“Under Corruption” – Minimising your exposure to the risks of bribery and corruption within the construction industry

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In recent months, the media has been awash with headlines that suggest that the UK, and the London property market in particular, has become a safe haven for money launderers. Aside from the inevitable hyperbole, these headlines carry an element of truth and, more importantly, act as a cautionary reminder of the pervasive nature of corruption, particularly within the construction industry.

In 2011, Transparency International’s Bribe Payers Index indicated that, out of the 19 different business sectors it surveyed across 28 of the world’s largest economies (including the UK), bribery was perceived to be most common in the public works contracts and construction sector. This perception of the construction industry remains and is not confined to jurisdictions that are seemingly more corrupt than the UK. A report produced by the Chartered Institute of Building (CIOB) in September 2013 found that 49% of the 701 UK based construction professionals it surveyed considered that corruption was either extremely or fairly common within the UK construction industry. This sentiment was reinforced by a subsequent report published by the Organisation for Economic Cooperation & Development (OECD) in December 2014, which analysed 427 bribery enforcement actions across 17 countries (including the UK) between February 1999 and June 2014 and noted that almost two thirds of the cases occurred in just four sectors, with the construction industry ranking as the joint second most corrupt of those sectors.

Arguably, these findings should come as no great surprise. The nature, scope and scale of the construction industry inevitably make it more susceptible to corruption than other business sectors. It is a universal industry that spans the public and private sectors, often experiencing pressures on time and cost, normally requiring some form of government or local authority approval (for example planning permission, licences etc) and increasingly involving large sums of money, cross-border transactions, as well as multiple parties from multiple jurisdictions with, quite often, differing attitudes towards or laws on...
bribery and corruption. Undoubtedly, these factors will increase the external and internal threats of corruption, whether they be from organised crime or from individuals and organisations within the industry itself. So, with so many potential risk factors, what can organisations do to minimise their exposure to bribery and corruption risks?

First, a brief recap of the law in the UK

The anti-bribery and corruption regime is governed by the Bribery Act 2010, which came into force on 1 July 2011. It created four main offences, namely, bribing or being bribed (note that the specific act of bribing a foreign public official forms a separate offence) and failing to prevent bribery. An organisation may be liable for the latter if a person associated with the organisation commits one of the other three offences. However, the organisation can raise a defence to this offence if it can show that it has implemented adequate procedures to prevent bribery. It is important to note that the Bribery Act is broad in scope. It applies to the public and private sectors alike and covers conduct within and outside the UK (as long as the party involved or the activity in question is closely connected to the UK).

The anti-money laundering regime is governed by the Proceeds of Crime Act 2002 (POCA) and the Money Laundering Regulations 2007 (MLR). They create offences regarding money laundering itself, as well as failures to report money laundering offences. More specifically, the MLR relate to money laundering within the regulated sector (more recently expanded to include estate agents). It should be noted that the Fourth Money Laundering Directive is on its way, which will mean that the MLR will be amended in the UK in the next 12-24 months (depending on when the Directive is finalised). Like the Bribery Act, the anti-money laundering legislation is wide in jurisdictional scope, as it can apply to criminal conduct committed in other jurisdictions if that conduct would be deemed to constitute an offence in the UK, even if it is not an offence in the jurisdiction in question. A party may be able to raise a defence to such an allegation in limited circumstances.

The impact on your organisation

Under the Bribery Act, POCA and MLR, unlimited fines may be imposed upon the convicted individuals or organisations and property may be confiscated from them. The convicted individuals may also be imprisoned for up to 10 years under the Bribery Act, 14 years under POCA or five years under the MLR. In addition, under the Public Contracts Regulations 2015, organisations will face a mandatory 5 year exclusion period from participation in public procurements if convicted of bribery, corruption or money laundering offences.

Aside from the criminal and civil sanctions imposed by this legislation, there are additional risks to those operating in the construction industry. These include reputational damage, tendering uncertainty, dangerous or overpriced projects and reduced project opportunities in the future.

Minimising your exposure

To minimise your exposure to the risks of bribery and corruption within the construction industry, you should have regard to the following:

– **Conduct a risk assessment of your organisation** - The UK government’s guidance on the Bribery Act states that an organisation should have an anti-bribery policy in place if there is a risk that it may be exposed to bribery. To assess that risk, the organisation should have regard to the countries and sector that it is operating in, the value and duration of the services and/or products that it is providing, the other individuals and organisations that it is working with, as well as the contractual and supply chain structures that it has in place.

– **Conduct adequate due diligence of the projects you will be working on and the parties that you will be working with** – This due diligence will overlap with, and inform, the overall risk assessment of the organisation. It may also be necessary under the UK’s anti-money laundering legislation. In addition, it will help an organisation identify any specific risks in the project’s supply chain (ie inadequacies in the other parties’ anti-bribery, corruption and money laundering policies, or concerns regarding the transparency of budgets, payments or certifications on the project etc)
Pending the outcome of the risk assessment and due diligence, ensure that adequate policies and procedures are put in place and disseminated throughout your organisation. The UK government’s guidance on the Bribery Act states that the policy should be appropriate to the risk level (i.e., the higher the risk, the more stringent the policy needs to be). The policy should be clear. If appropriate, it should set out guidance on risk management, internal audits and any internal reporting procedures. The organisation should also ensure that all staff are aware of and trained to practice the policy. This includes senior and middle management, as well as all other staff. As noted above, a defence to some of the Bribery Act’s offences can be successfully raised by an organisation if it can be shown that it had adequate procedures in place to prevent bribery.

Ensure that your organisation’s policies and procedures are also disseminated to other parties that could be deemed to be associated with the organisation, such as intermediaries in other jurisdictions. The OECD’s 2014 report found that 75% of the corruption cases that it reviewed involved payments through intermediaries. An organisation should therefore ensure that it has communicated its policies and procedures to its associated parties so as to avoid any inadvertent breaches of the applicable UK legislation (e.g., in jurisdictions where facilitation, or “grease”, payments are considered the norm).

Regularly review, update and amend your organisation’s policies and procedures and disseminate those changes throughout the organisation and to other associated parties.

Maintain full and accurate records of the projects that you are working on and conduct internal audits where necessary. This may help maintain some transparency on the projects and flag any suspicious activity (e.g., theft of materials, unusual payments, etc.).

Keep up to date with any changes in the applicable UK legislation. Also be aware of the anti-bribery, corruption and money laundering legislation in the jurisdictions that you are operating in, albeit the UK’s legislation is perhaps the most stringent and far reaching of all current regimes.
RICS Lender v Valuer ADR Service

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As many in the industry will be aware, in June 2015 the Royal Institute of Chartered Surveyors (RICS) commenced a consultation regarding a proposed new form of alternative dispute resolution (ADR), specifically tailored to deal with residential valuation claims by lenders.

There have of course been a multitude of such claims in the years following the financial crisis, often first intimated in large numbers and on a largely unsubstantiated basis, which has had the effect of reducing the availability and affordability of insurance for valuers.

If and when implemented, therefore, the hope is that the new ADR Service, administered by the Dispute Resolution Service (DRS) at RICS, will serve to streamline the claim process, filter out the purely speculative claims, and ultimately, of course, save money and reduce premiums. Moreover, in circumstances where certain court decisions in recent years have arguably cast doubt on the reliability and persuasiveness of expert valuation evidence in litigated proceedings, the time is perhaps ripe for a change in approach.

The ADR Service

In short, what is proposed in the RICS consultation document is that valuers’ terms of engagement with their lender clients will include a so-called ‘Beale Clause’ (a nod, presumably, to the lawyers who have assisted RICS in the development of the proposal).

If implemented as presently drafted, the Beale Clause will require lenders, before litigation can be commenced in respect of any alleged negligent overvaluation of a residential property:

– To obtain a ‘mean retrospective valuation’ (MRV) based on two indexes from an approved list of index providers
– If the MRV suggests an overvaluation, to serve a notice on the valuer giving details of the lender’s claim
– Depending on the extent of the alleged overvaluation, to refer the dispute to either Independent Valuation or Adjudication

Independent valuation

Where the extent of the alleged overvaluation is relatively minor (as determined by reference to agreed parameters), the lender will be required to apply to the DRS for appointment of an Independent Valuer from an approved panel of appropriately qualified valuers.

The appointed Independent Valuer will be provided with details of the lender’s claim and may then also require such further information from the parties as he/she sees fit. Thereafter, within 21 days, the Independent Valuer will produce a written decision determining the lender’s financial entitlement, if any.

Adjudication

Alternatively, where the alleged overvaluation is more significant (again, as determined by reference to agreed parameters) – or if either party wishes to challenge the Independent Valuer’s decision – the dispute may be referred to Adjudication.

Within a maximum of 25 working days of his/her appointment, the Adjudicator will hand down a decision on the dispute on the basis of:

– The evidence and submissions of each party (which may be given in writing or orally at a joint meeting)
– The results of any independent investigations and enquiries the Adjudicator may decide to carry out
– The application of his/her own knowledge and expertise

Significantly, it is proposed that, regardless of the outcome, each party will bear their own costs of the Adjudication, albeit that the Adjudicator will have discretion to determine which party should pay his/her fees.

Effect of adjudicator decision

According to the consultation document, the decision of an Adjudicator will be binding on the parties “until such time as the dispute is finally determined by legal proceedings or by agreement”. Notably, therefore, it does not appear to be intended that the Adjudicator’s decision will be taken to “finally determine” the claim, or that the ADR Service will necessarily prevent the issue of court proceedings.
However, at the very least, one can certainly see that the process should oblige both the valuer and the lender to engage properly with the merits of a claim from the outset and, moreover, that a losing party following Adjudication would have to think very long and hard before commencing legal proceedings in the hope of obtaining a more favourable outcome. That being the case, therefore, the scheme should certainly help to reduce the number of claims currently proceeding to formal litigation.

Our thoughts about the ADR Service

As mentioned above, the idea behind the ADR Service is to provide a more streamlined and economic way of dealing with lender claims. Moreover, by requiring lenders to follow the process, including, in particular, obtaining MRVs from the outset, it is no doubt RICS’ hope to reduce the incidence of what have become known as ‘confetti’ letters from lenders, in which claims – often very large numbers of claims – are intimated without any proper substantiation but which nevertheless require notification by the valuer to insurers, thus potentially affecting renewal terms and premiums even where a claim is not ultimately pursued.

From the perspective of valuers and their insurers, therefore, the appeal of the ADR Service is clear, being targeted specifically at reducing legal costs and filtering out weak claims. It is fair to say though that the proposal is still in its formative stages and certain questions occur to us as remaining to be answered:

How will the process sit alongside the existing professional negligence pre-action protocol?

If it takes place after the Protocol has been followed, it is difficult to see why it would necessarily prevent the much hated ‘confetti’ letters, given those letters are effectively just Preliminary Notices under the Protocol. Therefore, is the ADR Service intended to take the place of the steps currently prescribed under the Protocol and, if so, will valuers be satisfied they have had adequate opportunity to analyse and present their case under what is a significantly expedited timeframe compared to that allowed under the Protocol (particularly in more complex/non-standard claims)?

How rigid is the emphasis on MRV?

Is it suitable in every case to assess retrospective value by reference to approved indexes? We wonder if there may be a risk of oversimplifying the valuation process, potentially even losing sight of the aphorism that valuation is an art and not a science. Certainly, in our experience, different cases call for different approaches and methodologies and we find it hard to believe that a simple MRV based on approved indexes will necessarily provide a proper and satisfactory basis in every instance for a lender’s decision to pursue a claim.

To what extent can or should an Independent valuer or adjudicator assess a lender’s entitlement to compensation?

Assessing whether or not a property was overvalued is one thing but the question of what compensation a lender is entitled to receive as a consequence of that overvaluation is a separate matter and is far from straightforward. Determining the compensation a lender is entitled to involves strict legal considerations, such as the applicability of any SAAMCo cap, the recoverability of claimed losses by reference to Swingcastle principles as well as questions of causation, contributory negligence and mitigation. Is it intended that the Independent Valuer or Adjudicator will be specifically trained in such matters? Alternatively, will they simply determine whether or not there was an overvaluation and leave the question of the compensation payable to be separately debated between the parties?

In any event, it seems to us that whether or not the scheme will be capable of achieving its aims will depend on these and many other factors; not least of course how lenders respond to the proposal (and we understand the Council of Mortgage Lenders was included in the consultation).

The consultation period has now closed and we can presumably expect a further announcement from RICS in the near future. Indeed, the consultation document mooted a ‘soft’ launch of the scheme at the end of Summer 2015 so we wait with interest to learn in exactly what form the ADR Service will be rolled out in light of responses received to the consultation.

There can be no doubting the worthwhile and commendable intentions underlying the proposal and we certainly hope that the scheme, if and when implemented, will at the very least help to ensure a reduction in the number of valuation files having to be recalled from archives on the eve of limitation expiry on account of a lender having suffered a loan shortfall and casting around speculatively for an insured defendant to offset its losses…
Claims arising from property management

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In the world of real estate, the role of the managing agent is growing. As investment in various types of property increases, so does the need for property management. The type of properties that are managed might range from buy-to-let bedsits, to agricultural or industrial estates. The aim of this article is to focus on a few areas where claims may be brought against managing agents, and identify how such claims might be avoided.

In this article we focus on claims against managing agents where there is a contractual nexus between the parties, but agents should be aware that the Courts are willing to find that duties are owed to third parties in the absence of a contractual relationship. Hines v King Sturge (2010) is a case in point, where the Scottish Courts allowed a claim against managing agents to proceed to proof on the merits despite there being no contractual relationship between the claimant tenant and the agents. Agents should not, therefore, assume that their duties are circumscribed solely by the terms of their contractual appointment.

Occupier’s liability

The most common type of claim brought against managing agents is for personal injury. If a visitor has an accident on the premises caused by a failure to keep the premises in adequate repair, the visitor may well claim compensation. The legislation in this area is fairly straightforward. The “occupier” of any property owes a duty to take reasonable care to ensure that any visitors will be reasonably safe in using the premises as needed. In certain circumstances the managing agent will be an ‘occupier’ of the property under management. Where a managing agent has been appointed, all notices and information relating to the relevant property should identify the managing agent as being the person responsible for its upkeep: so any claims would therefore be directed towards the managing agent (which is in any event usually employed to discharge the duty owed by the landlord).

The exact obligations a managing agent must perform will vary in each case and each contract. Some will be responsible for the management of an entire property, and others may only be responsible for an aspect of it. In Harrison v Technical Sign Co Ltd (2013) a firm of surveyors were appointed, as agents of the landlord, to inspect the awning over a shop window for damage supposedly caused by the landlord’s workmen. When the shop’s sign fell to the pavement causing serious injuries to passers-by, the surveyors were not held liable to compensate the injured persons or the shop owners. The surveyors’ involvement was limited to inspecting the awning, as agents of the landlord: they had not been asked to advise the shop owner in relation to the condition of the shopfront in general.

As this case suggests, usually a managing agent will not owe a tortious duty that is greater or wider in scope than the duties assumed under contract with the landlord (however, note the possible Hines v King Sturge example referred to above). As long as the managing agent performs its obligations with reasonable care and skill, in the event of an accident it can usually look to the landlord for an indemnity.

Maintenance and repair

Managing agents might commission and conduct maintenance and repair to properties, ranging from homes to light industrial units. Some agency agreements will allow them to commission these maintenance and repairs on behalf of the principal; others will require the managing agents to obtain sign-off before any work is commissioned.

Where managing agents do undertake, commission or oversee maintenance and repair they are under the common law duty to take reasonable care in doing so. It is essential, in such circumstances, that managing agents ensure that property owners communicate exactly what is expected of them and the scope of the agent’s duty is clearly delineated. In this regard, agents should bear in mind that, where a property is mortgaged and/or insured, there may be specific requirements in either the mortgage deed or insurance policy that must be complied with in certain circumstances, such as when significant work to the property is undertaken. For example, in EB v RC (2013), insurers of an empty property required weekly inspections and the draining of the water system during the winter. The
principal, who was acting under a power of attorney, failed to pass this information on to the managing agents, and when the property subsequently flooded, insurers refused to indemnify the property owner for the damage sustained. In a subsequent dispute, the principal sought to blame the agents for the failure to comply with the insurers’ requirements, but was given short shrift by the court, which held that the primary responsibility for ensuring that the policy was complied with lay with the principal. Whilst, in this case, it may be said that the allegations against the agents were weak, had the agents ensured that their terms of appointment included provisions that compliance with the requirements of third parties such as insurers lay with the principal, the dispute might never have arisen.

Negligent misstatement and misrepresentation

In some cases, managing agents may be required to enter into, or negotiate contracts on behalf of, the property owner. These situations provide a number of potential pitfalls. Even through a simple typo a managing agent could be at risk of a claim. In *Knight Frank LLP v Du Haney* (2011) the agent entered into a contract with Knight Frank and misspelt the name of his principal on certain documents. It was held that whilst the agent had misrepresented the name of his principal, he had only provided a warranty as to the fact of his being an agent, not as to spelling his principal’s name correctly. Therefore, he avoided liability for the unpaid fee of his principal. To that end, managing agents would do well always to clearly emphasise in what capacity they are acting, and to be aware of the risks involved with signing any contract on their principal’s behalf.

Property provisions and service charges

Managing agents should also keep their eyes peeled for questionable details in every document they read relating to the property. For example, in *Ground Rents (Regisport) Limited v Mr Hamish Dowlen, Mr Andrew Greene, Mr William Rose* (2014) a managing agent’s misreading of a utility bill landed many tenants in a spot of hot water. In the mistaken belief that water invoices related to three blocks of flats, the appellant’s managing agents apportioned the sums due and collected them through service charges payable by tenants in all three blocks of flats. In fact, the invoices related to only one of the three blocks. Five years down the line, the managing agent inspected the blocks and noticed for the first time that each had its own separate water meter. Only then did it review the invoices and realise they referred just to one of the blocks of flats. Unsurprisingly, the Leasehold Valuation Tribunal concluded that the managing agent should have realised something was amiss. As a guidance point, this case clearly evidences that managing agents should be trained properly for site inspections. Had a competent inspection been performed and slightly closer attention been paid to the relevant documents, disaster could have been averted.

Conclusion

Managing agents potentially face a number of different types of claim in the course of their professional duties. There are, however, practical precautions that can be taken and guidance that can be followed to avoid or minimise that risk. For example, managing agents should:

- Ensure that clear written instructions are obtained from principals so that the extent of their obligations are properly understood from the outset
- Be aware of, and comply with, regulations in relation to health and safety, particularly in relation to trip and slip hazards
- Ensure that property inspections are carried out in accordance with the principals’ requirements, and in any event regularly
- Ensure that persons inspecting managed properties are properly trained
- Ensure that all contractors and workmen instructed on behalf of the principals are appropriately qualified, certified and supervised

However, this is by no means an exhaustive guide, and many other issues related to the appointment of managing agents may arise. For instance there are frequently “double” insurance issues arising when a member of the public is injured (a public liability) at a property managed by an agent due to an alleged error or omission in the discharge of the agent’s professional duty (a professional liability). Should you have queries or concerns in relation to any of the above, we can help you address and navigate them.
Know your limitations!

Tom White, Partner, and James Wowk, Associate

The law on limitation – or the requirement to issue a claim within a defined period of time, as determined by Parliament – is a fundamental consideration in all forms of dispute. It is so fundamental that practitioners acting both for claimants and defendants will begin every case by asking the same question: is this claim time-barred? If you are the defendant, your focus inevitably turns to the grounds on which you might answer that question in the affirmative, so as to give you an outright defence to the claim without getting into knotty questions of duty, breach, causation or loss.

Limitation in connection with claims against surveyors and valuers can have an added level of complexity. In many cases, negligence will arise as a consequence of “latent damage”. In other words, some act, neglect or default which is not reasonably discoverable until sometime after it occurs.

There are often times when the negligence may not come to light for many years – usually for claims against surveyors because the consequences have been concealed by the rising property market.

What should you do when faced with such a claim? Are such claims “in time”? Can they be defended on technical grounds and what can you do now to help the future defence of such claims?

The law

The Limitation Act 1980 provides that there are different limitation periods for different types of cause of action, but generally:

– A claim founded on simple contract has a limitation period of six years from the date on which the contract was breached

– A claim founded in tort has a limitation period of six years from the date on which the claimant suffers damage

These time limits are often referred to as “primary limitation” in lender claims. In a typical lender claim in relation to a valuation, the bank instructs a surveyor to value the property, so that the bank can form a view on whether the property will provide adequate security for the loan. If things do not go to plan, the bank can consider a claim against the surveyor in one of two ways: breach of contract or breach of duty of care, or indeed both. In both cases, the bank’s entitlement to sue expires after six years, but (sometimes critically) the clock begins to run from different dates depending on the basis on which the claim is advanced.

The start date for the limitation period in relation to a claim for breach of contract is usually easily identified: it will generally be the date on which the valuer provided the allegedly negligent valuation.

Identifying the start date for a claim in tort, ie the date on which the claimant suffers damage, can be more problematic. The principle established by the House of Lords in Nykredit Mortgage Bank PLC v Edward Erdman Group Limited (no 2) (1997) is that the lender will suffer damage when the amount of the loan exceeds the package of borrower covenants and security to which the lender has access in respect of that loan. This may not always be immediately upon drawdown of the loan, especially if the loan was at a relatively low loan-to-value ratio. The uncertainty of valuing the borrower’s covenant and the lender’s security (including the property which is the subject of the claim), and fluctuations in these values due to market forces, can make it very difficult to identify exactly when the lender suffered damage. Often it is not possible to be certain until the court has given judgment on what the values were at the relevant time.
Latent Damage Act 1986
The Latent Damage Act came into being in 1986 in order to address a perceived unfairness for claimants who only discovered that they had a claim more than six years after the date of breach/date on which damage is suffered. The 1986 Act operates principally by inserting sections 14A and 14B into the 1980 Act.

Under section 14A of the 1980 Act, if, at the time the claimant’s cause of action (in negligence) accrues, he does not have knowledge of all material facts to enable him to know that he has a cause of action, the limitation period will be the later of:
- Six years from when the cause of action accrued
- Three years from the date the claimant knows or ought to have known:
  - The material facts about the loss suffered
  - That the loss was attributable in whole or in part to the act or omission alleged to constitute negligence
  - The identity of the defendant

Section 14B provides a longstop date of 15 years. This means that claims brought 15 years or more after the date of the alleged negligence, irrespective of whether the cause of action has accrued, will be time-barred. In addition, where there have been successive acts of negligence, each separate act will effectively set the 15-year longstop running afresh.

The key element of section 14A is knowledge – specifically the claimant’s knowledge both that he has suffered a loss and that the loss was attributable to the defendant. In lender claims, the lender will often know early on that it has suffered, or will suffer, a loss i.e a shortfall on the recovery of the loan. However, it may not realise until later that one of the contributing factors was an allegedly negligent valuation at the outset of the loan.

The knowledge required for section 14A includes constructive knowledge. This means knowledge that a person might reasonably have been expected to acquire, whether from a factual situation which they can observe/ascertain, or with the help of an expert, where it is reasonable for such an expert to be consulted.

Practical tips
By definition, claims in which limitation issues arise will relate to historic matters, involving staff who may have moved on or retired. Memories will have faded and people may no longer have clarity on what happened at the material time. This can create risks, since a potential answer to a claim may have been forgotten. The following practical advice should be borne in mind:
- Make sure fee earning staff keep clear records evidencing the instructions they receive, any changes to it or development in those instructions, the work they have undertaken and any assumptions they have made
- Where possible, files should be scanned and saved in an easily accessible electronic format
- Have a clear document retention policy
- There might be a temptation to try to shorten the limitation period by contractual means. This is possible, but it is important to note that such a provision may be subject to the reasonableness test pursuant to the Unfair Contract Terms Act 1977 – see, for example, the recent decision of the Manchester County Court in Goel and Trivedi v Ryanair (2015)
- If a claim does arise, don’t panic: there are many grounds on which you can show that a claim has been issued out of time, which, if argued successfully, may provide a complete defence
Flood Re: an update

Clive Brett, Partner, and Jonathan Herne, Associate

In the February 2015 edition of our Surveyors & Valuers Newsletter, we considered the likely impact of the Flood Re scheme on property valuations and the risks the scheme might create for surveyors & valuers. At that time, it was anticipated that Flood Re would come into force in July 2015. However, setting up the scheme has proved more difficult than expected and implementation is now expected by April 2016. In this brief article we outline the current position and the scheme’s anticipated structure.

Government scheme

Flood Re is a government backed re-insurance scheme owned and operated by the UK insurance industry. Insurers will identify the highest risk 1-2% of homes in the UK, thought to be around 350,000 properties, and re-insure those risks at a fixed premium within a collective “pool”, allowing insurers to cap the cost of these risks and to compete to offer affordable premiums for otherwise high risk properties.

Flood Re was passed into law in the 2014 Water Bill and the regulations as to how Flood Re will operate, the Flood Reinsurance (Scheme Funding, Administration and Amendment) Regulations 2015 (‘the Regulations’) were separately laid before Parliament in April 2015.

Funding

Flood Re will be a not-for-profit private company collectively owned by the insurance industry, similar to the terrorism risk pool, Pool Re.

The scheme is funded by:

- Premiums paid on the properties within the scheme, based on council tax banding and capped at GBP 210 for bands A and B, rising to GBP 1,200 per annum for Band H (Band I in Wales)
- A fixed excess of GBP 250 per claim per property
- A cross-subsidy on all residential buildings and contents insurance policies of around GBP 10.50 per policy. The subsidy, totalling GBP 180 million per annum, will be collected as a statutory levy from all householders and is provided for by the Regulations

Flood Re will then reinsure the risk held in the scheme on the open market with a lower limit of cover of GBP 250 million. The scheme is designed to hold sufficient funding for a “1 in 200 year” disaster, the cost of which is assessed at around GBP 2.4 billion. The Government has agreed to meet any liabilities in excess of this ceiling.

As the scheme is funded primarily by the statutory levy, it must meet strict criteria imposed by public procurement rules and its senior figures will be directly accountable to Parliament. In addition, the scheme must also fulfil the requirements, including those as to capitalisation, imposed by the Financial Conduct Authority and the Prudential Regulation Authority (‘PRA’). While these challenges have caused delays in the implementation of Flood Re, the scheme has this month started the on-boarding process for participating insurers working toward a revised launch date of April 2016.

Capitalisation concerns

Taking into consideration the multi-billion pound cost of floods in 2007 and 2012, there are serious concerns that the scheme will be undercapitalised in its early years and unable to meet its liabilities in the event of a major flood. The scheme’s lower limit of insurance of GBP 250 million will do little to guard against a re-run of, say, 2012’s events.

Flood Re must now demonstrate to the PRA that it has access to sufficient capital to meet its full liabilities should a major flood occur. Provision has therefore been made for an additional, ad-hoc, statutory levy to be raised from ABI members to cover any shortfall which may arise. This additional levy may be raised without recourse to
Parliament, to allow immediate payment to households in the event of a major flood, with the additional costs passed on to consumers by way of the cross-subsidy.

It is believed that the power to raise the additional levy, alongside the ‘last resort’ guarantee provided by the Government, will be sufficient to meet the capitalisation requirements, but until the worst happens, there can be no certainty in this regard.

Exceptions
Although Flood Re is designed to cover residential properties in high risk areas for flooding, some properties are excluded, either because they are classed as commercial property, or for policy reasons:

- Apartments in blocks of 4 or more properties or buildings split into 3 properties where the freeholder is not resident
- Buy-to-Let properties
- Properties in high-risk areas built after 1 January 2009

Whether these exclusions are reasonable remains to be seen. With the Regulations governing the scheme yet to be finalised, it will be interesting to see if any legal challenge is made to the decision to exclude apartment blocks or Buy-to-Let properties in particular. Given the stated purpose of Flood Re, it is arguably unreasonable to exclude any type of residential property from the scheme. Similarly, those living in properties built in the last 6 years may argue that their exclusion is arbitrary and unfair.

Additionally (although not yet the subject of great discussion) there are an increasing number of units designated as “live-work” spaces by local authorities. Such properties may require business insurance, dependent on the nature of the work to be carried out on the premises and, if so, under the present rules, would not be eligible for Flood Re. As these properties become more prevalent and the range of insurance products available increases, guidance will likely be required on the scheme’s approach to these units.

Summary
Flood Re is a welcome step to address the risks posed by climate change and the increased financial costs of flooding to insurers. However, the scheme, as presently outlined, has the potential to be extremely divisive, creating significant variations in the insurability (and therefore value) of properties based entirely on the nature of their ownership rather than the physical risk of flooding. Until implementation, properties affected by flooding remain exposed to the open market, and many will be uninsured due to prohibitive risk based pricing. Further significant improvements to flood defences will still be required in the coming years to ensure prohibitive insurance premiums (or blanket uninsurability) are not an issue on the scheme’s expiry in 25 years. Flood Re may yet prove to be no more than a holding measure, and an inadequate one at that.
A view from Hong Kong of the surveyors and valuers’ market

Patrick Perry, Partner

Claims trends against surveyors and valuers

With a rising property market over the last 10 years in Hong Kong, valuation surveyors have experienced relatively few claims. Whether this will change depends upon the future state of the economy, and the property market in particular.

At present, Hong Kong is one of the world’s most expensive cities in which to live. It also has the highest disparity between the average house price and the average income, at nearly one-17th of the home price. In 2012, the IMF was predicting an abrupt correction and a bursting of the Hong Kong property “bubble”. Remarkably, however, the price of Hong Kong property has continued to increase. Despite numerous cooling measures introduced by the government, such as mortgage-tightening and increased stamp duties, Hong Kong’s residential property prices have jumped 18.7% in the past year.

Nonetheless, with about 15,000 housing units available for sale or rent in the market, some analysts are predicting a 5 – 10% drop in new property prices by the end of this year, signifying an end to the decade-long property boom. This “correction” in itself is unlikely to trigger a swathe of claims, particularly with the economy still predicted to grow.

Even if Hong Kong does see a sudden drop in property prices, there are various other factors which should act to reduce the prospects of claims against valuation surveyors in Hong Kong.

Firstly, the Hong Kong Monetary Authority has taken a pro-active stance in capping the maximum value loan on a property. This, in turn, reduces the prospect of the property suffering such a severe drop that the lender suffers a loss and brings a claim. It is unlikely that Hong Kong will see the raft of lender claims that have plagued surveyors in the UK.

Secondly, deciding the potential market value of an apartment in Hong Kong where numerous other identical properties have been sold over the previous period is a far more certain (and less risky) exercise than predicting the value of a one-off house, where nothing comparable may have been sold in the area in recent years.

Thirdly, the Hong Kong Institute of Surveyors (“HKIS”), equivalent to the Royal Institution of Chartered Surveyors in the UK, is seeking to ensure that Hong Kong valuation surveyors continue to meet the required levels of expertise. The HKIS published the Valuation Standards (latest edition in 2012) to bring Hong Kong in line with international standards. In addition, to supplement the Valuation Standards, the Hong Kong Stock Exchange issued a formal Guidance Letter in September 2013, and further refined it in January 2015, to provide guidance on the preparation of property valuation reports and market reports in relation to listing documents.

Whilst it could be said that new standards give rise to a higher benchmark against which to judge competency, in our experience, the “prevention is better than cure” approach adopted by the HKIS should lead to a reduced number of claims.

We would consider therefore that the outlook for valuation surveyors in Hong Kong is positive for now. The exposure areas are likely to be in other activities carried out by the profession, such as in the FM and Property Management areas.
Footnotes

Bush v Summit Advances Ltd (High Court, February 2015)

The claimant maintained that it was owed a personal duty of care in relation to an alleged over-valuation of a property, on the basis that it had asked for a specific individual because of his experience, and the valuation report stated that "the valuer accepts responsibility to the client". The defendant’s application for summary judgment was refused, and he appealed.

The High Court allowed the appeal. An individual acting as an agent, whether as an employee or not, did not incur personal responsibility to a claimant on the basis of his advice unless:

– That individual had, by words or conduct indicated to the claimant that he was prepared to accept personal responsibility in the event that his advice was negligent
– It was reasonable for the claimant to rely upon those indications

In this instance, although the claimant had placed great emphasis on the words “the valuer accepts responsibility”, the expression “valuer” (which was not defined) could not be interpreted as referring to the defendant as an individual. The report had been prepared by the company, and the company’s logo had been stamped below the individual’s signature. Further, it was not reasonable for the claimant to have understood that the individual had assumed responsibility; it was wildly improbable that an employee would have accepted liability to a financial institution for many thousands of pounds. Anyone looking at the report objectively would have understood that it was the company’s report.

Note that the Court indicated that, had the report been written in the first person singular (“I” and “my”), rather than in the first-person plural (“we” and “our”), there might have been some substance to the claim.

RTA v Bracewell (High Court, March 2015)

The claimant carried on business as business transfer agents and agreed, for a fee, to find a buyer for the defendant’s business. A dispute arose, the defendant failed to pay the balance of the fee due, and the claimant issued proceedings for recovery. The defendant contended that the agreement was not enforceable for illegality, on the basis that:

– The claimant’s activities fell within the definition of “estate agency work” in s.1(1) of the Estate Agents Act 1979
– The claimant therefore fell within the remit of the Money Laundering Regulations 2007 (“the Regulations”)
– In breach of the Regulations, the claimant was not registered with the OFT

The court dismissed both the claim and counterclaim. Whilst the claimant’s failure to register with the OFT did not indicate dishonesty or turpitude (and the OFT plainly took the same view, as it had not sought to impose any civil penalty on, or to prosecute, the claimant), so as to render the contract void for illegality for that reason alone, on a proper construction of the Regulations, the effect of the breach (failing to register with the OFT when registration was required) was that the claimant was prohibited from carrying on the relevant work. It followed that the agreement was illegal and consequently unenforceable.

Tiuta International v De Villiers Chartered Surveyors Ltd (High Court, March 2015)

The claimant provided a GBP 2.2m loan facility in February 2011, on the basis of the defendant’s valuation of a property. Nine months later, the defendant revalued the property, on the basis of which the claimant provided a further, increased, loan facility. The second loan fully redeemed, and replaced, the first loan. When the second loan term ended the borrower failed to repay the sum due. The claimant alleged that the second valuation had been negligent and sought to recover the shortfall following sale of the property from the defendant.

The Court held that that there could be no claim in relation to the first valuation because it had been fully redeemed and the claimant had therefore suffered no loss in relation to it. The claim in relation to the second valuation had to stand or fall on its own merits, and the Court found that the losses attributable to the existing indebtedness - the monies advanced by the claimant under the first loan facility and outstanding at the time of the second loan facility - were not caused by any negligence in the second valuation. Summary judgment was therefore granted to
this extent, although it was acknowledged that it was open to the claimant to seek to amend its particulars of loss, as the value of any lost claim in relation to the first valuation could be relevant to ascertaining the extent of the loss caused by a negligent second valuation.

**STV Central Limited v Semple Fraser LLP (Extra Division, Inner House, Court of Session (Scotland), May 2015)**

The Inner House reversed a decision (see Surveyors & Valuers Newsletter, February 2015) to dismiss a claim by Semple Fraser against CBRE Ltd, as third party, arising out of an error in the rent review clause of the lease relating to STV’s premises in Glasgow.

The Inner House concluded that Semple Fraser had raised a sufficiently relevant and specific contractual case against CBRE which, even though there was no written contract or instructions between STV and CBRE, was not bound to fail. Semple Fraser and CBRE were members of a team of professional advisers, working together on the wording of the rent review clause in the lease. Whilst the success or failure of Semple Fraser’s argument that CBRE owed STV a contractual duty would be dependent on the facts established at trial, it was not a foregone conclusion that the argument was bound to fail. The Inner House determined that Semple Fraser’s contribution claim should therefore be permitted to go to trial.

**Northampton Regional Livestock Centre Co Ltd v Cowling & Anor (Court of Appeal, June 2015)**

The defendants, Mr Cowling and Mr Lawrence, traded as a property consultancy partnership, MCL, which was instructed in relation to the marketing and sale of a property from about 2002 onwards. Mr Lawrence resigned from MCL with purported effect from 4 July 2005, but continued to act in relation to the property and introduced the ultimate buyer of the property. The buyer (without the knowledge of Mr Cowling or the seller) agreed:

- To pay Mr Lawrence one-third of any uplift it received on a subsequent sale of the property to a third party
- That Mr Lawrence would continue to act in relation to such onward sale of the property

On the day the sale completed, the buyer simultaneously sold the property to a third party for about GBP 2.75m more than it had paid. Northampton pursued a claim against both Mr Cowling and Mr Lawrence, arguing that the property had been sold at an undervalue.

At first instance the Court held that Mr Lawrence, whilst not negligent, had acted in a position of conflict and in breach of fiduciary duty, and was therefore liable to account to Northampton for the commission received (some GBP 740,000). MCL was also held not to have been negligent, and Mr Cowling’s conduct was held to have been both reasonable and non-negligent. Further, Mr Cowling was held not to be vicariously liable for Mr Lawrence’s breach of fiduciary duty, as his conduct was sufficiently divorced from the ordinary business of MCL that it should not be considered to have been in the ordinary course of the partnership business.

On appeal, the Court of Appeal unanimously found that Mr Cowling and Mr Lawrence were jointly and severally liable in respect of Mr Lawrence’s breach of fiduciary duty in accepting commission on the resale of the property. Although it was clear that Mr Cowling had not authorised the wrongful act, the relevant issue was not authority but the connection between the wrongful conduct and the acts that the defaulting partner was authorised to do. Here, Mr Lawrence had not been moonlighting, but was carrying out the work for which MCL had been retained, albeit in a misguided fashion. Mr Lawrence continued to act in the context of the firm’s retainer, and it was axiomatic that he remained bound to conduct himself so as to ensure that his duty and his personal interest did not conflict.

However, the Court of Appeal upheld the first instance determination that the defendants had not acted negligently. The property had been sold for the best price reasonably obtainable in the circumstances. The advisers were not at fault simply because the property had been resold at a vast profit.
Consumer Rights Act 2015

On 1 October 2015 the main provisions of the Consumer Rights Act 2015 (“CRA”) came into force. The CRA reforms a large body of consumer law in the UK, and broadly speaking applies to businesses of all kinds - including surveyors, valuers and other property professionals – in relation to their dealings with consumers (a term which is limited to individuals acting wholly or mainly for non-business purposes, but which will encompass even very sophisticated, high net-worth private individuals). A number of key changes are introduced by the CRA. These include the following, amongst others:

– Information provided to a consumer client about the service and/or the firm, on which the client relies in entering into the retainer with the firm or in making decisions about the service afterwards, will now become a term of the contract of retainer unless the information is qualified appropriately

– New consumer remedies are introduced for breach of the statutory implied terms in relation to the supply of services. For example, if a service is not performed with reasonable care and skill or is not performed in accordance with information provided about the service upon which the client has relied, the client will be entitled to require repeat performance of the service or, if this is impossible or is not done within a reasonable time and without significant inconvenience to the consumer, a price reduction. These are in addition to existing remedies available at common law and in equity, although a consumer is not entitled to recover twice in respect of the same loss

– Changes to the law on unfair terms insofar as relate to consumers, including the application of the test of fairness previously found in the Unfair Terms in Consumer Contracts Regulations 1999 to all terms in contracts with consumers, whether individually negotiated or not, and to communications which do not become contractual terms as such but are nevertheless deemed “contractual notices”
Further advice should be taken before relying on the contents of this Newsletter.

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