hayne J described indeterminate to mean that "…the persons who may be affected cannot readily be identified".[61] He considered that since, in the present case, the parties to be affected could have been identified at the time of the negligent conduct, the liability was not indeterminate.[62]

Overlapping with the issue of indeterminacy was that of disproportionate liability, another concern raised by several members of the Court. For example, Gummow J warned that:

> A multiplicity of claims would be both vexatious to the courts … and unfair to the defendant whose careless slip may be completely out of proportion to the wide extent of the economic consequences. Enterprise may be discouraged and competition stifled.[63]

McHugh J, in denying that class size was an issue of indeterminacy, said that in the case of a huge class, "it is a policy of proportionality, not indeterminacy that prevents a court from imposing liability"[64]. Citing previous authorities, Callinan J[65] considered that "[O]ne of the major touchstones in a case of this kind will always be reasonableness[66], or as it has sometimes been put, proportionality".[67]

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[60] *Id* at para 112. This is called the "ripple effect", to which His Honour referred at paras 106 and 112, and is discussed by Jane Stapleton in "Duty of Care and Economic Loss: A Wider Agenda" (1991) 107 *LQR* 249 at 255.
[61] (1999) 73 ALJR 1190 at para 336.
[62] *Ibid*. Gummow, Kirby and Callinan JJ also referred to the issue of indeterminacy at paras 169, 298 and 402 respectively.
[63] *Id* at para 169.
[64] *Id* at para 108. His Honour cited Gibbs J in *Caltex* to support this proposition. (1976) 136 CLR 529 at 551-552.
[65] (1999) 73 ALJR 1190 at para 427.
[66] *Sutherland Shire Council v Heyman* (1985) 157 CLR 424 at 498, per Deane J; *San Sebastian v The Minister* (1986) 162 CLR 340 at 372, per Brennan J; *Caparo Industries v Dickman* [1990] 2 AC 605 at 618, per Lord Bridge of Harwich.
[67] *Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad"* (1976) 136 CLR 529 at 591, per Mason J.

McHugh J addressed the policy consideration of avoiding unnecessary interference with legitimate commercial freedoms in *Hill's v Van Erp*[68] and he repeated those words in *Perre*:

> Anglo-Australian law has never accepted the proposition that a person owes a duty of care to another person merely because the first person knows that his or her careless act may cause economic loss to the latter person.[69] Social and commercial life would be very different if it did.[70]

His Honour provided, as an example of the legitimate protection of one's interests, a consumer withdrawing custom from a trader, thereby causing the trader economic loss.[71] At the other extreme, "…deceit, duress or intentional acts"[72] were cited by his Honour as not being "…done in the legitimate protection of one's interests".[73] To determine where conduct becomes actionable, McHugh J stated "… the line of legitimacy will be passed only when the conduct is such that the community cannot tolerate it".[74] If a duty of care has already been established, His Honour considered that the principle of legitimately protecting one's business interests would not apply.[75]

Hayne J was also concerned "not to establish a rule that will render 'ordinary' business conduct tortious".[76] He concluded that the defendant's conduct would have been unlawful or tortious, had it been engaged in deliberately, so it was beyond the reach of what ordinary business conduct would entail.[77]

Development of the Law Concerning Pure Economic Loss

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[68] (1997) 188 CLR 159 at 221.
[69] *Dorset Yacht Co v Home Office* [1970] AC 1004 at 1027, per Lord Reid.
[70] (1999) 73 ALJR 1190 at para 114.
[71] *Id* at para 115.
[72] *Id* at para 116.
[73] *Ibid.*
[74] *Ibid.*
[75] *Id* at para 117.
[76] *Id* at para 329.
[77] *Id* at paras 346 – 351.

In *Caltex* [78] Gibbs J said:

> It may be right to say … that the distinction between recovery for economic loss and recovery for material loss is illogical, but that does not mean that the decisions that have drawn that distinction were erroneous, because the law aims at practical justice rather than logical consistency.[79]

In this search for practical justice, the courts are faced with the task of balancing the need for predictability and certainty, with the myriad different factual situations that confront them.

McHugh J in *Perre* warned:

> … the effectiveness of law as a social instrument is seriously diminished when legal practitioners believe they cannot confidently advise what the law is or how it applies to the diverse situations of everyday life or when the courts of justice are made effectively inaccessible by the cost of litigation.[80]

However, McHugh J acknowledged that the certainty achieved by *stare decisis* "should not always trump the need for desirable change in the law".[81]

To balance these competing needs, the courts have adopted two allied approaches to the development of the law concerning liability for negligence causing pure economic loss. The first is the categories approach, whereby a case falling within an existing category is decided in the same way as earlier precedents in that category. Quoting Lord Wright[82], McHugh J likens this method to "… the ancient Mediterranean mariners, hugging the coast from point to point, and avoiding the dangers of the open sea of system or science".[83]

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[78] (1976) 136 CLR 529 at 551-552.
[79] Cited by Callinan J in *Perre* (1999) 73 ALJR 1190 at para 388.
[80] *Id* at para 88.
[81] *Id* at para 92.
[82] Lord Wright, "The Study of Law" (1938) 54 *Law Quarterly Review* 185 at 186.
[83] (1999) 73 ALJR 1190 at para 93.

If a case falls outside an existing category, then the next step is the incremental approach. Analogous categories of cases are examined, together with "the few principles of general application that can be found in the duty cases"[84], and then the reasons for the court's decision become the principles of the new category.[85]

Callinan J drew on previous High Court opinions[86] in concluding that "the determination of a claim for pure economic loss is an area of the law in which the courts should move incrementally and very cautiously indeed".[87] Gaudron J also supported the categories approach.[88]

On the other hand, Kirby J was reluctant to apply either the existing categories or incremental advancement method, finding that they do not provide " … harmony with the methodology of the common law"[89], nor a "real guide"[90] for the determination of future cases.
Gummow J was even more critical of the two. He believed that:

> …the making of a new precedent will not be determined merely by seeking the comfort of an earlier decision of which the case at bar may be seen as an incremental development, with an analogy to an established category. Such a proposition, in the terms used by McCarthy J in the Irish Supreme Court "suffers from a temporal defect – that rights should be determined by the accident of birth"[91].[92]

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[84] *Id* at para 94, per McHugh J.
[85] *Id* at para 95. An incremental law-making model was advocated by Justice Michael McHugh in "The Law- making Function in the Judicial Process - Parts I and II" (1988) 62 *ALJ* 15 and 116.
[86] Gibbs J in *Caltex* at 555 et seq, citing Lord Diplock in *Mutual Life & Citizens' Assurance Co Ltd v Evatt* (1970) 122 CLR 628 at 642; [1971] AC 793 at 809; *Bryan v Maloney* (1995) 182 CLR 609 at 617-619, per Mason CJ, Deane and Gaudron JJ, citing Stephen J in *Caltex* at 575.
[87] (1999) 73 ALJR 1190 at para 405.
[88] *Id* at para 34.
[89] *Id* at para 258.
[90] Ibid.
[91] *Ward v McMaster* [1988] IR 337 at 347.
[92] (1999) 73 ALJR 1190 at para 199.

> The emergence of a coherent body of precedents will be impeded, not assisted, by the imposition of a fixed system of categories[93] in which damages in negligence for economic loss may be recovered.[94]

In summary, it is clear that there were a number of areas of agreement between the members of the High Court. The demise of the exclusionary rule and the inadequacy of reasonable foreseeability in cases of pure economic loss were not in contention.[95]

Similarly beyond dispute was the importance of preventing indeterminate liability.[96] The majority of justices also expressly approved the decision in *Caltex*[97], as well as the categories/incremental advancement method of tackling cases.[98] Proximity as a determinant of liability was also criticised by most of the Court.[99]

The Court however, did not agree on the actual principles to be applied in cases of liability for pure economic loss. Gleeson CJ[100] and McHugh J[101] emphasised the plaintiff's vulnerability; and control over the activity was considered relevant by Gaudron J[102] and Gleeson CJ.[103] Knowledge of an ascertainable class was

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[93] See the observations of Lord Goff of Chieveley in *Westdeutche Landesbank Girocentrale v Islington London Borough Council* [1996] AC 669 at 692.
[94] (1999) 73 ALJR 1190 at para 200. *See also Stapleton "Duty of Care and Economic Loss: A Wider Agenda" (1991)* 107 *LQR* 249. She criticises the categories approach, instead preferring a "more coherent approach of analysing the duty issue according to the policies which the courts have decided should govern the recognition of a duty of care"(at 284-285). These policies, which she sees as "necessary but not sufficient conditions", are: no indeterminate liability, "adequate protection from the risk … was not available elsewhere", there is no express statutory rule denying liability and the claim does not circumvent an agreement between the plaintiff and the defendant to the contrary (at 285 et seq).
[95] See n 5 – 10 above.
[96] (1999) 73 ALJR 1190 at para 5, per Gleeson CJ; para 32, per Gaudron J; para 169, per Gummow J; and at para 427, per Callinan J.
[97] *Id* at paras 50, 87 and 113, per McHugh J; paras 172 and 201, per Gummow J; para 278, per Kirby J; para 34, per Hayne J; paras 387-390 and 404, per Callinan J.
[98] *Id* at paras 94 – 95, per McHugh J; para 405, per Callinan J and para 31, per Gaudron J.
[99] *Id* at para 27, per Gaudron J; para 78, per McHugh J; para 330, per Hayne J.
[100] *Id* at paras 10-11.
[101] *Id* at paras 118-119.
[102] *Id* at para 38.
[103] *Id* at para 15.

important to McHugh and Hayne JJ. Justices Callinan[104] and Gummow[105] both adopted principles from *Caltex*. Kirby J took an entirely different view, following the British three-step test from *Caparo*.

The Implications of *Perre v Apand* to Auditors' Liability for Negligence

The decision in Esanda v Peat Marwick Hungerfords[106]

Two years prior to *Perre v Apand*, the High Court[107] looked at the issue of the duty of care for negligence causing pure economic loss in relation to an audit opinion relied on by a third party.[108]

As in *Perre*, the Court was unanimous in finding that a plea of reasonable foreseeability was insufficient to satisfy the proximity requirement in establishing a duty of care in negligent misstatement cases.[109] Elements of assumption of responsibility on the part of the defendant and reasonable reliance by the plaintiff were seen as necessary in establishing a duty of care, and these were not found to exist in *Esanda*.

None of the members of the Court found that proving an intention by the auditor to induce reliance on the advice by its recipient was a necessary prerequisite in the finding of a duty of care.[110] Dawson J considered it to be "merely one of the various means of proving reasonable reliance which, together with other circumstances, will found a duty of care".[111]

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[104] *Id* at para 388.
[105] *Id* at para 172.
[106] (1997) 188 CLR 241.
[107] Brennan CJ, Dawson, Toohey, Gaudron, McHugh and Gummow JJ.
[108] *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241.
[109] (1997) 188 CLR 241 at 249, per Brennan CJ; at 254, per Dawson J, Toohey and Gaudron JJ by implication; at 266 and 275 per McHugh J, and 301, per Gummow J.
[110] (1997) 188 CLR 241 at 272-275. This was the test that originated in *San Sebastian v The Minister* (1986) 162 CLR 340, and which was subsequently adopted in Victoria in *R Lowe Lippman Figdor & Franck v AGC (Advances) Pty Ltd* [1992] 2 VR 671.
[111] *Id* at 256.

Dawson, McHugh and Gummow JJ all relied heavily on public policy considerations of indeterminacy and disproportionate liability in finding for the defendant.[112] McHugh J also presented a number of policy reasons in support of a limited duty of care, such as a possible adverse affect on the availability of auditing services, especially if insurance was not available to cover any additional claim, the overburdening of courts with complex third party claims, and, the fact that third parties would be demanding compensation for losses from their own self induced reliance despite not paying the auditor for the report.[113] His Honour also pointed to the plaintiff's ability to seek confirming information elsewhere, as well as difficulties in proving that the loss was caused by sole reliance on the audit report.

Except for Gummow J, each of the members of the Court attempted to formulate the type of pleadings which would have been successful in *Esanda*. In an opinion dominated by the reasoning from Barwick CJ in *Mutual Life & Citizens' Assurance Co Ltd v Evatt* [114] and *Caparo*, Brennan CJ stated:

> ... in every case, it is necessary for the plaintiff to allege and prove that the defendant knew or ought reasonably to have known that the information or advice would be communicated to the plaintiff, either individually or as a member of an identified class, that the information or advice would be so communicated for a purpose that would be very likely to lead the plaintiff to enter into a transaction of the kind that the plaintiff does enter into and that it would be very likely that the plaintiff would enter into such a transaction in reliance on the information or advice and thereby risk the incurring of economic loss if the statement should be untrue or the advice should be unsound. If any of these elements be wanting, the plaintiff fails to establish that the defendant

[112] *Id* at 254, per Dawson J; at 272, per McHugh J and 303, per Gummow J.
[113] *Id* at 282 – 287. See here the contrary view of Sir Anthony Mason, "Law and Economics" (1991) 17 *Mon U L Rev* 167 at 181. "I must confess to serious misgivings about the prospect of courts proceeding to make or adopt economic analyses … for the purpose of *determining* whether it is proper to impose a liability on a defendant, that is, hingeing the decision on a judgment that the community or a section of the community can or cannot afford that liability."
[114] (1968) 122 CLR 556 at 571.

> owed the plaintiff a duty to use reasonable care in making the statement or giving the advice.[115]

Also relying heavily on Barwick CJ's judgment from *Evatt* and the majority from *San Sebastian*, Dawson J considered reasonable reliance to be the essence of the proximity requirement.[116] He reconciled the reference of Brennan J in *San Sebastian* in relation to the need for the speaker's statement to act as an inducement as being a reference to the need to prove reliance on the statement as an element of causation.[117] Dawson J also argued away the insistence in *Caparo* that the purpose of the report defined the class to whom a duty of care was owed by saying that in *Caparo*:

> [T]here was the possibility that [potential investors] might rely upon the report for the purpose of investing in the company but that was not the purpose for which the report was given and the possibility was insufficient to establish their reasonable reliance upon it...[T]hat is, of course, another way of saying that the report was not given with the intention of inducing potential investors to act upon it, which in turn pointed to lack of reasonableness in their placing reliance upon it for that purpose.[118]

The plaintiff did not plead that the auditors owed it a duty of care due to the statutory purpose of a published audit report in Australia, but Dawson J commented:

> The statutory scheme governing duties which are imposed upon auditors may well be relevant in concluding whether an auditor's report is made with the intention of inducing a particular person, or persons falling within a particular class, to act upon it in a particular way. ... In the end, those things will have a

[115] (1997) 188 CLR 241 at 252.
[116] *Id* at 256.
[117] *Ibid.*
[118] *Id* at 258.

> bearing upon whether any reliance placed upon the report is reasonable.[119]

Toohey and Gaudron JJ in a joint judgment also endorsed the reasonable reliance and assumption of responsibility argument as a basis for proximity in negligent misstatement cases. Like Brennan CJ and Dawson J, their Honours referred with approval to Barwick CJ in *Evatt*, as well as Mason and Aickin JJ in *L Shaddock & Associates Pty Ltd v The Council of the City of Parramatta*[120], before concluding:

> Thus, reliance is to be understood, in the context of the provision of information or advice, as an expectation, which is reasonable in the circumstances, that due care will be exercised in relation to that provision. Similarly, we consider that, in that same context, assumption of responsibility should be understood in the way explained by Barwick CJ in *Evatt*. More precisely, it should be understood as the assumption of responsibility for providing information or advice in circumstances where it is known, or ought reasonably be known, that it will or may be acted upon for a serious purpose, and loss may be suffered if it proves to be inaccurate.[121]
>
> ... commonsense requires the conclusion that a special relationship of proximity marked either by reliance or by the assumption of responsibility does not arise unless the person providing the information or advice has some special expertise or knowledge, or some special means of acquiring information which is not available to the recipient. Moreover, ordinary principles require that the relationship does not arise unless it is reasonable for the recipient to act on that information or advice without further inquiry. Similarly, ordinary principles require that it be reasonable for the recipient to act upon it for the purpose for which it is used. That is not to say that a

[119] *Ibid.*
[120] (1981) 150 CLR 225.
[121] (1997) 188 CLR 241 at 264.

> special relationship of proximity exists if these conditions are satisfied. Rather, it is to say that the relationship does not arise unless they are.[122]

McHugh J also drew heavily on precedent, both local and overseas, in formulating principles to guide cases involving auditors' liability to third parties. After quoting extensively from *San Sebastian* and *AGC*, he concluded that the law was correctly stated in these cases and that an auditor is not liable to third parties in the absence of an assumption of responsibility towards them or an intention to induce reliance on the audit opinion.[123]

Should Auditors' Liability Be Affected by Perre?

If the categories approach to judicial law making is adopted, then *Perre* should have little effect on future decisions involving auditors. There is already an established category of case law concerning auditors[124] in particular, and negligent misstatement[125] in general, so that a case about pure economic loss caused by the necessity to quarantine potatoes is unlikely to be considered necessary or relevant to the determination of cases with auditors. Also, there is no need for courts to move incrementally away from *Perre* in any later decision involving auditors, because incremental advancement in law making is only necessary where there is no established category.

However, since the membership of the High Court has changed between the time of *Esanda* and *Perre*[126] it is instructive to look at *Perre* as a way of predicting possible directions which the Court may take. In addition, courts have a tendency to look at cases beyond their immediate area of interest, for guidance on general trends in the law, especially when the case cited says something to support the point being made. Witness *Perre* itself, which

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[122] *Id* at 265.
[123] *Id at* 281.
[124] For example, *Esanda, Caparo, AGC.*
[125] For example, *Hedley Byrne, San Sebastian, Evatt.*
[126] Brennan CJ, Dawson and Toohey JJ have retired, and Gleeson CJ (May '98), Hayne (September '97) and Callinan JJ (February '98) have joined the High Court bench. Kirby J (who joined in February '96) did not sit on the *Esanda* decision.

drew on precedents as diverse as *Esanda*, *Hawkins v Clayton*, *Hill* and *Caparo*.

What Effect Will Perre Have on Auditors' Liability?

The likely effect of *Perre* is that it will confirm the current direction of the High Court in *Esanda* in relation to cases concerning auditors. In its policy discussions, as well as the tests formulated, the overwhelming emphasis of *Perre* was to avoid wide and indeterminate liability. The unanimous judgment in favour of the plaintiff was not an abrogation of this sentiment, but rather an acknowledgment of the unusual circumstances of the case.

Both *Perre* and *Caltex* involved physical damage to something – a pipeline in the case of *Caltex* and a disease to someone's potatoes in *Perre*, so that the size of the class which resulted was, and was also likely to be, small. Compare this to the situation with an auditor publishing an opinion in a company's annual financial report, which may be circulated to many thousands of people and may be read many months after it was prepared.

In addition, several members of the Court in *Perre* stressed the importance of avoiding disproportionate liability, and the situation of auditors exemplifies the worst extremes of such possible liability. Most businesses are limited companies, so that regardless of the size of the judgment against them, their liability is limited to their share capital. Company auditors, on the other hand, are not permitted to incorporate[127] and generally operate as partnerships, so that both negligent and "innocent" partners may be obliged to pay the full extent of the Court's judgment out of their partnership and personal assets.[128]

Much was made in *Perre* about the concept of vulnerability on the part of the plaintiff, as a corollary of the control that the

[127] Section 1279(1)(a) *Corporations Law*.

[128] The last decade has seen a number of attempts to rectify the problem of wide and disproportionate liability for professionals including auditors. See for example, Report of the Working Party of the Ministerial Council for Corporations *Professional Liability in relation to Corporations Law Matters* (June 1993), the *Professional Standards Act* 1994 (NSW) (re capping of liability) and Report of Stage Two of the Inquiry into the Law of Joint and Several Liability, January 1995.

defendant has over the act which is negligently performed. The plaintiff in *Esanda* was considered by several members of that Court not to be vulnerable [129], because they were a large finance company, who could have made their own enquiries before lending money to the company, Excel, whose financial statements were negligently and incorrectly certified by the auditors as true and fair.

However, many who rely on audit reports, the so-called "mum and dad" investors, are not able to verify the accuracy of a company's financial statements before making an investment. They are truly vulnerable to the auditors' negligence, and their reliance on the published audit report is certainly reasonable. But by its very nature, this class of plaintiff is indeterminate and likely to be very large, raising additionally the spectre of disproportionate liability, so that the application of *Perre* would result in liability to this class being denied for policy reasons.

It appears therefore that the ascertainable class of plaintiff, such as large lenders or investors, who would be sufficiently known to the defendant under the rules both *Perre* and *Esanda* is neither vulnerable, nor is its reliance reasonable; on the other hand, those who *are* vulnerable and who reasonably rely on the auditors' work, such as the mum and dad investors discussed above, are indeterminate. Consequently, the size of the claim would be a problem here. In order to pursue an auditor through the courts, the amount of money lent or invested on the strength of the audit report needs to be considerable. The plaintiff also needs to be of some substance to finance litigation, yet ironically this very size may indicate to the court that the plaintiff could, and should, have made its own inquiries and that its reliance on the audit report was not reasonable.

Gaudron J in *Perre* implies that, in *Esanda*, defects in the plaintiff's pleadings were the cause of the failure of their claim. Her Honour refers to *Esanda* as the basis of the test for cases in the category of negligent misstatement, that test being "known

[129] (1997) 188 CLR 241 at 252 per Brennan CJ, 255 per Dawson J, 261-262 per Toohey and Gaudron JJ.

reliance (or dependence) or the assumption of responsibility or a combination of the two".[130] She further states:

> And in *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords*, it was not pleaded that the auditors in question knew or ought to have known that a finance provider would rely on their audited statement of accounts, and, thus, it was held, on the pleadings, that no duty of care was owed by the auditors to the finance provider.[131]

However, Gummow J, who sat alongside Gaudron J in *Esanda*, expressed[132] the issue of the pleadings in *Perre* somewhat differently:

> In *Esanda* …the pleading was bad because it did not allege facts adequate to carry the auditors into a sufficiently close relationship with the creditors or financiers of the company so as to found the element necessary to constitute a duty of care to the appellant. There, the potential for foreseeable but indeterminate and possibly ruinous loss by a large class of plaintiffs and other circumstances pertaining to the relationships between auditors, company, and investors or creditors[133] made it appropriate to take into account various "control mechanisms". For example, Toohey and Gaudron JJ pointed out that:[134]
>
> > there is nothing to suggest Esanda was not itself able to have accountants undertake the same task on its behalf as a condition of its entertaining the possibility of entering into financial transactions with Excel. And, which is much the same thing in the circumstances of this case, there is nothing to

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[130] (1999) 73 ALJR 1190 at para 30, citing *Bryan v Maloney* (1995) 182 CLR 609 at 619, per Mason CJ, Deane and Gaudron JJ, referring to *Sutherland Shire Council v Heyman* (1985) 157 CLR 424 at 466-468; per Mason J, at 501-502; per Deane J and *Hawkins v Clayton* (1988) 164 CLR 539 at 545, per Mason CJ and Wilson J; at 576, per Deane J; at 593, per Gaudron J.

[131] See (1997) 188 CLR 241 at 303-304.

[132] (1999) 73 ALJR 1190 at para 202.

[133] (1997) 188 CLR 241 at 266.

[134] *Id* at para 266.

> suggest that it was reasonable for Esanda to act on the audited reports without further inquiry.[135]

CONCLUSION

It is difficult to establish the precise ratio of *Perre v Apand* due to the separate opinions of the seven members of the Court, but certain threads can be discerned. Dissatisfaction with proximity was widespread, as were expressions of the difficulty in formulating principles of general application for cases of pure economic loss. Knowledge of an ascertainable class and the vulnerability of the plaintiff to the defendant's actions were considered important by the majority of the Court.

However, the fear of indeterminate and disproportionate liability was a unifying theme, and it is these policy considerations which are likely to be the principal contribution of *Perre* to future cases involving auditors. The judgments say nothing to contradict the earlier decision in *Esanda*, and even if a later case concerns vulnerable plaintiffs who reasonably rely on a published audit opinion, it is probable that these policy considerations will prove fatal to their claim.

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[135] See Stapleton J, "Duty of Care: Peripheral Parties and Alternative Opportunities for Deterrence" (1995) 111 LQR 301, where she discusses the idea of denying liability on the basis that if the plaintiff could have done something to avoid the risk, the conduct of the defendant, even if careless, is causally peripheral, and therefore the defendant should not be blamed for it. She says, in such circumstances, "the intervention of tort is not only unnecessary to advance the goal of deterrence but might encourage free-riding." (at 342) She later comments, "…the principle has the potential for reorienting the focus of tort protection because it has a harder impact on commercial and institutional plaintiffs" (at 344).