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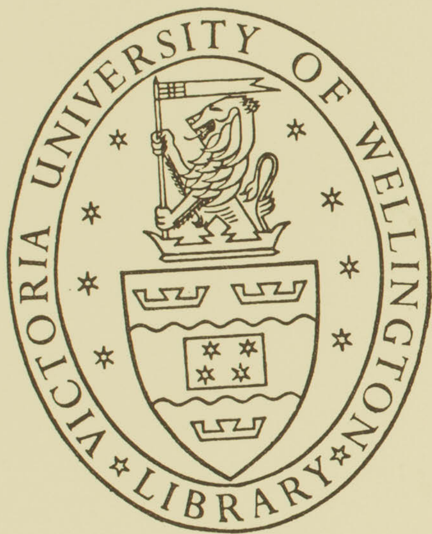
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THE ROLE OF THE STOCKBROKER AS AN INVESTMENT ADVISER
- WHAT DUTY OF CARE?

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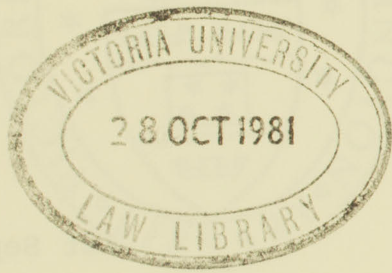

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I INTRODUCTION

Many individuals rely on the advice of their stockbrokers to determine their investment strategies. The aim of this paper is to examine the nature of this advisory role and determine whether or not the broker owes a legal duty of care to his client, beyond that of giving honest advice. It is naturally in the best financial interest of a broker to give careful and good advice in order to enhance his business reputation, but is there a legal duty to do so as well?

First, the nature of the broker-client relationship will be examined. The general tort liability for negligent misstatements will then be discussed and related to the role of the stockbroker in particular. Finally, the operation of a disclaimer will be examined, and the question of causation and damages in the event of a duty arising will be addressed.

II THE WORK OF BROKERS (IN GIVING INVESTMENT ADVICE)

For many clients a stockbroker acts merely as an agent on their behalf in the purchase and sale of securities. The client makes the decision as to which transactions are to be carried out, issues the broker with instructions and the broker is charged only with the execution of those instructions. The broker is a dealer, and his only liability to the client for negligence would be on a contractual basis, where he had failed to execute those instructions with reasonable care.

On the other hand, probably the majority of investors, both private and institutional, rely on the advice given to them by their brokers,in deciding about investment in various securities. It is a principal function of broking firms to provide such advice for their clients, and even to non-clients as well. Most metropolitan firms have research departments whose function it is to assess the relative merits of investment in various securities, with a view to

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relaying these opinions in the form of investment recommendations. Additionally, these research departments are likely to accumulate data on companies and industries, and are in a position to relay factual information as well.

Advice on the relative merits of different investments can be given in various ways. First, a private individual or an institutional representative may telephone or visit a broker for a discussion of his investment portfolio. The investment advice or information is given gratuitously. The reward for the broker is the possibility that the individual or institution will subsequently place an order to buy or sell securities, and will therefore pay brokerage on the transaction. There is a clear distinction to be drawn between this practice and that which sometimes occurs in some overseas countries (notably the United States), where a broker is paid a fixed retainer in return for providing investment advice. In New Zealand, the advice is not charged for, and may in fact be given to clients and non-clients alike.

A second situation is where an investment recommendation is prepared and sent out to all or some of the existing clients of a broking firm. This may take the form of a 'market letter' and deal with the merits of a number of securities, or it may be a 'special recommendation' focusing on one particular security. The recommendation made will generally suggest the buying or selling of particular securities, although more general matters may be dealt with.

Finally, a written recommendation may be prepared for a specific client. This is likely to be more detailed than a 'market letter', and tailored to the client's individual circumstances.

It is to be stressed that the investment advice given by brokers does not consist solely of their opinions as to the 'buys' and 'sells' of ordinary shares quoted on the stock exchange. In each situation identified above, a broker may provide purely factual information, for example as to the

yield and security of an investment or as to the payment of dividends. There need be no element of opinion in the broker's investment advice.

III THE NATURE OF THE RELATIONSHIP BETWEEN BROKER AND CLIENT

A difficulty arises in determining the exact legal description of the relationship between the stockbroker giving advice and the person to whom the advice is given. According to the circumstances, the relationship could be contractual, fiduciary or "special", leading to different duties of care and consequent liabilities arising.

A. Contractual

As already discussed in Part II, investment advice is generally given gratuitously in New Zealand. Therefore there is no direct contractual relationship between the parties, in which the broker provides investment advice in return for a fee from his client, and through which the client could sue the broker for negligently given advice.

On the other hand, it can be argued that a broker only makes an investment recommendation in an effort to induce a contract between himself and the recipient of the information, namely a contract to buy or sell shares. In many situations, of course, there will be no contract arising - the recipient is quite entitled to place his order with a different broker, or the advice may be not to sell a particular security. In a large number of cases however, investment advice given by a broker will induce the recipient to place an order with that broker, and hence enter into a contract with him.

Under section 6 of the Contractual Remedies Act 1979, where a party to a contract has been induced to enter into it by an innocent (or fraudulent) misrepresentation made by the other party to the contract, that misrepresentation shall be taken to be a term of the contract. The wronged party will then have an action for breach of contract, and it is expressly

provided in section 6 (1) (b) that any action in tort for negligent misrepresentation is excluded. Relating the operation of this section to the relationship between broker and client, if the client can show that the advice included a misrepresentation and that it induced him to place an order to buy the security, then the misrepresentation will be treated as a term of the contract. The contract in question is one of agency, in which the broker agrees to purchase the security on behalf of his client in return for remuneration in the form of brokerage. The investment advice is treated as a term of the contract, and the fact that it contains a misrepresentation means that the term is broken and the client has an action for breach of contract.

The operation of section 6 is absolute, in the sense that there is no need for the plaintiff to establish negligence on the part of his adviser. As Dawson and McLauchlan [1] point out, "[t]he philosophy behind the section is that where a person has made a representation which induces another to contract with him, he should be responsible for the accuracy of the representation irrespective of fault." [2] Therefore, where a broker makes a misrepresentation in the course of giving investment advice, and that misrepresentation induces a contract, it is not sufficient for him to show that he exercised due care in formulating the statement. If the statement is incorrect, he will be bound by it regardless.

In the case of brokers giving advice, the ambit of section 6 depends upon the meaning of the word "misrepresentation". Misstatements of opinion, as opposed to misstatements of fact, are not normally actionable in contract, and section 6 deals with "misrepresentations" which have previously been defined as false statements of existing or past <u>facts</u>. [3] Dawson and McLauchlan consider that there is a clear intention that this common law definition is to apply to the section:

> To constitute a representation there must be words which expressly or impliedly state a fact or some positive conduct which is tantamount to a statement of fact. [4]

Therefore, section 6 is intended to cover misstatements of fact, and does not extend to erroneously formed opinions.

In the Chancery case of Brown v. Raphael [5] it was held that where the speaker has an appreciably greater knowledge or means of knowledge than the recipient, his statement of opinion will be taken to include a statement of fact that he had reasonable grounds for forming the opinion. In that case, an erroneous statement made by a solicitor that the annuitant was "believed to have no aggregable estate", was held to include a misrepresentation that the solicitor had reasonable grounds for his belief. Relating this to the situation of the stockbroker, where the broker gives an opinion (as opposed to a bald statement of fact), he will be taken to have made an implied representation that he has reasonable grounds for his opinion, the broker having a greater means of knowledge in the investment area than the advisee. Therefore, a statement of opinion can also be caught as a "misrepresentation" inducing a contract.

It can be argued that section 6 of the Contractual Remedies Act will always cover the advice given by a broker, under the Brown v. Raphael principles. It will be very seldom that the broker does not have an appreciably greater knowledge in the area of investments than the person he is advising. However, in Brown v. Raphael Lord Evershed quoted with approval [6] the comment of the trial judge Upjohn J. that such an implied statement fact was made "where the opinion is expressed on facts assumed to be available to the vendor, which certainly are not available to the purchaser, and that opinion is expressed to induce that contract... ". Thus it would appear that such a statement of fact will only be implied where the speaker expresses an opinion which is itself in regard to an ascertainable fact. Every statement of opinion made by a speaker with a greater means of knowledge in the area will not involve an implied statement of fact that the speaker has reasonable grounds on which to base his opinion.

The investment advice given by a broker is usually in the form of a statement of opinion about future events, rather than of current facts. However, an example of the latter situation is where a client purchases a particular ordinary share because his broker has told him that the company in question is able to pay dividends which will be tax-free in the hands of shareholders. If this was not, in fact, correct and the client had to pay tax on the dividends received, then he would have an action in contract on the basis of section 6 of the Contractual Remedies Act, and any tort action would be precluded. He would not have to show actual loss, for the measure of damages in contract represents the restitution of the plaintiff to the position he would have been in, had the misrepresentation been true. Thus,he could recover for reduced profits, and not only for actual losses incurred.

Where the advice involves no statement of fact, whether express or implied, or where no contract is in fact induced, no action in contract will be available to the client who has been the victim of incorrect advice. Any action will have to be brought under some other head.

B. Fiduciary

In the Canadian case of Elderkin v. Merrill Lynch, Royal Securities Ltd [7] where the broking firm had negligently advised a client to purchase securities which subsequently became worthless, Cooper J.A. stated that:

> There is clear authority that a fiduciary relationship may exist between a stockbroker and his client.[8]

He went on to find that the defendants were also liable for negligent advice under the Hedley Byrne [9] principle. The duty on the part of an adviser who is in a fiduciary position is to advise "carefully, fully, honestly, and in good faith",[10] this being a higher standard than the Hedley Byrne requirement of absence of negligence. Under a fiduciary duty, the adviser must not withhold information or take undisclosed personal benefit. Once a fiduciary relationship is found to exist, the duty is imposed rather than assumed, and hence

any disclaimer of liability would be inoperative as inconsistent with the existence of such a relationship in the first place.

The traditional basis for the finding of a fiduciary relationship comes from the judgment of Lord Chelmsford L.C. in Tate v. Williamson:[11]

> Wherever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage...

It is clear that a person who relies on the advice of another in making investment decisions is 'reposing confidence in him'. However, a broker is not usually in the position of being able to 'abuse' this relationship for his own financial gain. In the Elderkin[12] case, the member of the firm which was advising the plaintiff about a particular company himself had a sizeable number of shares in it. Therefore, any investment on the part of the plaintiff would be to his advantage, in that the buying interest would enhance the share price.

It is possible that a broker may indeed have a financial interest in the securities he recommends. In such a case, he could be placed in a position where he is able to abuse the trust placed in him, and a fiduciary duty would be imposed upon him. If he did abuse his position and obtain personal gain, then the client would be able to bring an action for breach of a fiduciary duty. Similarly, where a broker acts as a principal to his clients, he must fully disclose that he is so acting[13]. Any recommendation made to purchase securities actually owned by the broker must therefore contain a statement of this fact.

However, in the normal course of a broker advising his clients and potential clients, he has no personal interest

in the securities, or if he has any interest it is of such a small magnitude as to be insignificant. In some instances, recommendations made by brokers include a statement to the effect that members of the firm hold securities in the relevant company. This may be an attempt on their part to discharge their fiduciary duty of 'full and honest disclosure', and is in fact required by the Stock Exchange Regulations.[14] The usual situation is that there is no conflict of interest at all.

In the English High Court decision of Woods v. Martins Bank Ltd[15], Salmon J. held that where a bank manager had undertaken to be the financial adviser to a client of the bank, a fiduciary relationship between the client and the bank was thereby created. Although it could be argued that the relationship was given the "fiduciary" status because the investments recommended by the bank manager resulted in the reduction of the overdraft of another of the bank's clients, Lord Hodson commented in Hedley Byrne[16]:

> For my part, I should have thought that even if the learned judge put a strained interpretation on the word 'fiduciary' which is based on the idea of trust, the decision can be properly sustained as an example involving a special relationship.

Lord Hodson emphasised the nature of a fiduciary relationship as one involving 'trust', implying that in such a situation the 'trustee' should not be able to take a personal advantage from his confidential position.

While a fiduciary relationship may be found to exist in certain limited circumstances, and give rise to a distinct fiduciary obligation, it will not usually arise in the case of a stock-broker. The ordinary giving of investment advice, without a personal financial interest on the part of the adviser, fits far more comfortably, if at all, within the concept of a "special" relationship.

C. "Special"

Having discussed the limited circumstances in which the relationship between broker and client may be contractual or fiduciary, the paper will accordingly go on to deal with the more usual situations in which investment advice is given. The basic question to be addressed is whether or not the relationship between broker and client is a "special" one within the Hedley Byrne parameters, and hence whether a broker owes a duty of care to his client when giving investment advice, beyond a duty merely to be honest.

IV TORT LIABILITY FOR NEGLIGENT MISSTATEMENTS IN GENERAL

The Hedley Byrne decision established the doctrine that a professional person could owe a duty of care in tort, quite irrespective of any contractual or fiduciary duty owed to a client, and that he could be liable for financial as opposed to physical loss. While the Hedley Byrne decision has been modified somewhat by subsequent cases, it is still the basis upon which tortious liability for negligent misstatements is founded.

Before Hedley Byrne, the Courts had not been prepared to allow a successful tort action of any kind for a misstatement, as long as it had not been made dishonestly [17]. Liability only arose where there was a contractual relationship between the parties, or where there was some fiduciary relationship.[18] In Hedley Byrne, however, it was established that where the parties were in a "special" though not contractual or fiduciary relationship, a duty of care in the making of statements could arise.

The various components required in Hedley Byrne to constitute a "special" relationship illustrate the desire of the Court to make a clear differentiation between negligence in word, and negligence in deed. Words were seen as generally being used with less care, often in informal situations and having a much greater chance of causing damage because of their wide potential audience. Therefore, although there was a need for a duty

to apply with respect to the giving of information or advice, this duty had to be limited, the 'neighbourhood' test [19] being too wide.

It may be doubted whether the distinction between negligence in word and negligence in deed is as important now as it appeared to be in the Hedley Byrne decision. It is to be remembered that Hedley Byrne was breaking new ground in allowing actions to be brought for negligent misstatements, not arising in the course of a contractual or fiduciary relationship, and their Lordships may have felt that to impose the same criteria as for physical negligence would be altogether too dramatic a step at that stage. In the Scott Group [20] case, Woodhouse J. questioned whether there should be any difference between the liability attaching for the use of negligent words and that for the carrying out of negligent acts.[21] He felt that there would be no great flood of litigation if Lord Atkin's test [22] was applied to words as well as deeds, and that in the case of professional advisers, insurance to cover such claims could be easily arranged. Cooke J. on the other hand treated the imposition of a duty as more of a policy matter, one of the factors to be taken into account being whether the negligence was in word or deed.[23] Nevertheless, the distinction certainly appears to be less important now than it was stressed to be in Hedley Byrne.

The principal components of the Hedley Byrne test for a "special" relationship can be summarized as follows:

(1) The plaintiff relied on the information or advice given.

(2) It was foreseeable that the plaintiff could rely on what the defendant said, and it was reasonable for him to do so in the circumstances.

(3) The defendant issued no clear qualification that he did not accept responsibility.

While there may not have been complete unanimity of thought amongst their Lordships as to the exact meaning of these requirements, it is probably more important to examine the law as it has developed through later decisions, than the individual variations in Hedley Byrne.

The main developments subsequent to the House of Lords decision have been concerned with the second component, namely exactly when it is reasonable to rely on a statement made. While there is a general acceptance of the idea that no liability should attach to statements made in an informal or social setting, the Hedley Byrne doctrine appears to have been limited by the Australian Privy Council decision in M.L.C. v. Evatt[24], to apply to professional people or those in the business of giving advice only. In that case, which is probably binding authority in New Zealand, Lord Diplock for the majority, said that the duty extended to those whose business or profession involved the giving of advice (of a kind calling for special skill and competence) and those who let it be known that they claimed to possess skill and competence in the subject-matter in question.[25] This has been followed in the New Zealand Supreme Court,[26] where it was emphasised that the subject-matter of the statement had to require some special skill or competence not possessed by the ordinary reasonable person.

Although the appellants in the Hedley Byrne case had specifically sought the information from their advisers, this does not seem to be a necessary prerequisite in finding a "special" relationship. In the New Zealand Court of Appeal decision in Scott Group for example, a duty could still arise where the information had been received unsolicited. The question of whether the advice or information was sought will therefore only go towards indicating whether or not reliance was reasonable in the circumstances.

In contrast to the contractual situation, from the Hedley Byrne decision onwards, no attempt has been made to differentiate between advice (opinion) and information (fact) tendered.[27]

Again, however, there could be some distinction when establishing what was reasonable reliance. When an adviser is stating an opinion, rather than conveying information, then the recipient is surely less able to place reliance on what is being said.

Finally, it seems to be reasonably settled that a tortious duty of care, of the type which applied in Hedley Byrne, can arise even though the parties are in a pre-contractual situation. The duty of care can exist quite independently, as long as the advice is not within the ambit of a pre-contractual "misrepresentation" inducing the contract as in section 6 of the Contractual Remedies Act. This position was dealt with by Greer L.J. in Jarvis v. Moy, Davies,Smith, Vandervell & Co:

> ...where the breach of duty alleged arises out of a liability independently of the personal obligation undertaken by contract, it is tort, and it may be tort even though there may happen to be a contract between the parties, if the duty in fact arises independently of that contract.

Therefore, as long as the contract which is formed between the parties is not a contract to provide information or advice in return for a fee, a duty of care can arise in tort under the Hedley Byrne principles. This proposition is supported by the decision of Lawson J. in Esso Petroleum Co Ltd v Mardon,[29] where a duty of care in making pre-contractual statements was held to exist even though the statement was treated as a contractual warranty as well. Also in the recent English High Court case of Ross v. Caunters,[30] it was held that a negligent solicitor could be liable not only to his client in contract, but also in tort to his client and to others to whom he owed a prima facie duty of care. Therefore, the only time when a duty in tort is definitely excluded is when section 6 of the Contractual Remedies Act applies.

V STOCKBROKERS' ADVICE AND A DUTY OF CARE

There are very few reported cases involving negligence on the part of brokers, and even fewer dealing with the question of negligent advice tendered. There have been statements made as to the general duty a broker has towards his client, but these have generally been in connection with the proper execution of the client's instructions. For example, in a recent Australian decision [31] Street J. said :

> Clients, some with great, others with little, business acumen and ability to protect themselves, seek and act on his advice and permit him to handle their money and their shares. Those clients are entitled to expect from a broker not only competence, but also integrity and absence of conflicting personal interests.

Whilst accepting that the broker may be under certain contractual duties to his client with regard to the execution of the client's orders, the object of this paper is to consider the broader issue of negligently given advice, and the question of what duty, if any, attaches to the professional investment adviser. Two particular situations have already been distinguished in Part III. Firstly, where a misstatement of fact is made by a broker, and it induces the client to place an order, that misstatement will be taken to form a part of the contract, and only an action for breach of contract will lie. Secondly, where the broker has some personal financial interest in the securities recommended, the action would be for breach of a fiduciary duty. In other cases the remedy, if any, will be in tort under the Hedley Byrne principles.

As already discussed in Part IV the test laid down initially in Hedley Byrne for determining whether a duty of care arose in the making of statements must be taken to have been modified by New Zealand and other courts. Nevertheless, the Hedley Byrne decision still forms the backbone of any such analysis.

The first component identified in the Hedley Byrne test was that the plaintiff relied on the information or advice given. While this will obviously be a question of fact to be deter-

mined on an individual case basis, it is not difficult to envisage that an investor will accept the advice given to him by a broker as being useful and correct, and act accordingly. Particularly in the cases of unsophisticated investors or where the advice is of a very technical nature, reliance on statements made will be easily proved.

The second component was that in the circumstances,it was reasonable for the plaintiff to rely on what the defendant said. Even if the courts adopt the more limited M.L.C. v. Evatt interpretation, that the duty applies only to those in the business of giving advice, it is difficult to see how brokers could escape the duty. In hanging out his "shingle", a broker is advertising to the public at large that he is prepared to give investment advice, and that he has some special skill or competence in the field, not possessed by the ordinary man. A stockbroker is not someone who is only occasionally called upon for investment advice, for as Street J. points out, "The primary function of a stockbroker is to advise his clients and to act on their behalf in the purchase and sale of shares." [32]. Just as in the case of the bank manager,[33] the stockbroker is in the business of giving investment advice, and can be similarly caught within the Hedley Byrne principles.

Looking at the question of when a duty of care should attach to the giving of information or advice in terms of the leading New Zealand case of Scott Group, it can be seen that whichever of the tests of the judges is applied, the result is the same. Richmond P.,in the minority on this point, took the narrowest interpretation of the Hedley Byrne decision, in saying that it would be reasonable for the plaintiff to rely on statements made by the defendant where the defendant "was, or ought to have been, aware that his advice or information would in fact be made available to and be relied on by a particular person or class of persons for the purposes of a particular transaction or type of transaction." [34] In this case, Richmond P. felt that it would be going too far to treat accountants, who prepared the annual accounts of a company, as assuming a responsibility towards all persons dealing with the company

and in particular someone subsequently making a takeover offer. No such difficulty arises in the situation of the broker who gives advice, as it is perfectly clear that the advice will be used by the person to whom it is given, and is likely to form the basis of an investment decision regarding the company concerned. The stricter approach adopted by Richmond P. could, however, limit the liability of a broker to third parties who obtain the advice or information indirectly and then act on it.

Woodhouse J., on the other hand, preferred to adopt a straight test of foreseeability, based on the speech of Lord Wilberforce in Anns v. Merton London Borough Council,[35] which was a case involving ordinary negligence, as opposed to negligent misstatement. It was sufficient that the defendants could reasonably foresee that the accounts they prepared would be relied on by identifiable persons when dealing with the company in significant matters.[36] Woodhouse J. qualifies this test of proximity slightly, by saying that it will be difficult in many situations for a potential plaintiff to show that the author of the advice should have foreseen that the plaintiff was within the class of persons likely to rely on it, and even more difficult to prove that the reliance was such as to be the effective cause of the loss.[37] Applying the Anns test to the situation of the broker giving advice, reliance on that advice by at least the recipient and his immediate family,would be reasonably foreseeable. The advice is given with the express design that it will in fact be relied upon.

Cooke J. formed the majority with Richmond P. in agreeing that the plaintiffs could not recover in this case. However, he felt that a duty of care did arise between the defendant accountants, and the plaintiffs, as did Woodhouse J. Cooke J. professed to adopt the test of foreseeability set out in the Anns case also, but in applying the test to the facts he limited its operation to an extent. Cooke J. emphasised that on the basis of the published accounts of the company in question, the eventuality of a takeover must have been reasonably foreseeable as virtually inevitable.[38] Therefore, whilst Woodhouse J. may have only required a foresight that the information or advice would be used in significant dealings

with the company, Cooke J. seems to require foresight of the particular (inevitable) use to which the advice would be put. In either situation, the use of a stockbroker's advice as the basis of an investment decision would fit within either category of being reasonably foreseeable.

Whether the duty of care should extend to cover third parties who become aware of the information or advice, is perhaps a more difficult question to answer. In the Canadian case of Central B.C. Planners Ltd v Hocker,[39] a securities salesman employed by a firm of stockbrokers received information which led him to believe, mistakenly, that a strike had been made at a particular oil well. He telephoned a second salesman for confirmation, telling him that he had orders to buy a substantial number of shares in the company which owned the well. This second salesman then represented to several customers that there had been an oil discovery,and that there was major buying interest in the shares. These customers purchased a substantial number of the shares and because of the inaccuracy of the representat-ions suffered a financial loss. The British Columbia Court of Appeal held the second salesman liable, because his relationship with the customers was such that he was under a duty to exercise reasonable care in giving advice, and had failed to do so. In addition, but for the fact that the representations made by the second salesman were so different from those which had been made to him, the first salesman would also have been liable to the customers, because he knew or should have known that the information conveyed to the second salesman would be passed on to customers of the firm.

The Central B.C. Planners Ltd case can hardly be interpreted as standing for the proposition that anyone who relies on advice or information given should have a duty of care owed to them by the person who originally formulated the representation. Rather, the case shows that in limited circumstances it is reasonably foreseeable that a certain class of persons will rely on the statements, even though they have been received indirectly. This is in accordance with the test established by Richmond P. in Scott Group, where the particular person or class of persons had to be reasonably foreseeable.[40]

Therefore, where a stockbroker gives investment advice to a person, it is reasonably foreseeable, and indeed likely, that that advice will be passed on to and relied upon by members of that person's immediate family. Where the advice goes further than this, however, for example if a market letter sent to a client is circulated amongst the business colleagues of that client, Richmond P. would probably say that they ceased to be part of a distinct foreseeable class of persons, and hence they were owed no duty of care. Woodhouse and Cooke JJ. on the other hand might be prepared to admit that the reliance of even this wider group was foreseeable, although the question of the reasonableness of reliance would surely be a negativing factor to a duty of care in such a situation.

The approach of all three of the judges in the Scott Group case was to consider whether, in the circumstances, it was reasonable to say that the defendants had assumed a duty of care. The focus was on whether it was reasonably foreseeable that the plaintiffs would rely on the statements made. It was probably implicit that the reliance placed by the plaintiffs would, in those particular circumstances, be reasonable, the statements being of a factual nature and released in a business context. In the Hedley Byrne decision, however, it was specifically emphasised that not only did the reliance have to be foreseeable, it had also to be reasonable in the circumstances.[41] Thus a broker cannot be held liable for every statement he makes which may foreseeably be relied upon : there must be reasonableness of reliance.

The stock market being inherently unpredictable, it can be argued that it is unreasonable to expect a broker's advice to be correct all the time. People investing in shares on the strength of a recommendation made to them by a broker should accept that they may lose money in the market, and that no-one will be answerable for the loss. This seemingly attractive argument fails to take into account the different types of advice given by brokers, and the different circumstances in which it is given. Such advice can range from purely factual information about the yield of a fixed interest security, to an opinion as to the credit-worthiness of a particular public company, to a guess as to the prospects of a speculative mining company.

Similarly, the circumstances in which the advice is given can have a large bearing upon whether reliance on the advice is reasonable. Where a detailed report is prepared for a particular client, it would be easier to show reasonable reliance than where a 'market report' dealing with a number of securities in a general way is sent out to clients. It is too simplistic an argument to say that because a stockbroker gives the advice, and he is concerned with an unpredictable market, he can never be held to have assumed a duty of care in making the statement.

In the recently decided English High Court case of Stafford v. Conti Commodity Services Ltd,[42] Mocatta J. accepted that, in the case of a commodity broker who gave investment advice as to the futures markets, there was a "special relationship" created between broker and client, and a duty of care was therefore owed. It was implicit that it was reasonable for a client to rely on the broker's advice, and the case turned on the strength of the standard of care applicable:

> I am also satisfied that with the best advice in the world, in such an unpredictable market as this, it would require exceedingly strong evidence from expert brokers in relation to individual transactions to establish negligence on the part of the defendants.[43]

Thus Mocatta J. was prepared to extend the Hedley Byrne principles to a broker-client relationship in saying that it would be reasonable for a client to rely on investment recommendations made to him. A major limit to a possibly endless flood of claims, however, was that very specific evidence of negligence would have to be proved.

The nature of the standard of care applicable was also considered in Woods v. Martins Bank Ltd,[44] (which was approved by Lord Hodson in Hedley Byrne). Salmon J. said:[45]

> Clearly the defendant Johnson was not negligent merely because his advice turned out to be wrong. Nor could he be negligent because he failed to exercise some extraordinary skill or care. His only obligation

> was to advise with the ordinary care and skill which the ordinary bank manager in his position might reasonably be expected to possess.

Because the type of advice which a broker might offer can vary considerably, the standard of care would be largely dependent on the subject matter involved.[46] The duty would be to exercise the due skill and care necessary and reasonable, according to the situation. For example, advice of a factual nature (and not covered by 'pre-contractual misrepresentation') would be more akin to the banker advising on another client's credit-worthiness (Woods v. Martins Bank Ltd), and a relatively strict duty would arise. On the other hand, where a recommendation was made which predicted the expected future prospects of a company, then it would be more difficult to show that the broker had been negligent because the security did not perform as expected. (Stafford v. Conti Commodity Services Ltd). Therefore, where a broker provides information of a factual nature, any negligence on his part will be more apparent. Where the advice is more obviously an opinion, it will be more difficult for the plaintiff to show that the defendant has been negligent. Also, the circumstances in which the advice is given, and the range of recipients, will go towards determining the initial question of whether reliance was reasonable, and then the nature and depth of research which could be expected from the broker in formulating his advice.

Financial Interest

In the Privy Council decision in M.L.C. v. Evatt, Lord Diplock was of the opinion that where the adviser had some sort of financial interest in the transaction on which he was giving advice, it might not be necessary to establish all the usual components of a "special relationship" which are normally required before a duty of care can arise.[47] In the M.L.C. case, a 'financial interest' on the part of the company would have removed the need for the plaintiff to show that the company was in the business of giving investment advice, or professed to have the special skill required for such a business.

This concept was approved by Cooke J. in the New Zealand case of Day v. Ost [48]:

> ... a duty of care will more readily be inferred when the adviser has a financial interest.

Here, it appeared that the fees of the defendant architect were at least to some extent dependent on the completion of the buildings in question, which the architect was trying to induce by his negligent misstatements.

Because a broker will receive remuneration from brokerage earned if a client follows his investment advice and places an order, it could be said that he possessed a 'financial interest' and therefore that a duty of care should be more easily inferred. However, in the New South Wales case of Presser v. Caldwell Estates Pty Ltd, [49] Asprey J.A. considered the impact of the existence of a financial interest as an exception to the "special competence and skill" which the adviser had to have to be under a duty of care in terms of M.L.C. v. Evatt. He held that the 'financial interest exception' only related to situations in which the adviser had previously had personal financial dealings which qualified him to give advice because of the knowledge he had gained from them. In Presser, the fact that a real estate agent would stand to gain a commission if he was able to sell the property in question, was not enough to displace the requirement that he be shown to possess some special skill or competence in the subject-matter before his advice could be reasonably relied upon.

Similarly, in the New Zealand Supreme Court decision in Plummer-Allinson v. Spencer Ayrey Ltd [50] Chilwell J. felt that a financial involvement was only relevant if it could give rise to an implication of a special qualification, skill or competence on the part of the defendant, which would qualify him to give professional advice. It has been argued that to accept any wider view of 'financial interest' would be to undermine the strength of the majority principle in M.L.C. v Evatt, and allow recovery of damages in cases where possession

of the financial interest was quite unrelated to the knowledge or ability of the adviser.[51] The Plummer-Allinson case admittedly adopts a restricted view of what could be seen as ambiguous words in M.L.C. v. Evatt, and a broader view is still open for argument in New Zealand at the Court of Appeal level.

A good analogy can be drawn between the activities of real estate agents and stockbrokers. In each case, there is a prospective financial gain from commission or brokerage if a sale or purchase is made, and in each case, the client is likely to rely on the advice given regarding the property in question. The Presser decision suggests that this type of financial interest is not sufficient to change the requirements for establishing a "special relationship". In the case of brokers, however, the issue is not whether the adviser has the necessary skill and competence to be seen as assuming a duty of care, for this is implicit in his being a stockbroker, but rather whether a financial interest such as his should make the reliance on his advice any more reasonable. It is submitted that this was not the type of effect that Lord Diplock had in mind in M.L.C. v Evatt,[52] and that reasonableness of reliance should be based solely on the nature of the advice given, and the circumstances in which it is given.

VI THE DISCLAIMER

Up until this point, the discussion of the application of the Hedley Byrne principles has involved the implicit assumption that the broker has issued no disclaimer of responsibility. However, in a large number of cases, especially in respect of 'market letters' and 'special recommendations', brokers do include at the bottom of the page some sort of purported disclaimer:

> While statements herein are believed to be accurate, no responsibility will be accepted for error or omission.

While, prima facie, it would be difficult to imagine a more categorical denial of a duty of care, the existence of such a legend may not be determinative of the issue.

The question of whether a duty of care is imposed by the law in certain circumstances, or whether it is assumed by the adviser, may be an important one. If the duty is imposed, the disclaimer will be less readily effective because the broker would have to be seen as expressly contracting out of a duty the law imposes on him. Where the duty of care is assumed by the adviser, however, then the presence of a disclaimer would tend to indicate that there was no intention to undertake such a duty at all.

In the Hedley Byrne decision itself, their Lordships seemed to be in agreement that the duty was the one assumed by the adviser in the circumstances establishing the "special relationship". In that situation, where the adviser expressly declares that he is not prepared to accept responsibility for the accuracy of his statements, he cannot be said to have accepted any duty of care at all. Lord Hodson said:[53]

> They cannot say that the respondents are seeking, as it were, to contract out of their duty by the use of language which is insufficient for the purpose, if the truth of the matter is that the respondents never assumed a duty of care nor was such a duty imposed upon them.

And Lord Devlin said:[54]

> A man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that in fact he is not.

It had been argued before their Lordships that, as in the case of a contractual exclusion clause, the disclaimer had to be very precise to be effective. However, it was held that a general disclaimer would suffice, and that the contractual situation was different. Lord Reid said:[55]

> In the case of a contract it is necessary to exclude liability for negligence, but in this case the question is whether an undertaking to assume a duty can be inferred : and that is a very different matter.

Their Lordships were unanimous in deciding that the disclaimer of responsibility which had been issued was effective in this case, and that the respondents could not be seen as having undertaken to accept any duty of care.

The comments of Lord Pearce in the Hedley Byrne case indicate a slightly less strict approach than that of his colleagues. In discussing the words disclaiming responsibility he said: [56]

> ...they clearly prevent a special relationship from arising. They are part of the material from which one deduces whether a duty of care and a liability for negligence was assumed.

Implicit in this statement is that there are circumstances in which the operation of a disclaimer could be ineffective, if all of the other material suggests that a duty of care was assumed. If the disclaimer forms only part of the material which indicates that a duty has been assumed, then it is not in itself of conclusive operation. Similarly, in the New Zealand Supreme Court case of Capital Motors Ltd v. Beecham, [57] the relevance of the disclaiming words was also said to be "part of the material from which one deduces whether a duty of care was assumed." [58]

Barwick C.J. in the Australian Privy Council decision in M.L.C. v. Evatt [59] said that the duty of care was, in his opinion, imposed by law in the circumstances. He went on to suggest that because the duty is imposed, the speaker could not always except himself from it:

> But the fact of such a reservation, particularly if acknowledged by the recipient, will in many instances be one of the circumstances to be taken into consideration in deciding whether or no a duty of care has arisen and it may be sufficiently potent in some cases to prevent the creation of the necessary relationship. [60]

Thus, although he has approached the duty question from a different angle, Barwick C.J. would appear to end up with a result similar to that of Lord Pearce in Hedley Byrne, although the statement of the latter is less unequivocal. This suggestion of Barwick C.J. that the existence of a disclaimer is only one of the factors to be taken into account in determining

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whether a duty of care has arisen, was not expressly alluded to in the Privy Council decision in M.L.C. v. Evatt, the point not being at issue.

The possible approach of the New Zealand courts in this matter is not immediately obvious, except for the brief comment of Cooke J. in Capital Motors Ltd v. Beecham already mentioned. In the Scott Group case, Richmond P. was concerned to limit the width of the duty of care so that professional persons would only be liable in circumstances where they knew the specific purpose for which their advice was required. [61] He did not wish to see the situation develop in which professional persons felt obliged to resort to a general disclaimer as negativing an assumption of responsibility. While his approach to the duty of care question was regarded as too narrow by Woodhouse and Cooke JJ., his reasoning is instructive : the courts should not force professional persons to resort to disclaimers of responsibility which would tend to conflict with their status as professionals, who should be responsible for their advice in certain situations.

Cooke J. on the other hand was prepared to suggest that where the speaker could disclaim responsibility for the statements he was making, but did not, it would not be too harsh to recognise a duty of care.[62] Thus, Cooke J. seems to accept that a disclaimer will be an effective discharge of the speaker's duty of care, this approach being more in line with that of Lord Pearce's colleagues in Hedley Byrne.

It is submitted that the approach of Lord Pearce and Barwick C.J. (and Cooke J. in Capital Motors Ltd v. Beecham), is to be preferred. Because it is the business of a broker to give investment advice, and because he clearly expects that advice to be relied upon, it would be somewhat inconsistent for him to be able to say, "this is what you should do, I stake my business reputation on it, but I accept no responsibility for any carelessness I may have committed in formulating the advice." [63] By hanging out his "shingle" a broker is announcing to the public that he is prepared to employ his special skill

and competence in advising members of the public. It would be unreasonable and inconsistent for him to be able to disclaim all responsibility on the basis of some fine print at the bottom of the page. If all of the other material indicates that the speaker was assuming a duty of care, then the presence of a disclaimer should not be allowed to override this evidence.

In New Zealand, it is the general practice of brokers to include fine print disclaimers in all of the circulars they send out to their clients. Such an attempt to escape liability for any negligence in the formulation of the advice,would seem to conflict with the broker's professional status. If all brokers use disclaimers, then a person who wants professional investment advice has no choice but to go to a person who will give him advice, but at the same time disclaim all responsibility for it. Given that stockbroking is supposedly regarded as a professional discipline, it would not be in the public interest for the courts to refuse to accept that a broker may be under a duty of care when formulating investment advice, even though a disclaimer of responsibility has been issued.

A subsidiary point to be made is that a stockbroker is unlikely to use disclaimers in every context of giving investment advice. For example, where the advice is given orally, or in response to an individual request, no disclaimer is likely to be attached because the broker feels that such an attachment would reflect badly on his personal integrity as a professional. Also where advice received with a disclaimer attached is passed on to a third person, that disclaimer is likely to be inoperative. Therefore, even if a strict interpretation of the operation of disclaimers is adopted by the courts in New Zealand, stockbrokers can still be liable for negligence where a disclaimer is not issued, or is not given directly to the recipient of the advice.

VII CAUSATION AND DAMAGES

Where the plaintiff has been able to establish the existence of a duty of care on the part of the broker, and a breach of that duty, he will still have to prove that the negligent advice actually caused the loss alleged.

In Stafford v. Conti Commodity Services Ltd [64] Mocatta J. held that the plaintiff had not established the required causal link, because he admitted that he only followed his broker's advice on some occasions, and was not therefore placing the requisite reliance on the statements made. Also, losses made on the market did not of themselves provide evidence of negligence on the part of the broker,[65] and the plaintiff would have to have shown that other experienced and careful brokers would not have given the same advice at the time.[66]

An additional point arises from the judgment of Cooke J. in Scott Group.[67] While he held that a "special relationship" existed, and there had been negligence, he dismissed the action against the auditors because he could find no loss incurred by the appellants. It was true that they might have successfully offered a lesser price for the shares had there been no negligence, but this was only indicative of the fact that a smaller profit was made by the appellants, rather than that a loss was incurred. A distinction was therefore to be drawn between damages in tort, which were for the harm done, and damages in contract, which were for the benefit promised but not received.

Therefore, the plaintiff must show (a) the existence of a "special relationship", (b) that he relied on the advice in making his investment decision and (c) that he incurred an actual loss as a result.

VIII CONCLUSION

The legal description of the relationship between broker and client is variable, according to the specific circumstances of their dealings. This description in turn determines the degree of skill and care which the broker must adopt when giving investment advice, and the level of disclosure with which he must comply.

Where the advice given can be seen as a pre-contractual misrepresentation, then the client will have an action for breach of contract, under section 6 of the Contractual Remedies Act 1979. The broker will be liable for any misstatements, regardless of his diligence in formulating the advice, and he will be liable to the extent of restoring the client to the position he would have been in, had the statement been correct.

Where there is a fiduciary relationship between broker and client, or where the broker is acting as principal, a duty of care will be coupled with a requirement of full disclosure of relevant material on the part of the broker. Courts have traditionally viewed breaches of fiduciary duties in a similarly severe way as breaches of trust.

In most circumstances, however, contractual or fiduciary duties will not arise, and any action for negligent advice would be brought under the Hedley Byrne principles. While it would appear that any financial interest on the part of the broker is insufficient in itself to create a "special relationship", a broker giving investment advice can be seen to have assumed a duty of care. The existence and width of this duty will depend upon the nature of the subject-matter of the advice, the circumstances in which it was given and the presence or otherwise of a disclaimer. It is submitted that while a disclaimer will certainly not weaken the position of the broker, its operation may not be conclusive. Given the difficulty a client is likely to have in showing that the advice was negligently formulated, that reliance on it caused the loss, and that it was an actual loss incurred rather than a profit reduced, it does not seem unreasonably harsh that a broker should be seen as having accepted some duty of care to his clients in his role as investment adviser.

FOOTNOTES

1 F. Dawson & D.W. McLauchlan, The Contractual Remedies Act 1979 Sweet & Maxwell (N.Z.) Ltd., Auckland, 1981.

2 Ibid. 12.

3 Maddison v. Alderson (1833) 8 App. Cas. 467; but see also Bisset v. Wilkinson [1927] A.C. 177.

4 Supra n.2, 14.

5 [1958] Ch. 636.

6 Ibid. 645

7 (1977) 80 D.L.R. (3d) 313.

8 Ibid. 323.

9 Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] A.C.465.

10 Burke v.Cory (1959) 19 D.L.R. (2d) 252, 258.

11 (1866) LR 2 Ch.55, 61.

12 Supra n.7.

13 Rothschild v. Brookman (1831) 5 Bligh N.5. 165.

14 N.Z.S.E. Regulations, August 1981, 30.13.
It is provided that a member shall disclose any interest held by himself or his family in the securities in question, and the existence of any professional association with the company. This requirement only extends to market letters sent out to clients, and not to specific verbal or written recommendations made. This is unlike, for example, the Australian requirement in s. 52 of the Securities Industries Act 1976 (N.S.W.) of disclosure in all investment advice given.

15 [1959] 1 Q.B. 55.

16 Supra n.9, 510.

17 Derry v. Peek (1889) 14 App. Cas. 337.

18 Nocton v. Lord Ashburton [1914] A.C. 932.

19 Donoghue v. Stevenson [1932] A.C. 562

20 Scott Group Ltd. v McFarlane [1978] 1 N.Z.L.R. 553

21 Ibid. 572.

22 Supra n. 19.

23 Supra n.20, 584.

24 [1971]A.C. 793 (PC).

25 Ibid. 806.

26 Plummer-Allinson v. Spencer Ayrey Ltd. [1976] 2 NZLR 254.

27 See Lord Devlin in Hedley Byrne at 528.

28 [1936] 1 K.B. 399, 405.

29 [1976] Q.B. 801.

30 [1980] Ch. 297.

31 Bonds & Securities (Trading) Pty Ltd. v. Glomex Mines NL [1971] 1 NSWLR 879, 891.

32 Hewson v. Sydney Stock Exchange Ltd. [1968] 2 NSWR 224, 231.

33 Supra n. 15.

34 Supra n. 20, 566.

35 [1977] 2 All. E.R. 492.

36 Supra n. 20, 575.

37 Ibid. 576.

38 Ibid. 582.

39 (1970) 10 D.L.R. (3d) 689.

40 Supra n. 20, 566.

41 Supra n. 9, per Lord Reid at 486, per Lord Morris at 503 and per Lord Hodson at 514.

42 [1981] 1 All. E.R. 691.

43 Ibid. 698.

44 Supra n. 15.

45 Ibid. 73.

46 cf. Lord Diplock in M.L.C. v Evatt at 802.

47 Ibid. 809.

48 [1973] 2 NZLR 385, 388.

49 [1971] 2 NSWLR 471.

50 Supra n. 26.

51 P. McKenzie, "What Ever Happened to Hedley Byrne?" [1974] NZLJ 543.

52 Lord Diplock's comments were based on the decision in W.B. Anderson & Sons Ltd. v. Rhodes [1967] 2 All. E.R. 850, where the financial interest arose from past financial dealings, and meant that the defendants had the necessary personal knowledge as opposed to skill and competence to be able to advise on the credit-worthiness of the company in question.

53 Supra n.9, 511.

54 Ibid. 533.

55 Ibid. 492.

56 Ibid. 540, emphasis added.

57 [1975] 1 NZLR 576.

58 Ibid 580.

59 (1969) 42 ALJR 316.

60 Ibid. 321.

61 Supra n. 20, 570.

62 Ibid. 580.

63 cf. D.G. Kember, "Liability for Negligent Misstatements: Round 2"(1969) 5 VUWLR 293.

64 Supra n. 42, 697.

65 Idem.

66 Ibid. 698.

67 Supra n. 20, 585.

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