

HKSA's advocacy action on the proposal for an equitable system of liability

The Professional Risk Management Committee (PRMC) of the Hong Kong Society of Accountants (HKSA), chaired by Mr Peter Wong since its inception from March 1996 to early 2002 and by Mr Ken McKelvie since early 2002, is tasked by the Council with the responsibility to study the feasibility of introducing a proposal for an equitable system of liability in Hong Kong.

The work of the PRMC in relation to the advocacy action on the proposal for an equitable system of liability, over the past six years, involved a whole spectrum of areas ranging from reviewing the tort reforms in overseas jurisdictions, seeking legal advice from Counsel and considering the various alternatives, including modified proportionate liability, limitation by contract, statutory capping, limited liability partnerships and others. All the hard work and efforts culminated in the HKSA submission 'Proposal for an Equitable System of Liability' which was sent to the Government on 16 April 2002.

The Standing Committee on Company Law Reform (SCCLR) Consultation Paper

In paragraphs 22.44 to 22.52 of the SCCLR's June 2003 Consultation Paper on Proposals made in Phase II of the Review on Corporate Governance (www.info.gov.hk/cr/download/scclr/cgr2_e.pdf), the SCCLR acknowledges the HKSA submission and indicates that it is unable to reach a decision on the issue of auditors' liability. It therefore seeks views from the public on the overall issue of auditors' liability with particular reference to the desirability or otherwise of proportionate liability and the UK Company Law Reform Steering Group's proposals. The UK Company Law Reform Steering Group's proposals as reproduced in the Consultation Paper were:

- a director's or employee's breach of the duty to assist the auditors (whether negligent or fraudulent) should give rise to civil liability, with vicarious liability for the company and the fault attributed to the company for contributory

the SCCLR is seeking views from the public on the overall issue of auditor's liability with particular reference to the desirability or otherwise of proportionate liability

HKSA submission dated 16 April 2002

The HKSA submission is a very comprehensive document which examines in detail the way in which the principle of joint and several liability applies. It looks at the problems of the principle of joint and several liability that arise in practice particularly for professionals (not only auditors), discusses the advantages and disadvantages of various mechanisms to alleviate the problems and sets out the HKSA's proposal in more detail, together with the justification for its introduction. A summary of the salient points of the HKSA submission is set out at the end of this article.

- negligence purposes, subject to the normal principles. The assistance duties should be owed to the auditors in order to achieve clarity as to the auditors' rights to contribution and to assert contributory negligence without any need to consider the question of the range of wider liability; and
- and auditors should be able to limit their liability contractually with the company and in tort (or delict) with third parties. Contractual limitation should be achieved by the repeal of the statutory prohibition on auditors' and companies' so limiting the liability. Such limitation should be publicised in the auditors' report and such



notice should limit those who rely on the report, thereby achieving limitation of liability in tort. In both cases, the limitation would not be effective without prior shareholders' approval.

The SCCLR has indicated that it will consider the comments received on the issue of auditors' liability and then make proposals regarding auditors' liability and proportionate liability. The Consultation period will expire on 30 September 2003.

The PRMC is tasked with the responsibility to respond to the SCCLR on the issue of auditors' liability, and to take any follow-up actions that are considered necessary in order to push for a reform of the existing system of auditors' liability.

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Summary of the salient points of the HKSA submission dated 16 April 2002 'Proposal for an Equitable System of Liability'

(A full copy of the HKSA submission is available at www.hksa.org.hk/professionaltechnical/submissions/docs/proposal-4th.pdf.)

The HKSA recognises that joint and several liability is still important in certain cases, most particularly personal injury actions. However, in the commercial and business environment, a rule which frequently results in liability wholly disproportionate to the contribution of any particular defendant to the overall loss cannot be justified.

The inevitable consequence of the joint and several liability is that a plaintiff will target defendants with 'deep pockets' rather than pursue those primarily to blame for the loss suffered.

Changes brought about in some common law jurisdictions by legislation which provides for apportionment between the plaintiff and defendant (contributory negligence) and between co-defendants (claims for contribution) have removed one of the main arguments for joint and several liability.

The existing legislation in some common law countries not only recognises the principle of apportionment of damage according to the degree of fault as between a plaintiff and a single defendant or as between defendants but also entrusts the courts with the application of the principle in practice. This acknowledges that the courts can fairly make such an apportionment in accordance with the justice of the case.

The HKSA accepts that professionals should take responsibility for their breaches of duty. The concern is to avoid the unfairness of professionals having to pay more than their fair share of loss suffered when they only have partial responsibility for that loss.

The submission re-emphasises that professionals will be accountable for their conduct and will be responsible for the financial consequences. They should not, however, bear the financial consequences of others' shortcomings.

The submission also refers to developments in proportionate liability reforms in Canada, USA, Ireland, Bermuda and the UK.

It sets out specific issues for auditors in particular that the amount of damages claimed against auditors in some cases is so huge that neither the professionals nor their insurers could cover them.

It points out specific issues for Hong Kong in particular that there is no doubt that professionals play a vital role in the operation of the capital markets and in helping to promote confidence in good corporate governance.

The professions need talented people at a time when the financial complexity of business is increasing. Bright graduates

must be encouraged to apply to join the professions and there must be a clear structure and good prospects for those who do join.

Finally, it sets out its proposal, which does not entail the wholesale displacement or exclusion of the principle of joint and several liability. The proposal involves the following main elements:

Essential idea – Proportionate liability should be introduced with exceptions. These exceptions would recognise that there are causes in which the principle of joint and several liability should continue to operate with normal consequences. For instance, joint and several liability should still apply where the defendant seeking to restrict liability has been found by the Court to have caused the damage or loss as a result of his fraud, dishonesty or wilful default.

The schedule of exceptions – The use of the schedule would help facilitate the inclusion of exceptions designed to restrict the application of proportionate liability for policy reasons. The schedule could be shortened or extended and certain types of actions can be excluded altogether. The focus of the proposal is on claims by plaintiffs seeking pure economic loss from defendant professionals. The HKSA does not suggest that proportionate liability should apply in other areas such as personal injury actions.

A separate award – No award would be made in favour of the plaintiff against any defendant unless the case falls outside the exceptions and any other conditions are satisfied. The Court would apportion as between the defendants the damages assessed against them in such proportion as may be just and equitable having regard to the degree in which each wrongdoer was at fault before making any separate award against the defendant in favour of the plaintiff. Under such a separate award calculated by reference to proportionate liability, the wrongdoer would be liable to pay the plaintiff only that sum which corresponds to his apportioned liability.

It concludes that it is important that steps should be taken now to address issues such as the unjust effect of the principle of joint and several liability on claims against professionals before problems strike in Hong Kong with damaging effects on confidence in our capital markets, Hong Kong as a whole and the financial viability of the professionals on whose skills they are so dependent.