

Duty of Care

The Professional Duty of Care

Most lawsuits involving a complaint about professional services or advice are based in negligence. Other grounds, like breach of contract, are also often raised, but the law of negligence is usually at the heart of such claims. The starting point for any professional negligence claim is to establish that the professional owed the plaintiff a duty of care. The test for determining whether a duty of care exists is vague. As a result, the duty of care concept has been the subject of extensive litigation.

At law, we each owe a duty to avoid doing something that we can reasonably expect might injure someone close to us. It is clear that a professional's clients are close enough to be covered by this test. For professionals, the duty of care concept often becomes trickier when the claimant is someone other than a client.

The long-standing test of whether a duty of care exists is to ask: at the time the defendant did something causing harm, should he have had the plaintiff in mind as someone who could be injured by his actions? If it is reasonable to expect the defendant could have foreseen that somebody might be harmed in the way that that the plaintiff was actually harmed, then the defendant may be liable. For some professions, this test implies wide-ranging liability. Is an engineer who designs a building potentially liable in negligence to any future visitor of the building? Is an auditor potentially liable to any future investor who happens to receive a copy of the client's financial statements?

The scope of a professional's duty of care was further increased by two developments in the law in the mid 1900's. One of these developments occurred in 1963 when the case of *Hedley Byrne & Co. v. Heller & Partners* established the right to recover damages caused by reliance on a negligent misrepresentation. This decision expanded the type of activity that can create a duty of care. Consider the case of a professional who provides advice about investments. Without some limit being placed on the legal duty of care owed, the professional could be liable to anyone who somehow receives and acts upon that investment advice.

In another development occurring at about the same time, the law expanded the type of loss that can be compensated in negligence. Where the plaintiff has suffered a personal injury or physical damage to property, the courts tended to apply the traditional duty of care test without many additional restrictions. However, the law had drawn a distinction between physical injury and economic loss, such as a loss of profit. Traditionally, plaintiffs could not recover economic loss unless they also suffered physical loss. More recently, the law has permitted recovery of pure economic loss. This change had major implications for various professionals.

These and other developments exposed professionals and others to increased liability to anyone who suffers a monetary loss after relying on their advice that turns out to be wrong. As a result, the law developed limits on the duty of care owed when providing advice in certain circumstances. These limits relate not only to the question of who can

claim for a loss, but also to the sort of harm complained of. Because of differences in the type of services provided by different professions, much of the case law is tailored to specific professions.

Auditors and Accountants

As with other professions, auditors and accountants almost always owe a duty of care to their clients. This duty arises from the law of negligence, contract, fiduciaries, or, in the case of auditors of corporate clients, from business corporations legislation. However, auditors and accountants have often also been held liable to third parties who have relied on their professional advice to a client.

When auditors or accountants provide an opinion on a client company's financial statements, they usually expect that the client will share the opinion with others who may rely on it, including bank creditors, suppliers, prospective investors and affiliated companies. The degree of reliance will generally increase when an audit opinion is given. In the case of large public companies, the audited financial statements can receive wide publication. As a result, under the traditional formulation of duty of care, accountants (and auditors in particular) could face liability in any amount to a virtually unlimited number of third parties.

The courts generally considered this to be an extreme and undesirable result. And so, over the past few decades, the law has evolved to limit the scope of the duty of care owed by auditors for financial statements which prove to be inaccurate. The limits which were developed address the question of who is owed a duty of care, as well as the question of what use is made of an auditor's or accountant's opinion.

Both of these issues were addressed in the 1997 Supreme Court of Canada decision in *Hercules Management Ltd. v. Ernst & Young*. The plaintiffs in that case lost on their investment as shareholders of the defendant auditor's client. This loss was foreseeable in that the defendant auditors could easily have anticipated that someone (including existing shareholders) might rely on their client's audited financial statements in making an investment in the client and could be harmed if the statements were wrong.

With respect to the "who?" question, the Supreme Court concluded that the auditors did not owe a duty to anyone and everyone who might be harmed by reliance on a negligent misstatement in the financial statements. An auditor will only owe a duty of care to someone who the professional actually knows might rely on the advice given. This would include a person who was a member of a specific class of persons that the professional knows about. In the *Hercules* case, the Court said that the existing shareholder plaintiffs did fall into this category.

Dealing with the second question, "for what use?", the Court went on to say that an auditor will only be liable to someone who used the advice for the specific purpose or transaction for which the advice was given. In the case of an audit opinion, the Supreme Court said that, ordinarily, that purpose is to assist shareholders in overseeing the management and affairs of the company, not to assist in making personal investment decisions. Therefore, the auditors were not liable to the plaintiff shareholders for their individual investment losses in this case. Auditors can be liable to their clients' shareholders if the shareholders as a group suffer a loss because inaccurate financial

statements prevented them from holding management of the company to account for some problem.

The Hercules decision, even though it dealt with a claim by shareholders, also affects the duty of care that auditors owe to lenders and other creditors. Before Hercules, auditors were usually not found liable to creditors of whom they were not aware at the time of the audit. There were many cases though where the courts held auditors liable to their clients' creditors (often a client's bank) where the auditors knew that that creditor might rely on the audited financial statements. After the decision in Hercules, a creditor known to the auditor must also show that the financial statements were prepared for the purpose for which the creditor relied on them. In the case of a routine annual audit, this will ordinarily not be possible.

Audits are sometimes conducted for purposes other than overseeing management, such as inclusion in an investment prospectus. Nevertheless, even in the case where the auditor has performed an audit specifically for the client to provide to a particular group of lenders for their use, the auditor still might not owe a duty of care to those lenders. Following Hercules, a duty of care may not be owed, for example, where the financial statements are to be provided to a third party for the purpose of attracting a \$10,000 loan and the third party relies on those statements in making a \$1,000,000 loan.

In unusual cases, an auditor's actions can create a duty of care to a third party who could not meet the Hercules test at the time of the audit. In the case of ADT Ltd. v. Binder Hamblyn, for example, the auditor met with a client's prospective investor and confirmed that the financial statements which were prepared for the company some time earlier, were accurate. The court found that the direct relationship formed with the investor at the meeting created a duty of care where none had existed before.

A claimant must prove not only the existence of a duty of care, but also the extent of the duty. The extent of the duty depends upon the nature of the engagement. In non-audit engagements, such as a review engagement, an auditor is not ordinarily required to consider factors like the client's own internal financial controls and procedures. If a review engagement client suffers a loss that could have been prevented had its accountant warned about problems with its internal controls, the accountant will usually not be liable unless the accountant actually noticed a significant problem resulting from poor controls, but failed to take appropriate action.

Engineers and Architects

Architects and engineers in the building trade owe a duty of care to the owner of a building project even if the owner is not their client and they have no contractual relationship with the owner. For example, a sub-consultant who was hired by the overall design consultant can be liable in negligence to the owner. If the design consultant hired the sub-consultant on behalf of the owner, then the sub-consultant could be liable to the owner in contract as well.

An engineer or architect hired by a contractor, could also be liable to the contractor, in contract or negligence, for faulty work or advice. If the engineer or architect does not have a contractual relationship with the contractor, a duty of care may still be owed. For example, in Edgeworth Construction Ltd v. N. D. Lea & Associates, the Supreme Court

of Canada allowed a contractor to recover damages from engineers who negligently produced deficient design specifications that the contractor relied upon when tendering for a highway construction project. The court reasoned that the engineers in that case should have expected that the contractor might be harmed if the design specs were wrong.

While a design consultant may owe a duty of care to a contractor, that professional will likely only be liable for negligent misrepresentation if the contractor relies on the design specs for a purpose that the design consultant could reasonably have expected. In *Auto Concrete Curb Ltd. v. South Nation River Conservation Authority*, the Supreme Court of Canada decided that a contractor could not recover damages from an engineer who did not warn of the need to obtain permits required for a dredging operation. The permits were required because the contractor decided to use a suction dredging method to complete the project. The court stated that the engineer did not accept responsibility for advising the contractor about the particular dredging method used.

The courts have treated safety concerns as a special consideration which affects the duty that architects and engineers owe to future owners and users of a building or structure. As a result, the courts have held engineers and architects liable to compensate people who are injured in an accident caused by a design failure even though no one could reasonably have foreseen injury to that specific individual, or even the general nature of the event causing the injury. This same broad duty has been applied to pure economic loss where there is a safety issue. For example, in 1995, the Supreme Court decided in the case of *Winnipeg Condominium Corp. No. 36 v. Bird Construction Co.* that a subsequent owner of a building may be able to recover from a general contractor for the cost of fixing dangerous design defects in a building. However, a subsequent owner who pays to fix a design defect that does not create a risk of hurting somebody likely cannot recover the repair costs from the design consultant.

Lawyers

Lawyers occasionally give advice which is widely disseminated, and can face liability to a large number of potential claimants as a result. In such cases, the duty of care considerations for a lawyer will be similar to those of accountants. However, a lawyer typically provides advice specific to an individual client's circumstances. Furthermore, it is ordinarily expected that the client will keep the advice confidential. The duty of care issue is therefore usually not as great a concern to lawyers as to some other professions.

However, lawyers are sometimes unexpectedly found to owe a duty of care to someone other than a client. This someone can even be the opposing party in a transaction or dispute. If a lawyer agrees to provide a service or advice to an opposing party, even someone represented by their own counsel, then a duty to that person may arise. The existence of a duty will depend on the agreement to provide a service and the specific relationship created between that person and the lawyer. The question is whether, in the particular circumstances, the lawyer should have considered that his carelessness could harm the person. So, for example, a real estate lawyer was held liable to the opposite party for failure to register documents as he had agreed to do. In another case, a lawyer was liable to the opposing party in a loan transaction where the lawyer had

incorrectly said that security documentation was binding on the debtor. A lawyer who fails to fulfil a formal undertaking given to the other side in a transaction can be liable as a result, particularly in a case where the lawyer has agreed to hold funds for a specific purpose. If the lawyer applies the funds for a purpose other than that agreed, the lawyer could be liable either to the opposing party who provided the funds or to a third party that was supposed to receive the funds.

As with most other professions, lawyers can owe a continuing duty of care to former clients to protect confidential information. In the case of lawyers though, a continuing duty may also exist relating to some activity completely unconnected to any previous involvement with the client. For example, a lawyer who goes into business with a former client or helps a former client with an investment can owe a professional duty of care regarding the new involvement. In one such case, a lawyer was found liable to a business partner for not telling him that he, the lawyer, was judgement-proof.

Lawyers can also owe a duty of care to someone whom the lawyer's client intends to benefit from the lawyer's advice or services. In one case a lawyer who drafted an agreement for a trust company, which intended to make the agreement available for use by its client, was found to owe a duty of care to that client. Generally, a professional who gives advice will only owe a duty of care to someone who actually and reasonably relies on that advice. However, there are exceptions to this principle in the case of lawyers who were asked by their clients to do something for the benefit of someone else. A good example is the testator of a will who intends to provide a benefit to a beneficiary who may not know that a will exists. Even though the beneficiary did not rely on the lawyer who prepared the will, he or she may be able to claim against the lawyer if the will is not properly prepared or executed.

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