Utrecht Law Review
published by igitur

Regulating regulators through liability
The case for applying normal tort rules to supervisors

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1. Introduction

1.1. The bigger picture: supervision as an emerging service

Modern 'Western' society can be characterized as a service-providing society. Services have thus become a major economic influence in for instance Europe and the United States. Related to this development seems to be the emergence of a new distinct type of service: supervision. Supervision and supervisory (or: regulatory)[1] authorities are becoming increasingly important as a means of regulating all kinds of public and private enterprises and markets, including the market for (other) services. In this respect, both services (in a broad and general meaning) and supervision (as a specific form of service) seem increasingly to interrelate and overlap. This is mainly accomplished through the creation and use of agencies that supervise and regulate certain specific (other) service providers. Important examples in this respect are the supervision of accountants and of financial service providers (banks, insurance companies).

This specific form of supervision raises several important questions, not in the least from a perspective of possible liabilities. One could analyze the current state of affairs as regards the (contractual or extra-contractual, civil or administrative) liability of both supervisors and service providers towards third parties, the clients of the service providers. One could also ask whether these possible liabilities are interrelated and if so, to what extent: what is the (legal and/or factual) influence of one liability on the other?

Supervision of and in connection with other distinct forms of (financial) services is, however, not the only aspect of supervision that is currently at the forefront. Several other forms and types of supervision are attracting attention as well. Country-wide supervision (or: regulation) of the banking system or indeed of the entire financial system in Western countries, for example, as opposed to the mere supervision of specific services provided by specific banks has recently gained importance.[2]

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1 I mostly use the term supervisor and not 'regulator' although both are meant to be included in this article. I opted against 'regulator' because not all supervisors have regulatory powers and because regulators are mostly found in the financial/economic sector while this article is meant to include supervisors in other areas of the law and every-day life as well, see below.

2 M. Tison, 'Do not attack the watchdog! Banking supervisor's liability after *Peter Paul*', 2005 *Common Market Law Review*, no. 42, pp. 639-675. Tison provides an overview of several legal systems as regards liability in respect of financial supervision. When a Dutch bank, Van der Hoop Bankiers, went into bankruptcy late 2005, questions were immediately raised as to the nature and quality of the supervision by the Dutch Central Bank. See *Kamerstukken II* 2005-2006, 30 300 IXB, no. 22, and 2006 *NJB*, pp. 460-461.

However, also in totally unrelated areas, such as the prevention of personal injury, supervision has become a force to reckon with. Public entities as well as private companies or even private citizens have been alerted to the fact that they sometimes have a supervisory function and duties related to this function. The municipality might for instance be held accountable if a local swimming area is not kept safe.[3] Public authorities thus find themselves in a position where they need to deal with a new form of liability. The same goes for private entities, as, for instance, privately owned swimming pools or recreational facilities must also be on guard against accidents occurring on their premises. The examples could be multiplied, but what is most important here is to note that supervision has become an important part of society, and with it the question as to the potential liability of supervisors has gained importance.

1.2. Limiting the scope of a still rather broad issue: liability of supervisors towards third parties

Not all of the questions related to the notion of supervision and the liability attached to it can be answered here, so this article deals only with the liability of supervisors towards *third parties*. This is of course a topic that has already received some attention across Europe, but this attention has been mostly due to troubles in the financial world. Regulators in the financial world and market authorities are being analyzed and scrutinized rather intensively.[4]

However, as outlined above, the topic of liability of supervisors towards third parties is much broader, now that for instance governmental failure in preventing certain types of accidents, disasters or mass accidents could also lead to supervisory liability questions.[5] Furthermore, practically all states are creating public regulatory or supervisory agencies or authorities obliged to watch over other people's interests. These supervisory bodies might act negligently at some point in time. And even then the limit has not been reached. For instance, how does a society deal with private parties performing a supervisory function, such as schoolteachers towards the children at school, swimming instructors and life guards towards visitors of the swimming pool or beach, owners of recreational facilities towards the users of these facilities? This means the topic has a very wide spectrum even if only the question of the liability of supervisors towards third parties is dealt with.

1.3. What follows: finding arguments

Instead of focusing on the exact legal definitions of supervision in several legal systems and on the precise boundaries between what would and what would not constitute a tort or a contractual breach on the part of all possible supervisory bodies towards all possible third parties (not being the entity under supervision), this article aims at finding and weighing the (extra-)legal arguments

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3 See for instance *Tomlinson* v. *Congleton Borough Council* [2003] UKHL 47 (liability was denied in that instance). I. Giesen, *Aansprakelijkheid en toezicht*, Deventer 2005, p. 127, deals with other cases that did in fact lead to liability.

4 Cf. most notably Tison 2005, *supra* note 2, pp. 639-675. The *Peter Paul* case decided by the ECJ (see Section 4.4 below) has also received attention in the national legal systems, for instance in the Netherlands, see R. Meijer, 'Peter Paul: aansprakelijkheid voor gebrekkig banktoezicht', 2005 *VrA*, no. 1, pp. 65 *et seq.* On liability of supervisors (both financial and other) see also extensively A.A. van Rossum, *Falend toezicht*, (inaugural lecture Utrecht University, the Netherlands) The Hague 2001; A.A. van Rossum, Civielrechtelijke aansprakelijkheid voor overheidstoezicht, in: *Toezicht*, *Handelingen Nederlandse Juristen-Vereniging 2005-I*, Deventer 2005, pp. 1 *et seq.*; Giesen 2005, *supra* note 3; C.L.G.F.H. Albers, 'Overheidsaansprakelijkheid voor gebrekkig toezicht en ontoereikende handhaving. De geest uit de fles?', 2005 *NTBR*, pp. 482 *et seq.*; all dealing with Dutch law, but mostly in a comparative perspective. See also footnote 5, as well as E. Wymeersch, 'Aspecten van Toezicht', 2004-2005 *RW*, pp. 201 *et seq.* (on Belgian law), and E. Wymeersch, *The Future of Financial Regulation and Supervision in Europe* (May 2005) http://ssrn.com/abstract=728183 (on European law). Especially for market authorities (from a Dutch perspective): F.B. Falkena et al. (eds.), *Markten onder toezicht*, Deventer 2004 (see especially the paper by Harmse/Wassenaar on liability issues in that volume).

5 See also the very recent report by C. van Dam, *Aansprakelijkheid van toezichthouders*. *Deel I en Deel II*, London 2006 (a report for the Dutch government, with country reports on several European jurisdictions, partly in English), as well as M. Faure and T. Hartlief (eds.), *Financial Compensation for Victims of Catastrophes*, Tort and Insurance Law, vol. 14, Vienna/New York 2006.

for and/or against liability of supervisors in general. This approach is taken because the legal systems will differ in the way liability is or is not dealt with while at the same time the arguments that can be found either for or against some form of liability will be the same or at least similar in all systems, although these might or might not get the (same) amount of attention they deserve everywhere. The analysis here thus primarily concerns the policy arguments (and their value and weight) behind the decisions made by courts and legislators in several different jurisdictions. The basic conception underpinning this paper is thus that the question of the liability of supervisors is in the end one of policy: does the system wish to grant 'victims' a way to reallocate the burden (and damage) of supervisory failure?[6]

In order to find the arguments used in this context and to decide on which of those arguments should really be considered relevant and which arguments should not, I will go through several legal systems in a rather 'picky' fashion. First, some necessary information on the legal background of claims against supervisors will be provided, albeit as briefly as possible. I will do this in Section 2 below. Next, I will deal with (case law and legislation from) several systems in an almost random fashion just to reveal the arguments used, not to state the current position of the law in those systems. The analysis (see Section 3) will thus (try to) be somewhat extra-jurisdictional.

Before concluding (Section 5), the 'list' of valid and mistaken arguments will be drawn up in Section 4. From that list, a further analysis of the legal landscape as regards supervisors and their liability can be presented. I will claim that liability of supervisors, given the arguments dealt with, should be treated as a regular form of civil law liability (either in tort or contract). There is no sufficiently compelling reason to deviate from the usual rules which we apply in the regular tort or contract law system. The regulators should therefore be regulated in a regular manner, on the basis of our regular rules. This also means that the case law of the European Court of Justice (ECJ) is mistaken in holding that immunity of supervisors, as granted in several jurisdictions, is indeed allowed and accepted, and even more so in suggesting that this would actually be the best way of dealing with liability of financial supervisors.

The analysis thus provided will hopefully increase our understanding of supervision and the liabilities between the supervisor and third parties. That will be of significant value, both on a practical as well as a theoretical scale, in a world where supervision is still becoming increasingly important.

2. The legal context of the arguments

2.1. Tort law requires acting reasonably

When considering the liability of a supervisor towards a third party, the courts will have to use tort law to solve the case, rare exceptions excluded.[7] Contract law will not be very significant since the supervisor and the claimant usually do not have a contractual relationship and extending contractual remedies is usually not possible.[8] In virtually all systems, however they may have been set up, the main questions are then whether there was (in terms borrowed from English law)

6 Cf. Tison 2005, *supra* note 2, p. 671. Of course, this will hardly come as a surprise since eventually all possible claims handled through tort law (or breach of contract for that matter) turn on a policy decision by the decision maker, be it the legislator or the judge. This policy decision might in some cases be easy; it still is policy that is decisive.

7 In most jurisdictions tort law is used as the primary ground for liability. See for example Giesen 2005, *supra* note 3, pp. 99-106.

8 The 'Vertrag mit Schutzwirkung Dritter' doctrine might be used in Germany (and Austria) but this doctrine will in general only be considered where tort law leaves a gap, even though some form of compensation seems to be in order (for instance with regard to the compensation of pure economic loss).

a duty of care and whether that duty, if present, has been breached. In some legal systems these two questions may be treated as one single question.
The answer to the first question in this line of reasoning (was there a duty?) depends on several circumstances, such as foreseeability and the relationship between the parties (proximity in English legal terms). The second question (was there a breach of the aforementioned duty?) depends on the answer to the question of whether the supposed tortfeasor acted in the same way as a reasonable person (or supervisor for that matter) in similar circumstances would have done (the average man of average skill and care).[9] This reasonableness depends on such factors as the nature and seriousness of the danger in question, the expected damage, the magnitude of the chance of the incident occurring, the foreseeability of the damage, the availability of alternative courses of action and the costs of preventive measures.[10]

2.2. A first example: schools

A first specific example in relation to personal injury might be the position of a schoolteacher and the Board of a school as the ultimate responsible party. According to *English* law, the school has a duty to guard the physical wellbeing of its pupils, while under specific circumstances, the educational needs (special training or courses, etc.) of a student need to be taken care of as well.[11]
In *France* separate rules have been developed for teachers (actually: the State on behalf of the teacher in person) in the public sector, see Articles 1384, Paragraphs 6 and 8, of the *Code Civil* and the Law of 5 April 1937. These rules state that a '*faute'* needs to be proven in order to establish liability. Article 1384, Paragraph 1 of the *Code Civil* which lays down the case–law-based liability for a '*fait d'autrui*' is not applicable here.[12] Whether that rule is indeed applicable in case of a private school, has not been settled yet.[13]
Under *Dutch* law a rather strict duty of care is placed on educational authorities and schoolteachers. They are obliged to watch over the health and safety of their pupils,[14] which means that educational institutions are good (*i.e.* deep pocket) defendants. It is therefore no surprise that case law is rather extensive.[15] However, suing a school is not always a guarantee for success[16] because the aforementioned duty for the children's health and safety is not so extensive that each and every child needs to be supervised constantly by its teacher(s).[17]

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9 For details, see Giesen 2005, *supra* note 3, pp. 106-107 and Chapter VIII.
10 With further references, Giesen 2005, *supra* note 3, pp. 115-116, using the Learned Hand-formula and its Dutch counterpart, the so-called *Kelderluik*-factors.
11 D. Fairgrieve, 'Pushing back the Boundaries of Public Authority Liability: Tort Law Enters the Classroom', 2002 *Public Law*, pp. 288 *et seq.* and p. 291, and J. Wright, 'Local Authorities, the Duty of Care and the European Convention on Human Rights', 1998 *Oxford Journal of Legal Studies*, p. 28, as well as *Van Oppen* v. *Clerk to the Bedford Charity Trustees* [1989] 3 All ER 389, at 401.
12 F. Terré, Ph. Simler and Y. Lequette, *Droit civil. Les obligations*, Paris 1999, nos. 805 *et seq.*; G. Viney and P. Jourdain, *Traité de Droit Civil. Les Conditions de la Responsabilité*, Paris 1998, nos. 897 *et seq.* On the rules regarding the doctrine of '*fait d'autrui*', see also Giesen 2005, *supra* note 3, pp. 102-105, and C. Coulon, *L'obligation de surveillance. Essai sur la prevention du fait d'autrui en droit français de la responsabilité civile*, Paris 2003, nos. 30, 34 *et seq.* Case law is usually so lenient as regards the fault requirement (see for example Cass. 2e civ., 23 October 2003, D. 2004, Jur. 728 note Petit and Dagorne-Labbe, and cf. Viney and Jourdain, no. 901), that pleas for the introduction of strict liability have been voiced, see Dagorne-Labbe. Viney and Jourdain, no. 919, propose to use the rules on liability for a '*fait d'autrui*'.
13 Viney and Jourdain, *supra* note 12, no. 925.
14 Rb. Alkmaar 19 August 1982 and 9 June 1983, *NJ* 1984, 215 (*Geervliet/Staat*).
15 Examples (liability established) are: HR 14 June 1985, *NJ* 1985, 736 (*Smit/Brevoord*); Hof Den Bosch 15 April 1992, *NJ* 1994, 760 (*Derwig/Katholiek Voortgezet Onderwijs Maastricht*); Hof Amsterdam 17 July 1997, *VR* 1998, 187 (*Spelhofen/Timmer*); Hof Arnhem 30 November 1999, *VR* 2000, 157 (*NOP/Rietel*); Rb. Arnhem 28 July 1994, *VR* 1995, 100 (*Van den Berg/Nebo*). See also C.C. van Dam, *Aansprakelijkheidsrecht. Een grensoverschrijdend handboek*, The Hague 2000, nos. 1408 and 1506; C.J.J.M. Stolker (ed.), *Onrechtmatige Daad*, Loose leaf edition, Kluwer: Deventer, (Oldenhuis), Art. 169, aant. 58b; C.J.J.M. Stolker (ed.), *Onrechtmatige Daad*, Loose leaf edition, Kluwer: Deventer, VIII.4 (Lindenbergh), aant. 19.
16 Liability was rejected in Hof Den Bosch 7 September 2000, *NJ* 2001, 577 (*VVAA/Nutsschool-Oost*), Rb. Alkmaar 19 August 1982 and 9 June 1983, *NJ* 1984, 215 (*Geervliet/Staat*) and Rb. Arnhem 10 December 2003, *NJF* 2004, 207 (*S./Rheden*). More information is to be found in: Stolker, *supra* note 15, (Oldenhuis), Art. 169, aant. 58b; Stolker, *supra* note 15, VIII.4 (Lindenbergh), aant. 19.
17 Explicitely Rb. Zutphen 12 August 2003, *NJ* 2004, 260 (*B./Zutphen*).

Proof for the fact that questions of liability in relation to supervision always need to be considered within the system of compensation as a whole (tort, social security, and private insurance) as well as within the confines of the case at hand is to be found in German law in this respect. Although liability of supervisors is not unknown, cases of the sort we are dealing with here (teachers and schools) are all taken care of through the social security system, the '*Unfallversicherung'*. This means that tort law and thus liability of supervisors is excluded.[18]

2.3. A second example: sports clubs

Another example can be found when looking at sports clubs. Case law tends to be rather strict here.[19] A famous Dutch example is the *Gymnastics* case in which it was decided that a Gymnastics club should take special precautions to ensure the safety of the athletes if certain risks (*i.e.*, the risk of falling) are as such not avoidable.[20]

A genuine case of supervision was that of a rugby club and its trainer being held responsible for the severe personal injury (spinal injury leading to paralysis) of a rugby player (member of the club). The player was injured after being moved to the dangerous front row of a scrum where he took a blow to the chin from an opponent.[21]

Rugby clubs in *France* will want to make sure they have sufficient insurance coverage, because their liability is one of the examples of liability that have been strongly influenced by the recent (and strict) doctrine of liability for a '*fait d'autrui*' based on Article 1384, Paragraph 1, of the Code Civil.[22] Rugby clubs are liable for damage suffered by a player due to an act of a club member during the game. A condition for liability is that the player causing the damage must also have been at fault. Such fault will constitute a violation of the rules of the game and must be attributable to the player in question.[23]

In *England*, things have been taken one step further in this respect when an injured player sued a referee, a supervisor '*par excellence'*. The court ruled that it would be 'fair, just and reasonable'[24] to accept a duty of care of the referee towards the player in question. It also held that the duty in question had been breached. The reason for finding that this duty existed was that players trust a referee to apply the rules of the game carefully for their protection.[25]

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18 M. Ebers, 'Haftungslücken beim Schadenersatz für Schulunfälle', 2003 *Neue Juristische Wochenschrift*, pp. 2655 *et seq.*; § 839 BGB, the 'Amtshaftung' is also important, cf. P. Ulmer (ed.), *Münchener Kommentar zum Bürgerlichen Gesetzbuch. Band 5. Schuldrecht. Besondere Teil III (§§ 705-853)*, München 1997, (Stein) 1997, § 832, Rdn. 6 and 21.

19 G.E. van Maanen, in: J. Spier et al. (eds.), *Verbintenissen uit de Wet en Schadevergoeding*, Deventer 2003, no. 49; Hof Arnhem 14 March 2000, *NJ* 2002, 289 (*Kirsty P./K.*) deciding that attention should also be given to sport injuries not mentioned by the athletes, and Rb. Arnhem 8 July 1994, *VR* 1995, 100 (*Van den Berg/Nebo*). See also Stolker, *supra* note 15, VIII.5 (Lindenbergh), aant. 9 (organizer) and 10 (trainer).

20 HR 6 October 1995, *NJ* 1998, 190 (*Turnster*). It must be stressed that in this case the victim was the same person as the person under supervision, which means that there was no third party. However, the tasks and functions of the trainer/supervisor were no different here from what they would have been if there had been a third party. Hence, I still consider this type of case as a case of supervision, for details see Giesen 2005, *supra* note 3, pp. 24-28. A similar relationship (supervisee is also victim) also existed in Hof Arnhem 14 March 2000, *NJ* 2002, 289 (*Kirsty P./K.*), a case concerning gymnastics, and in Hof Den Bosch 22 July 2003, *NJ* 2004, 367 (*MON/S.*). In the latter case, a contestant who struck a hard object when he fell held the organizer of a motocross race accountable.

21 Rb. Den Haag 28 October 1998, *VR* 2000, 156 (*Van der Meijden/Haagse Rugby Club*).

22 The famous *Blieck* case (Cass Ass. plén., 29 March 1991, D. 1991, Jur. 324 note Larroumet) has been the driving force here. See also W. van Gerven et al., *Common Law of Europe Casebooks. Torts. Scope of Protection*, Oxford 1999, pp. 517 *et seq.*; Giesen 2005, *supra* note 3, pp. 102-105, and Coulon, *supra* note 12, nos. 30, 34 *et seq.*

23 Cass. 2e civ., 20 November 2003, D. 2004, Jur. 300 nt. Bouché; S. Galand-Carval, 'Liability for Damage Caused by Others under French Law', in: J. Spier (ed.), *Unification of Tort Law: Liability for Damage Caused by Others*, The Hague 2003, p. 92, claiming this line of case law is applicable for other sports as well.

24 Of course, this refers to the third step in the process of finding a duty of care as accepted by the House of Lords in *Caparo Industries plc* v. *Dickman* [1990] 1 All ER 568. On that, see for instance M. Lunney and K. Oliphant, *Tort Law. Text and Materials*, Oxford 2003, pp. 119 *et seq.*

25 *Vowles* v. *Evans* [2003] 1 W.L.R. 1607, on which Elvin, LQR 2003, pp. 560 *et seq.* There is genuine concern that this case will also affect other contact sports, such as football.

2.4. Preliminary conclusion

It is a well-known fact that both as regards the question of (the existence of a) duty and as regards the question of a breach of that duty, policy arguments come into play. When dealing with supervisors, this is no different. For this reason, one can and should ask whether reasons of policy require (the acceptance of) a duty of care on the part of the supervisor towards the third party; one can and should also ask whether the duty of care between the persons concerned has been breached, given the policy reason for or against allowing tortuous liability in these cases. That being the case, it is paramount to start searching for those policy reasons that might be involved in cases of supervisory liability.

3. Arguments against and in favour of liability

3.1. Necessity of a solid foundation: floodgates and other fears related to liability

Liability of supervisors seems to be growing these days. Given the state of affairs outlined in the introduction, this trend will most probably continue.[26] The general movement to use the legal instrument of tort law to battle (perceived) injustice, sometimes branded as 'compensation culture',[27] will guarantee just that, or so it seems. The reason for engaging in tort law actions of this kind is of course first and foremost that victims are looking for a deep pocket.[28] Why only sue the mental patient, uninsured and without financial means otherwise, who actually caused the harm if there is a possibility to (also) sue the (insured) institution that was supposed to take care of the patient in question?

The trend is thus to sue the so-called 'peripheral tortfeasor' in addition to or even instead of the primary responsible wrongdoer. This 'peripheral tortfeasor', this secondary wrongdoer, such as the supervisor, is usually a solvent and/or insured legal person held accountable for a small mistake that proved harmful combined with the major mistake of the primary, insolvent actor.[29] Examples are psychiatric hospitals as already mentioned,[30] but also the notary who failed to warn against the fraudulent behaviour of the contractual counterpart of the victim.[31] I could also mention the public authority that did not act against the violation of permit requirement by the permit holder resulting in damage to a third party.[32] In each case, the peripheral tortfeasor omitted making use of the possibilities open to it to control the situation while others relied on it to do just that.[33]

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26 Some (anecdotal) evidence may be found in the Netherlands. A Supreme Court judgment in a case on the liability of the (former) authority dealing with insurance companies, the 'Verzekeringskamer' (whose tasks are presently performed by the Dutch Central Bank), is expected somewhere in May or June 2006. Furthermore, the District Court in Amsterdam has recently ruled that the AFM (the financial markets' supervisor in the Netherlands) acted negligently; see Rb. Amsterdam 16 August 2005, *NJ* 2005, 535 (*Befra/AFM*). In addition, several other Supreme Court cases could and actually should have been dealt with from the perspective of supervisory liability, see HR 7 May 2004, *RvdW* 2004, 67 (Linda); HR 28 May 2004, *RvdW* 2004, 78 (*Staat/K.*) and HR 28-5-2004, *NJ* 2005, 105 (*Hartmann/PJIAE*). Extensively on the last case, I. Giesen, *Handle with care!*, The Hague 2005 (Giesen 2005a).

27 On that phenomenon in the Netherlands, see M. Faure and T. Hartlief, *Nieuwe risico's en vragen van aansprakelijkheid en verzekering*, Deventer 2002, pp. 113 *et seq.*

28 Cf. with references: I. Giesen, 'Aansprakelijkheid voor gebrekkig toezicht', 2002 *AV&S*, no. 4, p. 106.

29 Giesen 2002, *supra* note 28, pp. 105-106; T. Hartlief, 'Kroniek van het aansprakelijkheids- en schadevergoedingsrecht 2000-2002', 2002 *NTBR*, p. 461; W.H. van Boom and I. Giesen, 'Civielrechtelijke overheidsaansprakelijkheid voor het niet voorkomen van gezondheidsschade door rampen', 2001 *NJB*, pp. 1676-1677, and dealing with American and English law, W.H. van Boom, 'Aansprakelijkheid naar rato van het veroorzakingsaandeel', in: W.H. van Boom et al. (eds.), *Tussen Alles en Niets*, Deventer 1997, pp. 135 *et seq.*

30 Dutch cases in point are HR 12 May 1995, *NJ* 1996, 118 (*'t Ruige Veld/Univé*) and HR 16 June 2000, *NJ* 2000, 584 (*St. Willibrord/V.*). See also Van Dam 2000, *supra* note 15, no. 1409.

31 Cf. Van Boom 1997, *supra* note 29, p. 151, note 66, referring to HR 18 December 1992, *NJ* 1994, 91 (Dicky Trading I).

32 For example: Rb. Rotterdam 26 May 2004, HA ZA 01-197 (*Caldic Chemie/Rotterdam*). In this case, the city was being held responsible for damage caused by a fire after the city had previously been lenient towards the permit holder violating permit regulations.

33 Cf. J.M. Barendrecht, 'De toekomst van het aansprakelijkheidsrecht in drievoud', in: J.M. Barendrecht and E. Bauw, *Privaatrecht in de 21e eeuw. Aansprakelijkheidsrecht*, The Hague 1999, p. 83.

However, liability of regulatory authorities is still hard to justify, mostly because, as mentioned, the supervisor is usually not the main cause of the damage.[34] We are dealing with a secondary (vicarious form of) liability, or so it would seem. Another party has in fact acted 'more' wrongfully.[35] Added to this is a certain reluctance to accept liability that usually accompanies the idea that liability here is for nonfeasance, not for misfeasance.[36]
In the light of the foregoing, one might wonder whether matters are not being taken too far. Are we not opening the floodgates to liability by allowing supervisory liability? Will this not lead to a form of 'defensive supervision',[37] forcing schools to prevent children from playing in the schoolyard during breaks as this creates situations which are beyond proper control? These questions are raised with good reason, given that no one is able to control everything happening around us.[38] That this fear is indeed present is no surprise as such, as liability of regulatory agencies could indeed be associated with the drawbacks of what I have branded the compensation culture above.
As reasonable and legitimate as this seems, for now it seems wise to leave fears of the floodgates to liability for what they are[39] in order to focus first on the framework of arguments for and against liability (and the desirability of such liability) in these cases.[40] That being said, it is important to keep in mind that in principle, looking at the general rules on tort law in place, supervisors might be held liable according to those rules in most countries, albeit that there might be some formidable hurdles to overcome in practice. However, exclusion of liability beforehand is not common, except for cases of financial supervision.[41] In that sense, there is no special treatment to be expected for those supervisors. Indeed, liability might be useful and desirable.[42]

3.2. Deterrence

Liability of supervisors can be based (at least to a large extent) on the argument that from a deterrence perspective, liability is a good thing. Placing liability upon the supervisor is one way to remind this supervisor that he has a function to fulfil in preventing accidents and damage from occurring. Liability can be a stimulus to try to do just that and to persuade the supervisor to perform the tasks assigned to him with (greater) care.[43]
Liability of supervisors will serve to prevent damage from occurring as the fear of being held liable will lead to greater care being taken by the potential defendant. This positive effect is

34 *Davis* v. *Radcliffe* [1990] 1 W.L.R. 821, at p. 827.
35 Cf. For instance the opening remarks in HR 28 May 2004, *RvdW* 2004, 78 (*Staat/K.*), at 3.4.
36 See J. Kortmann, *Altruism in Private Law*, Oxford 2005; Giesen 2005, *supra* note 3, pp. 47 *et seq.*; C.C. van Dam, *Aansprakelijkheid voor nalaten*. Preadvies voor de Nederlandse vereniging voor Rechtsvergelijking, no. 52, Deventer 1995. A third element leading to reluctance towards accepting liability is connected with the notion that we are dealing with cases of pure economic loss. On that, see critically and principally W.H. van Boom, 'Pure Economic Loss: A Comparative Perspective', in: W.H. van Boom et al. (eds.), *Pure Economic Loss*, Vienna 2004 (extending protection against pure economic loss, and rightly so).
37 The analogy with 'defensive medicine' and 'defensive bureaucracy' at the governmental level is apparent. On the last form, see C.J.J.M. Stolker, D.I. Levine and C.L. de Bel, 'Defensive bureaucracy? Rampen, de overheid en de preventieve rol van het aansprakelijkheidsrecht', in: E.R. Muller and C.J.J.M. Stolker (eds.), *Ramp en recht*, The Hague 2001, pp. 108-109.
38 G.T.M.J. Jurgens, 'Overheidsaansprakelijkheid bij gedogen', 2000 *NJB*, p. 1281.
39 An argument allowing us to do just that is provided by the fact that liability of supervisors has been busy taking root for some time now without the tort law systems, or any other system for that matter, exploding or imploding.
40 I will deal with all the arguments in separate section, fully aware that they are all related.
41 On those cases, see Tison 2005, *supra* note 2.
42 Explicitly Hartlief 2002, *supra* note 29, p. 461. Cf. Giesen, 2002, *supra* note 28, p. 108. Of course, someone else is also (jointly and severally) liable. This goes to show that supervisory liability does at least strengthen the compensatory function of tort law since it provides for another defendant.
43 Cf. Tison 2005, *supra* note 2, p. 672, and more general J.M. Barendrecht, 'Aansprakelijkheid en welzijn', 2002 *NJB*, p. 609; J. De Mot, 'Overheidsaansprakelijkheid voor toezicht: een economische analyse', 2001 *NJB*, pp. 1670 *et seq.* See also Coulon, *supra* note 12, no. 99 and nos. 214, 314 and 376. The last author even wants to promote deterrence by assigning liability to more potential tortfeasors, see Coulon, *supra* note 12, nos. 229-231.

enhanced by the fact that it may lead to a situation where the primary tortfeasor also causes less damage,[44] as the supervisor will in turn require more care from the primary tortfeasor so as to avoid liability.

Deterrence thus means that if the supervisor does not meet the requirements set for him, he can and will be held accountable, just like any other organization or service provider. The possibility of liability promotes careful behaviour and acts as a deterrent against other behaviour.[45]

A possible disadvantage of (liability for) supervision is that the supervisee might be inclined to become less careful, knowing that he is watched and supervised by a third party anyway, namely the supervisor. However, since the supervisor might incur liability if the primary tortfeasor is not careful enough, this supervisor will be more than happy to correct any inclinations in this respect (*i.e.* to be less careful) on the part of the supervisee.

Providing an incentive like this is in general very important, for it provides tort law with a specific (preventive) function, and this is even truer in cases of supervision. One justification for using this incentive is that the regular liability of the primary tortfeasor is usually rather ineffective as regards deterrence since this tortfeasor is not a solvent party and thus frequently 'judgment-proof';[46] he will not be able to put up the cost of liability if forced to pay up, and he knows this well in advance. The fact that he is jointly and severally liable is legally correct, but does not solve this issue of insolvency. Given this insolvency, careful behaviour is not warranted (liability will not deter someone without the means to pay the bill).[47]

A second justification for this incentive relates to the fact that cases of supervisory liability are often cases of pure economic loss. There are usually no other means to prevent this type of damage (criminal law is no incentive here) or if there are, they only work partially (reputation);[48] tort law can therefore not be missed here.[49]

Unanswered, as yet is the general question whether tort law has or can have any deterrent effect at all[50] and the related question whether it indeed has such effects for supervisors. Are there any

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44 For example J.M. Feinman, 'Liability of Accountants for Negligent Auditing: Doctrine, Policy, and Ideology', 2003 *Florida State University Law Review*, vol. 31, no. 1, p. 58 (supervising accountants is an incentive to take care); T. Hartlief and R.P.J.L. Tjittes, 'Kroniek van het vermogensrecht', 2004 *NJB*, p. 1583. Cf. also G. Dari Mattiacci and F. Parisi, *The Cost of Delegated Control: Vicarious Liability, Secondary Liability and Mandatory Insurance*, Law and Economics Working Paper Series 02-27, 2002: ssrn.com/abstract _id=343120, p. 2 and p. 23.

45 In general on this Faure and Hartlief 2002, *supra* note 27, pp. 18 *et seq.*

46 If one considers a solvent tortfeasor one might be tempted to say that supervisory liability would not be needed in those cases but even there, the supervisor is charged with an independent negligent act (his own behaviour).

47 See De Mot, *supra* note 43, p. 1674; A. Hamdani, *Gatekeeper Liability*, John M. Olin Center for Law, Economics, and Business. Discussion Paper No. 442, 10/2003, http://papers.ssrn.com/abstract_id=466040, p. 11 and p. 3; G. Dari Mattiacci and G. de Geest, *Judgment Proofness under Four Different Precaution Technologies*, Law and Economics Working Paper Series 04-03, 2003: ssrn.com/abstract=480441; A.M. Polinsky, *Principal-Agent Liability*, Stanford Law School, John M. Olin Program in Law and Economics Working Paper 258, May 2003 (Chapter 15 in: *An Introduction to Law and Economics*, 2003).

48 The incentive arising from the wish to prevent damage to one's reputation is not all that strong here, given that the other party, the third party, has no or only few alternatives to the supervisee.

49 T. Hartlief, 'De meerwaarde van het aansprakelijkheidsrecht', in: T. Hartlief and S. Klosse (eds.), *Het einde van het aansprakelijkheidsrecht?*, The Hague 2003, pp. 42-44. The incentives referred to are probably strongest in cases of 'specific' defective supervision (cases in which there had been a warning of some sort and the supervisor did not respond adequately) as opposed to in cases of 'general' defective supervision (supervision as a task performed in general, without any specific dangers or warnings being known). On this distinction, see Giesen 2005, *supra* note 3, pp. 116-119.

50 See for example P. Widmer, 'Swiss Tort Law also is European Tort Law', in M. Faure et al. (eds.), *Towards a European Ius Commune in Legal Education and Research*, Antwerp 2002, p. 234, who claims that the deterrence effect of liability is 'overestimated'. J.B.M. Vranken, *Mr. C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht. Algemeen Deel, Een vervolg*, Zwolle 2005, nos. 39 *et seq.*, is of the opinion that neither the presence nor absence of this deterrent effect has a sound basis in empirical research. See also R.W.M. Giard, *Aansprakelijkheid van artsen*, The Hague 2005, pp. 241-243, who adds that the possible absence of deterrent effect here might be due to the lack of deterrent effect of the tort law system in general (in his case: medical liability) or to the current legal system as such, which is not properly designed for the task. L. Visscher, 'De preventieve werking van het aansprakelijkheidsrecht', 2002 *RdW*, p. 71, concludes that empirical research provides no conclusive answers on this.

incentives for supervisors? Will they be tempted to act in a certain manner due to tort law rules?[51] Although 'hard' evidence on this is lacking the following might be said.[52] It would not be wise to overestimate the deterrence value of tort law in general. For instance, as regards traffic liability the incentive tort law provides will be minor at best, as people are driven to prevent accidents by the wish to protect their own bodily safety, not by tort law.[53] As regards supervision, matters are somewhat different, however. Here, we are usually concerned with defendants who can be expected (to some extent) to act rationally and to weigh the costs and benefits of their actions carefully. I call these defendants 'institutional defendants'.[54] Included in that category are financial supervisors or regulators but also psychiatric hospitals, schools, prisons, etc.

3.3. Reliance

Introducing a regulator or supervisor sends the clear message that there is someone to watch over whoever needs to be watched in the specific domain under supervision. It conveys that there is now an organization keeping an eye out for the interests of others. In order to indeed watch over others and their interests, the supervisor will need certain instruments as well as competences. If later it turns out that supervision has not prevented harm or damage to a third party one can conclude that the supervisor has not or not sufficiently made use of its powers or instruments to control certain situations, regardless, as yet, of whether that supervisor might be to blame in any legal sense.

The problem here is that others, the third parties suffering damage, have put their reliance, their trust in the supervisor, as they were in fact allowed to do, trusting him to act and supervise and thus prevent a certain type of harm. This reliance is automatically present; it comes with the creation of a specific body designed to supervise.[55] Introducing supervisors says: 'we will take it from here, do not worry about it anymore.' This trust, first created and then breached, is in my view a strong argument in favour of liability of supervisors.[56] Of course, given the importance of trust or reliance in private law in general, this is hardly surprising.[57]

The element of reliance becomes even stronger, in my view, if a branch of government is involved. If a government body decides to create and implement rules, it should also enforce these rules. Citizens rely on that.

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51 The question as to the deterrent value of tort law is connected with the question whether tort law leads to defensive conduct (Section 3.8), see Wright, *supra* note 11, p. 10. In *Hill* v. *Chief Constable of West Yorkshire* [1989] AC 53, at 63-64, the court openly doubts whether a duty of care would provide an incentive to the police. The court fears defensive conduct instead. See also *Alexandrou* v. *Oxford* [1993] 4 All ER 328, at 340. Again, the question whether the deterrent effect of tort law in fact exists or not, is as yet undecided. To be sure, as we will see below, the same holds true for the 'floodgates' and 'defensive conduct' arguments.

52 P. Cane, *Atiyah's accidents, compensation and the law*, London 1999, pp. 361 *et seq.*; J. Hartshorne, N. Smith and R. Everton, '"Caparo under Fire": a Study into the Effects upon the Fire Service of Liability in Negligence', 2000 *Modern Law Review*, p. 519.

53 See I. Giesen, *Bewijs en aansprakelijkheid* (Ph.D. thesis at the Katholieke Universiteit Brabant, the Netherlands), The Hague 2001, p. 155, p. 412 and p. 462, with further references, and Hartlief 2003, *supra* note 49, p. 61. The fact that Visscher, *supra* note 50, p. 71, concludes that in this part of tort law the deterrent effect seems to be stronger than elsewhere, is somewhat misleading in the sense that the reason mentioned above for careful behaviour (safety) might well enhance an otherwise small or barely existing deterrent effect. Moreover, research supporting his claim has yielded different results, see pp. 61-65.

54 Giesen 2001, *supra* note 53, p. 462, at note 78.

55 Cf. Tison 2005, *supra* note 2, p. 671. Opposed to this proposition (people may not rely on the supervisor to control the supervisee) are R. Smits and R. Luberti, 'Supervisory Liability: An introduction to Several Legal Systems and a Case Study', in: M. Giovanoli and G. Heinrich (eds.), *International Bank Insolvencies: A Central Bank Perspective*, The Hague 1999, p. 377.

56 Cf. Hof Den Haag 27 May 2004, *JOR* 2004, 206 (Vie d'Or), at 7.16, and M. Tison, *Challenging the Prudential Supervisor: Liability versus (Regulatory) Immunity*, Working Paper Series 2003-04, Financial Law Institute, Gent 2003, p. 5; A. Haan-Kamminga, 'Aansprakelijkheid voor toezicht', in: H. Boschma et al., *LT. Verzamelde 'Groninger' opstellen aangeboden aan Vino Timmerman*, Deventer 2003, p. 127 (rejecting this).

57 With regard to the burden of proof see Giesen 2001, *supra* note 53, p. 418. With regard to governmental liability as such, see C.C. van Dam, 'Aansprakelijkheid van de overheid wegens onvoldoende toezicht en handhaving', in: J.M. Barendrecht et al., *Kring van aansprakelijken bij massaschade*, Lelystad 2002, p. 48.

3.4. The purpose of and idea behind supervision

The idea behind having supervision, its purposes, such as preventing harm or damage or creating and safeguarding reliance[58] seem to be more in favour of liability for supervisors than against. Given this general notion underpinning supervision, it should be encouraged – and tort law might be just the incentive and instrument to do so – that supervisors keep a close watch over their supervisees (the potential tortfeasors) to make sure that they behave as they should. As their potential liability will encourage the supervisor to scrutinize closely the persons under its supervision (Section 2.2), in conformity with the notion underpinning their supervisory duties, these supervisors will then in turn encourage the supervisees to act in accordance with what may reasonably be expected from them and to prevent harm.[59] The incentive here is clearly provided in two stages; an incentive is provided to the supervisor to encourage the supervisee to act in a certain manner.

In line with the foregoing, it should be remembered that the supervisor is in the end responsible for doing its job properly, which includes being responsible in a legal sense if it fails to act with the proper amount of care in the exercise of its task, just like any other person would be held accountable if their performance was found lacking. A supervisor is supposed to supervise, that is its function and its duty, and if this duty is not performed properly, this might well lead to liability, for instance towards third parties.[60]

The ground for accepting this duty is to be found in the notion that the legal person who assumes care towards another also assumes the obligation to protect third parties from harm through the person under its care. The supervisor accepts a duty of care not only towards the supervisee but also, and maybe even more so, towards third parties.[61] Liability of the supervisor is then easy to explain because if the supervisor cannot make good on the amount of care it was supposed to deliver, it might even be considered to have acted wrongfully itself in even having taken up the task of supervising.[62] It is important to stress here that the blame attached to the supervisor is blame for his *own independent* conduct and not merely blame and responsibility for the acts and the conduct of another.[63]

3.5. Reasons for being reluctant to accept liability

The reluctance to award claims which is alleged to be characteristic in supervisory liability[64] is in my opinion not justified. The argument made is that this reluctance is part and parcel of liability for nonfeasance and for all types of secondary liability and should therefore also be paramount with regard to supervisors. Of course there is some sense in this proposition. Liability of a supervisor might indeed be less easy to justify because this supervisor was not the ultimate or most important cause of the harm. Another party acted wrongfully first and foremost. Calling

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58 On this aspect, see Tison 2003, *supra* note 56, p. 5.

59 Dari Mattiacci and Parisi, *supra* note 44, p. 2 and p. 23; Coulon, *supra* note 12, nos. 392-393. Haan-Kamminga, *supra* note 56, p. 121, states that the incentive for the primary wrongdoer would be lost by introducing liability of the supervisor. I do not agree, especially not since the possibilities to steer the conduct of the supervisee have multiplied over the past few years (criminal sanctions).

60 H. McLean, 'Negligent Regulatory Authorities and the Duty of Care', 1988 *Oxford Journal of Legal Studies*, p. 454; Cf. also M. Whincup, 'Liability of regulatory agencies', 1994 *New Law Journal*, p. 23, who argues that you cannot hold someone responsible for the conduct of another, but goes on to state: 'We still need to know why the regulatory body failed to fulfil the very purpose for which it was created.' See also Coulon, *supra* note 12, no. 367, and A.M. Hol, 'Preventie van criminaliteit en aansprakelijkheid van politie', in: A.M. Hol and C.J.J.M. Stolker (eds.), *Over de grenzen van strafrecht en burgerlijk recht*, Deventer 1995, p. 64.

61 Coulon, *supra* note 12, nos. 95-96, who mentions § 832 of the German BGB.

62 Again, see Coulon, *supra* note 12, no. 97. He concludes (no. 369) that anyone whose activity may result in risk of damage, should strive to control this risk.

63 See Hartlief 2003, *supra* note 49, p. 43 and p. 44. As the independent conduct of the supervisor itself is at stake, the defence that another person was (also) at fault, is not valid here.

64 For the Netherlands, see HR 7 May 2004, *RvdW* 2004, 67 (*Linda*); HR 28 May 2004, *RvdW* 2004, 78 (*Staat/K.*).

supervisors secondary defendants should however not be misconstrued and read as if a secondary defendant might not be liable at all, just because there is a primary wrongdoer as well.
In an English case, Lord Mackay has said in that respect:[65]

> 'It is plain (...) that the fact that the damage, on which a claim is founded, was caused by a human agent quite independent of the person against whom a claim in negligence is made does not, of itself, preclude success of the claim, since breach of duty on the part of the person against whom the claim is made may also have played a part in causing the damage.'

The 'problem' of course remains that the party that is served with the tort claim was in fact not the party most responsible. That would have been the primary tortfeasor, the supervisee.[66] This means that it is at least not self-evident that only the secondary wrongdoer, the supervisor, is sued and taken to court.[67] Or, as Mcivor states:[68]

> '(…) what causes these decisions to conflict so sharply with instinctive notions of natural justice is the fact that there are clearly other parties who are more closely and directly involved with the harm, and who have played a much more significant role than the defendant as regards its infliction (…).'

Tony Honoré has also noted that 'not preventing harm' is viewed as less serious than (actively) bringing about harm,[69] even if the consequences of both types of wrongdoing might in fact be the same:[70]

> 'At any rate, feeling is in practice more often directed against the person who did the harm than the person who abstained from preventing it. Even when the harm is equal (…) the agent is not regarded as on a level with the non-intervener.'

Not only from a 'natural justice' perspective, but also from a deterrence perspective the incentives should be aimed at the primary wrongdoer.[71] This party is usually the so-called 'cheapest cost avoider', the party best able to prevent damage from occurring.[72] The reason for still seeking redress from the secondary party, the peripheral tortfeasor, is of course that he is (more) solvent where the primary wrongdoer frequently is not (or is at least less solvent).[73] This primary wrongdoer is then considered to be 'judgment-proof'.[74] Furthermore, entering a claim against the

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65 *Smith* v. *Littlewoods Organisation Ltd.* [1987] 1 AC 241; [1987] 1 All ER 710, at p. 720 (per Lord Mackay), and *Perret* v. *Collins and Others* [1998] EWCA Civ 884 (per Buxton LJ).

66 *Alexandrou* v. *Oxford* [1993] 4 All ER 328 at 334 (per Glidewell LJ). See also Haan-Kamminga, *supra* note 56, p. 118 and p. 121.

67 Rather explicitly *Davis* v. *Ratcliffe* [1990] 1 W.L.R. 821, at p. 827 (per Lord Goff.). Cf. HR 28-5-2004, *RvdW* 2004, 78 (*Staat/K.*), at 3.4 and 3.7.1; Hartlief 2003, *supra* note 49, p. 43, and Haan-Kamminga, *supra* note 56, p. 118 and p. 121.

68 C. Mcivor, 'Liability in respect of the intoxicated', 2001 *Cambridge Law Journal*, p. 125. See also Chr. von Bar, *Gemeineuropäisches Deliktsrecht*, Band I, München 1996, Rdn. 100, and A.S. Hartkamp (m.m.v. C.H. Sieburgh), *Mr. C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht. Deel I. De verbintenis in het algemeen*, Deventer 2004, no. 459.

69 For a psychological account of this, see Giesen 2005a, *supra* note 26, p. 70; J. Baron, *Judgment Misguided*, New York 1998, pp. 8-9, each with further references.

70 T. Honoré, *Responsibility and Fault*, Oxford 1999, p. 61.

71 Van Boom and Giesen, *supra* note 29, p. 1677; Barendrecht 2002, *supra* note 43, p. 609.

72 Dealing with supervisors De Mot, *supra* note 43, p. 1670. See also Hol, *supra* note 60, p. 63.

73 Van Dam 2000, *supra* note 15, nos. 1302 and 1404; Van Boom and Giesen, *supra* note 29, p. 1676; A well-known example of a solvent defendant and a deep pocket is the accountant, see Feinman, *supra* note 44, p. 19 and p. 57. The French strict liability based on Art. 1384 *Code Civil* see above, is based on this notion, see Galand-Carval, *supra* note 23, p. 91.

74 Even if the principal wrongdoer is sufficiently solvent, the supervisor might still be held accountable, as it is still to blame for its own omission, *i.e.* not supervising correctly.

secondary tortfeasor will also lead to incentives for desired behaviour (taking precautions) aimed at the primary target.[75]

A second reason for reluctance is that the cases in question are mostly cases of nonfeasance.[76] Liability is usually viewed and (only) accepted with caution in those cases because one needs the existence of a positive duty to act, incumbent upon a person, before an award in damages can be accepted at all. Such a positive duty is not always easy to find or construe, or so it is claimed. Imposing a positive duty to act on someone is regarded as more of an interference with freedom of action than imposing a duty to abstain from certain acts. Lord Hoffmann puts it as follows: [77]

> 'It is one thing for the law to say that a person who undertakes some activity shall take reasonable care not to cause damage to others. It is another thing for the law to require that a person who is doing nothing in particular shall take steps to prevent another from suffering harm from the act of third parties (…).'

This statement needs to be put in perspective however. First, a case of nonfeasance or omission can usually (and should sometimes) also be treated as one of misfeasance.[78] The distinction is difficult to make and usually easily circumvented. To put it (much too) bluntly: each nonfeasance can also be framed as misfeasance.[79] Second, the relationship between the parties involved, or other factors, might be such that this would bring about a duty (to act) in any case.[80]
In the case *Stovin* v. *Wise* Lord Hoffmann mentions three arguments for his proposition that liability in negligence should be the exception in cases of nonfeasance. First, as stated above, interference with personal freedom is greater when one accepts a duty to act in a certain way rather than merely a duty to refrain from something. Second, such a duty would be incumbent upon a large and unlimited amount of people, thus validating the question why one particular party should be the one to be sued (this is also known as the '*why pick on me'* argument). Third, economically it would be more efficient if an activity were to bear its own costs, thus internalizing these costs.[81]

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75 This is of course a 'principal-agent' problem, see Polinsky, *supra* note 47. The peripheral tortfeasor will have problems mobilizing the primary wrongdoer to take precautions but he will do his utmost since the alternative is paying the bill himself. Fault-based liability seems to be working best in these situations, see Dari Mattiacci and De Geest, *supra* note 47. On judgment-proofness, see also Faure and Hartlief 2002, *supra* note 27, pp. 75 *et seq.*; De Mot, *supra* note 43, p. 1673. Of course a second reason to seek redress elsewhere might be that the principal wrongdoer is no longer in existence or traceable. See Coulon, *supra* note 12, no. 401.

76 Extensively on this topic: Kortmann, *supra* note 36.

77 See *Stovin* v. *Wise* [1996] AC 923; [1996] 3 All ER 801 at p. 819. See also Lord Nicholls at p. 806.

78 *Stovin* v. *Wise* [1996] AC 923; [1996] 3 All ER 801, at p. 806 (per Lord Nicholls), See also W.V.H. Rogers, *Winfield & Jolowicz on Tort*, London 1998, pp. 118-120; Cane, *supra* note 52, p. 60; Van Dam 2000, *supra* note 15, no. 511; S. Deakin, A. Johnston and B.S. Markesinis, *Markesinis and Deakin's Tort Law*, Oxford 2003, p. 149.

79 Cf. Lunney and Oliphant, *supra* note 24, p. 426, building on H.L.A. Hart and T. Honoré, *Causation in the Law*, Oxford 1985, p. 138.

80 See Deakin, Johnston and Markesinis, *supra* note 78, pp. 149-150; Van Gerven et al., *supra* note 22, p. 71; Honoré, *supra* note 70, pp. 55 *et seq.*; Cane, *supra* note 52, pp. 61 *et seq.*; J.M. Smits, *The Good Samaritan in European Private Law* (inaugural lecture University of Maastricht, the Netherlands), Deventer 2000, p. 9; Van Dam 2000, *supra* note 15, no. 512; Van Dam 1995, *supra* note 36, p. 7-8, and Lord Goff in *Smith* v. *Littlewoods Organisation Ltd.* [1987] 1 All ER 710, at pp. 730-731.

81 *Stovin* v. *Wise* [1996] AC 923; [1996] 3 All ER 801, at p. 819. On these arguments, see also S.D. Sugarman, 'Rethinking Tort Doctrine: Visions of a Restatement (Fourth) of Torts', 2002 *University of California Los Angeles Law Review*, vol. 50, no. 2, pp. 617-618; Cane, *supra* note 52, pp. 61 *et seq.*, and Kortmann, *supra* note 36, pp. 9 *et seq.* The first argument was decisive for Lord Hoffmann in *Tomlinson* v. *Congleton Borough Council* [2003] UKHL 47, nos. 44 *et seq.* On that, see also H. Koziol, 'Die "Principles of European Tort Law" der "European Group of Tort Law"', 2004 *Zeitschrift für Europäisches Privatrecht,* p. 248.

In my opinion the above needs to be viewed critically. I do not find these arguments convincing.[82] Being reluctant with liability in cases of nonfeasance is of course countered by the fact that relationships involving supervision are most often also cases involving special relationships between supervisors and supervisees, thus supplying us with a legal argument to in fact impose a positive duty to act on the supervisor. This special relationship has evolved, at least in part, because supervision by nature involves anticipating dangers early on in situations where the third party may not expect them and then taking protective action.[83]
Furthermore, the fact that we are dealing with a form of secondary liability is of no concern to issue of liability because supervisors can actually only be peripheral or secondary tortfeasors. This is so because the entire concept of supervision centres round the notion that there is a primary responsible person other than the supervisor. Consequently, not accepting liability of a supervisor as (it is) a secondary tortfeasor would principally exclude any form of liability of supervisors, a line of reasoning that should not be pursued given the injustice it would entail.[84] In addition, the blameworthy act for which the supervisor is sued is in the end an act committed by the supervisor itself, independent of any other behaviour of any other person.
Even if we were to accept that the supervisor should not be the *sole responsible* party, we would still be confronted with the fact that the third party and actual victim is not to blame in any way whatsoever (possible contributory negligence excluded for now). There is no reason then to let the loss lie where it fell originally, at the third party.[85] Of course, immunity for liability will diminish the responsibility of the supervisor and thus create a moral hazard, namely a supervisor not acting as carefully as it could due to the absence of any pressing need to do so.[86] Indeed, case law has shown, and fortunately so, that the reluctance preached in theory is not practised to the same extent,[87] and that for other types of relationships which are not dissimilar to supervisory relationships, such as the relationship between parent and child, secondary liability is accepted without much hesitation.[88]

3.6. Interference with free will

As stated above, in the English case of *Stovin* v. *Wise* three arguments were put forward as to why liability should be rare. The first argument was that the interference with personal freedom is greater when one accepts a duty to act in a certain way instead of a duty to refrain from something.[89] Next, in *Tomlinson* v. *Congleton Borough Council* it was stated that 'people should accept responsibility for the risks they choose to run'. Because the swimmer who was the plaintiff in this case after having broken his neck due to diving into shallow water 'freely and voluntarily' undertook a certain activity creating a certain risk, there could be no duty (and thus no liability) on the land owner to prevent the risk from materializing.[90]

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82 See I. Giesen, 'Toezicht en aansprakelijkheid jegens derden voor letselschade: de zorgvuldigheidsnorm en de rechtvaardiging voor aansprakelijkheid', in: C.J.M. Klaassen et al. (eds.), *Aansprakelijkheid in beroep, bedrijf of ambt*, Deventer 2003, pp. 332-333, and I. Giesen, *Aansprakelijkheid na een nalaten. Een verkennend rechtsvergelijkend onderzoek naar de aansprakelijkheid wegens nalaten, in het bijzonder van toezichthouders*, 'Studiekring Prof.mr. J. Offerhaus', nieuwe reeks, nr. 8, Deventer 2004, pp. 19 *et seq.*
83 With references: Giesen 2002, *supra* note 28, p. 105.
84 Giesen 2002, *supra* note 28, p. 106. Less reluctance would fit in well with current trends to accept third-party liability more readily, see Mcivor, *supra* note 68, p. 126.
85 Explicitly Feinman, *supra* note 44, p. 62.
86 Tison 2003, *supra* note 56, p. 6 and p. 28 (accepting liability might increase a supervisors' reputation and thus create a 'competition for excellence').
87 Giesen 2005, *supra* note 3, pp. 119 *et seq.*
88 Cf. Art. 6:169 Dutch Civil Code; Art. 1384 Para. 5 French *Code Civil*; § 832 German BGB.
89 Lord Hoffmann in *Stovin* v. *Wise* [1996] AC 923; [1996] 3 All ER 801, at p. 819.
90 *Tomlinson* v. *Congleton Borough Council* [2003] UKHL 47, nos. 44-47 (per Lord Hoffmann).

Apart from to the outcome of this case[91] I would also like to point to the fact that the free will that is being promoted here in such a highly strung manner[92] is actually extremely difficult to reconcile with the entire notion and concept of supervision. After all, as an abstract notion supervision is about protecting persons who, however free to determine their own course of action, are not entirely capable of exercising this freedom to the maximum of possibilities, for instance, because they lack relevant information or because they are not capable of using that information properly. Given this idea and given the purpose of supervision, it would not seem appropriate to reject liability in general terms for putting free will at stake. If indeed this free will is to be so predominant that liability cannot be accepted it would be wiser to abolish supervision altogether, just to be clear and avoid false pretences.

3.7. Opening the floodgates to liability: who can tell…

The most commonly used argument to defend the idea that liability should be rarely assumed for supervisors (but also outside that specific scope) is of course the 'floodgates' argument, usually in connection with the notion of 'defensive conduct', here labelled 'defensive supervision' (see Section 3.8). The greatest fear in introducing any kind of liability going beyond a theoretical possibility seems to be that it will open the floodgates to claims or open them too wide. Too many persons would be liable to too many others for too much money.[93] What makes this argument suspicious from the start is that it is always used when a development towards some new form of tortuous liability is being considered. Of course, this could be a fair and just response, but as it is always the same and always so instant, suspicions are fed.

The 'floodgates' argument is thus put forward on a regular basis. The liability of a financial supervisor would, for instance, have 'far-reaching implications' for a 'wide variety of regulatory agencies'.[94] The bill would be too high for supervisors if they had to pay for insolvent supervisees in the financial world.[95] Also mentioned here is that preventing 'public officers' who always act for the good of the people from being taken in by 'unmeritorious actions' is a valid reason for considering the liability of for instance the Bank of England or other supervisors as marginally possible. Of course, seen from a different perspective, tort law could be used against abuse of power by the executive, which in this case are the supervisors.[96]

The ease with which this argument of floodgates being opened is usually introduced is so suspect[97] that it should be made absolutely clear that this argument is not and should not always

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91 I would like to point out however that while swimming in the pond in question had been forbidden years ago, it still continued, even after previous accidents had occurred. At least the city council should have been aware of this and with that awareness some form of action might, in my opinion, have been expected.

92 Lord Hoffmann states that the risks in question and individual autonomy require the court to perform a balancing act 'which in England reflects the individualist values of the common law', see *Tomlinson* v. *Congleton Borough Council* [2003] UKHL 47, no. 47.

93 The Dutch Supreme Court on one occasion at least has been swayed by this argument, see HR 7 May 2004, *RvdW* 2004, 67 (*Linda*), ground 3.4.3. Critically on this fear of the court, Hartlief and Tjittes, *supra* note 44, p. 1583. See also the opening statement in HR 22 February 2002, *NJ* 2002, 240 (*Taxi van*). On the 'floodgates' argument also Fairgrieve 2002, *supra* note 11, p. 296.

94 *Yuen Kun-yeu* v. *Attorney-General of Hong-Kong* [1988] AC 175, at 190; [1987] 2 All ER 705, and McLean, *supra* note 60, p. 449. For French law, D. Fairgrieve, 'Liability of the French State', 1999 *European Business Law Review*, p. 19 (an excess of bureaucratic controls) and p. 21. Liability for a proportion of the damage, for instance by using the loss of opportunity theory, see M. Andenas and D. Fairgrieve, 'Misfeasance in Public Office, Governmental Liability, and European Influences', 2002 *International Comparative Law Quarterly*, p. 771 and p. 779, could cure this fear.

95 M. Andenas and D. Fairgrieve, 'To Supervise or to Compensate? A Comparative Study of State Liability for Negligent Banking Supervision', in: M. Andenas (ed.), *Judicial Review in International Perspective* (Liber Amicorum Lord Slynn), The Hague 2000, p. 333 and p. 360; Fairgrieve 1999, *supra* note 94, p. 19 (French law).

96 More on this in *Three Rivers District Council* v. *Governor and Company of The Bank of England* [2000] UKHL 33; [2000] 3 All ER 1; [2000] 2 WLR 1220.

97 Especially in England the notion is well-known and followed. See *Yuen Kun-yeu* v. *Attorney General of Hong Kong* [1987] 2 All ER 705, at 715-716, where 'defensive conduct' also surfaces as an argument against liability ('there is much force in these arguments'). However, the argument is not always strong and in cases where it is not, cannot be decisive, cf. Vranken, *supra* note 50, nos. 39 *et seq.*

be decisive. That the floodgates argument must be considered critically is a known fact, even if only because it is frequently difficult to indicate whether the danger of the 'floodgates' is real or merely perceived.[98] In that light I would like to stress that the 'awkwardness' that the possible liability of the supervisor would create – the *freezing effect* of liability – is actually not always present. In this respect I refer to the investigation which was carried out in relation to the English fire departments. It turned out that the possibility of liability did not lead to defensive conduct on the part of the fire fighters or to high costs in relation to buying insurance against liability.[99] These data certainly chip away at the floodgates argument. And if the influence claimed to be present is not proven, the argument itself can and will not be decisive either.[100]
Even if we ignore this lack of proof, the floodgates argument is still not very useful in many cases.[101] Van Boom states, and rightly so, that what matters is that a court has to take the consequences of its decisions into consideration. If the foreseeable result of would be that the defendants would indeed be liable for an indeterminate amount to an indeterminate group of people, then this would be ample reason to restrict liability. The question then however becomes what 'indeterminate' means. Usually this relates to an unknown number of potential victims of an accident and to an unknown amount of damage. However, these matters are usually at stake in tort and thus add little to the equation. The first point can be of interest, but usually the number of victims is reasonably easy to determine.[102] 'Indeterminacy' is thus not always present, and that makes the use of the 'floodgates' argument less easy to justify.

3.8. 'Defensive conduct': also unclear

The next argument raised against the acceptance of a 'duty of care' for persons acting as a supervisor according to Lord Browne-Wilkinson is that:[103]

> 'the proper performance of the defendant's primary functions for the benefit of society as a whole will be inhibited if they are required to look over their shoulder to avoid liability in negligence.'

An important reason for reluctance is therefore that the defendant may not be hindered in performing his tasks by the threat of liability.[104] This translates as (a fear of) 'defensive conduct' on the part of the defendant, requiring that we weigh, on a more general level, 'the total detriment to the public interest' if one were to opt for liability or 'the total loss to all would-be plaintiffs'

98 Van Boom 2004, *supra* note 36, p. 33, and J. Elvin, 'Notes: Liability for Negligent Refereeing of a Rugby Match', 2003 *Law Quarterly Review*, p. 561.

99 Hartshorne, Smith and Everton, *supra* note 52, pp. 502 *et seq.*, in relation to *Capital and Counties plc* v. *Hampshire CC* [1997] 2 All ER 865, in which the argument is rejected (at 891). See also P. Craig & D. Fairgrieve, 'Barret, Negligence and Discretionary Powers', 1999 *Public Law*, p. 635, and *Perret* v. *Collins and Others* [1998] 2 Lloyd's Law Reports 255, at 276-277 (per Buxton LJ).

100 Of course the example does not show that this argument can never have any force. Both defenders and criticisers of the argument are unable to produce reliable data. However, the notion of 'floodgates' is not convincing if related to the amount of claims reaching the courts, see Van Boom 2004, *supra* note 36, p. 33, for cases of pure economic loss.

101 The fact that there might be many claims is really of no weight as to the amount of claims that are justified. If the act in question was wrongful, it is wrongful no matter how many people were injured or damaged.

102 Van Boom 2004, *supra* note 36, pp. 34-35. This indeterminacy brings with it problems of insurability, or at least the fear thereof. If the amount of damage is not determinable, the premiums cannot be calculated, making insurers nervous. It might even be that the premium was too low at the onset, leading to financial loss. The mere fact that risks are difficult to predict however, does not automatically mean that liability is uninsurable, see Faure and Hartlief 2002, *supra* note 27, pp. 137 *et seq.*

103 *Barret* v. *London Borough of Enfield* [1999] 3 All ER 193 at 199; [1999] 3 WLR 79 (per Lord Browne-Wilkinson).

104 See *e.g.* Van Gerven et al., *supra* note 22, p. 356, and also *Yuen Kun-yeu* v. *Attorney General of Hong Kong* [1987] 2 All ER 705, at 715-716 (stating that there is 'much force' in this argument).

if one were to opt for non-liability.[105] What is aimed at in this respect is preventing that a supervisor would act with (too much) caution when dealing with the supervisee ('defensive supervision'): 'the public interest is better served by an uninhibited watchdog than by a legally responsible one'.[106] The difficult judgments that supervisors are forced to make, after weighing all the evidence and circumstances, should not be aggravated by the possibility of liability.[107]
This defensive supervision argument can be countered in the same way as the floodgates argument. We still do not know if there is an effect related to liability that will cause people not to act or to act too cautiously.[108] As far as I can tell there is no convincing evidence to suggest that such a thing as defensive conduct in relation to liability exists.[109]
Next, I would like to point out that even if there was indeed such a thing as defensive conduct[110] related to the fear of liability, it would not suffice as an argument against liability. If damage occurs through an unlawful act, the party suffering the damage cannot justifiably be denied compensation simply because this might lead to higher insurance premiums or different conduct (intensified conduct and thus more costly conduct) in general or in future cases.[111] Compensation would be the result of choices made earlier (granting a claim) which can no longer be undone at that point in time. In principle therefore unlawful conduct leads to an award in damages. Also, accepting a duty of care may and can lead to more careful behaviour.[112]
I would also like to stress that the defensive conduct argument, if valid, could and maybe should be brought with equal force in several other classical areas of tort law, such as traffic accidents.[113] However, there the argument is hardly ever used. This might induce one to believe that the argument is mainly used to halt new developments in tort law at an early stage, sometimes even

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105 *Barret* v. *London Borough of Enfield* [1999] 3 All ER 193 at 199; [1999] 3 WLR 79 (per Lord Browne-Wilkinson). In the light of ECtHR 28 October 1998, *NJ* 2000, 134 nt. EAA (*Osman* v. *UK*), § 148-152, some caution should be exercised when granting immunity (for instance to the police force) on public interest grounds, as this makes breach of Art. 6 ECHR a distinct possibility. On this case and its aftermath, see B.S. Markesinis, 'Der wachsende Einfluß der Menschenrechte auf das englische Deliktsrecht', in: G. Hochloch et al. (eds.), *Festschrift für Hans Stoll zum 75. Geburtstag*, Tübingen 2001, pp. 289 *et seq.*; E. McKendrick, 'Negligence and Human Rights: Re-considering Osman', in: D. Friedmann and D. Barak-Erez, *Human Rights in Private Law*, Oxford 2001, pp. 331 *et seq.*

106 See McLean, *supra* note 60, p. 450; A. Page, 'Regulating the Regulator – A Lawyer's Perspective on Accountability and Control', in: E. Ferran & Ch.A.E. Goodhart (eds.), *Regulating Financial Services and Markets in the Twenty First Century*, Oxford 2001, p. 145.

107 McLean, *supra* note 60, p. 450; Page, *supra* note 106, p. 145, and R.M. Lastra and H. Shams, 'Public Accountability in the Financial Sector', in: E. Ferran and Ch.A.E. Goodhart (eds.), *Regulating Financial Services and Markets in the Twenty First Century*, Oxford 2001, p. 184, who point to 'the need for effective regulation' and speak of 'hampering in the discharge of (...) functions'. In the light of the foregoing, the Financial Service Authority in the UK had to develop a complaint procedure, on which Lastra and Shams, p. 184. Without reluctance as to the presence of 'defensive supervision': M. Quintyn and M.W. Taylor, 'Regulatory and Supervisory Independence and Financial Stability', 2003 *CESifo Economic Studies*, no. 2, pp. 271-272 ('is bound to paralyze' and 'are afraid to'). In relation to French law also Fairgrieve 1999, *supra* note 94, p. 19.

108 For example, Fairgrieve 2002, *supra* note 11, pp. 295-296, and J. R. Levine, 'Note: The Federal Tort Claims Act: A Proposal for Institutional Reform', 2000 *Columbia Law Review*, vol. 100, no. 6, pp. 1567-1568, stating that the literature is divided on the question as to the effect of governmental liability. Sugarman, *supra* note 81, p. 617, gives the example of therapists who did not as a body change profession after *Tarasoff.* v. *The Regents of the University of California* 17 Ca. 3d 425; 551 P.2d 334; 131 Cal. Rprt. 14; 83 A.L.R. 3d 1166, on liability of a therapist. See also Tison 2005, *supra* note 2, p. 673 (no proof for proposition that defensive conduct will arise). Visscher, *supra* note 50, p. 66, concludes for the medical profession that there is no proof for the proposition that the threat of liability results in a 'freeze'. Giard, *supra* note 50, p. 266, states that there seems to be more proof for than against the occurrence of a 'freeze'.

109 Again, proof that no defensive attitude is taken is not forthcoming, see the sources mentioned above and Feinman, *supra* note 44, p. 50 and p. 52, stating that the 'research' available is 'inconclusive'. In the same manner B.S. Markesinis, 'Judicial style and judicial reasoning in England and Germany', 2000 *Cambridge Law Journal*, pp. 303-304, and Wright, *supra* note 11, p. 3 and p. 10 ('unsupported by empirical evidence'). In *Capital and Counties plc* v. *Hampshire CC* [1997] 2 All ER 865, at 890, Lord Stuart-Smith would not be influenced by it. See also McLean, *supra* note 60, p. 454. In *Marc Rich & Co AG* v. *Bishop Rock Marine Co Ltd. (The Nicholas H)* [1995] 3 All ER 307, at 331, Lord Steyn stated that the effect must have been towards 'defensive conduct'. In the same vein: Haan-Kamminga, *supra* note 56, p. 122; Smits and Luberti, *supra* note 55, p. 380 ('adverse consequences … for the exercise of supervision.').

110 Related to defensive conduct is the argument that claims lead to all sorts of practical problems (time and costs). However, this argument obviously does not stand in the way of claims being filed, as this is true for all claims, even if totally justified. For more on this Fairgrieve 2002, *supra* note 11, p. 295.

111 *Perret* v. *Collins and Others* [1998] 2 Lloyd's Law Reports 255, at 277 (per Buxton LJ); Feinman, *supra* note 44, p. 52.

112 Among others: Fairgrieve 2002, *supra* note 11, p. 295.

113 Markesinis 2000, *supra* note 109, p. 303.

without going into the merits of the issue. The incremental approach to tort law, adopted for instance in England but followed elsewhere, would reinforce this line of reasoning.

3.9. Compensation

The compensation function fulfilled by tort law[114] would of course be served if the supervisor could be held liable without the need to meet any enhanced preconditions to this liability. The easier the determination of liability would be, the better this compensation would be attainable.[115] This seems to be the path chosen in France as regards the creation of strict liability for certain supervisors.[116]

Compensation can however only be a supportive argument in the background when deciding on the question of (the new) liability given that compensation is first and foremost the *result* of a decision, necessarily based on other arguments, to accept liability.[117] The ultimate question that needs to be answered by tort law is whether a person deserves compensation or not and especially when and why that would be the case.[118] When answering these questions several arguments need to be weighed, and in this balancing act the need or wish to compensate a party may be of some influence, but the idea of compensation alone cannot be decisive. The ultimate question would be whether compensation is in fact needed. If so, tort law can arrange this.

To base liability on compensation is thus not adequate but, as stated above, it could be used as a supportive argument. This might be the case for instance because the need to compensate might be so evident with a view to legal policy that this could be a factor in the decision to hold someone liable. Usually, the protection of victims will be invoked.[119] But again, if compensation is the only argument, it will not suffice.

3.10. Spreading the costs of liability: what costs?

Closely connected with the idea of compensation is the argument for liability that can be found in the notion of *spreading* the costs of liability.[120] If the government or another supervisor is held liable, the costs of failure in supervision will be spread over society as a whole through insurance, taxes or by other charges.[121] This could be an added argument to accept liability, based on the more fundamental notion of solidarity: more shoulders can carry a heavier burden.[122]

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114 Faure and Hartlief 2002, *supra* note 27, pp. 8-10; Barendrecht 2002, *supra* note 43, p. 606 and pp. 611 *et seq.*; Deakin, Johnston and Markesinis, *supra* note 78, pp. 37 *et seq.*, and in relation to non-economic harm A.J. Verheij, *Vergoeding van immateriële schade wegens aantasting in de persoon* (Ph..D. thesis Vrije Universiteit Amsterdam, the Netherlands), Nijmegen 2002, nos. 335 and 339.

115 J.M. Barendrecht, 'Vooraf: hoofdelijke aansprakelijkheid voor toezichthouders?', 2003 *NJB*, p. 957. It is of course also relevant to what extent the damage concerns pure economic loss or damage arising out of personal injury, as pure economic loss does not lead to compensation so readily, cf. Van Boom 2004, *supra* note 36. To be sure, a supervisor will not be held liable solely because there is a solvency problem on the part of the supervisee; a blameworthy act by the supervisors is also required.

116 Coulon, *supra* note 12, no. 43, nos. 70 *et seq.*, and no. 99, as well as no. 371.

117 Cf. C.H. Sieburgh, *Toerekening van een onrechtmatige daad* (Ph.D. thesis University of Groningen, the Netherlands), 2000, pp. 177-179 (dealing with protection of victims as a goal but not as a ground for liability); T. Hartlief, *Ieder draagt zijn eigen schade* (inaugural lecture Leiden University, the Netherlands), Deventer 1997, pp. 17-18.

118 The function of tort law is thus not just to compensate, but also to decide when compensation is in order, cf. Faure and Hartlief 2002, *supra* note 27, pp. 9-10.

119 Barendrecht 2002, *supra* note 43, p. 611, in fact equates compensation with protection of victims.

120 Hartlief 1997, *supra* note 117, p. 19; Faure and Hartlief 2002, *supra* note 27, p. 8, mention the spreading of costs as one the functions of tort law.

121 Chr. H. van Dijk, 'Aansprakelijkheid voor falend toezicht op banken en verzekeraars', 2003 *NTBR* 2003, p. 194, and on the principle Hol, *supra* note 60, p. 64.

122 An example of cases where this type of solidarity might be called for are where persons under a hospital order are allowed to go on trial leave (for therapeutic purposes) and reoffend causing damage. See for the Netherlands (in which this is a major issue) HR 28 May 2004, *RvdW* 2004, 78 (*Staat/K.*). Spreading of costs is also an important argument in the liability of parents for the acts of their children (Art. 6:169 Dutch Civil Code, and M. Haentjes and E. du Perron, 'Liability for Damage Caused by Others under Dutch Law', in: J. Spier (ed.), *Unification of Tort Law: Liability for Damage Caused by Others*, The Hague 2003, p. 175).

A counterargument here might be that it is not up to the court to spread tax money, which will in fact happen if the government is the defendant. Spreading costs in this case is the prerogative of politicians.[123] However, any judgment on liability leads to some form of cost spreading. This means that the position of the court in this respect is no different from that in any other case of tort liability. This counterargument may therefore not be so convincing after all, unless one were to draw the ultimate conclusion which is to withdraw all tort law from the realm of adjudication. This of course is completely unfeasible.

With regard to the *costs* of supervision and the possibility of liability of supervisors the following also needs mentioning.[124] With regard to for instance the liability of 'gatekeepers' (organizations such as accountants and lawyers able to prevent fraud within companies) it has been claimed that this liability will always be a 'costly, imperfect mechanism', resulting in liability being at most a relatively small factor as an instrument of 'social policy' to prevent misconduct.[125]
This also raises the issue of the costs of supervision (in general) in relation to their liability. However, the exact amount of the costs involved in establishing and maintaining a system of supervision cannot be determined due to the fact that the *net profit* (benefits minus costs) cannot be calculated. Of course, the amount will be considerable, both as regards benefits as well as costs, but to what net profit this leads is not apparent. It is not possible the measure the benefits of supervision because the success of supervision is not measurable.[126]
An example: without doubt, supervision in psychiatric institutions is very costly, but even then it might well be that psychiatric institutions are cheaper than the alternative, which would be to leave mental patients in the care of their families. These families, or some family members, would then be unavailable for other activities, such as paid employment. Another example: is supervision by two school teachers in the playground really so much more expensive than supervision by one teacher, given that the extra teacher is present at the school anyway? And what about the net profit if these extra costs are set off against the benefit of preventing accidents and the costs related to accidents?
The foregoing also means that the net profit of applying tort law to supervisors (which is, in fact, a form of supervision on the supervisor)[127] is not measurable. Of course, the use of tort law does lead to certain costs being made, also where the liability of supervisors is at stake.[128] One could think of the added costs of preventive measures, the costs of handling claims (including the costs of civil proceedings over the extent of supervision that was needed) as well as emotional costs.[129] However, these costs must be set off against the potential benefits, which are just not measurable. Furthermore, these costs play a role in all forms of liability. This means that their presence as such is not a justification for excluding liability for supervisors or treating it differently from other areas of tort law.[130]
What should not be forgotten either is that there will be a proper barrier to prevent these costs from sky rocketing, now that all that is asked of the supervisor is reasonable behaviour; to act as

123 In the context of supervision Van Boom and Giesen, *supra* note 29, p. 1681.
124 Extensively on the costs of tort law see for instance Barendrecht 2002, *supra* note 43. See also on the costs of supervision in the Netherlands: M.C.W. Janssen et al., *Literatuurstudie naar de kosten en baten van markttoezichthouders*, Rotterdam 2004.
125 Hamdani, supra note 47, p. 51.
126 Ch.A.E. Goodhart, 'Regulating the Regulator – An Economist's Perspective on Accountability and Control', in: E. Ferran & Ch.A.E. Goodhart (eds.), *Regulating Financial Services and Markets in the Twenty First Century*, Oxford 2001, p. 154 and p. 157.
127 Also known as meta-supervision, see below at Section 3.12.
128 Barendrecht 2003, *supra* note 115, p. 957 (liability is a major cost factor).
129 Suggestions to lower these costs need to be taken seriously, Barendrecht 2002, *supra* note 43, p. 616.
130 Cf. Wright, *supra* note 11, pp. 11-12.

a reasonable supervisor would. Taking additional precautions at additional cost is not necessary. Applying this 'reasonable man' test, in the form of the Learned Hand formula or another national equivalent (the *Bolam* test in England; the *Kelderluik* standard in the Netherlands) means that a supervisor is not automatically liable; there is a genuine boundary to cross as regards the amount of care that needs to be taken. All in all, since speculating on costs and benefits as shown above would be useless, the verdict on this argument should be 'neutral' as it does not dictate any specific outcome.[131]

3.11. How about discretion granted to the supervisor who is also a public body?

Liability of supervisors quite often involves the liability of a public body or agency or of a public authority, which raises the question what, if any, the effect is of the notion that public bodies have independent room for manoeuvre (discretionary powers).[132] For those cases, the following seems to be important.

Given the discretionary power granted to the supervisor a certain amount of freedom of action and thus a certain reluctance as regards liability may be required. In short, this discretionary power is to be included in considering whether the act or omission was careless or not.[133] This does not mean that only a marginal test of carelessness should be applied, however, for instance allowing a supervisor to ignore signs of mishap brought to their attention. These warning signs need to be followed up on.[134]

Better yet, in cases of specific supervisory failure the 'discretionary power' notion has insignificant weight (when standing alone) to reject liability because with the specific warning the discretion allowed has also been limited. Concrete signs of mishaps reduce the freedom to act in certain ways. If a mishap is or has become known the whole array of enforcement and supervisory functions needs to be unleashed in order to prevent damage from occurring. If not, a tortuous act will have been committed, leading to liability in tort and no possibility to plead discretion in defence.[135]

3.12. 'Meta-supervision' and 'accountability'

As a supportive argument for liability of supervisors one could point to the possibility that imposing liability would at the same time be a form of double supervision, 'supervision of the supervisor', effectively bringing about what I would call *meta-supervision* (in this case privately initiated, not publicly). Of course this meta-supervision will then also be imposed on the government in its supervisory capacity, which is also something that needs to be taken into account.

The main advantage of such a form of supervision is that this would highlight the 'accountability', the responsibility of supervisors.[136] This is important for two connected reasons.[137] First, a supervisor is considered to be successful if disasters – *e.g.* the collapse of the financial markets, the loss of consumer trust, death or personal injury – do not occur or are prevented. The measure

131 To speculate a bit: given the preventive incentives (Section 3.2) of supervisory liability, my guess would be that the costs of liability must be very high to be able to say that these costs outweigh the benefits.

132 Cf. Tison 2005, *supra* note 2, p. 654

133 See Hof Den Haag 27 May 2004, *JOR* 2004, 206 (*Vie d'Or*), ground 7.5; *Yuen Kun-yeu* v. *Attorney General of Hong Kong* [1987] 2 All ER 705, at p. 714.

134 See for example Rb. Rotterdam 26 May 2004, HA ZA 01-197 (*Caldic Chemie/Rotterdam*).

135 Van Boom and Giesen, *supra* note 29, p. 1679; Hof Den Haag 27 May 2004, *JOR* 2004, 206 (*Vie d'Or*); Rb. Amsterdam 16 August 2005, *NJ* 2005, 535 (*Befra/AFM*).

136 For a definition of 'accountability' and an extensive account see Lastra and Shams, *supra* note 107, pp. 167 *et seq.* 'Accountability is essential', according to Whincup, *supra* note 60, p. 24.

137 A separate problem is the need to use confidential information belonging to the supervisee, see Goodhart, *supra* note 126, p. 163.

for success is thus rather odd as it revolves around the absence of undesirable events. However, one can never be entirely certain whether or not the fact that these events did not occur has been due to the fine workings of the supervisor or to sheer luck.[138] Success is thus not measurable, as was already indicated above. However, especially because preventing disasters is their main task, supervisors have a natural tendency to focus on exactly this aspect by over-regulating and over-supervising to prevent disaster and by making sure that possible disasters will not be considered as failure on their part.[139] This result might be attained by agreements between the supervisor and the supervisee whereby the supervisor promises to abstain from taking certain measures if the supervisees in return take certain preventive measures, in the hope that this will do the trick. Meta-supervision could in principle lead to a necessary correction of behaviour here.
Second, the profound difficult of measuring the success of supervisors is a problem because the success rate will then be measured by looking at the *process* of supervising: how many visits have been made, how many fines have been imposed, etc.[140] These data however, tell us very little because truly bad supervisors may have made quite an extensive number of house calls. Expending time and energy does not mean that the time and energy are spent well.[141] In that light, it might be wise to let an outsider determine the quality of supervision, thereby focusing on content and not only on the process. Meta-supervision as discussed here might provide just that form of outside intervention.[142] Its importance is thus stressed regularly, for instance by Page:[143]

> 'Subject a regulator to too many controls and its effectiveness may be impaired; subject it to too few controls and its legitimacy may be impaired, with consequences no less serious for its effectiveness.'

3.13. Weighing the arguments differently

When weighing and deciding on the validity of the arguments mentioned, and others, if more are discovered,[144] it seems desirable to take into account the phenomenon that the weight of a certain argument might be different according to the situation in which it is brought up. McLean has stated that one should look at the policy issues again in each case, and that arguments may not always carry the same weight every time. One example is that the reluctance towards accepting the liability of financial supervisors in England is less of a surprise if one takes into account the general reluctance to award damages for pure economic loss there. However, using that line to decide against liability of supervisors in cases of personal injury would be wrong.[145]
Along the same lines, the idea that supervisors should not be sanctioned might in some cases come down to a complete denial of the purpose of that supervisor. In such a case, arguments relating to the notion of 'defensive conduct' would probably not be valued too highly.[146] In the

138 Goodhart, *supra* note 126, p. 154.
139 The mutual dependence of the supervisor and the supervisee enhances this urge, Cf. A. Schilder and W.H.J.M. Nuijts, 'Advies in vertrouwen; vertrouwen in advies', in: *Het advies en de rol van de adviseur, Handelingen Nederlandse Juristen-Vereniging 2004-I*, Deventer 2004, p. 11 and p. 68.
140 Cf. the annual report for 2003 of the Dutch Financial Services Supervisor (the AFM) (Amsterdam 2004, see http://www.afm.nl).
141 Goodhart, *supra* note 126, p. 162
142 Cf. Goodhart, supra note 126, p. 162 and p. 164.
143 Page, *supra* note 106, p. 148.
144 Whether the list is complete remains to be seen, but for now I fail to see any other arguments essential to the judgment that one needs to make here.
145 See McLean, *supra* note 60, p. 452 and p. 453. Furthermore, not everyone is convinced that economic loss should be treated differently, see Whincup, *supra* note 60, p. 24.
146 McLean, *supra* note 60, p. 454.

end, the liability of supervisors is and must remain a flexible system, with outcomes depending on for instance what sort of supervisor is involved.[147]

4. What to infer from these arguments?

4.1. Weighing arguments

The possibility of supervisory liability is in my opinion based on firm ground, made up of a mixture of the following arguments. The necessity and possibility of preventing damage (deterring unwanted behaviour), in connection with the trust and reliance which the supervisor has betrayed, and the essence of supervision (supervisors are created to supervise and must perform that task with care) undeniably point to the acceptance of (probably even strict) liability. The case for liability is strengthened by the fact that the reasons for reluctance towards liability seem to be erroneous. That we are dealing with omissions and with peripheral tortfeasors is not enough, and the same goes for interference with free will. It might be added that the most important counterarguments against liability ('*floodgates*' and '*defensive conduct*') are at best doubtful from an empirical point of view. All in all it we seem able to conclude that there is indeed a solid base for arguing in favour of a regular form of liability for supervisors.

The fact that compensation is as such no argument for liability, but rather a result of liability being accepted is not decisive, nor is the fact that the spreading of costs argument leads to undecided results, as both these arguments definitely do not argue against liability. The argument relating to the costs of liability simply does not point in any specific direction. Of course, supervisors do enjoy a margin of discretion, at least if they are governmental agencies, but this cannot be decisive either, as discretion is not unlimited and therefore cannot grant full immunity. The notion of *accountability* as explained above again argues in favour of liability.

In my opinion it would be valid to conclude that there is indeed a strong enough justification for a (tort law) rule arranging for liability for supervisors. This rule would then be a rule of 'regular' fault liability, based on a breach of a duty of care decided upon by means of a regular standard of care test (relating to the conduct to be expected of a reasonable supervisor).[148]

The question as to how far the liability in question will extend depends on the standard of care. The basic question is how stringently this requirement will be applied. Of course, liability also depends on more formal aspects such as the possibilities of proving a claim, but I will only elaborate on the first issue (Section 4.2) before briefly outlining (Section 4.3) the relationship between the duty of care and the other requirements involved in tort claims (causation, contributory negligence).

4.2. Regular rules ought to be in place

We have seen that there are valid and strong arguments to conclude that a duty of care in tort should be accepted. Liability of supervisors should function as any other 'regular' form of fault liability,[149] based on negligence on the part of the supervisor.[150] Alongside that duty, the general

147 For an explicit balancing of arguments see Lord Stuart-Smith in *Capital and Counties plc* v. *Hampshire CC* [1997] 2 All ER 865, at pp. 890-891.

148 It might well be that the justification given above is even strong enough to support a stricter liability. As a rule of thumb, however, I would not go so far, see the next footnote below.

149 Without going into details, I would like to point out that in my view accepting strict liability for supervisors could be considered, but should not be opted for. The reason is that the arguments put forward do not warrant or justify such a sweeping statement. Important in that respect is that we are dealing with peripheral tortfeasors, which is not an argument strong enough to deny liability but which is capable of excluding a stricter form of liability. Some blameworthy act of the supervisor itself must alos have occurred. For details, see Giesen 2005, *supra* note 3, pp. 222-223. See also Coulon, *supra* note 12, nos. 371, 396, and 404-420, who is also opposed to the idea of strict liability here, and Hamdani,

standard of care in negligence (what was to be expected from a reasonable person, *i.e.* a supervisor) decides whether or not damages can be awarded.[151]

To be sure, the system I favour for supervisors will not be one in which these supervisors can be held accountable on a whim in each case someone suffers some sort of damage through a supervised activity. Needed in any case is a wrongful act, attributable to the supervisor, as well as a causal connection and damage. Especially the breach of a duty of care requirement will pose a serious hurdle for many claims, preventing supervisors from being obliged to take drastic (preventive) measures in order to avoid liability. This requirement thus instantly puts the brake on the number of measures that should be taken (as well as the costs thereof).

It would not go well with this built-in tendency not to go overboard with liability to require specifically of courts or legislators to approach the issue with more than ordinary caution, for instance, because of the fact that a peripheral tortfeasor is being sued or because a fault of omission is to be decided upon. This would bring with it the need to actually abstain from taking legal measures that would inhibit the breach of duty requirement, for instance, by not allowing a regular claim for normal negligence but instead requiring gross negligence or another more stringent standard of care. Such measures are neither wanted nor needed and are thus not to be introduced.

Of course, the special position of the government as a defendant should be taken into consideration but that can easily be fitted in with the commonly applied requirement of breach of a duty, leaving room for discretion without immediately deciding the standard of care has been violated each time someone suffers damage in relation to a governmental agency acting in same capacity.

With this the case for applying the normal and regular rules of the normal and general systems of (tort) liability in Europe has been made. These general and regularly applied systems are fit to deal with the liability of supervisors in a just, fair and reasonable manner. Case law in some countries seems to have accepted this, now it is for courts elsewhere and for some legislators to follow suit.

4.3. Other requirements cannot be principal objections

The arguments used before are not only important as regards the duty and the breach of duty issue, but also in relation to the other requirements that need to be met in order to establish liability. If for instance the main arguments found would be against accepting a duty (and thus liability), one would be able to base the subsequent rejection of liability not only on the non-existence of a duty or a breach of duty but also on lack of causation or on lack of relativity (if this concept would be applied as it is in the Netherlands and Germany, for instance). In all cases, the arguments used against liability would be the same, only the concept used to base rejection on would be different.

The other way around, however, when we accept a duty of care (and thus possible liability) for supervisors, the general acceptance of some form of liability would logically entail that further

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supra note 47, p. 30 and p. 44 (denying strict liability for gatekeepers). Of course, some supervisors do incur strict liability in some systems (think of parents for the acts of their children, as in for instance France and the Netherlands) but this is not a line that is followed everywhere (most notably not in England, while in Germany the rule is one of presumed fault), while at the same time in those cases the relationship between supervisor and supervisee is so close that a stricter form of liability might be in order. In my view, strict liability could only be a serious option for regulation if the peripheral tortfeasor would be subject to a *subsidiary* or *proportional* liability, as is for instance the case with notaries under German law. In this article there is no room for further debate on this highly controversial issue, but see Giesen 2005, *supra* note 3, pp. 42-45; Van Rossum 2005, *supra* note 4, pp. 94-97, and T. Hartlief, 'Aansprakelijkheid van toezichthouders: vertrouwen is goed, controle beter?', 2005 *NJB*, pp. 1129-1130.

150 Tison 2005, *supra* note 2, p. 674, mentions that this is the approach selected recently in Austria.

151 If only because the 'judgment-proof' problem is best tackled through a form of fault liability, see Dari Mattiacci and De Geest, *supra* note 47.

requirements that need to be met cannot stand in the way of this conclusion on principle. Rejection of practically all claims outright, based on for instance causation, cannot be accepted if the duty and breach stage have been passed. Notions such as causation or contributory negligence are indispensable to tort law, and also in relation to supervisors, but these notions should not and may not be construed so as to block tort claims on a principal scale. That function is reserved for the breach of a duty requirement.[152] The decision taken at that level to allow tort law to play a part in relation to supervisors should not be undone on a next level of the playing field.

4.4. Providing (European) immunity is not the way forward

Financial supervisors sometimes enjoy immunity, either almost completely or partially, as in Germany and England.[153] In other cases, for instance in the Netherlands, the government has not granted immunity but has instead given the guarantee that it will take care of any damages granted in successful claims. As far as I am concerned immunity for supervisors goes too far. The arguments dealt with can only lead to that conclusion.[154]

Apart from these arguments, immunity would also be a mistake because then one would accept that there would be no possibility of obtaining a legal ruling on the conduct in question.[155] The option of accepting immunity, and thus not liability, is even more misguided for denying the simple fact that the supervisor has taken up or has been given the task of supervising. As with any other service provider, this institution should in that case also be held responsible – or at least, recourse to a court should be possible in order to establish responsibility – for errors in the performance of that specific task. Again, the concept of and the idea behind supervision supports that. As far as prevention goes, immunity would not promote this, and this is all the more true now that there are, as we have seen, several other arguments to be taken into account that would lead to accepting liability to at least some extent.[156]

The above is quite significant in the light of the latest developments at European Union level in respect of (financial) supervision. Without going into detail, it must be stressed that in the well-known *Peter Paul* judgment the European Court of Justice[157] went quite far in granting immunity to institutions entrusted with the task of supervising the financial world. Given the arguments discussed above, it must be concluded that this judgment sends the wrong message. It is incorrect in establishing that immunity of supervisors is allowed, and is even flawed in suggesting that this is actually the best way of dealing with liability of financial supervisors. Immunity is neither good nor needed.[158]

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152 Causation might give the court a possibility to ground its moral judgment that a supervisor should not be 'punished' as severely as the original wrongdoer. The concept of contributory negligence in relation to supervisors will play a minor role at best. Supervision presupposes that parties will not be able to prevent certain damages. If not, it would not be needed. If damage then occurs because a supervisor fails it will be most difficult to blame the victim for not taking better care of him.

153 See Tison 2005, *supra* note 2.

154 See also Van Rossum 2005, *supra* note 4, p. 122.

155 Art. 6 ECHR might (and should) serve as a strong barrier against accepting immunities since such immunities amount to a denial of access to justice. The *Osman* case dealt with above (at note 105) should serve as an example. There might be a valid case however for introducing, as in the Netherlands, a so called 'vrijwaring' (*i.e.*, government guaranteeing payment if a claim against a supervisor is granted), but only under certain conditions, such as a clause stipulating that the supervisor will have to bear part of the costs of the claim itself.

156 See the arguments dealt with above.

157 See ECJ 12 October 2004, Case C-222/02 (*Peter Paul et al./Germany*).

158 See also Tison 2005, *supra* note 2.

5. The final word cannot be spoken yet…

I have claimed that liability of supervisors, given the arguments discussed above, should be treated as a regular form of civil law liability (either in tort or contract). The rules regarding the existence and content of the duty of care are well equipped to deal with supervisor liability fairly and justly, thus preventing unwanted or unreasonable outcomes. There is no sufficiently compelling reason to deviate from these generally applied rules.
Of course, in due time the situation might change due to for instance a rush on supervisors for damage awards. In that case intensified action might indeed be expected,[159] but as yet there is no reason to fear that attention paid to supervisors will increase to the point that serious problems might arise. The incremental approach to tort law, which is not only the leading idea behind tort law in England, but which is (although implicitly) also a guideline elsewhere will ensure this.[160] And this approach will be backed up by a system of tort law that does not allow for easy results anyway in the sense that it sets quite strict requirements for liability generally.
However, given the developments still to be expected, the final word on the matter cannot be spoken yet. For the time being we may conclude that supervisors and regulators should be regulated in a regular manner, through the regular (fault-based) rules applying to all regular tortfeasors. They're just not that special...

159 This will mostly be due to issues of insolvency on the part of the primary wrongdoer. Preventing this tortfeasor from becoming judgment-proof might therefore be a wise course of action. In this respect, mandatory insurance might be considered, see S. Shavell, *Minimum Asset requirements and Compulsory Liability Insurance as Solution to the Judgment-proof Problem*, John M. Olin Discussion Paper Series no. 456, 02/2004, http://ssrn.com/abstract=580721Shavell 2004.

160 Case law in the Netherlands seems to be following this incremental approach (see for example the *Johanna Kruidhof* case (HR 28 May 1999, *NJ* 1999, 564) and the follow-up case HR 6 June 2003, *NJ* 2003, 504 (*Krüter/Wilton-Feyenoord*)). My educated guess would be that for German and French law and the other European systems the same holds true as well. For details on this approach, see for instance Lunney and Oliphant, *supra* note 24, p. 122.