OPINION

EQUITABLE LIFE

REMEDIES FOR MISREPRESENTATION AND NEGLIGENT ADVICE

THE OPINION OF MR HIRST Q.C.

I. INTRODUCTION

1. Mr. Hirst Q.C. has provided to the Financial Ombudsman Service ("FOS") his Opinion relating to the remedies that should be made available to former members of the Equitable Life Assurance Society ("the Society") whose complaints of mis-selling in relation to the GAR risks and costs are upheld.

2. The context of Mr. Hirst's Opinion is a group of lead or test cases, in each of which the complaint of a former member of the Society has been upheld by the FOS at the stage of adjudication. There has as yet been no provisional or final determination of these complaints by an ombudsman. Nor did the adjudications in the lead cases deal with the question of the appropriate remedy or damages.

3. Mr. Hirst has examined the adjudications in these lead cases and given his Opinion about the appropriate remedy. He has considered five such cases. In four of them, the adjudicator found that the claimant's purchase of one of the Society's products was induced by a misrepresentation relating to the risks and costs of funding GAR policies. The adjudicator also found that the Society had not established any reasonable ground for believing its representation to be true. Such findings create a liability in damages under

Section 2(1) of the Misrepresentation Act 1967. In the fifth case, the adjudicator found that the Society owed a duty to advise the claimant with reasonable care and failed to fulfil that duty. This breach of duty also related to disclosure of the risks and costs of funding GAR policies.

4. Although the FOS has not yet issued an adjudication or provisional assessment or final determination concerning the appropriate remedies, Ms. Whittles (the FOS Principal Ombudsman, Investment) has provided a summary of her view concerning remedies (enclosed with her letter dated 31 July 2003 to Ms. Houston of the Society). She has done this in the context of four of the five lead cases. They include the case in which the adjudicator found that there had been a negligent breach of a duty to advise.

5. It is apparent from Ms. Whittles' summary of her views that she has accepted the correctness of Mr. Hirst's Opinion. It seems, therefore, likely that that Opinion will be of significance in influencing future adjudications and decisions by the FOS. So it is important to examine that Opinion with some care.

6. In giving his Opinion, Mr. Hirst explained (in paragraph 16) that he had considered carefully a number of previous opinions given by others (including two to which one or both of us were signatories). However, Mr. Hirst does not address the views expressed in those opinions on grounds of economy. We can sympathise with this sentiment. But it is unfortunate. Mr. Hirst's own views differ significantly in major respects from the views expressed in those previous opinions. The result is that we do not have the benefit of Mr. Hirst's reasons for rejecting the views others have expressed. We are left to infer what those reasons are or might be from Mr. Hirst's formulation of his own affirmative views.

This is sometimes difficult and never entirely satisfactory. We would also point out that (putting our own opinions to one side for the moment) the opinions expressed by others over a substantial period of time include those of distinguished members of the Bar. Their authors include Mr. Glick Q.C., Mr. Richards Q.C. (as he then was and now Mr. Justice Richards, a member of the High Court bench), Mr. Martin Moore Q.C. (as he now is) and Mr. Richard Snowden Q.C. (as he is now is). To see their opinions rejected at a stroke and without reason is, to say the least, disquieting.

7. In this Opinion, we consider Mr. Hirst's Opinion. The matters under consideration are of very considerable importance both to the claimants and to the continuing members of the Society who will ultimately bear the cost of any compensation awarded to the claimants. We have thought it best to approach Mr. Hirst's Opinion not simply as an exercise in criticism but in a spirit of trying to uncover the best and most accurate legal analysis of the problems raised by these complaints.

II. SUMMARY OF MR. HIRST'S OPINION

8. Mr. Hirst's Opinion is a substantial one. A summary of it will not do it justice. But it is nonetheless important to formulate the main ideas and arguments that underlie it. We do that in this section.

9. Mr. Hirst's view is that, for a number of reasons, rescission is not an appropriate remedy for the claimants. We expressed the same view for substantially similar reasons in our Opinion of 19 September 2002. In the course of the last year, nothing has come to light to alter our view. We spend no more time on this question.

10. Mr. Hirst next considers a remedy in damages. He refers to the remedy of damages for negligent misrepresentation inducing a contract conferred by Section 2(1) of the Misrepresentation Act 1967 (paragraphs 28-29) and to the decision of the Court of Appeal in Royscot Trust Limited v. Rogerson [1991] 2 QB 297 (paragraph 33). That decision was to the effect that the measure of damages under Section 2(1) of the Misrepresentation Act is the same as the measure of damages in a claim based on fraud. He expresses the view that Royscot will probably (though not certainly) be overruled by the House of Lords if and when the opportunity to do so arises, but that in the meantime it remains of binding authority (paragraphs 33-36).

11. Mr. Hirst then examines the leading authorities on damages for fraud (paragraphs 37-38). He considers the implications of these authorities (paragraphs 39-51) and concludes that

(i) If the Society "under-performed the market," the resulting loss from that under-performance is recoverable as damages (paragraph 39);

(ii) General market losses are not recoverable (paragraph 45), unless the investor's next preferred alternative investment would have been a money market account (paragraph 47);

(iii) The date by reference to which loss is to be assessed is, in general, a short but reasonable time after investors became aware of the misrepresentation (paragraphs 50-51);

(iv) In the case of pension policies (as contrasted with life policies), there is a powerful argument that damages should be assessed by reference to the position as it stands at the date of the award of damages (paragraph 59).

12. Mr. Hirst then expressed the view (paragraphs 62-68) that the market value adjusters ("MVA") were to be taken into account in calculating damages. He also thought that any reduction in final bonus (imposed in July 2001 to reflect the fall in stock market values) would have been reflected in the transfer or surrender value of a policy and, for that reason, should be included in the calculation of damages (paragraph 71).

13. In proposing a suitable methodology for assessing damages, Mr. Hirst thought that damages should be measured by comparing the actual position of the complainant with his hypothetical position with a suitable comparator, the most suitable comparator being an average of other with profits funds (paragraph 73).

14. Mr. Hirst then formulated his conclusion (in paragraph 74) on how damages for misrepresentation should be calculated in the context of the lead cases. He said that there should be a comparison of

> "(a) The value of the pension fund that the claimant now has based on the reinvestment of the proceeds from the Equitable policy into an averagely performing "with profits" fund; and
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> (b) The value of the alternative investment that the claimant would now have, assuming the investment had been an averagely performing "with profits" fund. Where it is unclear what alternative investment the claimant would have made, but it is clear that an alternative investment would have been made, in my view the only sensible course is to look to what an average "with profits" fund would have achieved."

15. If this comparison revealed a loss (because (b) exceeded (a)), then the damages to be awarded should be the difference between these two amounts.

16. Mr. Hirst added two further points in the context of the lead misrepresentation cases. First, if damages were to be assessed by reference to the date of the award (rather than some earlier date), it would be open to the FOS not to award interest (paragraph 75). Secondly, if the claimant had purchased an annuity with the sum realised on surrender of his policy with the Society, then the date on which he purchased the annuity should be the latest date by reference to which damages should be assessed (paragraph 76).

17. Mr. Hirst then considered the lead case in which there was a finding by the adjudicator of negligent breach of a duty to advise. His conclusion (expressed in paragraph 86) was that the method to be adopted for assessing damages should be the same as that which he had proposed for the misrepresentation cases.

18. Finally, Mr. Hirst (in paragraph 87) briefly revisited the issue of damages for misrepresentation and concluded that even if (contrary to his opinion) damages for misrepresentation were not to be based on the fraud measure, this should make no difference to the measure of damages based on the assumption (which he regarded as realistic) that the Society was under a duty to advise the claimants who complained of misrepresentation.

III. GENERAL PRINCIPLE AND THE SCOPE OF THE DUTY

19. The most fundamental principle of the law of damages is that they are compensatory: the claimant is to be awarded a sum which will compensate him for the loss which the

wrongful act has caused to him. There are two corollaries of this principle. First, the claimant is not to be compensated for losses which he has not suffered. Secondly, the claimant is not to be compensated for losses which he *has* suffered but which were not caused by the defendant's wrongful act.

20. The distinction between losses suffered that were caused by the wrongful act and losses suffered that were not caused by the wrongful act requires careful analysis. It is most vividly illustrated by South Australia Asset Management Corporation v. York Montague Limited [1997] AC 191 (generally known as "SAAMCO" or "BBL").

21. The case involved three appeals to the House of Lords that were heard together. The facts of each were broadly similar. In each, a lender was considering making a loan on the security of real property. The lender engaged a professional valuer to value the property in return for a fee. The valuation was carried out negligently. It overstated the value of the property. In each case, if the valuer had provided a non-negligent (and, therefore, accurate) valuation, the lender would not have been prepared to enter into any loan transaction at all with the borrower on the security of the property in question. This was the significant factual feature of the case. In many cases of this type, the effect of an accurate (instead of an overstated) valuation is that the lender would still be prepared to make a loan but one for a lesser amount than the loan he in fact made. But in these three cases it was found as a fact that, if the true value had been known, the lender would not have lent at all.

22. After the loans were made, property values fell. The lenders had not advanced 100% of the valuation to the borrower. Like most lenders, they had allowed a margin or cushion to guard against fluctuations and falls in value.

23. The borrowers were unable to repay the loans. The fall in property values together with the initial overvaluation (and consequent relatively high sum lent) produced the result that the security was insufficient to discharge the loans and interest that had accrued on them.

24. To make the illustration clearer, it is useful to recall the (slightly simplified) facts of one of the three cases. In that case, the property had been valued at £2.5m. It was then in fact worth £1.8m. The lender, relying on the valuation, had advanced £1.75m. on the security of the property (which he thought, wrongly of course, to be 70% of the value of the property). The effect of the fall in property values was that the property realised only £950,000. The lender's loss (including unpaid principal and interest) was quantified as £1.3m. The lender was held entitled to recover as damages the sum of £700,000, this being the difference between the amount at which the property was negligently valued (£2.5m) and the amount it was in fact worth at the time of the valuation (£1.8m). The total loss suffered by the lender was £1.3m. But of this total, only £700,000 was caused by the negligent valuation. The balance of the loss was caused by the fall in property values.

25. If the valuation had not been negligently carried out, the lender would not have entered into any lending transaction at all with the borrower. He would then have avoided all loss on the transaction. But by relying on the negligent valuation, he was exposed to, and suffered, a loss of £1.3m. His damages were limited to £700,000. The reason is that

there were two causes of his loss. One was the negligent overvaluation. The other was the fall in property values. The amount by which the property was overvalued was £700,000. It followed that the loss attributable to the negligent overvaluation could not be greater than this sum. The lender could not recover damages for that portion of his loss that was caused by the fall in property values. This was so even though, but for the valuer's negligence, the lender would not have entered into any transaction at all and hence would not have been exposed to either the effect of the overvaluation or the effects of the fall in property values.

26. This decision shows the importance of analysing with care the scope of the duty and the risks which the defendant has assumed and hence the scope of the losses for which his breach of duty renders him liable. In SAAMCO, the valuer did not assume the risk of a fall in market values. He assumed only the risk of the valuation being negligently inaccurate. The fact that reliance on the negligent valuation was what exposed the lender to the fall in market values was irrelevant. The risk of such a fall was one which the lender had himself assumed. The most critical point in the analysis is this: even if the property had in fact been worth what the valuer negligently advised it was worth, the lender would still have suffered the loss associated with the fall in market values. It was not the inaccuracy of the valuation which caused that loss.

27. This idea of focusing upon the scope of the duty and risks undertaken by the defendant is not, of course, one of our making. Nor is it merely a matter of inference deduced from the result of the appeals in SAAMCO. It is the method of analysis explicitly proposed by Lord Hoffman (with whose speech the other four members of the House of Lords agreed).

28. The following passages from the speech of Lord Hoffman prove the point.

> "Much of the discussion, both in the judgment of the Court of Appeal and in argument at the Bar, has assumed that the case is about the correct measure of damages for the loss which the lender has suffered. (P.210G).... I think that this was the wrong place to begin. Before one can consider the principle on which one should calculate the damages to which a plaintiff is entitled as compensation for loss, it is necessary to decide for what kind of loss he is entitled to compensation. A correct description of the loss for which the valuer is liable must precede any consideration of the measure of damages. For this purpose it is better to begin at the beginning and consider the lender's cause of action." (p.211A-B).

> "A duty of care such as the valuer owes does not however exist in the abstract. A plaintiff who sues for breach of a duty imposed by the law (whether in contract or tort or under statute) must do more than prove that the defendant has failed to comply. He must show that the duty was owed to him and that it was a duty in respect of the kind of loss which he has suffered." (p.211G-H).

> "How is the scope of the duty determined? In the case of a statutory duty, the question is answered by deducing the purpose of the duty from the language and context of the statute: Gorris v Scott (1874) LR 9 Ex. 125. In the case of tort, it will similarly depend upon the purpose of the rule imposing the duty. Most of the judgments in the Caparo case are occupied in examining the Companies Act 1985 to ascertain the purpose of the auditor's duty to take care that the statutory accounts comply with the Act. In the case of an implied contractual duty, the nature and extent of the liability is defined by the term which the law implies. As in the case of any implied term, the process is one of construction of the agreement as a whole in its commercial setting. The contractual duty to provide a valuation and the known purpose of that valuation compel the conclusion that the duty includes a duty of care. The scope of the duty, in the sense of the consequences for which the valuer is responsible, is that which the law regards as best giving effect to the express obligations assumed by the valuer: neither cutting them down so that the lender obtains less than he was reasonably entitled to expect, nor extending them so as to impose on the

> valuer a liability greater than he could reasonably have thought he was undertaking." (p.212C-F).
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> "Rules which make the wrongdoer liable for all the consequences of his wrongful conduct are exceptional and need to be justified by some special policy. Normally the law limits liability to those consequences which are attributable to that which made the act wrongful. In the case of liability in negligence for providing inaccurate information, this would mean liability for the consequences of the information being inaccurate." (p.213C-D).
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> "I think that one can to some extent generalise the principle upon which this response depends. It is that a person under a duty to take reasonable care to provide information on which someone else will decide upon a course of action is, if negligent, not generally regarded as responsible for all the consequences of that course of action. He is responsible only for the consequences of the information being wrong. A duty of care which imposes upon the informant responsibility for losses which would have occurred even if the information which he gave had been correct is not in my view fair and reasonable as between the parties. It is therefore inappropriate either as an implied term of a contract or as a tortious duty arising from the relationship between them." (p.214C-E).

29. It may be permissible make a small comment on this last extract. The thing which Lord Hoffman describes as not being fair and reasonable as between the parties is the imposition of responsibility *"for losses which would have occurred even if the information which he gave had been correct"*. When inaccurate information is given, and what is under consideration is what the position would have been if the information had been correct, there are two different ways in which the information might be correct. Information is incorrect when it fails to correspond with the facts. It is correct when it corresponds with the facts. When information is incorrect, correctness may be hypothetically achieved either by altering the information so as to make it correspond with the facts or altering the facts so as to make them correspond with the information.

When Lord Hoffman referred to what would have occurred *"even if the information ... had been correct,"* it is plain that he is referring to the situation where the property was worth what the valuer stated it to be worth and not to the situation where the valuer gave a lower valuation which corresponded with what the property was actually worth. This deduction is easily made. The facts were that the lender would not have entered into the transaction at all if the valuer's valuation had been an accurate statement of the true value of the property. In that case, the lender would not have suffered any loss at all on the transaction because he would not have entered into it. Lord Hoffman, however, is supposing a case where the lender would still have suffered a loss even if the information given to him had been correct. This could only happen if the lender in fact entered into the transaction. For this to happen and in order also for the information to have been correct, we must suppose that the correspondence between the facts and the information is achieved by the property in fact being worth what the valuer said it was worth.

30. We may summarise this. Where negligently inaccurate information is given which induces a transaction, loss which would still have been suffered even if the facts were in accordance with the information given is not generally recoverable.

31. Applying this to the lead cases, if the GAR risk had been immaterial (as was represented), the claimants would still have invested with the Society and would still have suffered losses as a result of falls in equity values. Such losses should not in general be recoverable as a result of a breach of a duty to take care in providing accurate information concerning the GAR risk.

32. We have spent a little time referring to, and analysing, SAAMCO because of its central importance in highlighting legal policy, principle and method. It is obvious even from the brief passages that we have cited above that these policies and principles and this methodology are of a general character. Lord Hoffmann explains their application in cases of breaches of statutory duty, tort and breach of contract. That is not to say that there may not be exceptions in which a different approach is called for. In the present context of liability for negligent misrepresentation under section 2(1) of the Misrepresentation Act 1967, the defendant is liable for damages for negligent misrepresentation if he would have been liable for damages if the misrepresentation had been made fraudulently; and (as Lord Hoffmann recognised in SAAMCO at pp. 215H-216C), cases of fraud may require different treatment. Additionally, Lord Hoffmann was concerned with the negligent provision of information. He recognised that cases of a negligent failure to perform a duty to advise may call for different treatment (at p. 214E-F). We address these features below. But a sensible starting point is to have well in mind the law's general approach to the measure of damages and, in particular, to the logically prior question of the kind of loss for which a claimant is entitled to compensation having regard to the scope of the duty and risks undertaken by the defendant. As Lord Hoffmann observed, "A correct description of the loss for which the valuer is liable must precede any consideration of the measure of damages." (See the first extract cited in paragraph 28 above).

33. In four of the five leading cases with which Mr. Hirst was concerned, the cause of action was an alleged misrepresentation by the Society to potential new members about the effects of the GAR risks and costs. This was the wrongful act complained of. If we

were to apply the SAAMCO principles and methods, we should ask ourselves the question: what are the losses which *this* wrongful act has caused? In order to answer that question, we must then ask: what was the scope of the duty which the Society undertook and what were the risks which it assumed?

IV. UNDER-PERFORMANCE BY THE SOCIETY

34. Mr. Hirst suggests that the losses suffered by the lead claimants may have three components. These are

(i) The losses associated with the GAR cost;

(ii) The losses resulting from a general decline in market values experienced by all with profits funds; and

(iii) The additional losses suffered by the Society's members because (as Mr. Hirst suggests) the Society's with profits fund may have performed worse than other with profits funds and, hence, the decline in values suffered by the Society's members may have been greater than that suffered by members of other with profits funds.

35. We shall assume Mr. Hirst to be factually correct in identifying this third possible component of loss and consider the appropriate legal analysis on that assumption. We would also point out that it is not at all easy to make a direct comparison between the performance of different with profits funds. The policy of "smoothing" returns followed by most with profits funds in greater or lesser degree stands in the way of a direct comparison of performance and returns by reference to statements of policy value and

bonus declarations. Again, if statements of policy values and bonus declarations are compared, the leads and lags of the timing of the imposition of MVAs and policy value reductions amongst different providers is bound to cause difficulty. Again, it must be remembered that a contract by which a person takes out a life or pension policy is a contract for the provision of services rather than the purchase of tangible or intangible assets. The services provided by different providers may have different features and, hence, different values. The Society is generally regarded as having provided a high level of flexibility in the terms of the services which it provides. This factor also stands in the way of easy comparison by reference to fund or policy values.

36. Despite these difficulties, we proceed on the assumption that Mr. Hirst is correct in suggesting that there may be reason to suppose that the Society's with profits fund has under performed other with profits funds over periods of time during which the lead claimants were members of the Society.

37. Mr. Hirst's view is that a claim based on a misrepresentation of the GAR risk should entitle the claimant to recover for the first of these three components of loss (losses attributable to GAR itself) and for the third component (the Society's under performance in comparison with other with profits funds) but not for the second component (general asset value falls experienced by other with profits funds as well as the Society).

38. We can readily agree with Mr. Hirst's view about the first and second components of loss. But we find it impossible to agree with his opinion about the third component of loss (that resulting from the Society's under performance in comparison with other with profits funds).

39. There are several important features of the legal analysis of this third (assumed) component of loss which have to be set out in a little detail. The first of these derives directly from SAAMCO itself: ordinarily, a person may not recover for all of the consequences of entering into a transaction induced by reliance on negligently inaccurate information. He may recover only for the consequences of the inaccuracy of that information. If the representation concerning the GAR risk had been correct (i.e. the facts corresponded with what the misrepresentation stated), the claimants would still have suffered from the effects of a fall in equity values, including both general market declines and falls attributable to the Society's under performance. As Lord Hoffmann observed, to impose responsibility for such loss is not "fair and reasonable as between the parties." (See the last extract cited in paragraph 28 above.)

40. Now Mr. Hirst has accepted that the lead claimants may not recover for *all* of the consequences of having entered into a transaction with the Society. In particular, he excludes from the ambit of recovery the general market losses experienced by all with profits funds. On the other hand, he believes that recovery should not be confined to the losses associated with the costs of GAR and should extend to losses resulting from the Society's (assumed) under performance when compared with other with profits funds.

41. Putting the matter very simply, if we apply the reasoning in SAAMCO, it seems to us to be plain that the duty on the Society was not to misrepresent the GAR risk. Assuming that it has done precisely that (without reasonable grounds), the Society is liable for the consequences of misrepresenting the GAR risk. It is not liable for other consequences. In particular, it has committed no breach of duty in managing the assets and investments and maintaining their value relative to other with profits funds and is not to be held liable for

failing to do so. When the Society gave a representation about the GAR, it undertook the risk that its representation might turn out to be negligently false. It did not undertake the risk of under performance in comparison with other with profits funds. To hold the Society liable in damages for such under performance would be to impose upon it a form of strict liability for its under performance without any basis of liability for under performance having been established. It would place upon the Society and its members a risk which the investor himself undertook and one which would have occurred (and for which the Society would not have been liable) even if the facts concerning GAR had been in accordance with the Society's representation about GAR.

42. If the Society had been found to have conducted its investment activities negligently and this negligence had caused it to under perform other with profits funds, then the Society would be liable for that under performance. Mr. Hirst's Opinion treats the Society as if it had been found so liable. But there is, in fact, no such finding against the Society.

43. We have to say, with a high measure of emphasis, that SAAMCO does not permit recovery for the Society's under performance (in comparison with other with profits funds) where the wrongful act complained of is misrepresentation of the GAR risk. To permit such recovery would be to permit recovery for one of the consequences of having entered into the transaction in question as contrasted with the consequences of the wrongful act itself. The very heart and soul of SAAMCO is the denial of such a possibility.

44. Our first observation about Mr. Hirst's Opinion is, therefore, that if we were to apply the general principle propounded in SAAMCO, we would have no alternative but, first, to

deny recovery for relative under performance (i.e. the extent to which the Society under performed other with profits funds) and, secondly, to confine recovery to the losses caused to Claimants by the misrepresentation of the GAR risk. The position would be entirely different if the Society had been found to have acted negligently in the conduct of its investment business. But there is no such finding.

45. We can illustrate the point directly from Lord Hoffmann's speech in SAAMCO. Let it be supposed that the representation that the GAR risk was immaterial had been true. The investor would still have invested and would still have suffered the loss resulting from any under performance by the Society.

46. Let it be assumed the representation was not true. An investor is, therefore, entitled to recover for the loss he suffered as a result of it being untrue. But he is not allowed to recover for a loss which he would still have suffered even if the facts had been as represented. To hold otherwise would be to reallocate to the Society and its continuing members a risk which the investor undertook when he invested. The risks which may properly be allocated to the Society are those unleashed by its wrongful act, namely the misrepresentation. These risks do not include the risk that the Society might under perform other with profits funds.

47. All of this follows directly from Lord Hoffman's speech. It is embodied in the passages we have cited above (in paragraph 28). The following sentence bears repetition: "A duty of care which imposes upon the informant responsibility for losses which would have occurred even if the information which he gave had been correct is not in my view

fair and reasonable as between the parties." (See p.214D, cited in the last extract quoted in paragraph 28 above).

48. Similarly, to hold the Society liable for its under performance when the loss resulting from that under performance would have been suffered by the investor even if the facts had corresponded with the GAR representation is not fair and reasonable. It is not in accordance with the law.

49. What are we then to make of Mr. Hirst's opinion that damages are recoverable in respect of the Society's (assumed) under performance? There are two possibilities. The first is that Mr. Hirst believes that SAAMCO permits or requires recovery for relative under performance. The second is that, although SAAMCO does not so permit, he believes that SAAMCO is inapplicable in the present circumstances and that some other set of principles applies which permit or require recovery for relative under performance.

50. The first of these two possibilities seem to us to be tantamount to inconceivable. The analysis in SAAMCO is so clear and emphatic. We are, therefore, driven to infer that Mr. Hirst must have in mind the second possibility. He must, we deduce, believe that some other regime (different from SAAMCO) applies and that it compels or permits the conclusion that the victim of a misrepresentation about GAR risk can recover damages for relative under performance. Now we must ask: what is that other regime and why does it supplant SAAMCO?

51. Mr. Hirst refers (in paragraph 33 of his Opinion) to the decision of the Court of Appeal in Royscot Trust Limited v. Rogerson [1991] 2 QB 297. In that case, it was held that the measure of damages under section 2(1) of the Misrepresentation Act 1967 (which

supplies the claimants' cause of action in four of the five lead cases) is the same as the measure of damages for fraud. Mr. Hirst expresses the belief that if Royscot were to be reviewed by the House of Lords it would probably (though by no means certainly) be overruled; but for the moment it must be taken to declare the law as it presently stands.

52. It will be recalled that in SAAMCO, Lord Hoffmann referred to cases of fraud as being "commonly thought" to be an exception to the general principle that damages are recoverable only for the consequences of the wrongful act. (See at p. 215F and 215H). Although, with respect to Mr. Hirst, he does not say so in terms, we infer that his implicit rejection of the principle in SAAMCO rests upon the view that, following Royscot, section 2(1) of the Misrepresentation Act requires damages to be assessed on the same basis as in cases of fraud and such cases fall outside the SAAMCO principle.

53. It would be possible to devote considerable space to the single question whether Royscot was correctly decided and whether it correctly states the law. We resist the temptation to do so in the present context. But, summarising the matter very shortly, it seems to us to be plain that Royscot was an aberration and was wrongly decided. Mr. Hirst records his surprise that such a view can be expressed with such confidence. But the reasons for it are not hard to find. They were articulated clearly and economically by Mr. Richard Hooley in his case note on Royscot ((1991) 107 LQR 547). As he observed, as a matter of construction of section 2(1),

> "It is certainly arguable that the words "that person shall be so liable," mean merely, "that person shall be liable in damages notwithstanding that at common law damages were only available for misrepresentations proved to be fraudulent" (see Taylor (1982) 45 M.L.R. 139 at p. 141). On

> this interpretation the sub-section establishes liability in damages but not their quantum."

54. Once the issue of construction is disposed of in this way, the matter is one of legal policy. In commenting on the possibility that, exceptionally, in cases of fraud the whole risk of the transaction is cast upon the fraudulent misrepresentor, Lord Hoffmann (at p. 215G) in SAAMCO said:

> "Such an exception, by which the whole risk of loss which would not have been suffered if the plaintiff had not been fraudulently induced to enter into the transaction is transferred to the defendant, would be justifiable both as a deterrent against fraud and on the ground that damages for fraud are frequently a restitutionary remedy."

55. It is obvious that this specific legal policy in favour of an exception for cases of fraud is incapable of application to cases of negligence.

56. In Smith New Court Limited v. Scrimgeour Vickers [1997] AC 254 at p. 279F-280C, Lord Steyn said

> "*The justification for distinguishing between deceit and negligence*
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> That brings me to the question of policy where there is a justification for differentiating between the extent of liability for civil wrongs depending on where in the sliding scale from strict liability to intentional wrongdoing the particular civil wrong fits in. It may be said that logical symmetry and a policy of not punishing intentional wrongdoers by civil remedies favour a uniform rule. On the other hand, it is a rational and defensible strategy to impose wider liability on an intentional wrongdoer. As *Hart & Honoré Causation in the Law,* 2nd Ed. (1985), p. 304 observed, an innocent plaintiff may, not without reason, call on a morally reprehensible defendant to pay the whole of the loss he caused. The exclusion of heads of loss in the law of

> negligence, which reflects considerations of legal policy, does not necessarily avail the intentional wrongdoer. Such a policy of imposing more stringent remedies on an intentional wrongdoer serves two purposes. First it serves a deterrent purpose in discouraging fraud. Counsel for Citibank argued that the sole purpose of the law on tort generally, and the tort of deceit in particular, should be to compensate the victims of civil wrongs. That is far too narrow a view. Professor Glanville Williams identified four possible purposes of an action for damages in tort: appeasement, justice, deterrence and compensation: see "The Aims of the Law of Tort" (1951) 4 C.L.P. 137. He concluded, at p. 172:
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> > "Where possible the law seems to like to ride two or three horses at once; but occasionally a situation occurs where one must be selected. The tendency is then to choose the deterrent purpose for torts of intention, the compensatory purpose for other torts."
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> And in the battle against fraud civil remedies can play a useful and beneficial role. Secondly, as between the fraudster and the innocent party, moral considerations militate in favour of requiring the fraudster to bear the risk of misfortunes directly caused by his fraud. I make no apology for referring to moral considerations. The law and morality are inextricably interwoven. To a large extent the law is simply formulated and declared morality. And, as *Oliver Wendell Holme, The Common Law* (Ed. M De W Howe), p. 106, observed, the very notion of deceit with its overtones of wickedness is drawn from the moral world."

57. The very essence of these observations is to draw a distinction between the moral quality of negligent and fraudulent conduct. The justification for imposing the whole of the risk and loss of a transaction on the wrongdoer rests peculiarly on the distinct moral characteristics of dishonest and intentional wrongdoing. A claim based on section 2(1) of the Misrepresentation Act 1967 is, of course, a claim based on negligence. To apply to it the fraud measure of damages does violence to rational legal policy and is devoid of even the least justification.

58. It would be absurd to suggest that Parliament intended the negligent misrepresentor to be liable to the same extent as the intentional and dishonest wrongdoer. It will be recalled that, immediately prior to the enactment of the Misrepresentation Act 1967, there was no right of action for damages for misrepresentation inducing a contract, except where the misrepresentation was fraudulent. It is true that Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] AC 465 had already been decided. It created a cause of action for negligent misstatement where a special relationship existed. But the creation of that new form of action lay outside the field of contract. It was unclear how that new form of action would develop in the context of negligent mis-statements inducing a contract. Indeed, it was commonly said that it had no application to cases of contract (a point made by Mr. Hooley in his case note referred to above). The obvious intention of Parliament was to provide that there should be a cause of action in damages for a negligent mis-statement inducing a contract, just as there is for a fraudulent mis-statement inducing a contract.

59. In 1967, it could not have been fully appreciated that the measure of damages for fraud would develop in the way it has subsequently done. Even Doyle v. Olby (Ironmongers) Limited [1969] 2 QB 158 had not by then been decided. But it was that case which set the modern law of damages for fraudulent misrepresentation on the right road (after a series of erroneous and inconsistent 19th century decision).

60. A brief examination of the range of arguments advanced and discussed as late as 1996 in Smith New Court reveals that a fierce debate continued as to the appropriate measure of damages for fraud. It would be unrealistic to suppose that it was Parliament's intention to place misrepresentation on a parallel track with fraud such that whatever future

developments might occur in the law of fraud should attach themselves automatically to cases of negligent mis-statement. The two situations have fundamentally different characteristics and their different treatment in point of law rests upon fundamentally different policies.

61. We believe these considerations would be bound to give pause to anybody called upon to administer and apply the law pending further pronouncement from the House of Lords. In Smith New Court itself, the House of Lords signaled, in unmistakable tones, its concern over the correctness of Royscot. But it did not overrule it. This is unfortunate. Yet it represents no more than the usual practice of the House of Lords in addressing only the issues raised by the appeal before it. The failure to overrule Royscot should not be taken as indicating implicit approval of it. It is obvious that several members of the House of Lords were far from approving it.

62. It is also important to consider what it was that the Court of Appeal actually decided in Royscot. The case concerned a second-hand Honda motorcar. The dealer who owned the car agreed to sell it to a customer for a cash price of £7,600. The customer agreed to pay a deposit of £1,200 and to finance the balance through a hire-purchase agreement with a finance company. In proposing the transaction to the finance company, the dealer negligently misrepresented that he had taken a deposit of £1,600. It was, apparently, the policy of the finance company only to enter into such hire-purchase agreements if the customer paid at least 20% of the purchase price by way of deposit. The customer wrongfully disposed of the car. He failed to pay instalments due under the hire-purchase agreement. The finance company sued the dealer for misrepresentation under section 2(1) of the Misrepresentation Act 1967.

63. The two main questions considered by the Court were, first, whether the appropriate measure of damages was that for contract or tort and, secondly, whether (if tort) the appropriate measure was that applicable to fraud or that applicable to negligence. The appropriate measure was held to be tortious rather than contractual and the measure of damages that for fraud rather than negligence.

64. It is, in our opinion, of the utmost importance to be clear about the implications of this. The main point of the difference between damages for fraud and damages for negligence is that damages are recoverable for fraud whether or not the damage in question was foreseeable; by contrast, damage caused by negligence is recoverable only if foreseeable.

65. Although this is the main distinction between the two different measures of damage, it may not be the only distinction. As a result of Smith New Court, it appears that, at least in general, a person induced to enter into a transaction as a result of a fraudulent misrepresentation is entitled to recover by way of damages all of the loss directly suffered (foreseeable or unforeseeable) as a result of entering into the transaction. However, it is important to notice that this much broader formulation of the measure of the recoverable damages does not dispense with the need to establish the necessary causal connection between the wrongful act and the damage suffered. There are several pointers to the importance of this consideration. The most obvious is the statement of Lord Hoffman in SAAMCO (at p.216C-D) as follows.

> "My second observation is that even if the maker of the fraudulent misrepresentation is liable for all the consequences of the plaintiff having entered into the transaction, the identification of those consequences may

> involve difficult questions of causation. The defendant is clearly not liable for losses which the plaintiff would have suffered even if he had not entered into the transaction or the loss is attributable to causes which negative the causal effect of the misrepresentation."

66. At approximately the same time as the Court of Appeal decided Royscot, the House of Lords decided Caparo Industries plc v. Dickman [1990] 2 AC 605. This latter decision threw light upon the enormous importance which attaches to investigating whether the kind of damage that has occurred falls within the scope of the duty of care. It is the implications of this case and also the decision of the House of Lords in Banque Keyser Ullman SA v. Skandia (U.K.) Insurance Co. Ltd. [1991] 2 AC 249 (a decision also made at approximately the same time) which emphasised the importance of careful consideration of issues of causation in relation to the scope of the duty and which formed the basis and analysis of the decision in SAAMCO itself. The evolution of these developments in the law was, of course, scarcely beginning at the time of the decision in Royscot.

67. What remains to be fully worked out is the interaction between the idea that, in general, damages are only recoverable if caused by wrongful conduct falling within the scope of the defendant's duty and the idea that a defendant guilty of fraud is liable for all the damage directly flowing from the transaction in question. As Lord Hoffman observed (see paragraph 65 above), this issue can involve difficult questions.

68. Whilst it is clear that a defendant is liable for damage directly caused by his fraud (whether foreseeable or not), it is less clear to what extent a defendant guilty of fraud is liable for damage suffered by the claimant but caused independently of the false

statement of the representor. It would be too simple and superficial to conclude that all damage arising directly from a transaction induced by fraud is recoverable without more (including damage falling outside the scope of the wrongdoing) in view of Lord Hoffman's cautionary warning.

69. The decision in Royscot was not concerned with the problem that arises when a transaction causes two kinds of damage, one of which is within the scope of the duty which has been broken and the other of which is outside the scope of that duty. The proposition which Balcombe L.J. derived from his conclusion that the appropriate measure of damages was that for fraud was (at p.306H- 307B) as follows:

> "In my judgment, therefore, the finance company is entitled to recover from the dealer all the losses which it suffered as a result of its entering into the agreement with the dealer and the customer, even if those losses were unforeseeable, provided that they were not otherwise too remote."

70. The focus of the Court of Appeal's attention was on the distinction between damage that was foreseeable and damage that was not foreseeable. They did not have in mind (because legal development had not brought it to the forefront) the distinction between damage which was caused by the breach of duty in question and damage which fell outside the scope of that breach of duty. Furthermore, both members of the Court of Appeal (it was a two man court) held that the damage that had been suffered by the finance company was, in fact, foreseeable.

71. We may summarise the position as follows:

(i) The finding that the damage that in fact occurred in Royscot was foreseeable rendered unnecessary the conclusion that the appropriate measure of damages under section 2(1) of the Misrepresentation Act is that for fraud. Although any reasoned decision of the Court of Appeal is entitled to respect, it is doubtful if its decision on the fraud measure of damages is binding.

(ii) Even if it were regarded as binding, its decision was not directed to the possibility of recovering damages for loss which falls outside the scope of the duty which has been broken. The focus of discussion was the possibility of recovering directly caused damage (whether foreseeable or unforeseeable), this being, at that stage of legal development, the principal difference between damages for fraud and damages for negligence.

(iii) The lead cases are not concerned with the difference between foreseeable and unforeseeable damage. They are concerned with the possibility of recovering for damage which falls outside the scope of the duty which has been broken.

(iv) The fact that, in general, in cases of fraud the claimant may recover all the damage flowing from entering into the transaction does not resolve the question whether damage falling outside the scope of the duty that was broken is recoverable.

72. In our opinion, Royscot did not decide that a claimant can recover damage falling outside the scope of the misrepresentation in an action based on section 2(1) of the Misrepresentation Act. Admittedly it decided that the appropriate measure of damages was for fraud, although those observations were not necessary to the decision and were, in any event, not directed to damage falling outside the scope of the duty as contrasted with

directly caused unforeseeable damage. The extent to which the law will develop so as to render recoverable damage for fraud which falls outside the scope of the duty remains uncertain. In considering that question, as Lord Hoffman pointed out, there are likely to remain difficult questions of causation.

73. We would also point out that the precedential value of the decisions of the superior courts is of a different character in cases of the construction of statutes from cases which declare or develop the common law. We need not enter upon this question at length. It is sufficient to quote from the decision of the Privy Council in Ogden Industries Pty. Ltd. v. Lucas [1970] AC 113 at p.127F-G:

> "It is clear that judicial statements as to the construction and intention of an Act must never be allowed to supplant or supersede its proper construction and courts must beware of falling into the error of treating the law to be that laid down by the judge in construing the Act rather than found in the words of the Act itself. No doubt a decision on particular words binds inferior courts on the construction of those words on similar facts but beyond that the observations of judges on the construction of statutes may be of the greatest help and guidance but are entitled to no more than respect and cannot absolve the court from its duty of exercising an independent judgment."

74. Primarily, it is the duty of FOS to direct itself to the correct construction of the Misrepresentation Act. It could scarcely be said that the facts with which the FOS are concerned are "similar facts" to those with which the Court of Appeal was concerned in Royscot. The views of the Court of Appeal in that case are, in our opinion and for reasons which we have summarized above, unsustainable. But, independently of this, the opinion of the Court of Appeal "cannot absolve" the FOS "from its duty of exercising an independent judgment."

75. However, even if all the arguments and opinions we have expressed above directed to Royscot are wrong and even if the fraud measure of damages is to be applied to its fullest extent even in a case of negligent misrepresentation under section 2(1) of the Misrepresentation Act, then still, in our opinion, damages for relative under performance would not be recoverable. Mr. Hirst has, of course, proceeded from the premise that all the views we have expressed about Royscot are wrong and he has assumed or concluded that this means that damages for relative under performance are recoverable. With respect, we believe him to be mistaken. Even assuming everything against the opinions we have already expressed and starting from the premise that the measure of damages for fraud is to be applied to its fullest extent, then it is, in our opinion, still clear that damages for relative under performance are irrecoverable. We now explain why this is so.

76. The leading case on damages for fraud is Smith New Court Securities Limited v. Scrimgeour Vickers [1997] AC 254. The facts of the case concerned the purchase of shares in the Ferranti Company. They were complicated by the existence of two different frauds. The first fraud was a fraudulent misrepresentation made by a broker to a buyer of the shares. The effect of this fraudulent misrepresentation was that the buyer paid more for the shares than he otherwise would have been willing to pay. The second fraud played no part in this share purchase transaction. It was a fraud committed against the Ferranti Company itself. It had already been committed before the share purchase transaction was entered into; but it had not yet become public knowledge. In consequence, the market price of the shares at the time of the share purchase was substantially higher than it would have been if the fraud committed against the Ferranti Company had already become