

## **Professional Liabilities – The Ebbs and Flows**

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The extent of liability in damages of professionals can at times be a complicated exercise by the Courts. It involves considering the intermingled concepts of:

- (a) Causation;
- (b) Contemplation of the parties;
- (c) Scope of duty; and
- (d) Loss of a chance.

To demonstrate the variety of circumstances that can bring about these concepts and their sometimes difficult application, the following illustrations are considered from the last 20 years.

- 1) Inaccurate preparation of audited accounts of a limited company: BGM had been the auditor of 2 companies (A and B) for several years up to 1991. In 1987 C purchased 51% of the shares of B, which owned A. The purchase consideration was 5.2 times the net profits of A and B for 1986 under their audited accounts which were delivered to C by BGM. C then made loans totalling £30m to A and B over the next 6 years.

In 1992 C alleged that BGM has negligently prepared A and B's audited accounts from 1985 to 1990 by failing to discover and report substantial inaccuracies, and that if BGM had performed their audits properly the insolvency of A and B would have been shown. A, B and C alleged that if the true position had been known A and B would have immediately ceased trading and subsequent losses would not have occurred.

C's claim in respect of the lost loans was struck out, because BGM had not expressly been made aware that C might rely on A and B's audited accounts without independent inquiry, not had BGM intended C to rely on them.

The claims by A and B that they had accepted the loans from C in reliance on BGM's statements in the audited accounts were also struck out on the ground that the negligence was not the dominant or effective cause of the subsequent losses. Rather, BGM's alleged negligence had merely given the opportunity for the ensuing trading losses to be sustained.

How was a Court to decide whether the breach of duty was the cause of the loss or merely the occasion for the loss? It was not the application of the “but for” test, instead, Glidewell L J famously said at 1375A that this decision was “*by the application of the Court’s common sense*”. He agreed with the court below that “*If a company trades, it may suffer losses or it may enjoy profits, and those losses or gains depend on a number of factors such as the prudence of the trading, market conditions, and so on. It does not seem to me that trading losses as such can possibly be attributed to statements as to the status of the company before that trading ever takes place...*”

Galoo v Bright Grahame Murray [1994] 1 WLR 1360.

- 2) This application of this common sense test can be seen in another auditor case in 1995. Here an auditor of a Lloyd’s syndicate was sued by the syndicate’s members for alleged negligence in failing to discover or report an underwriter’s poor underwriting in the earlier periods of 1983 and 1984, which the syndicate members contended was the effective cause of losses over underwriting in 1989 and 1990. Gatehouse J struck out this part of the statement of claim, inter alia, on the ground that, at most, the 1983 and 1984 actions of the auditor in failing to discover or report the underwriter’s merely set the stage for the later losses and on any common sense view were not an effective cause of them.

Deeny v Littlejohn [1996] LRLR 276

- 3) A rather different approach to causation of losses was taken by the House of Lords when it considered the question in 1996. The appeals concerned the extent of property valuers’ liability in damages where the valuers had negligently overvalued properties on the security of which mortgages were advanced by the claimant mortgage companies. Those mortgages would not have been made if the true value of the properties had been known. The borrowers subsequently defaulted, and in the meantime the property market had fallen substantially, greatly increasing the losses eventually suffered by the claimants. There were 3 different scenarios in 3 appeals.

The claimants claimed as damages the outstanding amount of the loan less the net recovery from realisation of the security, plus unpaid interest.

- (i) Property valued at £15m, but actual value £5m.  
Claimant advanced £11m  
Realisation £2.477m

- (ii) Property valued at £2.5m, but actual value £1.8m to £1.85m.  
Claimant advanced £1.75m  
Realisation £0.95m
  
- (iii) Property valued at £3.5m, but actual value £2m to £2.35m.  
Claimant advanced £2.45m.  
Realisation £0.345m

It was held that the measure of damages was the loss attributable to the inaccuracy of the information suffered by the claimant through embarking on a course of action on the assumption that the information was correct. Thus:-

- (i) Succeeded as the lenders had £10m less security than they thought, and if there had been that margin then they would have suffered no loss, whereas they had lent much more than the property was actually worth;
- (ii) & (iii) succeeded, but, if they had had the margin they thought, they would have suffered a loss, so the damages were reduced to the difference between the valuations and the correct valuation at the date of valuation.

*n.b.* although cited in argument, Galo was not referred to in the speeches.

Thus, it could not be said that downward movement of the market was unlikely, but loss from the market fall was held not to be loss of a kind in respect of which the surveyors owed a duty to the lender. This conclusion was reached by considering the purpose of the contract and the degree of responsibility which the lender was reasonably entitled to expect of the valuer.

South Australia Asset Management Corpn.v York Montague (SAAMCO)[1997] AC 191.

- 4) What about this situation? Lawyers provided advice in 1992 upon how a company could lawfully be relieved of its obligations under 4 leases, this was acted upon and that company was later put into liquidation at the end of 1994. The liquidator then brought proceedings against the former directors of the company for fraudulent trading, one aspect being the alleged defrauding of the landlords. Those former directors brought a claim against the lawyers (solicitor and counsel) for an indemnity on the grounds of alleged negligence in their advice about the scheme which they, the directors, had relied upon.

Laddie J struck out this claim by applying Galoo's common sense test in that the only way in which the liquidator's claim against the former directors could succeed was upon the basis of dishonesty on their part. In those circumstances, and where there was no suggestion that any dishonesty on the directors' part, if any, was caused, encouraged, sanctioned, anticipated or even facilitated by the lawyers, no claim for an indemnity or contribution could succeed against the lawyers.

Bernasconi v Nicholas Bennett & Co [2000] BCC 921.

- 5) In another auditor case auditors were alleged to have failed to spot that the directors of the claimant company had carelessly over-estimated the profit margin on certain transactions and therefore seriously under-estimated the unreconciled liabilities of the company. The claimants set their prices for a following period in reliance on the audited accounts and suffered substantial losses. The auditors sought to strike out the claim, *inter alia*, on the basis that they owed no duty to protect the company from trading at a loss.

The approach in Galoo was distinguished because the claimant did not contend that it would have ceased trading, but that it would have ceased to trade in the manner that it did and would have carried on its business in a different way. Instead Tomlinson J considered that the strike out application should fail because the precise facts needed to be established before the process of causation could be properly analysed and determined.

He quoted from the New Zealand Court of Appeal case of Fey Hoy and Sons v Coopers & Lybrand [1996] 1 NZLR 392 where that Court had considered that there was a tenable causal connection in circumstances where a company would not have suffered trading losses subsequently if it had appreciated the true financial position.

Further, he relied on SAAMCO to say that there was a serious issue to be tried as to "*the extent it was foreseeable, or reasonably within the contemplation of an auditor, that a consequence of the incorrectness of the information which he gives is that the company will continue to trade in the manner in which it has hitherto traded with the result that it will incur losses which might otherwise be avoided.*"

Temseel Holdings Ltd v Beaumonts Chartered Accountants [2003] PNLR 27.

- 6) Let us look at another case of a company blaming professionals for advice which it is said led the company to continue to trade and thereby incur losses when, if in receipt of proper advice, the company would have ceased trading at the time of the advice.

In 1997 the claimant hotel company sued its solicitors for negligence in wrongly advising it in 1994 that it had no defence to possession proceedings brought its mortgagor bank and should consent to a possession order. The company relied on that advice and in November 1994 had consented to a possession order, suspended on conditions that the company cleared its overdraft and paid £2,800 a month interest on the loan borrowing of £335,000. The company did pay off the overdraft, but only made one payment of the interest. In April 1995 the decision was made to close the hotel as unviable, the bank took possession of the hotel and sold it for £252,000 i.e. less than the outstanding debt.

The hotel company sued for loss of the hotel business; for the loss of some 10 years of profitable trading that would have culminated in an increased capital value of the hotel as a running business; and, alternatively, for the loss of a chance of trading through the recession to achieve that outcome. The judge held that the solicitors had been negligent but awarded only £5 nominal damages. This was because the hotel business had been doomed to failure since 1994 so the claim for loss of profits was unsustainable, whether made directly or as a claim for loss of a chance. Nor had the company lost any capital by reason of losing the hotel because they had had negative equity in it. The company appealed.

The appeal was dismissed, putting the matter succinctly Sedley LJ said:

*“The ordinary measure of damages in an action against a solicitor for negligence in conducting litigation is the value of the chance of a better outcome than the one which eventuated, If there was in reality no such chance, there will be no damages. It follows that a claim such as the present one cannot survive a finding that, even if the negligent admission of liability had not been made and a triable defence entered, there was still no chance that the business would have pulled through.”*

Veitch v Avery[2008] PNLR 153, at 164.

- 7) Professional negligence claims by clients are, of course, generally brought in contract so let us look at a recent example of the application of the rule in Hadley v Baxendale (1854) 9 Ex 341 at 354 *per* Alderson B in relation to the limits placed on the extent of the liability of the professional who is in breach of the contract of engagement, or the barring of recovery by reason of remoteness of the loss suffered by the client:

*"...where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract is such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such a breach of the contract itself, or such as may reasonably be supposed to have been in the contemplation of the both parties, at the time they made the contract, as the probable result of it."*

As Lord Reid pointed out in Czarnikow v Koufos (The Heron II) [1969] 1 AC 350 at 385: *"...it is not enough that in fact the plaintiff's loss was caused directly by the defendant's breach of contract...The crucial question is whether, on the information available to the defendant when the contract was made, he should, or the reasonable man in his position would, have realised that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation."*

Most recently the Court of Appeal considered the case of a consulting engineer's breach of contract which had led to his developer client suffering a loss by reason of diminution in the market value of a development. The client had engaged the engineer to design a road and drainage scheme for a residential development, and to obtain approval from the local authority for the road's design. The engineer failed to complete the work by March 2007 as agreed. The client eventually engaged another engineer, who completed the designs and obtained approval 15 months after the agreed date. The engineer successfully claimed against the client for unpaid fees, but the judge also allowed the client's counterclaim which included damages for the decline in value of the development during the period for which its completion had been delayed as a result of the engineer's breach of contract in failing to complete its work on time. The trial judge found as a fact that the engineer had appreciated when he entered into the contract that delay on his part brought with it the risk that the property market might move considerably up or down.

Sir David Keene summarised the law in this way:-

*“If there is no express term dealing with what types of losses a party is accepting potential liability for if he breaks the contract, then the law in effect implies a term to determine the answer. Normally, there is an implied term accepting responsibility for the types of losses which can reasonably be foreseen at the time of the contract to be not unlikely to result if the contract is broken. But if there is evidence in a particular case that the nature of the contract and the commercial background, or indeed any other relevant special circumstances, render that implied assumption of responsibility inappropriate for a type of loss, then the contract-breaker escapes liability.”*

As to the application of these principles to the present case he upheld the trial judge after noting:-

1. there was no evidence to show that there was some general understanding or expectation in the property world that a party in this engineer’s position would not be taken to have assumed responsibility for losses arising from movement in the property market where there had been delay in breach of contract;
2. the engineer had no control over the property market, but that was the case with all markets, and there were many decided cases where delay in delivery of goods has been held to give rise to damages for loss suffered through a change in the market price;
3. whilst there are very few decided cases where a decline in the property market during a period of delay has been held to give rise to an actionable loss, there were no decided cases from the property world deciding the other way. He postulated that it may well be that the reason for the absence of many cases of this kind is that the property market does not move as quickly as certain other types of market involving commodities and other goods, and it takes a very lengthy delay in breach of contract before a provable loss of value can occur. A few days or even weeks delay is unlikely to give rise to a demonstrable loss on the property market. In the present case it was the engineer’s delay of 15 months which gave rise to a quantifiable loss;
4. contrasting the scale of the loss with the relatively low fee of the engineer is not in itself persuasive to conclude that the loss is too remote, it is merely one possible pointer towards a contracting party not having undertaken a potential liability which is reasonably foreseeable.