The Impact of the Trade Practices Act 1974 (Cth) on the Liability of Auditors

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The aim of this paper is to analyse the potential liability of auditors with respect to the *Trade Practices Act 1974* (Cth) (hereinafter referred to as TPA). The paper will focus predominantly on ss 52 and 74 of the TPA; however the relevant provisions of each State's *Fair Trading Act* will also be the subject of consideration. The authors suggest such legislation has the potential to greatly extend the scope of auditors' liability and, consequently, it is imperative that the auditing profession is aware of the relevant provisions.

It is perhaps surprising that relatively few plaintiffs have sought redress under these sections, given that decided cases indicate it will be an easier task to establish liability under certain statutory laws in comparison to the common law of negligence.[1] The authors suggest that the small number of actions against auditors may be attributed to a lack of awareness, on the part of plaintiffs, of the scope and applicability of the TPA.

The paper will be structured as follows. Firstly, the constitutional limitations found in s 52 will be addressed. Secondly, the authors will discuss briefly the law of negligence, as it is relevant to the activities of auditors. Thirdly, s 52 will be analysed with particular reference to matters such as intention, reliance and duties of disclosure in the interpretations of misleading or deceptive conduct. In the course of this discussion s 51A, dealing with representations as to future matters, will be discussed.

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1 Settled claims: The Victorian government settled for $136 million with KPMG Peat Marwick over the auditing of Tricontinental Bank; Keydata Corporation settled for $17.5 million with Coopers & Lybrand. Outstanding claims: Price Waterhouse against the liquidators of the Linter Group; Southerncross against Arthur Anderson; *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 142 ALR 750.

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The article will then examine relevant provisions from the *Corporations Law 1989*. Next, the implied warranties found in s 74 will be outlined. The article will conclude with a discussion as to the quantum of damages and the use of disclaimers.

Relationship between Auditing and Accounting

Auditing and accounting are often viewed as synonymous concepts; however, the two are separate disciplines with unrelated foundations and dissimilar bodies of knowledge.[2] The accounting process identifies, organises and communicates information in order to reflect economic events. Auditing, on the other hand, is a critical process whereby audit evidence is gathered and evaluated such that conclusions may be made as to the fairness of financial statements.[3] Consequently, accounting provides the raw materials with which auditors work.[4] The Table below illustrates these differences.

Table 1: Differences between Accounting and Auditing[5]

Accounting	Auditing
Guided by Accounting Standards	Guided by Auditing Standards
Responsibility of management	Responsibility of auditor
Analyse events and transactions	Obtain and evaluate evidence concerning the financial report
Measure and record transaction data	Verify financial information presented fairly in accordance with an identified financial reporting framework
Prepare financial report per identified financial reporting framework	Express opinion in audit report
Distribute financial report, including audit report, to shareholders	Deliver audit report to entity

2 D Ricchiute, *Auditing* (4th ed, 1995) 16.

3 For a detailed discussion about the relationship between accounting and auditing see, G Gill and G Cosseral, *Modern Auditing in Australia* (4th ed, 1996) 37.

4 B Porter, J Simon, D Hatherly, *Principles of External Auditing* (1996) 7.

5 Gill and Cosseral, above n 3, 37.

Function of Auditors

Auditors play a critical role in the contemporary corporate market place. There is a substantial body of literature documenting the importance of auditors and audit quality.[6]

In *Pacific Acceptance Corporation Ltd v Forsyth & Ors*[7] Moffitt J has explained the function of an auditor:

> *Prima facie* the duty of an auditor is to audit the books and accounts of the company ... In the absence of express terms the scope of the audit will depend on what is directly or indirectly required by the particular provisions of the *Companies Act* and of the articles ... The auditor promises, first, to conduct audit of some description and, second, to provide a report of his opinion on his audit work, which report to comply with the *Companies Act* and the articles, and also impliedly agrees to exercise reasonable skill and care in the conduct of the audit and in the making of the report.

Looking separately at the functions, the first, to conduct an audit has been explained in a passage in one textbook, which has received judicial approval, in these terms:

> An audit may be said to be a skilled examination of such books, accounts and vouchers as will enable the Auditor to verify the Balance Sheet. The main objects of the audit are: (a) To certify the correctness of the financial position as shown in the Balance Sheet, and the accompanying revenue statements. (b) The detection of errors. (c) The detection of fraud.

6 G Feltham, S Hughes, and D Simunic, 'Empirical Assessment of the Impact of Auditor Quality on the Valuation of New Issues' (1991) 14 *Journal of Accounting and Economics* 375; K Menon and D Williams, 'Auditor Credibility and Initial Public Offerings' (1991) 66 *Accounting Review* 313: (Companies wishing to signal increased growth prospects will switch to a larger, high quality auditor); M DeFond, 'The Association Between Changes in Client Firm Agency Costs and Auditor Switching' (1992) 11 *Auditing: A Journal of Practice and Theory* 16: (Firms increasing (decreasing) company debt will seek to select a replacement auditor of a higher (lower) quality); D Simunic and M Stein, 'The Impact of Litigation Risk in Audit Pricing: A Review of the Economics and the Evidence' (1995) *Unpublished Research Manuscript*: (Companies switching auditor prior to a new securities issue, will change from a local CPA firm to a larger auditor); A Craswell, S Taylor and S Woolcott, *Do Firms that Switch Auditors Manage Earnings* (Unpublished Research Manuscript, University of Sydney, 1996): (Selection of a similar or higher quality auditor would be an indication of management utilising the most efficient set of accounting policy choices); Z Palmrose, 'Audit Fees and Auditor Size: Further Evidence' (1986) 24 *Journal of Accounting Research* 97: (Risky clients are more likely to seek and switch to a larger, Big Five auditor with 'deep pockets'): cited in C Free, 'Limiting Auditors' Liability' (1999) *Bond Law Review*, fn 2).

7 (1970) 92 WN (NSW) 29, 51.

> The detection of fraud is generally regarded as, being of primary importance.[8]

The Institute of Chartered Accountants in Australia has described an audit as being

> the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon ... The auditor's opinion helps establish the credibility of the financial information. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the entity nor an opinion as to the efficiency or effectiveness with which management has conducted the affairs of the entity.
>
> While the auditor is responsible for forming and expressing an opinion on the financial information, the responsibility for its preparation is that of the management of the entity. Management's responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the entity. The audit of the financial information does not relieve management of its responsibilities.[9]

The second element of an auditor's function is the provision of a report of his or her opinion. Sections 331A-331F of the *Corporations Law* impose a duty on the auditor to report to the members of the company on the accounts in relation to an accounting period, which is a financial year. The auditor's report must state:

> whether the company's accounts are properly drawn up so as to give a true and fair view of the profit or loss of the company for the accounting period and of the state of affairs of the company as at the end of the accounting period: s 331B(1)(a);
>
> whether the accounts are properly drawn up in accordance with the provisions of the Law: s 331B(1)(b);
>
> whether the accounts are properly drawn up in accordance with applicable accounting standards (and, if not, the effect of the failure to do so): s 331B(1)(c).

Auditors are important to external users of financial statements as these users require an unbiased and independent opinion on the quality of the information reported. Therefore, auditors add value to financial reporting.[10] This value is consistently maintained, as all

8 R A Irish, *Practical Auditing* (3rd ed, 1942), quoted by Fullagar J in *Frankston and Hastings Corporation v Cohen* (1960) 102 CLR 607.

9 Statement of Auditing Standards AUS 1, 1993, paras 4, 8, 9.

10 W Messier, *Auditing – A Systematic Approach* (1997) 726.

auditors must follow Generally Accepted Auditing Standards.[11] These Standards represent guidelines for audit procedures and measures of quality against which all completed audits are judged.

Given that auditors have such a prominent role in evaluating financial statements, in times of corporate failure or financial loss, either a client or a third party will look to them for recompense. These potential plaintiffs are frequently ready to blame auditors for loss that is sometimes attributed to their own commercial misjudgment. Obviously, litigation in this situation is not based on an auditor's degree of fault but on the so-called 'deep pockets theory'. This theory provides that, as auditors are required to carry professional indemnity insurance, they may be the only party left with sufficient funds to indemnify the plaintiff's losses.[12]

This problem is currently being assessed and may be rectified by the Draft Proportionate Liability Provisions that have resulted from the Davis Report.[13] These provisions endeavour to overcome this type of injustice by providing a regime of full proportionate liability between all the parties responsible for loss. The parties that could be responsible include contributory negligent plaintiffs, insolvent defendants and any other person. The proposed provisions will cover damages claims arising under tort, contract, misleading or deceptive conduct under State *Free Trading Acts*, s 52 of the TPA and s 995 of the *Corporations Law*.[14]

However, until these provisions are implemented, the implications associated with the 'deep pockets theory' combined, with recent legal developments in auditors' responsibilities, should cause great concern for the auditing profession. Not only are auditors exposed to the usual allegations of negligence and breach of contract, they may be potential defendants to claims based on Australia's Trade Practices legislation. This legislation greatly extends the scope and risks of an auditor's exposure to legal liability.

11 Cited in Ricchiute, above n 2, 27.

12 Gill and Cosseral, above n 3, 96.

13 Attorney General's Legal Practice, *Inquiry into the Law of Joint and Several Liability* (the Davis Report), Report of Stage Two (1995); discussed by J Swanton, and B McDonald, 'Reforms to the Law of Joint and Several Liability - Introduction of Proportionate Liability' (1997) 5 *Tort Law Journal* 109.

14 H Anderson, 'The Auditors' Liability Headache: Is Proportionate Liability the Cure?' (1996) 4(3) *Current Commercial Law* 110, 111.

Constitutional Limitations

Section 52(1) of the TPA states 'A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive, or likely to mislead or deceive'. The precise boundaries to the operation of s 52 remain undetermined;[15] however it should be interpreted 'so as to give the fullest relief which the fair meaning of its language will allow'.[16] Viewed from an auditing perspective, this section would most likely be used in relation to audit reports given that they may be incorrect or inappropriately worded so as to mislead or deceive.

Prima facie, it may appear that Part V of the TPA does not apply to the auditing profession as s1279 of the *Corporations Law 1989* provides that only a 'natural person' is allowed to register as an auditor. Further, the words 'in trade or commerce' could be taken to exclude professional services. It will be shown that both of these conclusions are incorrect and accordingly the potential liability of auditors is greatly expanded.

Due to Constitutional restrictions on the Commonwealth's legislative power, the conduct of corporations,[17] rather than natural persons or unincorporated associations is the subject of scrutiny under the TPA.[18] However there are some exceptions to this limitation. Although s 52 requires that a 'corporation' shall not mislead or deceive, s 6 should be considered when examining the application of s 52. Section 6(2) extends the operation of, *inter alia*, s 52 to the conduct of individuals in trade or commerce between the States or Territories, within a Territory, between Australia and places outside Australia or through the supply of goods or services to the Commonwealth or a Commonwealth authority or instrumentality.[19] Section 6(3) extends the operation of section 52 to the conduct of natural persons involving the use of postal, telegraphic or telephonic services.[20]

15 *Brown v Jam Factory Pty Ltd* (1981) 35 ALR 79, 86.

16 *Accounting Systems 2000 (Developments) Pty Ltd v CCH Aust Ltd* (1993) 114 ALR 355, 387.

17 *Australian Constitution* s 51(xx).

18 Although note the recent enactment of mirror legislation by the States to extend the operation of Part IV (the restrictive trade practices provisions) of the TPA to natural persons and unincorporated associations.

19 Constitutional validity of the section is based on s 51(i) of the *Australian Constitution*.

20 The Constitutional validity of this section is based on s 51(v) of the *Australian Constitution*.

Therefore in circumstances falling within s 6(2) and (3), despite an auditor not being a corporation, s 52 would nonetheless apply.[21] The authors submit that s 6(3) is of particular relevance. Therefore where an auditors report is distributed via the postal system or fax or where auditors pass on information through the telecommunications system they will be exposed, as individuals, to the operation of s 52.[22]

This gap in the application of the TPA has been largely remedied by the enactment of the *Fair Trading Acts* [23] in each State. These statutes relate to all legal persons and thus auditors can not escape their application.

With that obstacle overcome, there is still a doubt as to whether persons who provide professional services, such as auditors, would be characterised as engaging in 'trade or commerce'. This doubt is based on two factors. Firstly, whether the conduct has the requisite nexus so as to be 'in' trade or commerce. Secondly, we must consider the traditional distinction between a 'profession' and a 'trade'.[24]

Initially it was uncertain whether the words 'in trade or commerce' would be interpreted so as to mean the conduct could be 'with regard to' trade or commerce (a wider interpretation that would catch more forms of conduct)[25] or whether the provision would be interpreted narrowly so as only to encompass activities which had a trading or commercial character. In *Concrete Constructions (NSW) Pty Ltd v Nelson*[26] the High Court held that the latter interpretation was appropriate. Therefore any conduct on the part of an auditor would need to have a trading or commercial character. Therefore we must consider whether the activities of professionals have such a character.

As early as 1976 the Trade Practices Review Committee in its Report (The Swanson Report) rejected a distinction between the trades and

21 D Godsell, *Auditors' Legal Duties and Liabilities in Australia* (1993) 148.

22 For a discussion of the relationship between s 52 and s 6(2) and (3) see *R v Industrial Court; Ex parte CLM Holdings Pty Ltd* (1977) 136 CLR 235, 279-80 (Mason J).

23 *Fair Trading Act 1987* (NSW) s 41; *Fair Trading Act 1989* (Qld) s 38; *Fair Trading Act 1987* (SA) s 56; *Fair Trading Act 1990* (Tas) s 14; *Fair Trading Act 1985* (Vic) s 10A; *Fair Trading Act 1987* (WA) s 10.

24 Godsell, above n 21, 149.

25 *Glorie v WA Chip & Pulp Co Pty Ltd* (1981) 39 ALR 67, 73, *Advanced Hair Studio Pty Ltd v TVW Enterprises Pty Ltd* (1987) 18 FCR 1, 14.

26 (1990) 169 CLR 594.

the professions.[27] In *Bond Corporation Ltd v Theiss Contractors Pty Ltd*[28] French J stated:

> Where the conduct of a profession involves the provisions of services for reward, then in my opinion, even allowing for widely differing approaches to definition, there is no conceivable attribute of that aspect of professional activity which will take it outside the class of conduct falling within the description trade or commerce.[29]

Further s 52 has been applied in several cases in relation to the work of accountants.[30]

More recently, in *Esanda Finance Corporation v Peat Marwick Hungerfords*,[31] the Supreme Court of South Australia examined whether the provision of accounting services is within the definition of 'trade and commerce'. Bollen J stated:

> The words 'trade or commerce' are to be given a wide import. [Dean J said 'the widest import"[32]]. The lending of money is surely trade or commerce. Accountants assist those who lend money. Auditors work for those who lend money. It may be held in the end that ... an auditor is right in the middle of trade or commerce.

Further, in *State of South Australia v Peat Marwick Mitchell & Co*[33] in relation to audit reports, half-yearly reviews and reports pursuant to Reserve Bank of Australia agreements, Olsson J held that:

> I see no reason why the presentation of the reports and reviews themselves is incapable of constituting conduct in trade or commerce, provided that proper pleas of material fact are made to support such a thesis. Such reports and reviews are the end result of professional services said to have been rendered for reward, apropos the business undertakings of the bank.

[27] 10.35 Div 1 of Pt V sets out certain minimum standards of business conduct. Most, if not all, professions impose equal, if not stricter, standards upon their members. We see no reason why these provisions should not apply to the professions nor would we expect its application to cause the professions any concern.

Cited in A Greinke, 'A Comment on S. 52 of the TPA' (1992) 4(1) *Bond Law Review* 95, 104.

[28] (1987) 14 FCR 215.

[29] Ibid 220.

[30] See, *Mackman v Stengold Pty Ltd* (1991) 13 ATPR ¶41-105; *Paper Sales (Australia) WA Pty Ltd v PSA Pty Ltd* (1991) 13 ATPR ¶41-142; *Sutton v A J Thompson Pty Ltd (in liq)* (1987) 9 ATPR ¶40-789; *Sweetman v Bradfield Management Services Pty Ltd* (1994) 16 ATPR ¶41-290.

[31] (Unreported, Supreme Court of South Australia, Bollen J, 29 September 1994).

[32] Dean J in *Re Ku-ring-gai Co-operative Building Society* (1978) ALR 621, 648-649.

[33] (Unreported, Supreme Court of South Australia, Olsson J, 15 May 1997).

Consequently, audit reports prepared by auditors for a fee could be characterised as work done 'in trade or commerce'. Alternatively, in line with the previous discussion, the *Free Trading Acts* in the individual States have put the issue beyond doubt as these statutes specify that trade or commerce includes any business or professional activity.[34]

Comparisons between Common Law and Statute Law

Now that it has been established that the Trade Practices legislation has application to the auditing profession, it is appropriate to consider the differences in bringing an action under the common law and s 52.

At common law, the problem with rendering auditors liable for negligent performance of their duties has been the difficulty in establishing whether an auditor owes a duty of care and, if so, to whom the auditor owes such a duty.

In the case of an auditor clearly a duty would be owed to the corporation which engaged the auditor and that corporation's shareholders. However, does the auditor owe a duty to persons outside this proximate relationship, for example where auditors have audited the corporation accounts, provided an audited statement and third parties, for example investors in, or creditors of, the corporation, have relied on that information to their detriment?

It is trite law to say that careless statements may cause as much loss as careless actions or, indeed, more loss than careless actions. The classic statement encapsulating the problem of negligent words causing merely economic loss was made by Lord Pearce in the course of the judgment in *Hedley Byrne& Co Ltd v Heller & Partners Ltd*[35] (*Headley Byrne*) where His Honour stated:

> Words are more volatile than deeds. They travel fast and far afield. They are used without being expended and take effect in combination with innumerable facts and other words. Yet they are dangerous and can cause vast financial damage.

In an effort to limit liability for pure economic loss caused by negligent misstatement the courts initially simply denied liability unless it

[34] *Fair Trading Act 1987* (NSW) s 5(1); *Fair Trading Act 1989* (Qld) s 5(1); *Fair Trading Act 1987* (SA) s 3(1) and s 46(1); *Fair Trading Act 1990* (Tas) s 3(1); *Fair Trading Act 1987* (WA) s 5(1).

[35] [1964] AC 465, 534.

was established the defendant had been fraudulent.[36] However, in the *Hedley Byrne* decision, the House of Lords determined that in certain circumstances a defendant may owe a duty of care to third parties for economic loss incurred as a result of negligent misstatement. The decision stressed the idea of proximity.

A factor establishing the requisite proximity is the issue of reliance. A statement, no matter how outrageous, cannot cause loss unless the plaintiff relies upon it. If a plaintiff relies on a statement, a duty of care can only be established if such reliance is reasonable.[37]

When determining whether reliance is reasonable, one needs to consider the level of expertise possessed, or said to be possessed, by the defendant. Where the defendant professes to have special skill or expertise in the area in which he/she is giving advice this will be a factor considered by the court when determining whether the plaintiff's reliance on the advice was reasonable.[38] The authors suggest it would be reasonable to place confidence in and rely on the advice of a qualified auditor. However, although clearly a duty will arise in some circumstances the important question is how proximate must the relationship between the auditor and the injured plaintiff be?

Auditors liability to third parties - an overview

Given the discussion of cases from other common law jurisdictions in the Australian cases involving auditors liability a brief review of the these decisions is beneficial.

Canada

Initially it appeared that the Canadian courts would take a benevolent view of persons suffering loss as a result of an auditor's negligence. In *Haig v Bamford*[39] the plaintiff was successful in his action against an auditor on the basis of a negligent and inaccurate preparation of a financial statement. However it should be noted that in this case the auditors were aware that the audited financial statement they pre-

[36] *Derry v Peek* (1889) 14 App Cas 337, *Candler v Crane Christmas and Co* [1951] 2 KB 164.

[37] *Shaddock & Associates Pty Ltd v Parramatta City Council (No 1)* (1981) 150 CLR 225, *Curran v Greater Taree City Council* (1992) Aust Torts Reps ¶81-152, *Mohr v Cleaver* [1986] WAR 67.

[38] *Mutual Life and Citizens Assurance Co v Evatt* (1968) 122 CLR 556, *Shaddock & Associates Pty Ltd v Parramatta City Council (No 1)* (1981) 150 CLR 225, *San Sebastian Pty Ltd Minister Administering the Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340.

[39] [1977] 1 SCR 466.

pared was to be utilised to encourage investment in the subject corporation.

327973 British Columbia Ltd v HBT Agra Ltd[40] involved liability for negligence involving an engineer. However statements from the case have been utilised as appropriate to issues of liability involving professions in Canada. The decision has also attracted favourable comment in the UK[41] and in Australia[42]. In summary the case is authority for the proposition that in cases where liability has been imposed in respect to a third party's loss the professional adviser must have been aware:

> that his/her statements would be presented to and used by the third person for a particular purpose, and
>
> that purpose was known to the professional adviser at the time the statement was made.

Recently, the issue of auditors' liability came before the Canadian Supreme Court. *Hercules Managements Pty Ltd v Ernst & Young*[43] involved a fact scenario now becoming familiar. The plaintiffs were shareholders of two corporations engaged in lending on real property mortgages. After the corporations went into receivership the plaintiffs commenced proceedings against the auditors, Ernst & Young, claiming that the auditors' reports for the years 1980-1982 had been negligently prepared. This led to claims for damages for loss of advances and loss of the value of the shareholding.

Citing similar criteria to those listed in *327973 British Columbia Ltd v HBT Agra Ltd*[44] it was held the statements must have been made in the knowledge that the plaintiffs would rely on them and that they would be used by the plaintiff for the specific purpose for which they were designed.

In relation to the issue of specific purpose the Court noted, citing sections of the judgment from *Caparo*:

> It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first, to protect the company itself from the consequences of undetected errors, or, possibly,

40 (1994) 120 DLR (4th) 726.

41 *Caparo Industries plc v Dickman* [1990] 2 AC 605.

42 Per McHugh J in *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords (reg)* (1997) 142 ALR 750.

43 (1997) 2 SCR 165.

44 (1994) 120 DLR(4th) 726.

> wrongdoing and secondly to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinize the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided.[45]

In other words the corporation and the shareholders are the focus. However did this extend to personal business decisions of the shareholders based on the information provided? In the view of the Court the duty did not extend so far. The Court held that the purpose for which the audited reports were prepared in this case was the standard statutory one, which permitted the shareholders as a group to supervise management and take decisions regarding the proper overall administration of the corporation.[46] Therefore the circumstances befalling the plaintiffs in this case were without recourse.

England

In a similar fashion to Canada, although the English courts initially appeared to have sympathy for third parties who suffered loss after following an auditor's negligent advice, the courts now appear to be taking a narrower view.

This proximity principle was examined in *JEB Fasteners Ltd v Mark Bloom & Co*.[47] There it was held that an auditor would be liable for the financial loss to an investor who reasonably relied on the auditor's negligent work.

However, in *Caparo Industries plc v Dickman (Caparo)*[48] the defendant audited the accounts of a firm called Fidelity plc of which the plaintiff was a shareholder. In reliance on the accounts supplied by the auditors the plaintiff increased its shareholdings. Then, after mounting a successful takeover bid for Fidelity plc, the plaintiff discovered that, rather than having a large pre-tax profit, the corporation in fact was running at a significant loss. The House of Lords denied that the defendant auditors owed a duty of care to the plaintiff. It was held that such a duty would only arise in circumstances where the defendant was aware the statement would be communicated to the plaintiff either as an individual or as a member of an identifiable class. In addition, the House of Lords concluded that the plaintiff's loss had to have been caused by plaintiff's reliance on the audited statement for

45 (1997) 2 SCR 165, 170.

46 Ibid.

47 [1981] 3 ALL ER 289.

48 [1990] 2 AC 605.

the purpose for which it was prepared and not some extraneous purpose.

New Zealand

New Zealand decisions suggest that the liability of auditors to third parties may receive a more liberal treatment than in other jurisdictions. In *Scott Group Ltd v McFarlane*[49] the defendant auditors prepared audited accounts for a public company and overstated the assets of the company to a significant degree. At the time they issued their report, they did not know that there were takeover negotiations under way and that the plaintiff had inspected the report with a view to completing the proposed takeover.

A majority of the New Zealand Court of Appeal concluded that the defendant auditors owed a duty of care to the plaintiffs. Their Honours[50] identified the defendant as members of a class of third persons: however, unlike other circumstances involving third parties, in these circumstances it was reasonably foreseeable that members of this class may rely on the audited accounts in significant matters related to the company assets and business. Although their Honours were careful not to make the liability unlimited in this case, they found that the defendant was liable.

Woodhouse J stated that a prima facie duty of care arises in the case of auditors because:

> auditing would be a fruitless exercise if accounts could not be relied upon,
>
> confidence in handling commercial arrangements would disappear if accounts could not be relied upon,
>
> third parties have limited or no opportunity to make independent examinations and
>
> all audited accounts are available to the public.[51]

Consequently, given that auditors may be held to owe a duty of care, Woodhouse J further held that a plaintiff must show that he or she had relied on the information such that this reliance was the actual cause of the loss.

49 [1978] 1 NZLR 553.

50 Cooke and Woodhouse JJ.

51 D Singh, *Auditors' Liability to Third Parties – Some Issues and Current Developments* (1987) 1-2.

Australia

The decision in *Scott Group Ltd v McFarlane*[52] was approved in Australia by *Shaddock & Associates Pty Ltd v Parramatta City Council.*[53] However, *San Sebastian Pty Ltd v The Minister*[54] narrowed the potential liability for giving professional advice and, more recently, in *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords (reg)*[55] (*Esanda)*, the High Court refused liability to third parties for audited information. Indeed it has been noted in relation to that case that

> the High Court's recent definitive statement on negligent misstatement has established that claims for negligent misstatement require proof of both reasonable forseeability (a relatively easy task) as well as proximity, and that proximity can be shown by an assumption of responsibility on the part of the defendant combined with reasonable reliance on the defendants statement by the plaintiff.[56]

It is only in recent times that the High Court has dealt specifically with the liability of auditors. Indeed, prior to the decision in *Esanda*, matters involving auditors have only been the subject of consideration in two Supreme Court decisions. The decisions demonstrated differing approaches to the problem. In *R Lowe Lippman Figdor and Franck v AGC (Advances) Ltd*[57] AGC was a creditor of a particular corporation. In reliance on the audited accounts of the corporation that stated the corporation was profitable AGC agreed to advance further funding. The financial position was not as it appeared and six months after the advance the corporation went into receivership. The plaintiffs failed in their action against the auditor. The Supreme Court of Victoria held that the auditor did not owe a duty of care to the plaintiffs unless the auditors had intended to induce the AGC, either individually or as a member of a class of which the third party (AGC) was a member, to rely on the audited statement. The Court held that this was the case even in these circumstances where the auditors were aware of the plaintiff's identity as a third party.

In *Columbia Coffee & Tea Pty Ltd v Churchill*[58] a corporation commenced proceedings in negligence against the auditors of Columbia

52 [1978] 1 NZLR 553.

53 (1981) 55 ALJR 713.

54 (1986) 162 CLR 340.

55 (1997) 142 ALR 750.

56 H Anderson, 'Auditors Liability: Is Misleading or Deceptive Conduct an Alternative to Negligence?' (1999) 17 *Corporationss and Securities Law Journal* 350, 351.

57 [1992] 2 VR 671.

58 (1992) 29 NSWLR 141.

Coffee. The case involved a variety of parties. The plaintiff of interest for the purposes of this article was an investor who had purchased shares in Columbia Coffee & Tea Pty Ltd in reliance on the auditors' assessment of the latter corporation's financial position.

Rolfe J held that there was an 'assumption of responsibility' on the part of the auditors in relation to their report on Columbia Coffee. His Honour held that the auditors owed a duty to the plaintiff corporation as a potential purchaser of shares.

In *Esanda Finance Corp Ltd v Peat Marwick Hungerfords (reg)*[59] Esanda loaned money to Excel Pty Ltd in reliance on the latter corporation's accounts. The defendants had audited Excel's accounts. Soon after Excel defaulted on the loan and Esanda commenced proceedings against the auditors in negligence.

The High Court held that the defendant auditors did not owe a duty of care to the plaintiffs. It is difficult to discern a consistent majority view in the decision; however perhaps the situation is best summed up by McHugh J who noted:

> Thus, the position in Australia to date with respect to liability for pure economic loss caused by negligent misstatement is that, absent a statement to a particular person in response to a particular request for information or advice or an assumption of responsibility to the plaintiff for that statement, it will be difficult to establish the requisite duty of care unless there is an intention to induce the recipient of the information or advice, or a class to which the recipient belongs, to act or refrain from acting on it. Mere knowledge by a defendant that the information or advice will be communicated to the plaintiff is not enough.[60]

His Honour supported the decision in *R Lowe Lippman* and the decision of the Full Court of the Supreme Court of South Australia in *Esanda*. He stated that:

> Those decisions correctly apply the principles laid down in *San Sebastian* to cases of auditor liability and they accord with the law as laid down in most common law jurisdictions. Moreover, I can see no good reason for extending the liability of auditors to those members of a class whom the auditor knows or ought to know will rely on the audit where the auditor has not assumed responsibility to those members or intended to induce them to rely on the audit.[61]

59 (1997) 188 CLR 241.

60 Ibid 275

61 Ibid 780 (McHugh J).

It appears that the High Court on numerous occasions has considered the 'laws concern to avoid the imposition of liability "in an indeterminate amount for an indeterminate time to an indeterminate class"'.[62] Clearly the decisions at common law in Australia and in other common law jurisdictions indicate that it will be extremely difficult to establish that an auditor owes a duty of care to any person other than the immediate recipient of the information.

Section 52 – the Alternative?

The authors submit that it is a better alternative for a plaintiff to utilize s 52 to establish liability as the section does not require any relationship of proximity nor does it require that the defendant's conduct amount to negligence. *In Brown v Jam Factory Pty Ltd* it was noted that s 52(1) is a comprehensive section of wide impact, which does not adopt the language of any common law cause of action.[63] For this reason, this 'catch all' section 'constitutes one of the most rapidly growing areas of Australian law'.[64]

Furthermore, it has been said that the TPA and the *Fair Trading Acts* of each State have rendered the common law of negligent misstatement redundant,[65] and, in particular, that Part V of the TPA has 'supplanted the law of misrepresentation in Australia'.[66] For example, Riordan[67] has suggested that if the plaintiffs in *Caparo Industries PLC v Dickman*[68] and *Al Saudi Banque v Clarke Pixley*[69] could have brought themselves within a claim based on a s 52 provision, then a finding opposite to the one laid down could have been reached. The auditors would have been held liable.

The Elements of Section 52

The Meaning of 'Conduct'

The question of liability hinges on the interpretation of the phrase 'conduct that is misleading or deceptive, or likely to mislead or deceive'. 'Conduct', in general terms, means to do or refuse to do any

62 Most recently see *Perre v Apand* (1999) 164 ALR 606, 615.

63 (1981) 53 FLR 340, 348.

64 B Hocking, 'Lawyers' Liability for Negligent Advice' (1997) 17(6) *Proctor* 40, 43.

65 Ibid.

66 Pearson, 'Naked Men, Food and Water: Marketing Law and Codes of Practice' (1996) 4 *Current Commercial Law* 21, 22.

67 P Riordan, 'Misleading Professionals' (1991) 65 *Law Institute Journal* 508.

68 [1990] 2 WLR 358.

69 [1990] 2 WLR 345.

act.[70] Initial court pronouncements stated that to offend s 52 the conduct must 'convey a misrepresentation'.[71] In *Taco Co of Australia v Taco Bell*[72] the Federal Court held that conduct could only be characterised as misleading or deceptive if the conduct conveyed a misrepresentation. This case highlights an important distinction, an expression of opinion compared to that of a factual representation. Consequently, there are doubts as to whether opinions fall within the ambit of the term.

In *Global Sportsman Pty Ltd v Mirror Newspapers Ltd*[73] the Full Federal Court held that an expression of opinion can constitute conduct which is likely to mislead or deceive, but only if the opinion conveyed a misrepresentation. However, the Court qualified this statement by holding that

> an expression of opinion which is identifiable as such conveys no more than that the opinion expressed is held and perhaps that there is a basis for the opinion. At least if these conditions are met, an expression of opinion, however erroneous, misrepresents nothing.

Consequently, although it is recognised that audit opinions may constitute misleading or deceptive conduct, a plaintiff who wishes to recover damages must demonstrate that the auditor did not have a reasonable basis for the audit opinion.[74] Gummow J in *Elders Trustee & Executor Co Ltd v EG Reeves Pty Ltd*[75] offers a neat and concise summary of the situation,

> where what is relied on for contravention of s 52 of the TPA is a statement of opinion, it will not be misleading or deceptive, or likely to mislead or deceive, merely because it misinforms or is likely to do so; the situation may differ if the evidence shows that the opinion was not held or that it lacked any reasonable or adequate foundation.

In addition, as audit opinions are offered by experts, the requirement for a reasonable or adequate basis is more strict. In the case of *Bateman v Slatyer*[76] an opinion given by experienced directors had contravened s 52. Burchett J concluded that the opinion given carried with it a representation that the opinion was 'honestly held upon rational

70 *Trade Practices Act 1974* (Cth) s 4(2)(a).

71 *Taco Company of Australia Inc & Ano'r v Taco Bell Ltd & Ors* (1982) 42 ALR 177, (1982) ATPR ¶40-303.

72 (1982) 57 ALJR 109.

73 (1984) 2 FCR 82, 88.

74 Godsell, above n 21, 144.

75 (1987) 78 ALR 193, 242.

76 (1987) 71 ALR 553, 559.

grounds involving an application of the relevant experience'. Accordingly, a court would assess an auditor's opinion against a test of reasonableness, where such a test would vary depending on the person's level of experience.[77]

In later cases the courts have interpreted the term 'misleading' as conduct that is inconsistent with the truth or which leads, or is likely to lead, the person to whom it is directed into error.[78] The term 'deceptive' has been said to carry 'a connotation of craft or overreaching'.[79] These cases establish that s 52 should not be approached on the assumption that it is exclusively confined to circumstances that amount to a misrepresentation. The issue is whether the impugned conduct, of its nature, constitutes misleading or deceptive conduct.[80]

The issue of whether conduct is misleading or deceptive, or likely to mislead or deceive, is a question of fact to be determined in the context of the evidence of the alleged conduct and the relevant surrounding facts and circumstances. In considering this question the courts have stated that the overall effect of the conduct is the major consideration. In *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*, Gibbs CJ noted:

> The conduct of the defendant must be viewed as a whole. It would be wrong to select some words or acts, which, alone, would be likely to mislead if those words or acts, when viewed in their context, were not capable of misleading. It is obvious that where the conduct complained of consists of words it would not be right to select some words only and to ignore others which provided the context which gave meaning to the particular words.[81]

[77] Godsell, above n 21, 106.

[78] *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (No 1)* (1988) 39 FCR 546, ATPR ¶40-850, 79 ALR 83; *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216, 18 ALR 639, ATPR ¶40-067; *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 47 ALR 1, ALJR 715, ATPR ¶40-307.

[79] *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 47 ALR 1, ALJR 715, ATPR ¶40-307, 43,782 (Gibbs CJ).

[80] *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (No 1)* (1988) 39 FCR 546, 79 ALR 83, ATPR ¶40-850, 49,151; *Rhone Poulenc Agrochemie SA v UIM Chemical Services Pty Ltd* (1986) 12 FCR 477, 68 ALR 77.

[81] *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 47 ALR 1, ALJR 715, (1982) ATPR 40-307, 43, 783.

Establishing 'Misleading Conduct' and the Liability of Auditors under the Trade Practices Act

Although professionals have been held liable on many occasions pursuant to s 52, the matter of auditors' liability has not been addressed. As stated earlier, interestingly accountants have been rendered liable under s 52 on a number of occasions.[82] However, there appears to be no reason why the provisions of s 52 will not be applicable to auditors. Also, as discussed, the ambit of s 52 appears wider than the common law of negligence.

In determining whether conduct is misleading or deceptive courts will often have recourse to the four stage test in *Taco Co of Australia Inc v Taco Bell Ltd*[83]. Therefore in determining whether a representation made by an auditor is misleading or deceptive it is a useful exercise to examine each of the following steps:

1. Identify the relevant sections of the public who are likely to be misled or deceived

This entails an examination of the section of the public that is likely to be misled by the conduct. Decided cases have established that this section of the public can range from the public at large to a particular geographic[84] or age[85] group to an individual.[86]

In a case involving an auditor, it is suggested that the class would not be as wide as the public at large. A representation in a corporation's annual report prepared by an auditor would clearly go to the firm and its shareholders. Clearly such persons would be regarded as members of the relevant class. However, it is likely that the representation would travel further and that many persons not in the former limited categories may obtain access to the report. It is submitted this would invite into the class a very diverse group of persons who are categorised as 'third parties' and without recourse at common law. Therefore persons without any direct connection to the corporation who simply obtain access to the report and act upon it may be regarded as members of the relevant class. The class would also include situations involving a shareholder who makes a private investment decision on

82 *Mackman v Steingold Pty Ltd* (1991) 13 ATPR ¶41-105, *Paper Sales (Australia) WA Pty Ltd v PSA Pty Ltd* (1991) 13 ATPR (Digest) ¶41-142, *Sutton v AJ Thompson Pty Ltd (in Liq)* (1987) 9 ATPR ¶40-789.

83 42 ALR 177.

84 Ibid; *Brownes Dairy Ltd v Dairyvale Metropolitan Co-operative Dairy Pty Ltd* (1981) ATPR ¶40-215.

85 *INXS v South Sea Bubble Co Pty Ltd* (1986) ATPR ¶40-667.

86 *Baxter v British Airways* (1988) 82 ALR 298, ATPR ¶40-877 *Dillon & Ors v Baltic Shipping Corporation Mikhail Lermontov* (1990) ATPR ¶40-992.

the basis of the report. Again, this person is likely to be excluded at common law but would obtain entry into the class required by s 52.

2. Test the matter by reference to all who fall within that class

After identifying the particular class, the court looks at the members of that class to examine, with reference to the members of that class, whether the conduct was misleading or deceptive. Section 52 examines the effect or likely effect upon the minds of those hearing or observing the conduct.[87] However, by what standard is the impugned conduct to be examined? The High Court considered the matter in *Parkdale*, but three views appear from the judgment of the court. Gibbs CJ[88] was of the view that the section must be regarded as contemplating the effect of the conduct on reasonable members of the class. Mason J[89]used a standard of an 'ordinary purchaser' while Murphy J[90] adopted a broader view to include persons 'both shrewd and ... ingenious, ... educated and ... uneducated and ... inexperienced in commercial transactions'.

At this stage it is necessary to ask whether a member of the class would be misled or deceived by an auditor's report? The answer appears to be yes. This appears to be the case whichever of the tests in *Parkdale* is adopted: an auditor is regarded as a professional and to be competent in his/her field. In the same way as a person could be expected to rely on the statements made and reports prepared by an auditor at common law so as to establish reliance, a member of the class of persons identified under s 52 could assume that the auditor was using due care and skill and that the contents of the reports could be safely relied upon.

3. Evidence of actual erroneous conclusion is not necessary

A plaintiff does not have to establish that any person has actually been misled or deceived by the conduct. This appears of little relevance here.

4. Has the misconception been caused by the behaviour in question?

The misleading conduct must have actually *caused* the loss or damage. Therefore, if the plaintiff was misled not by the conduct of the defen-

87 *Global Sportsman Pty Ltd v Mirror Newspapers Ltd* (1984) 2 FCR 82, 87.

88 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 199.

89 Ibid 210.

90 Ibid 214-215.

dant, but due to the plaintiff's own erroneous assumption or some other extraneous factor, liability will not be established under s 52.

This factor could be a vital one in determining the liability of auditors. Various other factors could impinge on the plaintiff's decision to make a particular business decision. Therefore while the plaintiff may have read through the auditor's report, there could have been other, more significant factors intruding on the particular decision, for example advice from a financial adviser. If the loss or damage was caused by the negligent advice, rather than the auditor's report itself, then no matter how misleading the auditor's report it could not be said to have caused the loss.

Interpretations of s 52 have also been at variance with well-recognised common law situations. Therefore a discussion of a number of these circumstances with a view to auditors' liability is necessary.

Intention

Section 52 and similar provisions of the State *Fair Trading Acts* can be characterised as strict liability sections. These sections generally do not require any degree of fault nor are they concerned with an intention of engaging in misleading or deceptive conduct.[91] Therefore, intention is not an element of s 52. It is not necessary to have any intention to mislead or deceive or any dishonest belief regarding accuracy of a statement. The only relevant consideration is whether the conduct was misleading or deceptive or likely to mislead or deceive.[92] Intention may be relevant in the case of promises, predictions and opinions which may involve a consideration of the state of mind of the maker at the time the offending statement was made.[93]

This fact may appear particularly hazardous for persons who pass on information given to them by others. However, the decision of *Yorke v Ross Lucas*[94] may bring some comfort as there the High Court held that s 52 would not be contravened in circumstances where it is 'apparent that the corporation is not the source of the information and that it expressly or impliedly disclaims any belief in its truth or falsity'.

91 *Yorke v Ross Lucas Pty Ltd* (1985) 158 CLR 661, subsequently confirmed in *Columbia Coffee & Tea Pty Ltd v Churchill* (1992) 149 NSWLR 141, 151.

92 *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216, 18 ACR 639, ATPR ¶40-067.

93 *Global Sportsman Pty Ltd v Mirror Newspapers Pty Ltd* (1984) 2 FCR 82, 55 ALR 25.

94 (1985) 158 CLR 661, 666.

Thus, the section would not be breached if the misleading or deceptive information is accompanied by a statement that the speaker is a mere conduit of information and that such statement was brought to the attention of the alleged victim.[95]

However, this comfort may be illusory. In the case of *Mackman v Stengold*,[96] the defendant accountants reproduced figures given to them by their client. These figures, together with a disclaimer, were then supplied to a third-party purchaser. The figures were later proved to be incorrect and the accountants were held to be in breach of s 52. Liability was attached despite the disclaimer putting the plaintiffs on notice that the accountants did not guarantee the figures in any way as they were merely passing on the information.

This decision seems to indicate that the Court may be changing its views in relation to information that is passed on. This change may, to some degree, be said to stem from the reasoning found in cases where an express disclaimer is absent. In these cases the courts have been reluctant to infer disclaimers of this kind. This is especially the case in situations where the defendant has experience and expertise in the relevant subject matter. This has been acknowledged in *John G Glass Real Estate Pty Ltd v Karawi Constructions Pty Ltd*[97] where it was held that 'a potential purchaser would ordinarily expect ... that the agent had no reason to doubt the completeness or accuracy of the information which it provided'. In addition, it has been said that even if there was reason to doubt the information, the mere fact that the defendant had considerable experience may be sufficient to attribute liability.[98] By analogy an experienced auditor would nevertheless be liable.

Reliance

Another element of s 52 is that defendants will not be relieved of liability even if the misleading or deceptive conduct was as a result of an honest and reasonable mistake.[99] Hence, defences available at common law such as a lack of proximity, honest and reasonable mistake, due diligence and mistaken belief cannot be used by a defendant. However, it is a defence to argue that the plaintiff had not

95 *Gardam v George Wills & Co Ltd* (1988) 82 ALR 415, 427.

96 (1991) ATPR 41.

97 (1993) ATPR ¶41-249, 41,359.

98 *Lezam Pty Ltd v Seabridge Australia Pty Ltd* (1992) 35 FCR 535, 553.

99 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 197.

placed any reliance upon the misleading or deceptive conduct. Without reliance no damages are claimable.

Accordingly, a plaintiff must show that he/she had placed reliance upon the defendant to the extent that he/she had been led into a mistaken belief and, as a consequence of which, a course of action had been taken. It must further be established that this course would not have been taken but for the reliance and as a result of this reliance a loss was thereby incurred.[100] From this discussion, it can be seen that reliance is inextricably linked with causation. In order for the plaintiff's claim to succeed, causation must be established between the careless statement and the plaintiff's damage. Clearly, establishing reliance is a means of proof of causation.[101]

It is important to realise that, although a defendant may argue that the party bringing the action knew of the true facts or did not rely on the misrepresentation, it is not relevant that the plaintiff would have ascertained the true position by making their own enquiries.[102] The use of s 52 is not precluded on the basis that the plaintiff did not exercise reasonable care to look after his/her own interests.[103] Consequently, the fact that the plaintiff could have discovered the misrepresentation does not prevent liability.

Furthermore, the liability faced by auditors not only originates from claims made by their clients, but also includes claims made by shareholders and other persons such as investors. This vastly extends the scope of liability such that auditors would be responsible for unforseeable persons who might rely upon audit reports in the future.[104] In effect, given that it has been shown that s 52 liability is both strict and open-ended, the plaintiff need only show that the defendant's conduct was misleading or deceptive or apt to mislead or deceive.[105]

Silence and the Duty of Disclosure

It can be argued that silence can constitute misleading or deceptive conduct if such silence conveys a misleading impression.[106] From an

[100] Godsell, above n 21, 144.

[101] C Lockhart, *The Law of Misleading or Deceptive Conduct* (1998) 237.

[102] *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (1988) ATPR ¶40-850; *Sutton v AJ Thompson Pty Ltd* (1987) 73 ALR 233.

[103] *Tiplady v GC Carton Pty Ltd* (1984) ATPR ¶40-472.

[104] Godsell, above n 21, 146.

[105] *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Pty Ltd* (1978) 140 CLR 216, 223.

[106] B Akhurst and A Bodger, 'Trade Practices Law: Proceed with Care' (1991) 62(3) *Charter* 54, 55.

auditing perspective, silence could include any omissions in advice or a failure to make a qualification of financial statements, the result of which would give rise to a mistaken belief. For example, an auditor has a responsibility to report a known fraud, error, or other irregularity to the members of a company if, in the auditor's opinion, the truth and fairness of the financial statements is thereby materially affected and directors have refused to amend the financial statements accordingly. If this has occurred, the auditor should issue an exception opinion that describes the financial statements clearly and unambiguously.[107]

The most prominent decision in this area is *Demogogue Pty Ltd v Ramensky*.[108] There it was held that there is no general duty of disclosure under s 52,but if the facts give rise to an expectation that, if there were any other facts that were relevant, they too should be disclosed.[109] Non-disclosure would amount to misleading or deceptive conduct. Consequently, there is a duty to reveal the truth such that half-truths would infringe the section.

Section 52 may also impose a duty to correct prior statements. This duty arises in situations where a statement is true when made, but subsequent events make it false.[110] Non-disclosure of the changed circumstance would amount to a half-truth as the person to whom the original disclosure was made is entitled to be informed as to any changes to the facts as represented.[111]

Hence, s 52 extends the boundaries of the common law as it compels a party to speak or correct prior statements. As a result, auditors should be very careful when giving advice or opinion so to avoid making any omissions or representations that may lead a person to a mistaken belief. They should also act promptly to correct any statements previously given, if at a later date they are found to be incorrect.[112]

Client Contravention

Closely linked to the duty to correct statements is the involvement in a breach by a client. Contravention of s 52 allows for a damages ac-

107 *Pacific Acceptance Corporation v Forsyth* (1970) 90 WN (NSW) 282, 290 (Moffitt J).

108 [1993] ATPR ¶41-203.

109 W Pengilly, 'Can the Blind Mislead the Blind' (1997) 5 *Trade Practices Law Journal* 6.

110 *Tiplady v G C Carton Pty Ltd* (1984) ATPR ¶40-472.

111 Pengilly, above n 109, 7.

112 Godsell, above n 21, 155.

tion to be made against any person involved in that contravention.[113] Section 75B refers to a person involved in a contravention as a person who 'has been in anyway, directly or indirectly, knowingly concerned in, or a party to, the contravention'.[114] This means that an auditor can be liable for their client's misleading or deceptive conduct.

For instance, in *Sutton v AG Thompson Pty Ltd*[115] an accountant was held personally liable for misrepresentations made by his client in his presence. Liability would not have followed if the accountant had corrected these misrepresentations. This duty imposed by the TPA may be seen to be in direct conflict with an auditor's duty to his/her client. If the auditor is to correct the misrepresentation this may well put the auditor-client relationship at risk. Nonetheless, the auditor has little choice but to correct the misrepresentation.

Section 51A and Future Matters

In situations where the opinion refers to some future matter, a plaintiff may find it more attractive to bring an action under s 51A of the TPA. This section deals with representations as to future matters and is usually in situations involving investment and predictions. Section 51A provides:

> (1) For the purposes of this division, where a corporation makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act) and the corporation does not have reasonable grounds for making the representation, the representation shall be taken to be misleading.
>
> (2) For the purposes of the application of subsection (1) in relation to a proceeding concerning a representation made by a corporation with respect to any future matter, the corporation shall, unless it adduces evidence to the contrary, be deemed not to have had reasonable grounds for making the representation.

Section 51A(1) has the effect that when a representation is made, such representation is deemed to be misleading unless it can be supported on reasonable grounds. Section 51A(2) goes further and deems that there are no reasonable grounds for making the representation unless evidence is adduced to the contrary. This effectively shifts the burden onto the defendant to prove that he/she had reasonable

[113] *Trade Practices Act 1974* (Cth) s 82.

[114] *Trade Practices Act 1974* (Cth) s75B(c).

[115] (1987) ATPR ¶40-789.

grounds for making the representation and also subjects him/her to cross-examination.[116]

Courts have generally interpreted this section quite strictly. In *Wheeler Grace & Pieriicci v Wright*,[117] Lee J held that experts must accompany any representations they make with relevant qualifications:

> The fact that the corporation believed or had reasonable grounds for belief that the prediction would be fulfilled, would not answer the question as to whether the conduct was misleading or deceptive conduct in trade or the misleading or deceptive conduct may be found in the failure to qualify the statement.[118]

The Judge's comments suggest that although a corporation's predictions be made on reasonable grounds, they may, nevertheless, be misleading if not accompanied by a statement to the effect that a different outcome is possible.

As David Godsell has pointed out, although the majority of audit work involves the expression of an opinion concerning past accounting events and transactions, many auditors and audit firms are also involved in accounting work and other services which are future-oriented.[119] In this context, liability under s 51(A) could readily arise if an accountant or auditor were to prepare or evaluate a prediction, projection, forecast or any other advice concerning a future matter. Such work would typically include, for instance, the preparation of profit forecasts, cash flows forecasts, budgets, net present valuations, and advice concerning intended acquisitions or disposals.[120] Extreme care should be taken performing such work and all predictions should be qualified, even if they are based on reasonable grounds.

However, an auditor may try to escape the operation of s 51A by using the previously mentioned authority of *Bateman v Slatyer*.[121] An auditor could try to make out an argument that the opinion about the future matter only constituted a representation that the opinion is presently held on rational grounds. In effect, although the opinion was about a future matter, it is not a representation with respect of a

116 Godsell, above n 21, 156.

117 (1989) ATPR ¶40-990.

118 Ibid 50,670.

119 Godsell, above n 21, 157.

120 Ibid.

121 (1987) 71 ALR 553.

future matter.[122] It remains to be seen whether such an argument would be accepted by a court.

Australian Securities and Investment Commission Act 1989 (the ASIC Act) and Corporation Law Provisions

In addition to the TPA, there are also remedies for misleading and deceptive conduct under the ASIC Act and the *Corporations Law*, but neither apply to the provision of an audit report by auditors. Section 12DA of the ASIC Act forbids a corporation from engaging in misleading and deceptive conduct in relation to financial services, and this is defined in s 12BA(1) to be in relation to a financial product. Even though a security is one of the financial products stated, the work of an auditor in stating compliance with auditing standards and the truth and fairness of the company's financial statements pursuant to s 307 of the *Corporations Law* does not involve work in relation to a financial product.

In addition, s 1005 of the *Corporations Law* allows a person to recover damages from persons who contravene s 995 or s 999. These sections run parallel to the operation of s 52 of the TPA as they too are aimed at misleading or deceptive conduct but in the context of securities. The ambit of these sections is very wide as they catch all misleading or deceptive conduct in the making of evaluations and recommendations of takeover offers, negotiations and preparatory arrangements and the issue of securities and prospectuses. This again, does not relate to the work of an auditor as mentioned above.

However, although s 995 and s 999 cover a broad range of misleading or deceptive conduct, s 1009 specifically deals with the activities of experts in producing prospectuses. If for example, an auditor has been named in a prospectus as an expert, the auditor would only be liable under s 1005 in respect of a false or misleading statement in the prospectus or for an omission from the prospectus. Therefore, s 1009 applies a more difficult test than that under s 995 and s 999. This demonstrates an intent that s 995 and s 999 were legislated only to cover specific types of misleading or deceptive conduct.[123]

Implied Warranties of s 74

Another important section in the TPA for auditors is s 74. This section implies certain warranties into contracts for the supply of serv-

[122] Riordan, above n 67, 510.

[123] Anderson, above n 14, 115.

ices. The most relevant are (1) that services will be rendered with due care and skill[124] and (2) where the consumer has indicated the purpose for which the services are required, that they will be reasonably fit for that purpose.[125] Liability, however, can be limited if it can be shown that the consumer has not relied, or it is unreasonable for him/her to rely on the corporation's skill or judgement.

The application of s 74 arises (a) if the 'corporation' and 'trade and commerce' requirements discussed earlier are met, and (b) if a contract is present. A further prerequisite for the operation of this section is that the contract must be for the supply of 'services' to a 'consumer'. Section 4 provides that 'services' include 'work of a professional nature'.[126] This should remove any doubt that work performed by auditors would fall within this definition. Section 4B defines 'consumer' in terms of the price of the service such that a person is deemed to be a consumer if the service costs $40 000 or less.

The justification of such a section is founded on the idea of extending consumer protection. Given that our current day market structure and business environment is becoming more sophisticated and complicated, auditing services have also become more complex and diverse. Consequently, the normal tasks performed by the auditing profession would fall within the ambit of s 74.[127]

Enforcement and Damages

An action for contravention of s 74 lies in a breach of contract rather than a breach of the TPA.[128] This results in damages being assessed under contract law. However the quantum of damages for contravention of other sections of the TPA is not as clear-cut. Numerous cases have dealt with this issue and it appears that the damages awarded, for example, for contravention of s 52, are less than damages amounts received at common law.

[124] *Trade Practices Act 1974* (Cth) s 74(1); K Cooper and J Jackson, 'The Impact of S 74 of the TPA 1974 (Cth) on the use of Disclaimers by Accountants and Professionals' (1991) 19 *Australian Business Law Review* 167, 202.

[125] *Trade Practices Act 1974* (Cth) s 74(2).

[126] The *Fair Trading Acts* clearly extend to professional services as the majority of States refer to 'trade and commerce' as including any business or professional activity: cited in F Gul, H Teoh, B Andrew and P Schelluch, *Theory and Practice of Australian Auditing* (4th ed, 1995) 42.

[127] Cooper and Jackson, above n 124, 203-4.

[128] Ibid 198.

Enforcement and remedy provisions under the TPA are located in Part VI of the Act. Section 80 provides that the Commission or any other person may seek injunctive relief. Section 82 allows a person who has suffered loss to recover such loss from persons breaching provisions of Part IV or V, which includes s 52, or from any other person involved in such contravention. Under s 87, the court may make a range of other orders.[129]

These sections offer the advantage of enabling a court to impose a wide range of remedies to suit the circumstances of each action and also avoid the problems of the common law rules of *locus standi*. All that a plaintiff must show is a causal connection between the conduct in breach of the Act and the loss suffered. This appears to greatly extend the ambit of liability of auditors compared to that in negligence.

However, the calculation of damages under s 82 may be less favourable than that at common law. A detailed study of damages is beyond the scope of this article, but it is nevertheless appropriate to mention the issues surrounding the recovery of lost expectations.

In a tort or breach of contract action, a claimant who has suffered loss is entitled to recover an amount which would 'put him/her in the same position as s/he would have been but for tort or breach of contract'.[130] These amounts will inevitably be different as damages from a breach of contract include an amount for the loss of profits or disappointed expectation.[131]

The High Court in *Gates v City Mutual Life Assurance Society Ltd*[132] clearly established that 'compensation on the basis of lost expectation would be appropriate, however, neither authority nor principle offer support for this approach'. This decision has been strictly followed such that, 'the general or ordinary rule ... is plainly that the tortious measure should apply'.[133] Yet the Court conceded that in some exceptional circumstances the tortious measures would be inappropri-

[129] These include, an order rescinding or amending a contract or collateral arrangement, an order directing the refund of money or the return of property, an injunction or restitution.

[130] *Johnson v Perez* (1988) 166 CLR 351, 371.

[131] W Pengilley, 'Section 52 of the TPA: A Plaintiff's New Exocet?' (Aug 1987) *Australian Business Law Review* 247, 271.

[132] (1986) 160 CLR 1, 4-5.

[133] *Sharp v Ramage* (1995) ATPR ¶41-398, 40,402.

ate.[134] It follows, that damages under s 82 for the contravention of s 52 are more restricted in quantum than those for the breach of contract.

Recently in *Accounting Systems 2000 (Developments) Pty Ltd v CCH Australia Ltd*,[135] the Court considered whether breach of a contractual warranty could constitute misleading or deceptive conduct, and damages should be awarded for loss of the expected performance of the warranty on the same basis as breach of contract. As stated by Lockhart and Gummow JJ in their joint judgment:

> Where contravention of s 52 is linked with a claim for damages under s 82 and the representation complained of was a contractual warranty, it may be necessary to consider whether the measure of damages that would be recoverable under s 82 would differ from that available at common law for breach of a warranty. The point was not ventilated in the present case. However, this situation does serve as a reminder of the danger of automatically translating into s 82 as the appropriate measure of damages that recoverable in an action for the tort of deceit.[136]

The above case has established that in any situation where a claimant has been misled as to the performance of a promise for the benefit of a claimant, even though the promise is not contractually enforceable, s 82 entitles the claimant to damages for the loss of the expectation of performance of the promise in accordance with the contractual measure. It appears that the courts are slowly beginning to recognise claims for the lost opportunity to earn profits under s 82.[137]

The Use of Disclaimers

Disclaimers have been discussed previously in the context of information that has been passed on. This section will more broadly deal with the effect of disclaimers under s 68. Section 68 provides that any contractual term that purports to exclude or restrict the implied warranties in s 74 is void. However, it does not prevent a person from inserting a clause having the effect of delineating their duty or providing limitations on performance.[138]

[134] The Court cited Lee J's reference to *Ellul & Ellul v Oakes* (1972) 3 SASR 377 in *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (1989) ATPR ¶40-986, 50,582.

[135] (1993) ATPR ¶41-269.

[136] Ibid 41,647.

[137] See C Colvin, 'Tales of the Unexpected: Damages for Lost Expectations' (1997) 5 *Trade Practices Law Journal* 17.

[138] Jackson and Cooper, above n 124, 195.

Thus, an auditor may seek to define his/her services, but cannot detract from the obligations found in s 74. As a precaution an auditor may wish to attach a clause to their disclaimer specifying that he/she is aware of the implied warranties established by the TPA and that the disclaimer in no way seeks to exclude their operation. If such a clause is not present a plaintiff may argue that the disclaimer is of the type which should be void by virtue of s 68.

Furthermore, not only are disclaimers void if they purport to exclude the operation of s 74, but courts also will not allow the use of disclaimers to limit the application of s 51A and s 52. This is because actions based on s 52 are 'outside ordinary actions in contract which exemption clauses might bar'.[139] Courts are also similarly opposed to disclaimers seeking to avoid liability under s 1005 of the *Corporations Law*.

This, however, does not mean that there is no role for disclaimers. The Federal Court in *Keen Mar Corporation Pty Ltd v Labrador Park Shopping Centre*[140] held that although disclaimers have no direct legal effect, they can be taken into account when deciding whether or not reliance had been placed on the misrepresentation. A more extreme view for the role of disclaimers is that given by the New South Wales Attorney-General's Department. In their Discussion Paper,[141] the Department stated that there is no public policy reason why disclaimers should not be used against third parties who have notice.

The courts do not agree with this view and also there is some evidence to suggest that the profession does not want total relief from liability either:

> Perhaps some auditors, naturally jealous of their professional reputation, would hesitate to announce such a disclaimer, nor do we know what the attitude of the stock exchange might be.[142]

Generally, the courts will not allow auditors to hide behind disclaimers. However, it is possible for auditors to reduce the risk of incurring liability by means of appropriate, clear and prominent warnings, qualifications and the like.[143] These warnings and qualifications can serve to (1) reduce the risk of a plaintiff being led into a mistaken be-

[139] *Petra Pty Ltd v EAJ Pty Ltd* (1984) 7 FCR 375, 390 (Wilcox J).

[140] (1989) ATPR ¶46-048.

[141] Legislation and Policy Division, NSW Attorney-General's Department, *Limitation of Professional Liability for Financial Loss* (1989) 33.

[142] *Scott Group v McFarlene* [1978] 1 NZLR 553, 581.

[143] Akhurst and Bodger, above n 106, 56.

lief and (2) be used as evidence leading to a conclusion that the plaintiff had acted for his/her own reasons.[144]

Conclusion

In conclusion, this paper has dealt with the liability of auditors under the TPA, with particular emphasis given to ss 52, 51A and 74. It was established that these sections are capable of applying to the profession and hence auditors should be conscious of this potential for liability. In addition, the application of the *Fair Trading Acts* should not be forgotten.

It has been shown that s 52 provides an attractive alternative to the unsatisfactory and restrictive rules of the common law. Plaintiffs are armed with factors such as strict, open-ended liability, no requirement of proving proximity and flexible remedies, to name but a few. Section 51A complements this section as it provides for the reversal of the onus of proof and covers opinions dealing with future matters.

Auditors are also under a duty to disclose additional information so as to avoid half truths and to correct any already existing disclosed facts. Furthermore, s 74 implies certain warranties into the auditor-client contract that can not be excluded by the use of disclaimers. Disclaimers are also important in the context of s 52 as the courts will render them ineffective if they purport to exclude liability.

The wide use of s 52 to date, combined with the growing creativity of lawyers, ensures that courts will be faced with actions against auditors for misleading or deceptive conduct. The current state of auditor liability may very well be returning to Cardozo J's view in *Ultramares Corporation v Touche*,[145] such that auditors would be faced by 'liability in an indeterminate amount, for an indeterminate time, to an indeterminate class'.

[144] Godsell, above n 21, 159.
[145] (1931) 174 NE 441.