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PROFESSIONAL INDEMNITY INSURANCE CONFERENCE

Legal Developments Affecting Professionals (July 2022)

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4 Paper Buildings

SAAMCO – Where next?

I am old enough to remember very clearly the arrival of the judgment of the House of Lords in SAAMCO, or more properly *South Australia asset Management Corp v York Montague Ltd* [1997] AC 191, over 26 years ago on a June day in 1996. I remember the interested members of my Chambers assembling in a conference room to consider the effect of the judgment on the morning that it was handed down. I can recall no judgment up to that time which had precipitated quite such an effect. I also remember reading the judgment of Lord Hoffmann and having the very clear impression that I must have missed a page, which I had not. It was simply a reflection of my inadequate initial grasp of what was a revolutionary approach to the issue of loss. I do not think that any of us felt that the information/advice distinction was readily workable as it stood but that we all understood that a very careful consideration of the operative duty of care was going to be required in many cases thereafter.

I am also very conscious that at a conference such as this, rooted in the practicalities of professional indemnity insurance and its operation, it is very easy for somebody such as me to pontificate upon something which can feel like a rather self-indulgent academic exercise. However, I would suggest that, in very many cases over the last 25 years, particularly cases involving large claims, the operation of the SAAMCO test has played a very significant role in limiting insurers' exposure and that, accordingly, the Supreme Court's recent revisit of the subject in *Manchester Building Society v Grant Thornton* [2021] UKSC 20 and *Khan v Meadows* [2021] UKSC 21 are likely to be of enormous practical significance in the years to come.

And the bad news is that the reappraisal which has taken place has been comprehensive but, I fear, the outcome provides no greater certainty, and arguably reduces the predictability of outcomes which, at the end of the day, is probably what the market requires most.

The Supreme Court clearly considered that hearing the two cases together, one in the context of audit negligence and the other in the context of clinical negligence would assist in providing clarity. It adopted a very similar approach 18 months ago in respect of the issue of illegality in the cases of *Stoffel v Grondona* [2020] UKSC 42 and *Henderson v Dorset Healthcare University HNS Foundation Trust* [2020] UKSC 43, albeit that in those cases the panels were not identical. I would respectfully suggest that this approach to decision-making has not been marked by success to date, at least so far as clarification is concerned.

Turning back then to the latest SAAMCO cases, the outcomes were unanimous in both cases. Regrettably, however, the reasoning of the Judges was not. The key questions were firstly how the scope of the duty of care should be determined and thereafter how the court should determine whether the losses sought fell within the scope of the duty which had been ascertained. The majority judgments were provided by Lords Hodge and Sales but significant, and different, analyses were provided in the judgments of Lords Leggatt and Burrows, and they have subsequently attracted considerable attention both from commentators and from judges.

I do not propose to set out the facts in any great detail but a brief synopsis may help. In *Khan* the claimant mother was negligently not advised that she was a haemophilia carrier and thus of the risk of haemophilia in any child she might bear. She then fell pregnant. Had she known of the risk of haemophilia she would have tested and, if the child was positive, would have had an abortion. She was not tested and her child not only suffered haemophilia but also autism. The Supreme Court held that she could not recover damages in respect of the consequences of the autism but only in respect of the consequences of the haemophilia.

In *Manchester* the building society held substantial mortgage loans. Grant Thornton was its auditor and negligently advised that the society could adopt what is known as hedge accounting in reliance upon which the society entered long term interest rate swaps as a hedge for lifetime mortgages. This served to conceal a severe mismatch between its loans and the swaps providing the hedge. When the accountants realised their error the accounts had to be restated and the society realised that its assets were reduced such that it now had inadequate regulatory cover. It therefore had to close its swap contracts early at a cost of £32 million. Up to the Court of Appeal it was held that the close-out costs fell beyond the scope of the accountant's duty. This was reversed in the Supreme Court, albeit that unusually, it imposed a contributory negligence deduction of 50% which the trial Judge, Teare J, stated that he would have imposed had he found the accountants liable for the swaps loss.

What one can say with confidence is that the majority emphasises the need to discern the scope of the defendant's duty in any case involving professional negligence. Less helpfully, the use of counterfactual analysis in testing the questions has been largely reined in. Happily the advice/information dichotomy has been discarded together with any acknowledgement of the concept of a “cap”.

The traditional simplicity of the component parts of the tort of negligence has all but been rejected. Those four traditional considerations of, duty of care; breach; causation; and damage are further muddied by the consideration of the issue of “scope of duty” and the emphasis upon it. The Supreme Court’s majority emphasise that scope is a question distinct from factual causation and foreseeability. The restructured tort of negligence requires consideration of six questions: actionability, scope of duty, breach, factual causation, and the nexus between duty and loss and legal responsibility. However, even this must be treated as a guide rather than a structural analysis.

The scope of the duty questions feature both in respect of the question, “what are the risks of harm to the claimant against which the law imposes a duty on the defendant to take care” and, “is there a sufficient nexus between the particular damage sought and the subject matter of the defendant’s duty of care”. The issue of scope of duty thus requires an objective assessment of the reason for which the advice is provided. However the question also features in the fifth issue namely that of nexus which in itself encapsulates two parts whereby consideration is first given to the total loss factually caused by the defendant’s breach from which there is then extracted the loss considered to fall within the harm against which it was the defendant’s duty to guard.

Scope of duty and remoteness remain distinct legal concepts but the interrelationship remains intimate and increasingly difficult to separate and one can well imagine that both practitioners and judges will grapple with the problem of allocating factual issues between the questions in the cases which follow in the next few years.

What many considered to be a valuable crosscheck under the operation of SAAMCO namely, would the loss still have been suffered if the advice had been correct? is significantly downplayed by the Supreme Court which considers the question to be too susceptible to manipulation, or in other words capable of being framed to serve the "desired" answer. In a subsequent Privy Council case, *Charles B Lawrence and Associates v Inter Commercial Bank Ltd* [2021] UK PC 30, the counterfactual which had been applied by the court below was comprehensively rejected in its entirety.

How the court will operate the duty/nexus question in future remains most distinctly obscure. It has already triggered considerable academic debate. The majority judgements in *Manchester* favour a test by reference to whether the loss in question materialised from risks assumed by the defendant. Commentators have suggested that this sounds remarkably similar to the "assumption of responsibility" test which has caused so much difficulty in the past, not least because the answers provided tend to be self-supporting rather than grounded upon reasoning, an objection so firmly expressed in respect of the counter-factual test. It is here where the concurring minority judgment of Lord Leggatt has attracted particular attention with the reliance which he places upon a causation based analysis with some weight placed upon the counterfactual. Lord Leggatt suggests that, "the loss must be caused by the particular matters which made the defendant's advice incorrect and not by other matters unrelated to the subject matter of the defendant's negligence". This feels "right" and emphasises that the court is not simply addressing "but for" causation but focuses on the logical and permissible entitlement to compensation but it has been suggested that very modest variations of fact could lead to dramatically different outcomes. My response to that is that such will always occur at the boundaries of permissible recovery.

What we can say with considerable confidence is that everybody is going to be less confident about their application of the new guidelines for a considerable time to come and I have heard that lack of confidence expressed by more than one member of the present Court of Appeal highly experienced in professional negligence matters.

We have now seen a few cases which have come to trial under the new regime. To my eye, they have emphasised the increased factual sensitivity in determining the outcomes. Perhaps the most useful of them in general terms is that of *Auriam Real Estate London v Mishcon de Reya LLP* [2022] EWHC 1253. The facts are complex and arose out of a solicitor's retainer in the context of an effort by the claimant company to buy out all of the interests in certain adjacent plots of land with a view to selling the entirety with vacant possession for re-development. One tenant refused to vacate. It was alleged that the solicitors had advised a "build around" strategy which resulted in negotiations to sell being placed on hold. The tenant subsequently obtained a declaration that a build-around would be a breach of the terms of its lease and the underlying buyer withdrew. The claimant company sought damages from the solicitors including the cost of its default on loans taken to buy-off other tenants and the lost chance of the sale. The case failed *in limini* because the judge rejected the existence of <u>any</u> retainer to provide advice as to the viability of the build-around scheme and the absence of a duty of care to do so. However, the court then proceeded to consider the scope of duty question in case its primary conclusion was incorrect. A key finding was that the claimant did not have one single fixed exit strategy but was considering its options at all times in a dynamic fashion. The court considered that the solicitors were not retained to provide advice in respect of possible protection against an inability to sell within the term of the available financing. The court was influenced by the fact that there was no request for advice on the implications of any particular build around scheme for the purposes of a successful sale; it was never a given that a sale would proceed on that basis and that the matters complained of were essentially commercial rather than legal considerations.

All of us advising in this area have emphasised for many years the importance of the careful definition and recording of retainers. It is my experience, and I believe that of many other advisers in this area, that this remains a difficult issue, particularly in transactional retainers where the transaction can be the subject of metamorphosis over the months. Emphasising to all practitioners the importance of retaining more than half an eye on the task which they have undertaken and the need to identify when that task needs to be amended cannot be over-stated and the failure to undertake that process will continue to cost the professions, and thus their insurers, dear in many, but as we will see not all, cases.

AGGREGATION – Will it or won't it?

In *Baines v Dixon Coles & Gill* [2021] EWCA Civ 1211, the Court of Appeal had to consider the aggregation provisions of the SRA's minimum terms and conditions. The case was extremely unusual because very few aggregation cases have come to court over the last 20 years, most proceeding by way of arbitration. I believe that it is fair to say that the eventual outcome departed significantly from market expectations arising as a result of the arbitration experience. It is perhaps noteworthy that neither the Judge at first instance (h.H. Judge Saffmann) nor any of the Court of Appeal panel of Judges would, I believe, have ever held themselves out as being insurance specialists, or indeed would have suggested that professional indemnity work played any significant part in their professional practices.

The facts were startling and indeed a sad reflection on the quality of financial oversight both within the profession and the Church of England. Mrs Box had long been the senior partner of a very long-established practice in Wakefield. She was a pillar of the community, had formally been Registrar of the diocese of Wakefield and at the time of the discovery of her comprehensive frauds was the Chancellor of the Diocese of Southwell and Nottingham.

Over a period in excess of a dozen years Mrs Box raided the practice client account to support herself and her family with expensive holidays, businesses, fine wines and other extravagances. At her criminal trial she was charged with offences totalling in excess of £4 million and by common consent it was quite possible that her thefts were very significantly greater. The Diocese of Leeds and Wakefield alleged that it had suffered considerable losses (which seemed to reduce by 50% during the course of the case) but it was perhaps an unfortunate reflection of its own financial incompetence that it could not say what sums it had entrusted Mrs Box with. The practice had only minimum primary cover. Losses had also been suffered by charities which had not received bequests from various estates.

The Insurers had discharged claims as they arose and were established up to the limit of indemnity and the claimants then sought declarations that the insurers were not entitled to aggregate the claims notwithstanding that the thefts at all occurred from the client account, had all been committed by Mrs Box and that there had been processes of teeming and lading between client ledgers. The judge at first instance resolved the matter against insurers but gave permission to appeal. The SRA then intervened to support the claimants. Insurers' argument was based upon the effect of the alteration and "extension" of the aggregation clause by agreement between the market and the Law Society following the decision of the House of Lords in *Lloyds TSB General Insurance V Lloyds Bank Group Insurance Co Ltd* [2003] UKHL 48.

I do not propose to set out in great detail a commentary on the decision of the Court. Suffice it to say that the decision that the additional protection which the market believed that it had agreed with the Law Society following the decision in *Lloyds TSB* has proved to be illusionary and that all of the primary market insurers must view themselves as exposed in cases such as that of Mrs Box. The 2004 re-negotiation has been held to have achieved nothing in respect of such cases and indeed the SRA contended that it was not intended to, which I believe would have surprised those who were party to that exercise.

The Australian market has approached this troublesome issue by an express provision within its policy providing that all claims arising out of the dishonesty of one individual or group of individuals within a practice shall be treated as one claim. It is difficult to see that the primary market can disregard both the risk and the attitude which was taken by the SRA. It is frequently the case, in my experience over 30 years, that when one is dealing with a dishonest individual stealing from the client account the losses are allocated to a variety of clients. Given the sums of money which can pass through the hands of high street probate solicitors for example, and the possibilities of concealing such dishonesty over extended periods, I believe that insurers should be considering this issue together very carefully.

Last month the Supreme Court refused permission to appeal on this point.

DUTY OF CARE – Some interesting examples

Having expressed my views as to the importance of retainer letters a few minutes ago, I will turn to look at an important case in which the defendant patent agent was successful in persuading a judge that a limited duty of care existed notwithstanding the absence of retainer letter. In *BASF Corporation v Carpmaels and Ransford* [2021] EWHC 2899, the defendants negligently failed to file an appeal against a revocation of a patent by the European Patent Office in time. It was alleged that, as a result, damages in respect of profits of US $1.2 billion, or the chance of receiving part thereof, had been suffered by way the claimant. Negligence was admitted. However, the defendants contended that their only client was the first claimant and that the first claimant had suffered no loss. Any losses which might have been suffered, which were in any event denied, had been suffered by other parts of the group which were the trading companies which were not clients of the defendants. There was no written retainer letter.

Notwithstanding that important absence, Adam Johnson J concluded that the defendant's only client was the first claimant and that the defendant owed no duty of care to the other companies within the group, which were not in fact subsidiaries of the first claimant. The claimants argued that the absence of the retainer letter stood in the way of the defendants successfully contending that their retainer was limited and that a broader retainer should be inferred against them. The judge rejected this argument. Whilst the absence of the retainer letter was a factor to be taken into account, the assessment of who the client was, or clients were, was an objective one to be determined by reference to the evidence of the relationship(s) as a whole.

This is quintessentially an example of a case in which one's presumption as to the likely outcome, a presumption presumably shared by the claimants' team, was not supported by the evidence.

Although the judge's decision on the absence of a duty of care to the trading companies was adequate to dispose of the claim as a whole he did then proceed to consider the allegations of loss and wholeheartedly rejected the contentions that the claimants collectively would have taken the steps which they contended, an issue to be resolved on the balance of probability, and also rejected the contention that they had any real and substantial prospect of obtaining the profit for which they contended from the relevant patents. A lose-lose on any view.

Another interesting decision on the duty of care of a professional man is the architect's case of *Rushbond plc v JS Design Partnership LLP* [2021] EWCA Civ 1889. The claimant was the owner of the disused Majestic cinema in Leeds which anyone arriving by train in Leeds will have passed in various states of repair for many years. The defendant architects' practice had been engaged by a prospective lessee to assess the work needed on the building were a lease to be taken. The defendants sought access to the property by one of its partners in company with an engineer and quantity surveyor and he was provided with the keys to a side door by the claimant's letting agents. He was also provided with the code to the alarm. He gained access but did not lock the access door behind him. While the inspection was taking place intruders seemingly entered the premises through the door which had been left unlocked and, although he locked up and set the alarm when the team had completed their inspection, the intruders who had remained inside later started a fire causing damage to the tune of £6.5 million. The claimants sued the defendant for negligence alleging them to have been at fault in leaving the door open and that the resulting damage was foreseeable as a consequence of that neglect. The defence sought to strike out the claim on the basis that the architect had been guilty of an omission only and that no duty of care to take positive steps to protect the property was owed to the claimant. That application was granted at first instance and was appealed.

It must of course be emphasised that this was an appeal against a summary dismissal of the claim. O'Farrell J had concluded that the case was bound to fail. She considered that the claim did arise from an omission to protect the claimant from the depredations of a malicious third party and that there had been no assumption of a positive responsibility to protect the claimant's property from harm.

The Court of Appeal disagreed. Coulson LJ delivered the judgment and considered the so-called "pure omission" cases and distinguished them. He concluded that they were cases in which the defendant had done nothing at all that was of relevance to the claim being made. Similarly, he concluded that the cases concerning a failure to keep property secure, following which trespasses set fire to the property which then spread were of no assistance whatsoever. The court readily accepted that it was arguable that this was not a pure omission case. They considered that the architect, as the temporary keyholder, was in a position in which it was “fanciful” to suggest that he owed no duty of care to take reasonable precautions.

I must re-emphasise that this was a preliminary argument on a strike out application. However, it does serve to emphasise that professionals remain exposed to potentially very large claims in circumstances where all of us might reasonably say, “there, but for the grace of God, go I!”

REFLECTIVE LOSS – mirror, mirror on the wall …

Another area which has proved to be fertile territory for dispute in a professional indemnity context is that of reflective loss. What is, or was, the rule and why do lawyers continue to get so bound up by it?

It is necessary to set out, very briefly, the history of the issue. In 1843 in a case called *Foss v Harbottle* Vice-Chancellor Wigram held that where a loss had been suffered by a company which had a cause of action, only the company itself could sue for the loss. An action could not be brought by an individual shareholder. An exception existed for "derivative" claims, that is to say claims which the court permitted a shareholder to bring for the benefit of the company (quintessentially in circumstances where it is alleged that the wrongdoer had control of the board and/or general meeting). The continued existence of the rule was upheld by the Court of Appeal in *Prudential Assurance Co v Newman Industries Ltd* in 1982.

However, the rule was "re-interpreted" by the House of Lords in *Johnson v Gore Wood* in 2002 and Lord Millett in particular emphasised that the rule was designed to provide a guard against double recovery. A claimant and its representatives could not recover more than 100% of its damages and a defendant should not be exposed to more than 100% of the damage it had caused and the rule was designed to ensure such outcomes.

As you will be aware, in 2020 the Supreme Court re-visited the issue in *Sevilleja v Marex Financial* [2020] UKSC 31. Lord Millett's approach to the issue was roundly rejected. Lord Reed pointed out that double recovery could not provide an answer as a diminution in a value of shares would not necessarily correlate to a loss caused to the company itself. This was because share prices are informed by market sentiment and that sentiment might cause the shareholders loss to be greater or less than that of the company. Accordingly, considerable care had to be exercised in assessing the basis for any bar. It had to be accepted that different parties' losses might have the same cause but give rise to different numerical outcomes. Where a person could sue as a creditor, whether or not he was a shareholder, that action had remained permissible for many years and the rule would serve to limit claims to the smallest extent considered necessary. The minority went further and contended for the abolition of the doctrine in its entirety. I emphasise that thiswas the minority view but it is clear that the ambit of the rule has been significantly reduced.

The judgment of the majority in *Marex* contended that the test was a "bright line" test. However, subsequent cases suggest that the line is by no means as bright as the Supreme Court's majority hoped.

In *Broadcasting Investment Group v Smith* [2021] EWCA Civ 912, the Court of Appeal permitted concurrent claims by a shareholder and a company against the same third-party wrongdoer. The reasoning placed significant weight upon the operation of the Contracts (Rights of Third Parties) Act 1999 but nevertheless appears to me to reflect a further diminution of the ambit of the reflective loss rule.

I do not propose to consider the other cases in which the point has arisen. Suffice it to say that this remains an area in which professionals can expect to be exposed to additional claims rendering it all the more important that they are careful to define the scope of the client relationship and the ambit of the duty of care arising thereunder.

CONTRIBUTION CLAIMS – curiouser and curiouser

In *Percy v Merriman White* [2022] EWCA Civ, the Court of Appeal allowed an appeal from a decision in which solicitors had obtained a contribution from a barrister in respect of a claim which they had previously settled. Mr Percy had been represented by the solicitors and counsel in an earlier claim in which he sought to bring a derivative action against a joint owner of a company which had begun in circumstances in which Mr Percy contended that the joint owner had acted fraudulently towards company assets. The application for permission to bring the derivative action had been hotly contested and, in the event, the application had failed with the deputy judge making swingeing criticisms of the claimant's solicitors and counsel. Mr Percy then sought damages from that team but discontinued his claim against the barrister. The solicitors representatives settled Mr Percy's claim and then sought a contribution from the barrister.

It was contended before the trial judge that, by reason of the provisions of section 4 of the Civil Liability (Contribution) Act 1978, the settlement of the claim in circumstances in which identical allegations were made against both solicitors and counsel meant that the barrister could not challenge the solicitors' entitlement to seek the contribution provided that the factual allegations would have given rise to liability. The trial Judge also accepted that the barrister could not challenge the findings of the original trial judge.

Both of those points were rejected by the Court of Appeal. The Court considered that there was no objection to the barrister contending that the original trial judge was wrong, even if the solicitors had settled the client's claim on the basis that it was correct. There was also no objection to the barrister inviting the subsequent court to reject the earlier findings of the judge who refused leave to bring the derivate action. The Court held that the provisions of the 1978 Act did not in any way diminish the evidential burden in seeking the contribution so far as establishing negligence on the part of the defendant to the contribution proceedings was concerned. That matter would have to be proved in the usual way.

There is no doubt that the decision provides a stark reminder of the difficulties of advancing contribution proceedings in isolation. A party will frequently settle the claim because it forms a view as to the commercial risks of fighting the matter through to a trial. Whilst a party from whom a contribution may be sought cannot challenge the settling party's liability, provided the stated original claim demonstrated a cause of action in law, the party defending the claim for contribution can otherwise run all of the defences which it could have run as an original defendant. This will include issues as to causation so far as the original claimant was concerned, for example. It can readily be seen that, in those circumstances, the party seeking contribution is going to be severely disadvantaged if it does not have the wholehearted support of the original claimant in providing evidence. Given that a claimant may well have provided a discount to his claim in order to avoid the trauma of giving evidence it can also be seen that, in many cases there will be a reluctance, if not an absolute refusal, to support contribution proceedings. The terminology of section 4 of the 1978 Act is far from being pellucidly clear but what one can say is that, on the construction accepted by the Court of Appeal, it is a limited shield for the party claiming contribution but it provides no tool to assist in extracting the contribution from the defendant to the contribution proceedings. It is fair to reflect that the defendant who seeks a commercial settlement must accept that recovery from a stubborn co-defendant can prove a very uphill struggle.