Negligence and the quasi-arbitrator

The law relating to attributable negligence extended

Before the decision of the House of Lords in the case of *Hedley Byrne & Co Ltd v Heller & Partners Ltd* the English law was that "in the absence of a contractual or fiduciary relationship between the parties, a negligent misrepresentation causing financial loss only ... will not give a cause of action". Then along came the *Hedley Byrne* case which decided, in English law at least, that there was such a thing as a liability in delict for negligent misstatement. It is beyond the scope of this article to consider the extent of this liability or the classes of potential plaintiffs. Nor do I wish to embark on a detailed discussion of whether or not *Hedley Byrne* would be followed in our law; it seems that the position is not yet settled. Be that as it may, the very possibility that the law of delict may recognise a duty of care (even if only to a limited class) in the case of negligent misstatements, has come as yet another burden to the auditing profession. For it is in the nature of that profession to certify financial statements upon which all sorts of people place great reliance, including many with whom the auditor himself has no contractual nexus.

Now, in England, a new hazard has come into the auditor's life in the shape of the decision of the House of Lords in *Arenson v Casson Beckman Rutley & Co*, and which involved a firm of auditors who undertook the task of valuing shares in a private company. The responsibility of valuing shares in a private company is, amongst other similar responsibilities, often thrust upon auditors. Attorneys, being in the main simple men, terrified by even the most straightforward balance sheet, are wont when drafting contracts, to place great reliance on those sophisticated financial wizards, the parties' auditors. Which auditor has not been confronted by a clause such as the one that caused all the trouble in *Arenson's* case? The clause read:

"6. 'Fair Value' shall mean in relation to the shares in A Arenson Limited, the value thereof as determined by the auditors for the time being of the Company whose valuation acting as experts and not as arbitrators shall be final and binding on all parties."  

I shall refer to this clause from now on as "the Arenson clause".

Two points

Two points in the *Arenson* clause are particularly germane to the discussion that follows:-

1. There was no question of a dispute; the purpose of interposing the auditors was to prevent a dispute from arising.

2. The auditors were to act as experts and not as arbitrators. In other words, their duty was to value the shares using their own independent knowledge and experience. There was no need for them to call evidence from the parties themselves nor from any third parties nor to receive or have regard to any representations made by the parties.

Thus, it may be said that the auditors, when assigning a price to the shares, did so as expert valuers.

The facts in the *Arenson* case appear from the headnote:

"In 1964 the plaintiff was taken into his uncle's business, which was then a private company. The plaintiff's uncle gave the plaintiff a parcel of shares in the company. By a written agreement it was provided that if the plaintiff ceased to be employed in his uncle's business he would sell the..."
shares back to his uncle at a 'fair value'.

. . . In 1970 the plaintiff's employment in
the business was terminated. The com-
pany's secretary orally requested the de-
fendants, who were the company's audit-
ors, to value the plaintiff's shares. The de-
fendants valued the shares at £4,916 13s
4d. In reliance on that valuation the plain-
tiff transferred the shares to his uncle on
payment of £4,916 13s 4d. Shortly after-
wards the company 'went public', the trans-
action involving a report by the de-
fendants on the company's affairs. The
plaintiff took the view that the transaction
disclosed that the shares which he had
transferred to his uncle were in fact
worth £29 500, i.e. six times more than the
valuation originally placed on them by the
defendants'.

The plaintiff brought an action for negli-
gence against the auditors alleging:

"(a) that the defendants' original valuation
of the shares 'was misconceived and erro-
neous in one or more fundamental re-
pects and was made on a wrong basis';
(b) further or alternatively that the de-
fendants had been negligent in making
their original valuation; and (c) that by
reason of the defendants' negligence he
had suffered damage'.

To a South African lawyer, it would be
self-evident that a valuer who is negligent
in making a valuation is liable for that
negligence, at least to such parties as
specifically would ex contractu rely on his
valuation and who did in fact rely on it.
The broader issue of a more general
liability for negligent misstatement giv-
ing rise to an action will not lie against an
auditor alleging:

"The broader issue of a more general
liability for negligent misstatement giv-
ing rise to an action . . . is that clear that our law recognises that a per-
son acting in a judicial or quasi-judicial
capacity is not liable for negligence . . .
If, therefore, defendant, when issuing a
final certificate under clause 25(f), can
rightly be said to be in the position of a
quasi-arbitrator, there is good reason in
principle for holding, with the English
law, that defendant is not liable for negli-
gence in issuing such a certificate".

He continues at 757:

"The provisions in the above-cited clause
25(f) relating to the issue of a final certifi-
cate make no reference to any actual dis-
pense between the parties upon which the
architect is to adjudicate. Nor does that
clause provide for any representations be-
ing made to the architect by the con-
tractor".

In these circumstances, the court con-
cluded that the architect was not acting in
a quasi-judicial capacity and was liable
for negligence (at 757).8

There is thus little doubt that the Arenson
clause would fall within the reasoning of
Ogilvie Thompson J in Hoffman v Meyer.
In passing, it should also be noted that
the valuation could, in these circum-
stances, almost certainly be set aside as
between the parties requiring the valua-
tion 8 (see Dublin v Diner). The oppor-
tunity to set the valuation aside would
cease once the transaction underlying
the valuation had been implemented. The
aggrieved party would, in that event, be
unable to claim against the other party
and would be forced to resort to an
action against the valuer.
After that potted summary of the South African law on the point, the time has come to turn to the speeches of the Law Lords in Arenson's case, remembering that Sutcliffe v Thackrah was to lawyers, for three-quarters of a century steeped in _Chambers v Goldthorpe_, something new, and to be treated with respect. But, as we shall see, when the winds of change are astir, it is difficult to turn them off - and thus, judicial cogitation takes us beyond _Sutcliffe v Thackrah_ and into some uncharted and potentially dangerous territory.

Five speeches were made in _Arenson’s_ case which illustrates perhaps that the Law Lords, although broadly in agreement, each saw the ramifications differently.

Lord Simon of Glaisdale dealt firstly with the public policy underlying judicial immunity from suits founded in negligence. He commenced by disposing (at 907) of the argument raised by respondent’s counsel that:

“So far as public policy is concerned, no logical distinction can be drawn between the speedy and final settlement of disputes by an arbitrator and the obviation of disputes by a valuer in the position of the respondents: if public policy requires immunity in the one case, so it must also in the other”.

Lord Simon found there to be a more primary consideration of public policy, jealously guarded by the law, namely:

“. . . , where there is a duty to act with care with regard to another person and there is a breach of such 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”.

**Primary rule**

The primary rule is therefore one of responsibility; in order to negate it, there must be a formulated dispute which is to be resolved. While reference is made in passing to the other test of quasi-judicial capacity suggested in _Hoffman v Meyer_ and _Cape Town Municipality v Kollberg_, namely the reception of rival contentions or evidence, this is not regarded by Lord Simon as a _sine qua non_.

With respect, Lord Simon’s summation (at 912) is not entirely satisfactory to a South African lawyer; the point is to some extent left hanging. Lord Wheatley’s consideration is, I think, to be preferred, despite his enunciation of “indicia” rather than general principles. At 915/6 he says:

“The indicia are as follows: (a) there is a dispute or a difference between the parties which has been formulated in some way or another; (b) the dispute or difference has been remitted by the parties to the person to resolve in such a manner that he is called on to exercise a judicial function; (c) _where appropriate_, the parties must have been provided with an opportunity to present evidence and/or submissions in support of their respective claims in the dispute; and (d) the parties have agreed to accept his decision” (my underlining).

In essence, therefore, Lord Wheatley is in agreement with Lord Simon in what I shall refer to as the conventional approach, one which is sufficiently close to Ogilvie Thompson’s J formulation to be broadly acceptable in South African law (except for the words underlined).

Lord Kilbrandon goes beyond the conventional approach. And here we find, once the sails are billowing before the winds of change, how difficult it is to halt the vessel of logic. At 917–918 we find this passage:

“...The question which puzzled me as the argument developed was: what was the essential difference between the typical valuer, the auditor in the present case, and an arbitrator at common law or under the Arbitration Acts? It was conceded that an arbitrator is immune from suit, aside from fraud, but why? I find it impossible to put weight on such considerations as that in the case of an arbitrator (a) there is a dispute between parties; (b) he hears evidence; (c) he hears submissions from the parties, and that therefore he, unlike the valuer, is acting in a juridical capacity. As regards (a), I cannot see any juridical distinction between a dispute which has actually arisen and a situation where persons have opposed interests, if in either case an impartial person has had to be called in to make a decision which the interested parties will accept. As regards (b) and (c), these are certainly not necessary activities of an arbiter. Once the nature and limits of the submissions to him have been defined, it could well be that he would go down at his own convenience to a warehouse, inspect a sample of merchandise displayed to him by the foreman, and return his opinion on its quality or value. I have come to be of opinion..."
that it is a necessary conclusion to be drawn from Sutcliffe v Thackrah and from the instant decision that an arbitrator at common law or under the Acts is indeed a person selected by the parties for his expertise, whether technical or intellectual, that he pledges skill in the exercise thereof, and that if he is negligent in that exercise he will be liable in damages”.

With respect to the learned Law Lord, what is he really saying? Is he drawing a distinction between an arbitrator who, by his terms of reference must hear evidence and submissions, and one who need not, or is he stating that an arbitrator will always be liable for negligence, irrespective of his terms of reference? Startling as it may seem, reading this passage in the context of the ensuing passage in Lord Kilbrandon’s speech, it is the second conclusion that is to be extracted from this particular obiter dictum. Thus he ends by saying (at 919):

“You do not test a claim to immunity by asking whether the claimant is bound to act judicially; ... I have, I fear, been led rather far from the actual substance of this appeal, but my reason is this. Since I can find no satisfactory distinction between the liability for negligence of persons in the position of the respondents and that of arbitrators, had I not been of opinion that arbitrators at common law or under the Acts have no immunity, I would have been unable to agree that the appeal should be allowed.”

Lord Kilbrandon is supported, although with less certitude by Lord Fraser of Tullybelton, who, at 927, remarks:

“But many arbitrators are chosen for their expert knowledge of the subject of the arbitration, and many others are chosen from the legal profession for their expert knowledge of the law or perhaps because they are credited with an expertise in holding the balance fairly between parties. It does not seem possible, therefore, to distinguish between mutual valuers and arbitrators on the ground that the former are experts and the latter are not. I share the difficulty of my noble and learned friend, Lord Kilbrandon, in seeing why arbitrators as a class should have immunity from suit if mutual valuers do not”.

Perhaps the conflict between the conventional approach and the obiter dicta of Lords Kilbrandon and Fraser is best resolved by Lord Salmon in dealing with an arbitrator who, although formally appointed as such has a purely investigatory role in regard to an already formulated dispute and does not hear evidence or submissions. At 925, he says:

“I find it difficult to discern any sensible reason, on grounds of public policy or otherwise, why such an arbitrator with such a limited role, although formally appointed, should enjoy a judicial immunity which so-called ‘quasi-arbitrators’ in the position of the respondents certainly do not”.

Solution

It seems to me that Lord Salmon has distilled the approach the South African courts would take in the form of a workable solution to the question of an arbitrator’s immunity from suit. Applying this in practice, here are some rules that a wary auditor should bear in mind before setting out to “value” shares:

1 He should be careful of the Arenson clause; if he accepts the appointment under it, he should ask for a suitably worded indemnity.

2 If he is acting in a true arbitral capacity, he should not rely exclusively on his own skill or knowledge but must receive evidence and contentions from both parties. That alone is, however, insufficient; there must also be a dispute.

3 A mere appointment to act as arbitrator, at common law or under the Arbitration Act will give the auditor sufficient power to conduct a proper arbitration. Provided he abides by the ordinary rules of natural justice and gives each party a fair hearing, no proceedings can (in the absence of fraud) be brought against him.

4 Finally, even if he is appointed as an “expert” rather than as an arbitrator, he will act in a quasi-arbitral capacity as long as he observes Lord Salmon’s approach. The submissions and evidence need not, in my view, be oral and so the diligent (but careful) auditor would, when confronted by the Arenson clause (and in the absence of an indemnity)—

(a) ask the parties themselves to value the shares and only act if they failed to agree,
require each to let him have such evidence as they wished (including other expert valuation eg regarding plant or mining rights) and to advance such arguments as they thought relevant. As McKenzie says in his book: ⑪

“This does not mean they must necessarily observe the precision and forms of a court of law, but they must proceed in such manner as to ensure a fair administration of justice between the parties”.

While I have devoted this article to the position of auditors in regard to the valuation of shares, its conclusions are not so limited. Whatever I have said is equally applicable to auditors who fulfil other functions of a valuation or arbitral nature and to any other persons who, in terms of any other agreement, act in a similar capacity.

As an afterthought, another possible advantage to a “quasi-arbitration” rather than an expert valuation (at least from the point of view of the proposed valuer) is that when acting as an arbiter, he can be fairly certain that his award is not intended for use by persons other than the parties to the submission. A valuation could be used for many other purposes and, depending on the facts, there may well be a case in which such a valuation gave a third party rights to proceed against the valuer, in terms of the principles laid down in the Hedley Byrne case, to the extent that such principles represent the law of delict in South Africa.

Summary
To summarise the Arenson case for a South African audience, it seems to me that there are two distinct stages:-

1 The case has reinforced Sutcliffe v Thackrah and has dispelled any doubt that may have been left by that case as to the liability (contractual at least) of any person who, when acting in an expert capacity, does so negligently. To this extent, it is neutral as far as South African law is concerned.

2 Insofar as the court went beyond what was necessary to the judgment (particularly Lords Kilbrandon and Fraser), what they have said must be obiter but would open up a dangerous and unexplored world if it were ever to be accepted as law either in England or South Africa. Fortunately, dicta in such cases as Matthews v Young and Penrice v Dickinson⑫ would, if followed keep the liability of any person acting in a judicial capacity within the bounds of Lord Salmon’s approach; these dicta would, I believe, not easily be overruled. Thus, even if the English law stretches into some of the wilder reaches of judicial imagining consequent on the Arenson case, I doubt that our courts would follow. In the end, it appears to me that the rule of public policy that pressure should not be brought to bear on any person acting in true judicial or quasi-judicial capacity would be bound to override that of responsibility as enunciated by Lord Simon.

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⑪(1963) 2 All ER 575 (HL).
⑫per R G McKerron in (1963) 80 SALJ at 484 and authorities there cited.
⑬sec W H B Dean (1970) 87 SALJ 149, Murray v McLean 1970(1) SA 133 (R) and McKerron (op cit).
⑭(1975) 3 All ER 901 (HL).
⑮(1974) 1 All ER 859.
⑯(1901) 1 KB 624.
⑰1956(2) SA 753. And see Bellamini v Western Hotels (Pty) Ltd 1960(4) SA 137(T) and Randcon (Natal) Ltd v Florida Twin Estates Ltd 1973(4) SA 181(D). Cape Town Municipality v Kollberg 1966(2) SA 471(C). In the last-named case, the court accepted (at 475, the essentials of “quasi-judicial” capacity as being a dispute and a proper hearing for the parties.
⑱An interesting sidelight on judicial cross-pollination appears from the speech of Lord Reid in Sutcliffe v Thackrah when in overruling Chamber v Goldthorpe he said that he had less hesitation in so doing “because ... in other parts of the Commonwealth a number of judges have expressed doubts or disapproval of it” (p 864). Hoffman v Meyer was one of the cases cited in the argument. So, as so clearly emerged in Lynch v DPP (1975(1) All ER 913), persuasive authority is not a one-way traffic.
⑲1964(1) SA 799(D) at 802-805.
⑳42 of 1965.
⑱Respective 1922 AD 492 at 508-9 and 1945 AD at 15.

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