FUND MANAGEMENT REGULATIONS
NEGLIGENT MISSTATEMENT

CASE STUDY

Donoghue v. Stevenson [1932] AC 562.

> ***One must take reasonable care to avoid acts or omissions which one can easonably foresee would be likely to injure one's neighbour' – Donoghue v. Stevenson [1932] AC 562.***

The law relating to the negligence of fund management companies (and 'experts' generally) who owe a duty of care to others is an example of the area of law known as the law of tort.

Before we begin to examine this important area of the law relating to fund management it is important to understand the meaning of the term 'tort' and to understand its relationship with the law of contract we examined earlier.

In the case quoted above, a consumer of ginger beer alleged that she had become seriously ill as a result of drinking from an opaque bottle which was subsequently found to contain the remains of a snail. Since she had been given the bottle by a friend, and had not purchased the bottle herself, there was no contract between her and the retailer. Instead, she sued the manufacturer in tort for negligence. The House of Lords ultimately found that the manufacturer had a duty of care to the consumer of the ginger beer.

The case illustrates that a tort represents a civil wrong independent of contract. The law of tort protects the general rights of every person (which also includes the general rights of the contracting parties) which arise under the common law. The Law of tort allows compensation for losses suffered, and the remedy for a breach of tort is an action for damages.

Contrast with the Law of Contract

In a fund management context, there will normally be a contract between the fund management company and the investor client. The contract may, for example, include a requirement that the fund management company maintains various records of the investment portfolio belonging to the client. Should the fund management company fail to maintain these records there would be a breach of contract and, as we saw in the previous topic, the investor client would be entitled to claim compensation (damages) for the consequences of a breach of the promises the fund management company agreed to perform.

But what if the investor claims that the fund management company had been negligent in the investment of the funds? If there is no contract, the law of tort enforces the terms of the duty of care owed to the client. If there is a contract but no term of the contract covers the duty of care, again the law of tort enforces the terms of the duty of care.

In the situation where the terms of the contract do include an element describing the duty of care owed to the investor, the question arises as to whether the investor can obtain a remedy against the fund management company under the terms of the contract. If the contract prescribes a standard of care then the investor can enforce compliance with that standard of care under the contract and, in some cases, may also have a cause of action in negligence.

Proximity

As we have seen in the ginger beer case, the law of tort protects the rights of individuals who may or may not be a party to a contract. These rights are conferred under common law. In the absence of a contract the law of tort enforces the law's judgment as to what the terms of the relationship should be.

The law of tort can, however, only be enforced where there is sufficient proximity (or closeness) to give rise to a duty of care. A trustee of a pension fund, whose investments are managed under a contract by a fund management company, would clearly be regarded as sufficiently close to bring an action for negligence. A beneficiary, or member of the pension fund, would also be sufficiently close to bring such an action even though he or she was not a party to the contract between the fund management company and the pension fund trustee. Should the trustee be unwilling to take action against the fund management company, the law of tort would allow the beneficiary or member to obtain a remedy for losses suffered by the negligence of the fund management company.

From a practical point of view, this means that an aggrieved investor such as a pension fund trustee who has contracted with a fund management company has to decide whether any action for alleged negligence should be brought under the law of tort or for breach of contract. Consequently, it is common for contracts between a fund management company and an investor to exclude contractual liability for negligence. Even if there is no contract a fund management company may be able to exclude liability for negligence by using an appropriately worded disclaimer.

In this topic we will examine the concept of negligence and the duty of care owed by professionals such as fund management companies. In the context of negligence we will examine two aspects particularly relevant to fund management companies — negligent conduct and negligent misstatement (or negligent advice).