THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

REPORTABLE
Case No: 200/11

In the matter between:

CAPE EMPOWERMENT TRUST LIMITED **APPELLANT**

v

FISHER HOFFMAN SITHOLE **RESPONDENT**

Neutral citation: *Cape Empowerment Trust Ltd v Fisher Hoffman Sithole* (200/11) [2013] ZASCA 16 (20 March 2013).

Coram: Brand, Maya, Cachalia, Shongwe JJA and Swain AJA

Heard: **28 February 2013**

Delivered: **20 March 2013**

Summary: Negligent misstatement – degree of negligence not relevant in considering whether or not liability should be imposed for consequent loss – wrongfulness and legal causation not established.

ORDER

On appeal from: Western Cape High Court, Cape Town (appeal against judgment by Davis J, sitting as court of first instance. Cross-appeal against judgment of Binns-Ward AJ, sitting as court of first instance):

1. The appeal is dismissed with costs including the costs of two counsel.
2. The cross-appeal is upheld with costs including the costs of two counsel.
3. The order made by Binns-Ward AJ is set aside and replaced with the following:

   'The plaintiff's claim is dismissed with costs including the costs of two counsel.'

JUDGMENT

BRAND JA (**MAYA, CACHALIA, SHONGWE JJA and SWAIN AJA CONCURRING**):

[1] The appellant is Cape Empowerment Trust Limited, a black economic empowerment company listed on the Johannesburg Stock Exchange. The respondent is Fisher Hoffman Sithole, a partnership of auditors. In correspondence included in the record on appeal, reference is often made to the appellant as CET and to the respondent as FHS. I find it convenient to use the same descriptions. Proceedings started when CET instituted a claim against FHS in the Western Cape High Court for delictual damages, comprised of wasted expenses it claimed to have incurred, in the amount of just under R17 million. In support of its claim CET relied on an alleged negligent misstatement by one of the partners in FHS, Mr Justin Nield. As a result of the misstatement, so CET contended, it was induced to enter into a disadvantageous business deal that caused it to incur the wasted expenses claimed.

[2] During the pre-trial proceedings, CET applied for a separation of issues in terms of Rule 33(4). Despite opposition by FHS, the court a quo granted the separation sought. In the event the court ordered that the issues pertaining to FHS's liability on the merits were to be determined first, while those relating to the quantum of CET's claim stood over for later determination. The trial on the preliminary issues commenced before Binns-Ward AJ in August 2004. After hearing evidence for several days he gave judgment, substantially in favour of CET, on 28 January 2005. In broad outline the judgment declared:

(a) That 'subject to [CET] establishing the element of legal causation in the second stage of the trial, . . . [FHS] shall be liable to [CET] for 70 % of the amount of the financial loss . . . which the latter might prove itself to have suffered as a result of having relied on the negligent misstatement by Nield . . .'

(b) That the costs of the preliminary hearing be costs in the cause.

As a token of his displeasure regarding the conduct of Nield, Binns-Ward AJ directed that a copy of the judgment be forwarded to the Public Accountants' and Auditors' Board.

[3] The hearing at the second stage took place before Davis J. Due to lengthy postponements of the matter, his judgment was only handed down on 2 March 2010. In this judgment Davis J assumed, without deciding, that CET had succeeded in establishing legal causation. But he dismissed the claim on the basis that CET had failed to prove that it had suffered any loss as a result of Nield's negligent misstatement. CET's appeal against that judgment is with the leave of the court a quo. So is the cross-appeal by FHS against the judgment of Binns-Ward AJ. The issues that arose in both the appeal and the cross-appeal are fairly complicated. They are primarily rendered so by the intricate background facts, which I will endeavour to simplify, whenever possible, in the account that follows.

[4] On 23 August 1999 CET concluded a written sale of business agreement with another listed company, Paradigm Interactive Media Ltd (Paradigm). Pursuant to the agreement, a subsidiary of CET, H Investments No 194 (Pty) Ltd (H 194) purchased a business from Intella Ltd, a subsidiary of Paradigm. The business sold comprised the businesses of four subsidiaries of Intella and the

share capital of another (the Intella business). The only Intella subsidiary that played any part in these proceedings was AMT Technologies (Pty) Ltd. Although H 194 and Intella were described as the direct parties to the sale, it is apparent that they were used by the two listed companies as vehicles for purposes of the transaction. Hence, for example, CET and Paradigm bound themselves as sureties for and co-principal debtors with their subsidiaries for due performance of their obligations arising from the agreement, including the cancellation thereof. The purchase price agreed upon for the Intella business was R147 million, of which R137 million was paid after all suspensive conditions had been fulfilled while the balance of R10 million became payable one year later. As it turned out, the R10 million was never paid, while the payment of the R137 million was structured in a very complicated way. But I will come to that.

[5] During the negotiations which preceded the conclusion of the sale agreement, Mr Shaun Rai, the then chief executive officer of CET, was informed by various directors of Paradigm and Intella that the Intella business had made a substantial loss during the first eight months of the 1999 financial year, which covered the period 1 July 1998 to 28 February 1999. However, so Rai was told by these directors, the business had experienced a turnaround in fortune during the last four months, ie between 1 March and 30 June of the 1999 financial year, mainly because of a lucrative contract with a company, Ubunye (Pty) Ltd, which was involved in the minibus-taxi industry. The assurance of a profit found its way into the sale agreement in the form of the following warranty by the seller to the purchaser: the [gross] profits from the '[Intella] business for the period 1 March 1999 up to and including 30 June 1999 will not be less than R10 million (ten million rand). . . . '

[6] Another warranty given by the seller in terms of the agreement, which proved to be relevant, was that 'all accounts receivable are good and collectable to the full amount thereof . . .'. Why this turned out to be relevant is that, on the accounting information provided to CET, it was clear that the guaranteed profit of R10 million was entirely dependent on the collection of a debt in excess of R10 million from Ubunye for the installation of about 3 000 devices, referred to as fare collection and vehicle tracking systems, in minibus-taxis by AMT Technologies as

part of the Intella business. Though an invoice of this amount was ostensibly rendered to Ubunye on 30 June 1999 – ie, on the very last day of the 1999 financial year – the debt remained unpaid at the time of the sale agreement. I say 'ostensibly rendered' because it later became apparent that the invoice was in fact created in October 1999 and backdated to 30 June. Moreover, Rai discovered in about March 2000 that the Ubunye debt was entirely fictitious in that only a small number of the units had been installed, not by AMT Technologies as part of the Intella business, but by another company in the Paradigm group, which was not included in the sale.

[7] But, reverting to the sale agreement; its operation was rendered subject to various suspensive conditions. One of these was that CET be allowed to complete a due diligence investigation which its own auditors, Arthur Andersen, had started prior to the conclusion of the sale agreement. Another suspensive condition was that the agreement be approved by CET's board of directors before 15 October 1999 and in a general meeting of its shareholders by 30 November 1999. As it happened, CET's board resolved to approve the agreement on 20 September 1999, but the approval by shareholders only occurred on 6 December 1999. This happened despite a reminder to CET on 22 November 1999 by Mettle Limited, who acted as its corporate advisors, that it was of crucial importance to obtain the shareholders' approval before 30 November 1999, because of the express provision in clause 4.3.2 of the agreement, that upon non-fulfilment of this suspensive condition on due date, 'this agreement will automatically fail and be of no further force and effect'. The consequence of all this was that, by virtue of this clause – and, in any event, as a matter of law – the agreement had lapsed on 30 November 1999 by reason of the non-fulfilment of the suspensive condition. But according to Rai's testimony, the directors of CET only became aware of this after February 2000.

[8] In preparation of the shareholders meeting of 6 December 1999, Rai requested an audit certificate by FHS, as Intella's auditors, confirming the warranty that the gross profits of the Intella business for the period March 1999 to 30 June 1999, were not less than R10 million. According to Rai's evidence he made this request pursuant to an arrangement with the representatives of

Paradigm to the effect that he would be content to accept an audit certificate by FHS in lieu of the completion of the due diligence investigation by Arthur Andersen. Although apparently unaware of this arrangement, Nield issued the certificate requested, which later matured into the *fons et origo* of the protracted litigation leading up to this appeal. The certificate was communicated to Rai in the form of an e-mail dated 3 December 1999. It became known during the trial as the 'profit certificate' and it read:

'I . . . advise that the after tax earnings for the Intella group for the year ended 30 June 1999 as reported in the published results of Paradigm amounted to R9,141 million.

The Intella group had incurred a substantial loss for the period 1 July to 28 February 1999. Unfortunately I do not have the breakdown between the two periods but I am satisfied that the after tax profit of Intella group for the period 1 March 1999 to 30 June 1999 amounted to in excess of R10 million.'

[9] We now know that the statement conveyed by the profit certificate was wholly untrue. Since the alleged profit was contingent upon the fictitious Ubunye transaction, the Intella business did not make a profit during any part of the 1999 financial year. In fact it showed a substantial loss. Binns-Ward AJ found that Nield was not only negligent but grossly negligent in communicating this misstatement. I do not think the finding of gross negligence on the part of Nield can be faulted and I did not understand counsel for FHS to contend otherwise. In broad outline the finding derived from evidence that in September 1999 a partner of FHS, Mr Butch Abbott, who was responsible for the audit of AMT Technologies, the subsidiary of Intella which rendered the invoice of R10 249 800 to Ubunye, raised very serious doubts and pertinent questions about the validity of the claim. Since he remained unpersuaded by the answers that he received from the company, he refused to give an audit clearance for AMT Technologies. All this was communicated to Nield, who was responsible for the consolidated financials of Intella. So, for example, Abbott wrote to Nield on 30 September 1999, with reference to the Ubunye debt, that 'we have no proof of what this debt was raised for nor any proof of its recoverability'. Nonetheless, Nield proceeded to issue the profit certificate based on this doubtful claim, apparently without any further investigation. Since Nield did not give evidence before Binns-Ward AJ, his

conduct remained unexplained. This is why I believe the finding of gross negligence was justified.

[10] In March 2000 Rai found out that the statement in the profit certificate confirming the R10 million profit was untrue in that the Ubunye claim, on which it was based, was in fact wholly fictitious. It meant that on the face of it, Rai was defrauded by the directors of Paradigm and Intella. It also meant that various warranties given to CET in the sale agreement remained unfulfilled. These included the warranty of a R10 million profit during the last four months of the financial year as well as the warranty that 'all accounts receivable are good'. At more or less the same time Rai was advised by CET's attorney that the sale agreement had probably lapsed on 30 November 1999. The basis of this advice was, of course, that the suspensive condition pertaining to approval of the transaction by CET's shareholders remained unfulfilled on that day, which was the date stipulated for fulfilment by the agreement of sale. We now know that despite Rai's discovery that he had been defrauded, CET was precluded from recovering its losses under the warranties because of its own conduct in allowing the agreement to lapse. Why CET did not simply rely upon restitution of what had been performed and, perhaps, instituted a delictual claim based on fraud, is best understood against the background of the intricate structure devised by the advisors of Paradigm and CET to effect payment of the purchase price.

[11] Apparently CET did not have the R137 million which became payable, in terms of the sale agreement, at the end of February 2000. Hence it issued shares in itself to the value of this amount. These shares comprised of 72 million preference shares and 65 million ordinary shares at R1.00 per share. In further execution of the transaction, CET entered into an underwriting agreement with Paradigm and a subsidiary of the latter, Bohumi Corporate Finance (Pty) Ltd. In terms of this agreement Bohumi subscribed to the 137 million issued shares at the placement price of R1.00, while Paradigm bound itself as surety and co-principal debtor for due performance of Bohumi's obligations under the agreement. In return for its services, CET undertook to pay Bohumi an underwriting fee of R6 million.

[12] Once the shares had been issued, Bohumi paid the sum of R137 million to CET. CET in turn invested this amount in preference shares issued by Gauret Investments No 1 (Pty) Ltd (Gauret 1), a subsidiary of PSG Investment Bank Limited (PSG). At the same time H 194, the designated purchaser in terms of the sale agreement, borrowed an amount of R137 million from Gauret Investments No 2 (Pty) Ltd (Gauret 2), another subsidiary of PSG. Gauret 2 paid this amount in settlement of the purchase price under the business sale agreement, not to Intella, the designated seller, but directly to Paradigm. The loan was repayable by H 194 on 28 February 2005 while the preference shares were redeemable on the same date. Gauret 2 guaranteed performance by Gauret 1 under the preference share agreement while CET stood surety in favour of Gauret 2 for the performance of H 194's obligations under the loan agreement. At the same time CET and Gauret 2 agreed that on due date set-off will be applied to extinguish the reciprocal obligations of all parties in terms of the various agreements.

[13] Shorn of all the elaborate detail, so it seems to me, CET's debt to Gauret 2 existed on paper only and even as a paper debt, it was intended to be cancelled by the creation of another reciprocal paper debt so that the net result was nil. Moreover, the result of the web of agreements created in the intricate structure, as I see it, was simply that Paradigm received CET shares in exchange for the Intella business. The reason for all the scheming is not hard to find. As was highlighted in all the proposals pertaining to the scheme, it was aimed at securing a tax advantage in a predicted amount of R13.4 million for CET. Incidentally, I agree with the submission by counsel for FHS that the scheme displayed certain features now dealt with in s 80 A of the Income Tax Act 58 of 1962 which was introduced in 2006, under the rubric 'Impermissible tax avoidance arrangements'.

[14] Against this background I can now revert to the question that instinctively arose, namely why CET did not immediately latch on to the opportunity to extricate itself from the business sale agreement which had lapsed, at a time when Rai had already established the fraud. Rai's answer to this question was, in short, that the maze-like structure of agreements in which CET entangled itself did not allow it. In motivating this answer, Rai explained that when CET sought to withdraw from the transaction, Bohumi claimed repayment of the R137 million on

the basis that, if the business sale agreement was invalid, the underwriting agreement was equally so. When CET was unable to meet this demand, Bohumi brought an application for the liquidation of the company. The legal advice Rai then received, so he said, was that CET was in no position to ward off Bohumi's application while it proceeded with a probably lengthy and uncertain process of seeking to recover the R137 million purchase price from Intella or Paradigm. However, until the purchase price could be recovered, CET was unable to meet Bohumi's claim. Binns-Ward AJ found this explanation entirely acceptable (paras 31 and 32). I shall presently return to the enquiry whether I believe he was right in doing so.

[15] In this court counsel for CET introduced a further argument as to why it was impossible for CET to extricate itself from the unfavourable business deal despite its invalidity. According to this argument, the loan agreement with Gauret 2 was perfectly valid and could not be cancelled. Gauret 2 was therefore in a position to reclaim the R137 million for which CET stood surety. On the other hand, CET was not entitled to obtain a return of the amount it invested in Gauret 1 preference shares. The validity of this argument will also be considered at an opportune stage. What is relevant at this stage, however, is that on 20 July 2000 Rai entered into a settlement agreement, on behalf of CET and H 194, with Paradigm, Bohumi and Intella. The settlement acknowledged that the sale of business agreement and the underwriting agreement had lapsed because of the non-fulfilment of suspensive conditions. The parties agreed, however, to reinstate these agreements with retrospective effect to the date of their conclusion. Further terms of the settlement agreement were:

(a) CET and H 194 retained the merx under the sale of business agreement. Paradigm and Intella retained the purchase price, but Bohumi and Paradigm waived their right to receive 72 million preference shares in CET in terms of the underwriting agreement.

(b) Paradigm and Intella admitted that they were liable to H 194 in respect of the Ubunye claim as a breach of warranty and admitted that the debt was collectable. In settlement of this debt Paradigm undertook to return 15 million of the ordinary shares received by Bohumi in terms of the underwriting agreement.

[16] Subsequently, the parties to the July 2000 settlement, together with certain other parties, concluded two further settlement agreements. The overall result of these agreements included the following: CET transferred the shares in H 194 to a third party and thus became separated from the Intella business; CET received return of a further 21 million ordinary shares that it had transferred to Bohumi in terms of the underwriting agreement; and CET paid an amount of R2,7 million to Gauret 2 in overall settlement of the Gauret transactions.

[17] At the second stage trial before Davis J, CET formulated its claim for damages under the following four headings, all comprising of wasted expenses incurred:

(a) A so-called success fee paid to Mettle Limited, who acted as the corporate advisor of CET in respect of the Intella transaction, in an amount of R1,5 million.

(b) An underwriting fee of R6 million paid to Bohumi in terms of the underwriting agreement.

(c) A payment to Gauret 2 in terms of the final settlement, in an amount of R2,7 million.

(d) An irrecoverable working capital loan to H 194 in an amount of R6 241 095.

[18] During the cross-examination of Rai before Davis J, it was, however, pointed out to him that according to CET's 2001 financial statements, the Intella transaction showed an overall profit of R37,6 million. Rai's response to this line of questioning was, in short, that although the financial statements were approved by CET's board of directors, including himself, the statement that the company had made any profit from the Intella business – let alone a profit of R37,6 million – was a mistake. As a result, the trial was postponed and the issue became the subject of an intense and lengthy debate. In the course of this debate CET presented the expert evidence of a chartered accountant, Mr Desmond Hudgson. According to his testimony, it appeared from a study that he did of 25 journal entries which formed part of the audit working papers of CET, that the R37,6 million profit derived from sources unrelated to Intella and that this profit was therefore wrongly attributed to the Intella business in the financial statements.

[19] In rebuttal of Hudgson's evidence, FHS relied on the testimony of another chartered accountant, Mr Brian Abraham who expressed criticism of Hodgson's methodology which he regarded as fundamentally flawed. In consequence, so Abraham testified, it could not be concluded that the 2001 financial statements were wrong in ascribing the profit of R37,6 million to the Intella business. In the event Davis J preferred the opinion of Abraham. This led him to the conclusion that the veracity of the entry in its own financial statements had not been adequately disproved by CET and that any wasted expenses it might have incurred had thus been cancelled out by a profit derived from the same transaction, or by application of what Davis J referred to as the 'swings and roundabout' principle. In consequence, so Davis J held, CET's claim could not succeed, even if the element of legal causation in respect of the wasted expenses were to be assumed.

[20] In turning to the appeal and cross-appeal, logic dictates that I first deal with the judgment of Binns-Ward AJ, which focused on three of the elements of aquillian liability (wrongfulness, fault and factual causation). With regard to fault, I have already referred – during my recital of the background facts – to the finding that Nield was not only negligent, but grossly negligent in making the false statement contained in the profit certificate. I have also indicated that, in my view, that finding cannot be faulted. The same goes, I think, for his finding that factual causation had been established. It is well known by now that the enquiry into factual causation involves an application of the so-called 'but-for' test. In accordance with this test, as Corbett CJ explained in *International Shipping Co (Pty) Ltd v Bentley* 1990 (1) SA 680 (A) at 700F-G:

'. . . [O]ne must make a hypothetical enquiry as to what probably would have happened but for the wrongful conduct of the defendant.'

In applying this test Binns-Ward AJ held – and I believe rightly so – that had the profit certificate reflected the true financial position of the Intella business, CET's shareholders would not have approved the transaction which would in turn have caused the train of events to come to an abrupt halt.

[21] The element of wrongfulness is more problematic. Since we are dealing with pure economic loss – as opposed to a loss resulting from injury to person or

property – wrongfulness is not presumed. More is needed. Considerations of public and legal policy dictate whether FHS should be held legally liable for the loss resulting from the misstatement or whether it should be afforded legal immunity (see eg; *Legal Transitional Council of Delmas v Boshoff* 2005 (5) SA 514 (SCA) para 19); *Telematrix (Pty) Ltd t/a Matrix Vehicle Tracking v Advertising Standards Authority of SA* 2006 (1) SA 461 (SCA) paras 13 and 14). With reference to these considerations of policy some categories have crystallised where legal liability for pure economic loss will be imposed as a matter of course (see eg *Telematrix* para 15; *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 (2) SA 150 (SCA) para 21). But negligent misstatement by an auditor is not one of those. On the contrary it was said in *Axiam Holdings Ltd v Deloitte & Touche* 2006 (1) SA 237 (SCA) para 18:

'It is universally accepted in common-law countries that auditors ought not to bear liability simply because it might be foreseen in general terms that audit reports and financial statements are frequently used in commercial transactions involving the party for whom the audit was conducted (and audit reports completed) and third parties. In general, auditors have no duty to third parties with whom there is no relationship or where the factors set out in the *Standard Chartered Bank* case [ie *Standard Chartered Bank of Canada v Nedperm Bank Ltd* 1994 (4) SA 747 (A)] are absent.'

[22] The policy based determination whether legal liability should be imposed on an auditor for loss resulting from a negligent statement, must therefore be determined with reference to the facts and circumstances of the particular case. That much was appreciated by Binns-Ward AJ. A policy consideration that in his view weighed heavily in favour of imposing legal liability in this case was the gross nature of Nield's negligence. This appears from the following passage in his judgment (para 109):

'In *Perre v Apand [(Pty) Ltd* (1999) 198 CLR 180 (H C of A)], at para 132, McHugh J observed that "because fault remains the basis of negligent liability [he could] see no reason why recklessness or gross carelessness should not be a relevant factor in determining whether a duty of care was owed". In a South African context accepting this is to be so would not be, as might at first blush appear, to confuse negligence with wrongfulness. In many delictual cases the facts which establish negligence are precisely the same as those which establish wrongfulness. That characteristic does not detract from the distinction between the legal elements and the necessity for the success of any

claim under the Aquillian action that both be established. . . . As Lewis JA said in *Premier, Western Cape v Fair Cape Property Developers (Pty) Ltd* 2003 (6) SA 13 (SCA) at para [42] "The test for reasonableness goes not only to negligence, but also to determine the boundaries of lawfulness".'

[23] Despite Binns-Ward AJ's express disavowal of confusion between negligence and wrongfulness, I believe his reasoning demonstrates the very confusion cautioned against by the Constitutional Court when it said in *Le Roux v Dey (Freedom of Expression Institute and Restorative Justice Centre as amici curiae)* 2011 (3) SA 274 (CC) para 122:

'In the more recent past our courts have come to recognise . . . that in the context of the law of delict: (a) the criterion of wrongfulness ultimately depends on a judicial determination of whether – assuming all the other elements of delictual liability to be present – it would be reasonable to impose liability on a defendant for the damages flowing from specific conduct; and (b) that the judicial determination of that reasonableness would in turn depend on considerations of public and legal policy in accordance with constitutional norms. Incidentally, to avoid confusion it should be borne in mind that, what is meant by reasonableness in the context of wrongfulness has nothing to do with reasonableness of the defendant's conduct [which is part of the element of negligence], but it concerns the reasonableness of imposing liability on the defendant for the harm resulting from that conduct.'

[24] Confusing wrongfulness and negligence not only offends the sensitivities of the legal purists. It has practical consequences. In the law of delict in general and in the context of negligent misstatements in particular, the element of wrongfulness introduces a measure of control. It serves to exclude liability in situations where most right-minded people, including judges, will regard the imposition of liability as untenable, despite the presence of all other elements of aquilian liability. If the test for negligence and wrongfulness is telescoped into one, the function of the latter element as a measure of control is lost completely (see eg *Roux v Hattingh* 2012 (6) SA 428 (SCA) para 35). The problem is demonstrated thus by Harms JA in *Telematrix* para 14:

'To illustrate: there is obviously a duty – even a legal duty – on a judicial officer to adjudicate cases correctly and not to err negligently. That does not mean that a judicial officer who fails in the duty, because of negligence [or even gross negligence], acted

wrongfully. Put in direct terms: can it be unlawful, in the sense that the wronged party is entitled to monetary compensation, for an incorrect judgment given negligently [or even grossly negligently] by a judicial officer, whether in exercising a discretion or making a value judgment, assessing the facts or in finding, interpreting or applying the appropriate legal principle? Public or legal policy considerations require that there should be no liability, ie, that the potential defendant should be afforded immunity against a damages claim, even from third parties affected by the judgment.'

[25] It therefore appears, in my view, that Binns-Ward AJ was persuaded to impose liability on FHS by a consideration that should not be afforded any weight at all. In the more recent past the courts and academic authors have attempted to identify the relevant policy considerations that come into play in determining wrongfulness (see eg *Fourway Haulage* para 22; *Delphisure Group Insurance Brokers Cape (Pty) Ltd v Dippenaar* 2010 (5) SA 499 (SCA) paras 24-26; Jonathan Burchell *The Odyssey of Pure Economic Loss* in T J Scott and Daniël Visser *Developing Delict* – essays in honour of Robert Feenstra – first published as *Acta Juridica* 2000 – 99 et seq; Max Loubser and Rob Midgley (eds) *The Law of Delict in South Africa* Ch 8). None of these authorities, incidentally, mention the degree of negligence as one of these considerations and, for the reasons given, I believe rightly so. Two considerations they do mention as relevant in the context of negligent misstatements are, first, whether the representation was made in a business context and in response to a serious request and, secondly, whether the plaintiff was dependent upon the defendant to provide the information or advice sought.

[26] In this case the first of these considerations seems to indicate the imposition of liability. It must have been evident to Nield that the confirmation of profits earned by the Intella business was sought from him, as the auditor of the business, for consideration at the upcoming meeting of shareholders. By reason of his earlier involvement in the transaction, he must also have known that the object of the meeting was to consider whether or not the sale should be approved. I accept that Nield was unaware of the arrangement between the parties to the sale that CET would accept Nield's assurance in lieu of the

contractually stipulated due diligence investigation. Nonetheless, he would have realised that the information was sought for a serious purpose.

[27] On the other hand, the fact that the correct information was available to CET from another source appears to be a contra indication. The available source was of course the due diligence investigation by CET's own auditors, Arthur Anderson, for which it contractually stipulated. It stands to reason that if a comprehensive due diligence investigation had been completed, Arthur Anderson would in all probability have been able to establish the true financial situation of the Intella business. After all, the alleged profit was entirely dependent on one transaction with one debtor purportedly evidenced by a single invoice for more than R10 million. Rai's explanation for his decision not to insist on the completion of the investigation was that he decided 'not to waste any more of Arthur Anderson's time and our fees'. This explanation is unconvincing. In view of the amounts of money involved the additional fees to complete an investigation already started could scarcely have been a serious consideration. What is more, Rai, who is an auditor himself, could hardly have thought that the terse unmotivated profit statement by Nield would serve as a substitute for the protection that a comprehensive due diligence investigation by CET's own auditors would provide.

[28] But the consideration which, in my view, weighs most heavily against the imposition of legal liability on FHS in the circumstances of this case is the one that has become known, in the context of wrongfulness, as the plaintiff's 'vulnerability to risk'. As developed in our law, under the influence of Australian jurisprudence, vulnerability to risk signifies that the plaintiff could not reasonably have avoided the risk of harm by other means. What is now well established in our law is that a finding of non-vulnerability on the part of the plaintiff is an important indicator against the imposition of delictual liability on the defendant (see eg *Trustees, Two Oceans Aquarium Trust v Kantey & Templer (Pty) Ltd* 2006 (3) SA 138 (SCA) paras 23-24; *Fourway Haulage* para 25; *Delphisure Group Insurance Brokers Cape* para 25). The role of this consideration is best illustrated, I think, by McHugh J in *Perre v Apand (Pty) Ltd* (1999) 198 CLR 180 (H C of A)] *supra* para 118:

‘Cases where a plaintiff will fail to establish a duty of care [or, wrongfulness in the parlance of our law] in cases of pure economic loss are not limited to cases where imposing a duty of care would expose the defendant to indeterminate liability or interfere with a legitimate acts of trade. In many cases there will be no sound reason for imposing a duty on the defendant to protect the plaintiff from economic loss where it was reasonably open to the plaintiff to take steps to protect itself. The vulnerability of the plaintiff to harm from the defendant’s conduct is therefore ordinarily a prerequisite to imposing a duty. If the plaintiff has taken or could have taken steps to protect itself from the defendant’s conduct and was not induced by the defendant’s conduct from taking such steps, there is no reason why the law should step in and impose a duty on the defendant to protect the plaintiff from the risk of pure economic loss.’

[29] In this case we know that CET did indeed cover itself against the risk that the Intella business may not have attained the profits represented by the sellers. It did so by procuring an express warranty from the sellers to that effect. In substance the content of the warranty corresponded exactly with the representation by Nield. The sellers were thus contractually bound to CET to make good the level of profits stated by Nield. Together with the provision entitling the purchaser to conduct a due diligence investigation, the profit warranty effectively shielded CET from any adverse consequence of any misstatement of profit of the Intella business by anybody, including Nield. On the face of it, CET was therefore not vulnerable at all.

[30] But, as we also know, CET, through its own conduct in allowing the agreement to lapse had deprived itself of these contractual remedies when the profit statement proved to be false. To make matters worse, it did not use the opportunity to extract itself from the disadvantageous transaction when it was advised that the sale had in fact lapsed by demanding and tendering restitution of what had been performed. On the contrary, it affirmed the transaction in terms of an agreement of settlement. On the face of it, CET therefore appears to have been the author of its own misfortune. Yet, Binns-Ward AJ nonetheless decided to impose delictual liability for the misfortune on FHS because he accepted Rai’s explanation that CET had no option but to conclude the settlement agreement. It will be remembered that according to this explanation, CET was faced with an

application for its liquidation by Bohumi on the basis of the failure of the underwriting agreement and CET's consequent liability of R137 million, which it was unable to settle while seeking to recover the R137 million from Intella and Paradigm.

[31] However, unlike Binns-Ward AJ I am not persuaded by Rai's explanation, which relied largely on the complexities of the transaction. The reason for my scepticism is that the transaction was not that complicated. When the sale and the underwriting agreement proved to be unenforceable, I believe the position was simply this: Paradigm and its subsidiary, Intella, owed CET and its subsidiary H 194 R137 million in respect of the purchase price paid to Paradigm in terms of the sale agreement. CET in turn owed another subsidiary of Paradigm, Bohumi, R137 million in respect of the share subscription paid under the underwriting agreement. In the result CET (and its subsidiaries) owed Paradigm (and its subsidiaries) R137 million while the latter in turn owed the former a reciprocal debt of precisely the same amount. In this light I do not believe that CET was in any real danger of being wound-up at the behest of a Paradigm subsidiary. Its defence was virtually unanswerable. It would pay the subsidiary when it was paid by Paradigm.

[32] I remain equally unpersuaded by the alternative explanation for CET's predicament for being compelled to conclude the settlement agreement. This argument, introduced by its counsel, rested, so it will be remembered, on the proposition that the unenforceability of the sale and the underwriting agreement did not detract from CET's liability for R137 million to Gauret 2 under the loan agreement. What this argument loses sight of, I think, is that CET's liability under the loan agreement was mirrored by the liability of Gauret 1 to CET under the preference share agreement; that Gauret 2 stood surety for the obligations of Gauret 1 under that agreement; and that the parties to all these agreements expressly stipulated that the reciprocal obligations thus created would be extinguished by set-off on 28 February 2005. In short, CET's liability to Gauret 2 under the loan agreement would be cancelled out by the liability of the latter to the former under the preference share agreement.

[33] In argument, CET's counsel submitted that this approach was too legalistic. Whatever the true legal position might have been, so the argument went, CET's position could very well appear far more bleak and intimidating from Rai's perspective than what the perfect light of hindsight might reveal. However, even on this assumption, there is a further consideration why, in my view, it would be unreasonable to impose liability on FHS for CET's loss. It is this: If Rai's explanation is accepted at face value, the reason why CET could not extricate itself from the disadvantageous business deal must be ascribed to the seeming complexity of the deal. But that complexity was created by or on behalf of CET with the purpose of procuring a substantial tax benefit for itself. Translated into the language of vulnerability, it would mean, as I see it, that CET rendered itself vulnerable to risk by allowing the agreement to lapse and by reinstating the agreement in order to procure a tax benefit. The answer to this proposition offered by CET's counsel was that, at the time, the business deal was not illegal and thus not wrongful in itself. But I think this answer misses the point. The point is that as a matter of policy it would, in my view, be unreasonable to impose liability on FHS for a loss to which CET had exposed itself, and hence rendered itself vulnerable, while attempting to gain a tax benefit. For these reasons I do not agree with the finding by Binns-Ward AJ that CET had succeeded in establishing the element of wrongfulness. This means that the cross-appeal should succeed with costs.

[34] This brings me to the appeal against the judgment of Davis J. The first issue presented to him for determination was whether CET had succeeded in establishing the element of legal causation. The second was whether CET had suffered any loss at all. Because Davis J decided the second issue in favour of FHS, he assumed, without deciding, that CET would succeed on the first. For reasons that will soon become apparent, I find it appropriate to adopt the opposite approach by considering the issue of legal causation – which is referred to by some as remoteness of damage – at the outset.

[35] It has by now become quite well settled that, in the same way as the element of wrongfulness, legal causation is also determined by considerations of legal and public policy. This is so because broadly speaking wrongfulness – in

the case of omissions and pure economic loss – on the one hand, and legal causation on the other, perform the same function. They both serve as safety valves preventing the imposition of liability in a particular situation which most right-minded people will regard as untenable, despite the presence of all other elements of delictual liability (see eg *International Shipping Co* 700H-701F; *Fourway Haulage* para 31). Since wrongfulness and remoteness are both determined by considerations of policy, a certain degree of overlapping is inevitable. It follows that, in my view, most of the considerations that served to exclude a finding of wrongfulness in this case will also rule out a finding of legal causation. So, for instance, I think it could be found with equal validity that because CET's loss ultimately resulted from its own failure to extricate itself from the transactions which gave rise to the loss when it had the opportunity to do so, not only was wrongfulness not established, but neither was legal causation. Incidentally, I believe that this overlapping militates against the separation of issues in a case such as this.

[36] Having said that, it is equally apparent, on the other hand, that wrongfulness and remoteness are not the same in all respects. They involve two different elements of the law of delict, each with its own characteristics and content. Even where negligent conduct resulting from pure economic loss is for reasons of policy found to be wrongful, the loss may therefore, for other reasons of policy, be found to be too remote and therefore not recoverable. This happened, for example, in *International Shipping Co (supra).* Determination of remoteness also requires application of yardsticks such as foreseeability and direct consequences which do not play a role in establishing wrongfulness (see eg *Fourway Haulage* para 28). What has also become generally accepted is that these yardsticks should not be applied dogmatically but, rather, in a flexible manner. This means that if the application of any or all of the known criteria should lead to a result which is untenable, legal causation will not be found (see eg *S v Mokgethi en Andere* 1990 (1) SA 32 (A) at 40I-41D; *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 (3) SA 688 (SCA) para 23; *Fourway Haulage* paras 33 and 34; *mCubed International (Pty) Ltd v Singer and others NNO* 2009 (4) SA 471 (SCA) paras 31-32).

[37] With regard to foreseeability CET contended that the wasted expenses for which it claims resulted from the implementation of the business sale agreement and were thus foreseeable by Nield when he made the misstatement on 3 December 1999. As far as the statement goes, it seems to be correct. However, what was not foreseeable by Nield, as I see it, is that CET would not avail itself of the contractual safety nets – a due diligence investigation by its own auditors and the profit warranty – that were stipulated in its favour in terms of the business sale agreement. On the contrary, the most likely inference, I think, is that if Nield were to have applied his mind to the potential consequences of a misstatement, he would have thought that even if his statement proved to be untrue, CET would be adequately protected by the safety nets for which it had stipulated. After all, these safety nets were installed to provide precisely for that eventuality.

[38] If one were to adopt the direct consequences criterion instead, the result would in my view be the same. I say that because I regard the settlement agreement as a *novus actus interveniens* that broke the causal chain of events. But for the settlement agreement, CET would not have incurred the losses it now claims at all if it had claimed restitution of its performance under the lapsed agreement and perhaps claimed damages as a result of the fraud. At the same time, it is plain that the intervening event of the settlement agreement was not of Nield's doing. CET's argument in answer to these propositions was that, since it was compelled to enter into the settlement agreement because of its commercial predicament, that agreement cannot be regarded as a *novus actus interveniens.* But I have already arrived at the conclusion that, even if CET had found itself in this predicament – which in my view it had not – the predicament was in any event of its own making. The consequence, as I see it, is that even if on a strict application of the direct consequences test there was no *novus actus interveniens,* a flexible application of the test would still lead to a finding that legal causation had not been established.

[39] In the result I agree with the ultimate conclusion arrived at by Davis J, albeit for different reasons. This renders it unnecessary to decide on the correctness of his reasoning, since an appeal does not lie against the reasons for judgment but against the substantive order made by the court a quo (see eg

Western Johannesburg Rent Board and another v Ursula Mansions (Pty) Ltd 1948 (3) SA 353 (A) 355). It follows that, in my view, the appeal should be dismissed and the cross-appeal should be upheld, in both instances with costs in favour of FHS. As to the costs in the court a quo, Binns-Ward AJ made costs orders in respect of interlocutory matters, but ordered the costs of the proceedings before him to be costs in the cause. Since FHS eventually achieved overall success before Davis J, he awarded the costs of all proceedings, including those before Binns-Ward AJ, in its favour. In the event I can see no reason to disturb any of the costs orders made by the court a quo.

[40] For these reasons:

1. The appeal is dismissed with costs including the costs of two counsel.
2. The cross-appeal is upheld with costs including the costs of two counsel.
3. The order made by Binns-Ward AJ is set aside and replaced with the following:

   'The plaintiff's claim is dismissed with costs including the costs of two counsel.'

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F D J BRAND

JUDGE OF APPEAL

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