

DIRECTORS' LIABILITY IN NEGLIGENCE – CHALLENGING THE "ELEMENTS OF THE TORT" APPROACH

*Victoria Stace**

This article suggests that the "elements of the tort" approach to directors' liability in negligence to third parties should be discontinued on the basis that assumption of responsibility as a threshold test is not an element of the tort of negligence or negligent misstatement and a more constructive approach would be to address the policy issues associated with imposing liability on directors as part of the two-stage duty of care inquiry.

I INTRODUCTION

In a series of mostly High Court cases involving leaky buildings, the New Zealand courts have demonstrated an inconsistent and sometimes confused approach when determining what legal test to apply in a negligence action brought by a third party against a company director. In 2009 the Court of Appeal removed some of the confusion by dismissing principles of attribution, limited liability and inconsistency with contractual relationships as the rationale for the Court's earlier decision in *Trevor Ivory v Anderson*,¹ leaving it with the "elements of the tort" approach.² This approach requires that an "assumption of responsibility" be found when that is an element of the relevant tort.

Recent scholarship has found that assumption of responsibility, in the sense of being a threshold requirement before a non-director defendant is found to have a duty of care to a third party, is not an element of the tort of negligence or negligent misstatement. Why should the approach be any different if the defendant is a director? This paper argues that the correct approach in relation to an action in negligence or negligent misstatement against a company director, is to apply the two-stage proximity plus policy approach. Under this approach, which has been recently confirmed by the Supreme Court as the approach to take when determining whether to impose a duty of care in a

* LLB (Hons) VUW, LLM (Cambridge), lecturer at Victoria University of Wellington, Faculty of Law.

1 *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517 (CA).

2 *Body Corporate 202254 v Taylor* [2008] NZCA 317, [2009] 2 NZLR 17 at [33].

novel situation,³ the overall inquiry is whether it is fair, just and reasonable to impose a duty of care. There are two broad fields of inquiry. First the court asks, is the relationship between the alleged wrongdoer and the person who has suffered loss sufficiently proximate such that a duty of care arises? The court then asks, looking at the effects on society more broadly, and on the law, of imposing a duty, are there any policy considerations that count for or against the existence of a duty? Under this approach, any concerns about imposing liability on company directors can be addressed at the policy stage of that inquiry.

II THE TESTS APPLIED IN THE LEAKY HOMES CASES TO ASSESS WHETHER DIRECTORS ARE LIABLE IN NEGLIGENCE

In a situation where a construction company has gone out of existence (which is often the case in relation to companies that were involved in building leaky homes), the ultimate owners of the house (or apartment) faced with a large bill for remedial work might seek to recover against someone who they see as responsible for bad workmanship. Often this is a director of the defunct construction company. That person will commonly not have been personally involved in the building work. This presents issues for the courts, because the negligence claim has to attach to something the director did or said. The director is a separate legal person from the company. While the company can be vicariously liable for the negligent acts of its employees and agents, the director cannot. The tests the New Zealand courts have applied to assess whether the director's involvement was such that he or she should be held responsible in negligence are the "assumption of responsibility" and the "degree of control" tests.

However these tests are very different. The assumption of responsibility test, from *Trevor Ivory* and *Williams v Natural Life Health Foods Ltd*,⁴ is a threshold test which must be met before a duty of care arises. It requires a close examination of what the director did or said, in order to ascertain (objectively) whether the director can be said to have assumed a legal responsibility towards the plaintiff, almost like a contractual undertaking but with no consideration. The degree of control test, by contrast, is a way of establishing proximity, particularly where a director did not have a hands-on role in the building of the defective structure. It is part of the two-stage duty of care inquiry, and focuses on the degree of control the director had over building operations.

III ASSUMPTION OF RESPONSIBILITY IS NOT AN ELEMENT OF THE TORT OF NEGLIGENCE

Recent scholarship has argued that assumption of responsibility is not an element of either the tort of negligence or negligent misstatement, in the sense that it must be established before a duty

³ *Carter Holt Harvey Ltd v Minister of Education* [2016] NZSC 95 at [14].

⁴ *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830 (HL).

will arise. Rather, to the extent that it is part of the duty of care inquiry, assumption of responsibility is what the court will impose once it finds a relationship of proximity. The arguments made by these writers are compelling, particularly that the law of negligence is a unified whole and negligent misstatement should not be treated as a special case requiring a voluntary assumption of responsibility.

In a recent essay, Robertson and Wang conclude that, in relation to liability in negligence for economic loss, including (but not limited to) negligent misstatement, assumption of responsibility is not "a distinct category of obligation, but a loosely defined subset of proximity".⁵ This conclusion is supported by other writers and is consistent with the New Zealand Court of Appeal decisions in *Attorney-General v Carter (Carter)*, and *Rolls Royce New Zealand Ltd v Carter Holt Harvey Ltd (Rolls Royce)*.⁶

Robertson and Wang review *Hedley Byrne v Heller* and find their Lordships ambivalent on the issue of whether assumption of responsibility is a voluntarily assumed obligation or a manifestation of the neighbourhood principle, in other words, an obligation imposed by law.⁷ Lord Devlin's speech gives the most support for the former analysis. Supporters of this approach ("rights based" proponents) argue that we do not have inherent rights to protection from economic loss, so the right of action must stem from a quasi-contractual undertaking by the defendant. Whether the defendant has undertaken such responsibility is to be assessed objectively.

Robertson and Wang point out numerous problems with this approach. In particular, it is inconsistent with *Customs and Excise Commissioners v Barclays Bank plc*, where the House of Lords made it clear that the proper inquiry was whether proximity was established.⁸ *Williams*, which provides strong support for the rights based proponents, has been criticised and is inconsistent with other cases such as *Smith v Eric S Bush*.⁹ Robertson and Wang conclude that:¹⁰

... what characterises the assumption of responsibility cases is simply that the defendant has accepted a role, or embarked on a task, in which the claimant is so closely and directly affected by the defendant's

5 Andrew Robertson and Julia Wang "The Assumption of Responsibility" in Kit Barker, Ross Grantham and Warren Swain (eds) *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing, Oxford, 2015) 49 at 82.

6 *Attorney-General v Carter* [2003] 2 NZLR 160 (CA); and *Rolls Royce New Zealand Ltd v Carter Holt Harvey Ltd* [2005] 1 NZLR 324 (CA) [*Rolls Royce*] discussed further in Part X of this article.

7 *Hedley Byrne v Heller* [1964] AC 465 (HL).

8 *Customs and Excise Commissioners v Barclays Bank plc* [2006] UKHL 28, [2007] 1 AC 181.

9 *Smith v Eric S Bush* [1990] 1 AC 831 (HL).

10 Robertson and Wang, above n 5, at 82.

acts and omissions that the defendant ought to have the claimant in contemplation when considering whether and how to act.

Witting describes the use of assumption of responsibility in *Williams* as "a mere device for the protection of small company directors and to reinforce rules of separate legal personality".¹¹ He argues that assumption of responsibility as an independent test for duty is contrary to both its usage in *Hedley Byrne* and the observations in *Barclays Bank*. His approach is that the law of negligence is a unified whole and a common set of elements (in particular proximity) can be employed regardless of the type of negligence involved. Because financial interests are not highly valued by comparison to other interests in tort law, policy plays a big part in determining liability, particularly in relation to misstatement cases.

Witting acknowledges the rights based proponents' arguments, that claims for loss resulting from negligent misstatements should only be allowed where there is a right that has been violated, and that the only possible "right" is one arising from an undertaking made by the defendant. However this would make the law of negligent misstatement different from all other negligence law. No support for that can be found in *Hedley Byrne*. In *Smith*, the House of Lords demonstrated that, at the end of the day, liability in tort is imposed, not assumed. In *Barclays Bank* the House of Lords confirmed that assumption of responsibility is a type of proximity found within the *Caparo* three-fold test for a duty of care (foreseeability, proximity and policy).¹² The real issue, says Witting, is the attitude of the law towards these issues.

Barker also acknowledges the opposing views of the rights based proponents on the one hand and, on the other, those who believe that the duty of care issue in cases involving economic loss is no different from that in other types of negligence cases.¹³ The latter argue that words are simply a form of conduct and duties of care arise from the basic premise that we ought to take reasonable care to avoid harming the interests of others who may foreseeably and directly be affected by what we do or say. The special relationship in *Hedley Byrne* is seen as one instance of the proximity that gives rise to duties. Duties of care in relation to economic loss are, on this view, "progressive, incremental extensions of an existing, welfarist tradition in tort law" and reflect "the rising importance of pure economic interests in the modern world".¹⁴

11 Christian Witting "What are We Doing Here? The Relationship Between Negligence in General and Misstatements in English Law" in Kit Barker, Ross Grantham and Warren Swain (eds) *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing, Oxford, 2015) 223 at 223.

12 *Caparo Industries plc v Dickman* [1990] 2 AC 605 (HL). *Caparo* itself was a case of negligent misstatement causing financial loss.

13 Kit Barker "*Hedley Byrne v Heller*: Issues at the Beginning of the Twenty-First Century" in Kit Barker, Ross Grantham and Warren Swain (eds) *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing, Oxford, 2015) 3.

14 At 16.

Assuming then that we come down on the side of the scholarship that rejects the need to base liability for economic loss on a voluntarily assumed obligation, should the law be different if the defendant is a company director? Is there any justification for the protectionist approach referred to by Witting? This article suggests no.

IV THE LEAKY HOMES DECISIONS

In the context of leaky homes litigation, the courts have demonstrated an inconsistent approach to the issue of when a director will be found to owe a duty of care to a third party. Sometimes the test applied is whether the director personally assumed responsibility. Sometimes the test is whether the director had a sufficient degree of control over building operations such that proximity is established. Sometimes both tests are applied.

The degree of control test is from the 1984 High Court decision of *Morton v Douglas Homes Ltd*. Hardie Boys J, drawing on earlier authority, found that the degree of control that a director had over the operations of the company provided a test of whether or not his or her personal carelessness would be likely to cause damage to a third party, so that he or she became subject to a duty of care.¹⁵

In *Body Corporate 202254 v Taylor* the Court of Appeal attempted to clarify the correct approach to directors' liability in negligence, leaving us with the elements of the tort approach. In doing so, it has singled out negligent misstatement as a branch of negligence requiring special treatment, at least where the defendant is a company director.¹⁶ This is inconsistent with the scholarship discussed above.

Confusion has also arisen from the courts' lack of clarity on the meaning of assumption of responsibility. Sometimes assumption of responsibility is required, but it is not made clear whether this is treated as a threshold test or part of the two-stage proximity plus policy inquiry. On occasion the court says assumption of responsibility is required, but the inquiry then focuses on the degree of control the defendant had over operations rather than whether they can be said to have taken on a voluntary obligation.

There is also confusion over the difference between the assumption of responsibility test and the degree of control test. The assumption of responsibility test (from *Trevor Ivory* and *Williams*), and the degree of control test (from *Morton*) are fundamentally different. As explained above, the former is a threshold test, which must be met before a duty of care will arise. It involves looking at what the director said and did, in an attempt to find, objectively, whether he or she can be said to have taken on a personal obligation of liability to the plaintiff. The latter is part of the proximity test. It involves looking at the director's role, so that even if the defective work was in fact carried

¹⁵ *Morton v Douglas Homes Ltd* [1984] 2 NZLR 548 (HC).

¹⁶ *Body Corporate 202254 v Taylor*, above n 2.

out by (for example) subcontractors, if there is evidence of personal control or instruction, the director might be liable for failure to exercise care in his or her role as controller.

With these parameters in mind, the next section turns to look at the leaky homes decisions in more detail.¹⁷

V HIGH COURT CASES PRE-TAYLOR

In *Drillien v Tubberty* in 2005, Associate Judge Faire considered that personal assumption of responsibility in the *Trevor Ivory* sense was required whenever an action was brought against a director in negligence (including for defective buildings). However he then went on to consider whether there was the necessary proximity to establish a duty of care, and found that the director was not involved in the areas of defective workmanship nor directly responsible for them, in effect applying the degree of control test to the proximity inquiry.¹⁸

In *Dicks v Hobson Swan Construction* in 2006, Baragwanath J recognised the competing policy considerations then stated that the "advice cases are distinctive as turning on the specific identity of the (legal) person on whom reliance is placed and thus the limited scope of the duty assumed under the relatively new tort of negligent misstatement".¹⁹ He eventually decided to follow *Morton*, even though, as he acknowledged, it conflicted with *Trevor Ivory* because it could be read as meaning the court will impute an assumption of responsibility.

In *Hartley v Balemi* in 2007, Stevens J said the starting point was the two-stage test for a duty of care from *Rolls Royce*. He described *Trevor Ivory* as the "leading case" on directors' liability and stated that an assumption of responsibility is required in order to create personal liability.²⁰ He acknowledged that *Trevor Ivory* involved negligent misstatement, which was not the case here. After referring to the degree of control test from *Morton*, he said that the effect that *Trevor Ivory* has had on that test is "somewhat unclear".²¹ He decided that in the context of leaky homes, it was appropriate for decisions makers to apply, where appropriate, the degree of control test.

In *Body Corporate 188273 v Leuschke* in 2007, counsel for the plaintiffs argued that the director assumed personal responsibility (in a *Trevor Ivory* sense) to the owners by virtue of his total control of the project (based on *Morton*), in effect combining the two tests. Harrison J stated that:²²

¹⁷ Only a selection of the many cases is considered in this article.

¹⁸ *Drillien v Tubberty* (2005) 6 NZCPR 470 (HC).

¹⁹ *Dicks v Hobson Swan Construction* (2006) 7 NZCPR 881 (HC) at [49].

²⁰ *Hartley v Balemi* HC AK CIV 2006-404-002589 29 March 2007 at [81].

²¹ At [87].

²² *Body Corporate 188273 v Leuschke Group Architects Ltd* (2007) 8 NZCPR 914 (HC) at [52].

... an individual who commits all the elements of a tort ... will be held directly liable for the consequences, whether solely or concurrently with his principal according to the rule of attribution and irrespective of whether or not he was acting as a director or pursuant to any other agency. The status of director does not carry any special immunities from personal liability.

Where the tort of negligent misstatement is alleged (said his Honour), an assumption of responsibility is one of its critical elements. By contrast, in cases of general negligence, the existence of a duty is determined by a two-stage inquiry, focusing first on proximity and then expanding into a wider policy analysis. However, he then stated that the element of assumption of personal responsibility is:²³

... central to the proximity inquiry ... That concept has been expressly identified as the appropriate test for determining a director's personal liability; and is often satisfied "where the director or employee exercises particular control or control over a particular operation or activity".

VI BODY CORPORATE 202254 v TAYLOR

In *Taylor*, the Court of Appeal, after considering the previous decisions in *Trevor Ivory* and *Williams*, dismissed principles of attribution, limited liability and inconsistency with contractual relationships as the rationale for the approach taken in those decisions, leaving it with the 'elements of the tort' approach. This was the approach primarily adopted by McGechan J in *Trevor Ivory*. William Young P in *Taylor* stated:²⁴

In a situation where assumption of responsibility is an element of the tortious liability, an employee who is acting on behalf of a principal can only be liable if there is a personal assumption of responsibility by that employee.

Taylor involved a claim in negligence against a company director, alleging he was negligent in his conduct and management of a property development where the property developed leaky building syndrome within two years of completion. As it was a strike out application, the court had only limited facts before it but it appears Mr Taylor, while not directly involved in the construction, may have been in a position of control over operations.

A complicating factor was that a brochure had been produced by the real estate agent which promoted Mr Taylor as a person with over 25 years' experience, represented that there would be a high level of workmanship, and described the external cladding in a potentially misleading way. The court said Mr Taylor was "ultimately responsible" for the material that appeared in the brochure and

23 At [55].

24 *Body Corporate 202254 v Taylor*, above n 2, at [33].

most likely approved its contents.²⁵ His actions might then have founded an action in negligent misstatement, but the court proceeded on the basis that it was a general negligence claim.

Having found that the elements of the tort approach was the right one, William Young P then proceeded to inquire whether Mr Taylor had assumed a personal responsibility to the eventual purchasers of the property. He considered it necessary to find personal assumption of responsibility before a duty of care arose. The fact that the director, Mr Taylor, did not appear to have done more than was "commonplace in the way in which small companies operate" counted against finding an assumption of responsibility.²⁶ In effect he regarded assumption of responsibility as an element of the tort in this case.²⁷ In his minority judgment, Chambers J expressed the view that assumption of responsibility was only an element of the tort if the claim was in negligent misstatement (because negligence by words required special rules), and that it was therefore not required here.²⁸

One might wonder why the majority proceeded to inquire into whether there had been an assumption of responsibility, given that the claim was made in general negligence.²⁹ The High Court recently offered an explanation: the majority in *Taylor* was applying the control test from *Morton* as it "involved similar considerations".³⁰ Another reason may be that the majority regarded assumption of responsibility as an element of the tort of negligence in cases involving economic loss.³¹ Or possibly the Court was influenced by the fact that the director was "ultimately responsible" for the statements in the brochure. In any event, based on the majority decision, we are left with a situation where assumption of responsibility is generally regarded as an element of the tort of negligent misstatement, and certainly when the defendant is a company director.

VII HIGH COURT CASES POST-TAYLOR

In *Chee v Stareast Investment Ltd* in 2009, Wylie J, when referring to the previous cases, said "[s]ome of these decisions are not altogether easy to reconcile" and "finding a consistent and principled approach has proved difficult".³² Here the Tribunal below had referred to both the

25 At [65].

26 At [43].

27 The Court adopted the expression "elements of the tort" from an article in *NZ Lawyer* which asserted that assumption of liability is an element of the tort of negligent misstatement: see Lewis Turner "Searching for a principled approach – directors' personal liability in tort" [2006] 49 *NZ Lawyer* 14.

28 *Body Corporate 202254 v Taylor*, above n 2, at [144].

29 See Stephen Todd and Others *The Law of Torts in New Zealand* (6th ed, Brookers, Wellington 2013) at 383–384.

30 *Barron v Hutton* [2012] NZHC 2183 at [28].

31 *Hedley Byrne* can be read as applying to economic loss cases generally and not as being restricted to negligent misstatement.

32 *Chee v Stareast Investment Ltd* HC AK CIV 2009-404-005255 1 April 2010 at [91].

assumption of responsibility test and the degree of control test, but was found to have applied incorrect principles of law. Referring to the recently decided *Taylor* case, Wylie J said:³³

An elements of the tort approach requires as a pre-condition for liability a conclusion that the director assumed personal responsibility for the relevant conduct associated with a presumption against such an assumption where the director was simply acting on behalf of the company ...

Because assumption of responsibility was not regarded as an element of the tort of negligence, all that was required here was the establishment of a legal duty of care. The Tribunal:³⁴

... should have asked itself whether the director assumed personal liability for the relevant conduct. The "degree of control" test articulated by Hardie Boys J in *Morton* is likely to be of considerable help in answering that question.

In *Lockie v North Shore City Council* in 2011, actions were brought in negligence and negligent misstatement against an employee of a consulting engineering firm.³⁵ The employee had performed a pre-purchase inspection and signed the report which said there were no structural deficiencies in the house. This was not a case against a director but an employee. The action in negligence was struck out leaving the action in negligent misstatement. *Morton*, *Trevor Ivory*, *Dicks* and *Leuschke* were all referred to by counsel. Associate Judge Faire found that because this was a negligent advice case, for liability to attach "there must be an assumption of responsibility, whether actual or imputed".³⁶ Because he was carrying out work for the company, no personal commitment was found to have been undertaken.

In *Body Corporate 314950 v James Hardie* in 2013, the sole director of a liquidated developer was sued by the subsequent purchasers of a leaky apartment development.³⁷ It was claimed the director was liable in negligence because he was the ultimate controller of the project, or he had personally performed certain building acts, or he had inadequately supervised employees, or had failed to have proper control of construction. Counsel for the plaintiffs argued, based on *Morton*, that the director could be liable if he had personal control over the building operations, and also that he could be liable if he had assumed a duty of care "actual or imputed" based on *Trevor Ivory*, depending on the facts and policy considerations.³⁸ Associate Judge Christiansen referred to three earlier cases which were decided either on the basis of assumption of personal liability or

33 At [109].

34 At [113].

35 *Lockie v North Shore City Council* HC AK CIV 2007-404-6546 6 July 2011.

36 At [56].

37 *Body Corporate 314950 v James Hardie* [2013] NZHC 1744.

38 At [9].

responsibility for supervision, and proceeded on the basis that the ultimate inquiry was the degree to which the director had been personally involved in the building operation.

In *Derwin v Wellington City Council* in 2014, an action was brought against the Wellington City Council in negligence for issuing a code compliance certificate (CCC) where there were no reasonable grounds for believing the building work complied with the building code.³⁹ The Wellington City Council claimed against Mr Derwin, the managing director of the building company that had constructed the house, on the basis that Mr Derwin had made negligent representations in relation to the issuing of the CCC. The Court found there was no general rule shielding a person who acts on behalf of a company from liability for the person's wrong doing. After considering *Trevor Ivory, Williams and Taylor*, the Court found that the test for liability was whether the director had (objectively) assumed personal responsibility, either to the Council or to the eventual purchasers. There was no personal assumption of responsibility here because Mr Derwin was not directly involved in the building, or the plans, or the supervision, and was never on the building site. In other words, because he had no control over operations.⁴⁰

VIII STEPHENS v BARRON

The issue of directors' liability in negligence recently came before the Court of Appeal in another context. *Stephens v Barron* was a summary judgement application in relation to a negligence claim against a company director for failing to use reasonable care and skill in relation to the supervision, instruction and training of an employee who negligently conducted a pest-control spraying operation causing significant damage and economic loss.⁴¹ The director (and another senior employee also facing allegations of negligence) did not personally take part in the spraying operation. The Court of Appeal refused to grant the summary judgement, in effect saying it was not satisfied, on the limited evidence before it, that none of the claims could succeed.

In the High Court, Doogue J had reviewed *Morton, Trevor Ivory and Taylor* and concluded that assumption of responsibility is not an element of the tort of negligence (as opposed to negligent misstatement).⁴² His Honour adopted the degree of control test from *Morton*, which he recognised as a way of establishing proximity but not a precondition to finding a duty of care.

In the Court of Appeal, arguments that judgment should be given for the defendants because imposition of a duty would be an attack on limited liability, or inconsistent with the contractual

39 *Derwin v Wellington City Council* [2014] NZHC 341. The judgment was overturned on appeal in part but the Court of Appeal did not consider the negligence cause of action: *Wellington City Council v Dallas* [2014] NZCA 631 at [3].

40 At [97].

41 *Stephens v Barron* [2014] NZCA 82, (2014) 21 PRNZ 734.

42 *Barron v Hutton*, above n 30.

framework, failed. No specific mention was made of the need to establish a personal assumption of responsibility, either by the director or the senior employee. O'Regan P, giving the decision for the Court, said:⁴³

If any duty is established, it would be a duty arising from the personal actions of Mr and Mrs Stephens, not from their position as directors of ACSD. It would not make any difference whether the business they were directing, or for which they were working, was conducted through a limited liability entity or otherwise, what would matter would be their role in the business and the personal action said to give rise to a duty.

This statement can be read as consistent with the application of the degree of control test.

IX THE APPROACH OF THE ENGLISH COURTS

The English courts commonly require an assumption of responsibility when an action in negligence or negligent misstatement is brought against a company director. *Sainsbury's Supermarkets Ltd v Condek Holdings Ltd* is a recent example.⁴⁴ In *Sainsbury's Supermarkets*, Sainsbury's brought an action in negligence for the design and construction of a car park against both the inventor of the carpark system and the company that he operated his business through. Drawing on *Williams* for the applicable law, the court found that the assumption of responsibility principle from *Hedley Byrne* is not limited to statements but extends to the provision of services. In a case where:⁴⁵

... a trader incorporates a company to which he transfers his business, personal liability under the extended Hedley Byrne principle will not be established in the absence of a special relationship between the erstwhile trader who is alleged to be a tortfeasor in his personal capacity and the Claimant. In other words, there must have been an assumption of responsibility such as to create a special relationship between the Claimant and the director or employee himself.

Stuart-Smith J said as the test is objective, the focus must be on what was said and done by the defendant, and there will be no special relationship or assumption of responsibility "if the director does no more than act in a way that is consistent with his position as director".⁴⁶ Mere routine involvement does not justify a belief that the director accepted a personal commitment, as opposed to a known company obligation. There was no need to inquire as to whether it was fair, just and reasonable to impose a duty, as the case never got over the threshold test of assumption of responsibility.

43 *Stephens v Barron*, above n 41, at [30]. Only one was a director at the relevant time.

44 *Sainsbury's Supermarkets Ltd v Condek Holdings Ltd* [2014] EWHC 2016 (TCC).

45 At [17]. See also *Robinson v PE Jones* [2011] EWCA Civ 9.

46 *Sainsbury's Supermarkets Ltd v Condek Holdings Ltd*, above n 44, at [18].

This article suggests that the New Zealand courts should not adopt this approach. Requiring an assumption of responsibility as a threshold test masks the issue of whether there are policy reasons why company directors should be shielded in whole or in part from liability in negligence. In addition, requiring a finding that the director stepped out of their role as director and acted on their own account will make it very difficult to establish liability, as the defendant director will almost always have acted on behalf of the company. The result can also turn on finding that the director did certain acts that were potentially inadvertent (such as using personal stationery rather than company letterhead).

X THE APPROACH TO THE DUTY OF CARE ISSUE IN NEW ZEALAND

In relation to non-director defendant cases, the New Zealand courts have adopted a two-stage test for when a duty of care will be found to arise in a novel situation. The test is broadly based on the *Anns* formulation, but the questions to be asked at each stage of the inquiry have been reformulated. The first stage focuses on the relationship between the parties and the second involves broader considerations of policy or principle that count for or against finding a duty.

In 2004 the Court of Appeal in *Rolls Royce* summarised the relevant test for finding a duty of care in a novel situation in the following terms, citing *South Pacific Manufacturing Co Ltd v New Zealand Security Consultants & Investigations Ltd*, and *Carter* as authority:⁴⁷

The ultimate question when deciding whether a duty of care should be recognised in New Zealand is whether, in the light of all the circumstances of the case, it is just and reasonable that such a duty be imposed. The focus is on two broad fields of inquiry but these provide only a framework rather than a straightjacket. The first area of inquiry is as to the degree of proximity or relationship between the parties. The second is whether there are other wider policy considerations that tend to negative or restrict or strengthen the existence of a duty in the particular class of case. At this second stage, the court's inquiry is concerned with the effect of the recognition of a duty on other legal duties and, more generally, on society.

In *Carter* the Court of Appeal discussed the correct approach in cases of negligent misstatement (as opposed to general negligence) and considered whether there was some extra element of the test in the case of an allegation of negligent misstatement such as "the existence of some special skill and its application for the assistance of the plaintiff before one gets to the questions of assumption of responsibility and reliance".⁴⁸ The Court found that there was no additional requirement. Assumption of responsibility was part of the proximity inquiry, the ultimate inquiry is whether it is

⁴⁷ *Rolls-Royce*, above n 6; *South Pacific Manufacturing Co Ltd v New Zealand Security Consultants & Investigations Ltd* [1992] 2 NZLR 282 (CA); and *Attorney-General v Carter*, above n 6. See also *Carter Holt Harvey Ltd v Minister of Education*, above n 3, at [14].

⁴⁸ *Attorney-General v Carter*, above n 6, at [29].

fair, just and reasonable to require the defendant to take reasonable care to avoid causing the plaintiff loss or damage of the kind for which compensation is being sought and there was no materially different approach in a negligent misstatement case.⁴⁹ The Court said:⁵⁰

Each case will have its own particular combination of circumstances against which the necessary judgment must be made. To assist in answering the ultimate question, a two stage approach, under the headings of proximity and policy, has been found helpful and is now firmly established in our law.

In cases of negligent mis-statement, as we have seen, the concepts of assumption of responsibility and foreseeable and reasonable reliance have been adopted to assist in reaching a principled and reasonably predictable answer to the proximity inquiry.

The High Court recently adopted the *Rolls Royce* two-stage test, in *Houghton v Saunders*, a case involving an allegation of negligent misstatement against company directors.⁵¹ No part of Dobson J's decision focused on the need to find an assumption of responsibility.

XI ATTACHING LIABILITY FOR NEGLIGENT ACTIONS OR WORDS TO A COMPANY DIRECTOR

The New Zealand courts should reject assumption of responsibility as a threshold requirement in an action in negligence or negligent misstatement against a company director. To require an assumption of responsibility is inconsistent with recent scholarship which argues that assumption of responsibility is not an element of the tort of negligence or negligent misstatement. Assumption of responsibility as a threshold requirement for establishing liability in negligence or negligent misstatement against a director is also inconsistent with the Court of Appeal's recent decision in *Stephens*. The correct approach is to apply the two-stage proximity plus policy test from *Rolls Royce*.

Whether the proximity part of the two-stage test will be satisfied is a mixed question of fact and law and will require careful inquiry into the circumstances of the particular case. The proximity stage of the inquiry would focus in particular on the nature of the relationship between the defendant director and the claimant. Here the court will consider such matters as: whether there was a contractual relationship showing that the parties had allocated risk in some other way; whether the loss was foreseeable; whether there was reliance (in the case of a misstatement) and whether reliance was foreseeable and reasonable; whether there was any relevant statutory context; whether the claimant was vulnerable such that the law should be involved in providing protection; and whether there is any degree of analogy with previously decided cases. The director's degree of

49 At [30].

50 At [30]–[31].

51 *Houghton v Saunders* [2014] NZHC 2229, [2015] 2 NZLR 74 at [672].

involvement in the negligent act will be important. If the director said the offending words, or did the offending act then it will be easier to establish proximity.

If the director has not performed the offending act or said the offending words, but is one step removed from the person who did so, then it is still possible to find that the director owed a duty of care to the plaintiff. Liability would have to be based on the director's personal actions or involvement and is separate from any liability that attaches to the company vicariously. Again the two-stage proximity plus policy test should be applied. The degree of control test from *Morton* may be of assistance in establishing proximity.⁵² However even in this situation there should be no threshold requirement that assumption of responsibility must be found. Any concerns that the court has about imposing liability on a company director (by reason of being a company director) can be addressed as part of the policy stage of the duty of care inquiry.

XII THE POLICY CONSIDERATIONS IN THE DUTY OF CARE ASSESSMENT

The courts' approach has been to proceed with caution when considering whether to impose liability for negligence on a director. What this sense of caution stems from is unclear. The decision in *Taylor* suggests the basis may be "the idea that a corporation has a legal identity which is separate from those of the individuals involved in it".⁵³ This article proposes that concerns about imposing liability on directors should be addressed as part of the two-stage duty of care inquiry. At the policy stage of the inquiry the court can consider these issues directly. There has been significant academic debate about whether company directors should receive special protection from tort liability because of their status as a company director. This article argues that the policy considerations in favour of imposing a duty are compelling.

The law should aim to deter directors from engaging in actions (including negligently) that might be detrimental not only to third parties but also to the company or its shareholders.⁵⁴ "Deterrence and distribution of loss require that an individual bears responsibility for civil wrongs committed by him or her. A company director is no exception."⁵⁵ If the company is the only party

52 Another way of attaching liability to a director who did not perform the wrongful act is if it can be shown that the director "directed or procured" the company to commit the tort. If this route to liability is used the director becomes a secondary tortfeasor and the inquiry focuses on whether he or she directed or induced the commission of the tort. Liability stems from *Rainham Chemical Works Ltd v Belvedere Fish Guano Co* [1921] 2 AC 465 (HL) at 476. See also *Wah Tat Bank* [1975] AC 507 (PC) at 514–515; and *MCA Records v Charly Records* [2001] EWCA Civ 1441, [2002] BCC 650.

53 *Body Corporate 202254 v Taylor*, above n 2, at [33].

54 Helen Anderson "Piercing the Veil on Corporate Groups in Australia: The Case for Reform" (2009) 33 *Melb U L Rev* 333 at 344; and Stefan HC Lo "Liability of Directors as Joint Tortfeasors" (2009) *JBL* 109 at 123.

55 Giora Shapira "Liability of Corporate Agents: *Williams v Natural Life Ltd* in the House of Lords" (1999) 20 *Co Law* 130 at 134.

liable to a tort victim, that could encourage corporate controllers to engage in excessively risky activities through undercapitalised companies, or to reduce professional standards.⁵⁶ The application of tort rules to company directors is a way to ameliorate abuse of the company form by small businesses.⁵⁷

If directors are (effectively) shielded from liability in tort, that creates an unfair distinction as regards liability of employees.⁵⁸ Employees are under current law personally responsible for wrongdoing, so directors (who are also often employees, at least in closely-held companies) should be liable as well. There are some who argue that employees (including directors) in general should not bear responsibility for their wrongdoings.⁵⁹ That is another debate and should be addressed head-on rather than obliquely by requiring an assumption of responsibility for some employees, namely directors.

Parliament has shown its intention to make directors liable for their negligent wrongdoings in various legislation, such as the recent Financial Markets Conduct Act 2013 (and previous securities legislation). Flanagan attributes the "more or less continuous increase in the range and scope of statutory liability for directors" to the recognition that risk-taking should be disciplined by responsibility for its adverse consequences.⁶⁰ More generally it indicates recognition of a broader public interest in holding directors liable for their negligence, at least in certain contexts.⁶¹ However, unless there is first established a sound reason for excluding directors from the ambit of common law negligence liability, issues of directors' liability should not be left exclusively to statute law.

Some commentators argue that company law requires modification of the normal consequences of wrongdoing (except where there is fraud).⁶² These commentators argue that personal liability of directors is constrained by the doctrines of company law. Directors are protected, the argument

56 Lo, above n 54, at 110; Shapira, above n 55, at 138; and Stephen Todd "Assuming Responsibility for Torts" (2003) 119 LQR 199 at 203.

57 Christian Witting "The Small Company: Directors' Status and Liability in Negligence" (2013) 24 KLJ 343 at 364.

58 Todd, above n 56, at 202; and Witting, above n 57, at 355.

59 See for example Michael Sharp "Who Assumes Responsibility for Negligent Acts of Employees?" (2012) 18 NZBLQ 3.

60 Robert Flannigan "The Personal Tort Liability of Directors" (2002) 81 Can Bar Rev 247 at 262.

61 Anderson, above n 54, at 345.

62 See in particular Ross Grantham "Company Director's Personal Liability in Tort" (2003) 62 CLJ 15; Ross Grantham and Charles Rickett "Directors' Tortious' Liability: Contract, Tort of Company Law?" (1999) 62 MLR 133; and Ross Grantham and Charles Rickett "Company Directors' Liability for Torts" [2003] NZLJ 155.

goes, for two reasons: separate corporate personality and, in cases involving economic loss, the need for a quasi-contract. However it can also be argued that it would be a subversion of the separate corporate personality principle not to apply the ordinary tort rules. Both the company and its directors are capable of committing torts and of being held accountable for them, because they are separate legal persons.⁶³ Further, as the leaky homes cases demonstrate, failure to recognise a general duty in negligence can leave a potential gap in liability coverage. This gap is particularly evident in the case of a tort committed by a company which declines into insolvency, leaving the victim with no one worth suing.⁶⁴

Concerns about the breadth of liability in particular for negligent statements can be met in other ways, for example requiring causation. In order to found the commission of the tort, there must be a causal relationship between the error in the statement and subsequent injury to the claimant. At a minimum, the claimant must have heard or read the statement in question and acted upon it to his or her detriment.⁶⁵ Finally, often voiced concerns that "competent individuals will refuse to serve as directors" are not supported by sound empirical evidence.⁶⁶

XIII CONCLUSION

Determining the liability in tort of an individual who is a director of a company is a "complex issue",⁶⁷ particularly in closely held companies where one person may at different times act in many capacities and have several legal relationships with a company. The Federal Court of Canada said in *Mentmore Manufacturing*:⁶⁸

On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of limited liability afforded by incorporation. On the other hand, there is the principle that everyone should be answerable for his tortious acts.

This article has argued that to cloak discussion of the issues by requiring an assumption of responsibility before a duty of care arises is not helpful. It is inconsistent with judicial authority and unsupported by recent scholarship. A more useful approach is to address policy issues directly as part of the two-stage duty of care inquiry. As part of policy considerations, the courts can directly

63 Witting, above n 57, at 364.

64 At 365.

65 At 367. Reliance in fact must be established as well as that reliance was reasonable in the circumstances.

66 Flannigan, above n 60, at 313–317.

67 Susan Watson "Liability of Individuals for Torts of the Company" [2007] NZLJ 27.

68 *Mentmore Manufacturing Co v National Merchandise Manufacturing Co* (1978) 40 CPR (2d) 164 (FCC) at [23].

address the issue: is the fact that the defendant is a director relevant in the sense that it counts against imposition of the duty of care, and if so why?

