FUND MANAGEMENT REGULATIONS
NEGLIGENT MISSTATEMENT

NEGLIGENT CONDUCT

The Duty and Standard of Care

A duty of care is an essential element in the tort of negligence, but its existence is not an absolute warranty of success. A fund management company does not guarantee that his or her investment decisions made on behalf of a client are absolutely correct (unless it is done so expressly in a contract — an unlikely event). A negligent breach of the duty of care must be shown.

Actionable negligence is the neglect of the use of ordinary care or skill towards a person to whom a duty of care is owed. This raises the question as to what standard of care is required. In law, the 'reasonable person' concept defines the standard. Therefore, if a person professes to be someone with particular skills, the law requires them to show such skill as any ordinary member of the profession to which he or she belongs, or claims to belong, would display.

Professionals such as fund management companies must use reasonable care and skill. In other words, they must not be negligent. Negligence means failure to do some act which a reasonable person in the circumstances would do. But where there is a situation that involves the use of some special skill or competence, the test as to whether there has been negligence or not is the standard of the ordinary skilled person exercising and professing to have that special skill. It may be that performance tables and similar analyses of investment expertise can be helpful in assessing the level of the 'ordinary skilled person' who is a professional fund management company.

However, deciding the standard of care that should be observed by a fund management company in a particular situation is not simple — particularly in fast-moving securities markets where investment decisions are often judged with the benefit of hindsight and where no two investor circumstances are precisely similar.

In deciding what standard of care should be observed in a particular situation, it seems that all those facts that would influence the actions of a 'reasonable' fund management company should be taken into account. These facts would include the foreseeable consequences of a fund management company's investment decisions and the impact of those decisions on investors to whom a duty of care was owed. This does not mean that the 'reasonable person' should seek to eliminateall the risk of damage.

In observing a duty of care, the following elements should be considered by the 'reasonable' fund management company:

- the risks inherent in the conduct
- the seriousness of possible injury
- the opportunities of reducing or avoiding the risk.

We shall return to the steps that the fund management company can take to reduce liability for damage through alleged negligent conduct when we examine the issues of risk management, compliance and due diligence in a later topic. It should be noted at this stage that the standard of care required of a fund management company is a dynamic concept, i.e. that professional standards have a tendency to change to a higher and more exacting standard over time.