Lawyers' Liability Briefing
March 2013

CLYDE&CO

Newsletter

Introduction

Much has changed since the last issue of our Lawyers' Liability Briefing. The new Outcomes Focussed Regulation Regime has now been in force since October 2011. Firms will by now have had to appoint their Compliance Officer for Legal Practice (COLP) and Compliance Officer for Finance and Administration (COFA) although there has been some technical hold-ups in firms obtaining SRA approval for their compliance officers. We have prepared a series of three briefings on the COLP role which are available on our website. If you would like to be added to the circulation list to receive any future editions, or material on similar topics please let us know.

This issue of the LLB includes an article written by Trevor McCann in our Montreal office. This reflects the growing internationalism of our practice to reflect the changing nature of our clients and the firm's broader spread as a result of the merger on 1st November 2011 between Barlow Lyde & Gilbert and Clyde & Co. If there are any issues that you would like to discuss please contact Richard Harrison, the Head of the Lawyers' Liability Group or your usual contact.

Litigation risk

A recurring issue for litigation lawyers is how best to advise clients on the merits of cases and their settlement value. The giving of optimistic advice can lead to a client who proceeds to trial and is disappointed by the outcome complaining that they were not properly advised about the risks. The giving of pessimistic advice can lead to a client who settles and later regrets doing so blaming their lawyer. The giving of advice which becomes more negative as trial looms may lead a client to question their legal team's stomach for the fight, or to lose confidence in their team's expertise.

A number of decisions in recent years have considered the question of when a lawyer will be found to have given negligent advice in relation to the prospects and settlement of litigation. For example, in the case of *Levicom v Linklaters* (2010), solicitors' advice had been expressed in terms that the contractual provision upon which a dispute turned was clear, when in fact the position was more complicated. The client had, on the basis of that advice, rejected settlement offers and commenced arbitration proceedings. It was found that the solicitors had given advice to the client in overly positive terms, and that had caused the bringing of the proceedings. Conversely, *Berry v Laytons* (2009) is an example of a case where solicitors were found to have conveyed a negligently pessimistic view of the prospects of successfully litigating a claim, leading to the client settling the claim on terms which were less favourable than they should have been.

While it remains vital for solicitors to take care in the formulating, delivering and recording of advice on litigation, the recent Court of Appeal decision in *Langsam v Beachcroft LLP* (2012) offers some reassurance to litigation lawyers that the courts will not take too prescriptive an approach to the way in which they give their advice. The decision will also be of interest to solicitors who instruct leading counsel to advise on the merits and settlement in the lead up to trial.

Facts

The claimant businessman, Mr Langsam, instructed Hacker Young, a firm of accountants, to advise him in relation to negotiations with the Inland Revenue about obtaining non-domiciliary status for tax purposes. The Inland Revenue ultimately declared that he had such status. In due course, Mr Langsam and his then business partner entered into an equity release arrangement which involved a bank making a loan to the partnership so as to enable the partners to withdraw equity and to invest the funds released. The advantage of this to Mr Langsam was that, as a non-domiciled person, he was able to invest the sums out of the jurisdiction, with consequent tax benefits.

Mr Langsam then brought a professional negligence claim alleging that Hacker Young should have realised that he was entitled to non-domiciliary status much earlier than they did and that, had they done so, he would at an earlier stage have entered into an equity release arrangement, invested the released funds offshore and obtained the tax benefits of doing so. This claim gave rise to difficult questions of causation and loss, with damages falling to be assessed on a loss of a chance basis taking into account a number of variables.

Beachcrofts were instructed to act for Mr Langsam in the claim and, in due course, instructed leading counsel. The solicitor at Beachcrofts with responsibility for the matter gave advice, including on quantum, from an early stage. In the run-up to trial, leading counsel advised on various matters including evidence, quantum and settlement. The proceedings were ultimately settled by consent shortly before trial, with Hacker Young paying Mr Langsam GBP 1 million inclusive of costs.

Disgruntled with that outcome, Mr Langsam subsequently brought proceedings against Beachcrofts. He claimed that they had given excessively cautious and pessimistic advice in relation to settlement in the run-up to trial. He appears to have been particularly aggrieved that the advice which he received in the period just before trial was less optimistic than that which he had been given previously, and also complained that he had only been given conservative advice about settlement based on figures at the bottom end of the bracket of what he might recover, rather than being advised about the spectrum of possible outcomes at trial. He also contended that Beachcrofts had failed appropriately to advise on the importance of certain witness evidence and had failed to obtain timely valuations of partnership assets. He claimed that these breaches of duty prevented him from recovering a total of around GBP 3 million from Hacker Young.

Beachcrofts denied negligence and argued that they had followed advice received from leading counsel. They also brought a counterclaim for fees which they contended were due under a conditional fee agreement. Neither party brought any claim against counsel.

The trial judge dismissed Mr Langsam's claim, finding no negligence. Mr Langsam appealed.

Advice on settlement

The Court of Appeal upheld the trial judge's decision that the advice which operated on Mr Langsam's mind in settling the claim had been given not by Beachcrofts but by leading counsel. However, the Court of Appeal also considered the content of the advice given and found that, whilst it was on the conservative side, it was not negligent. A lawyer is not in breach of duty just because he does not provide an indication of the bracket or spectrum of likely quantum but only a figure at the bottom end of the bracket, provided that the advice given falls within the range of advice which a reasonably competent lawyer could give. Mr Langsam's contention to the contrary was described as entailing "an over-prescriptive approach as to the way in which legal advice is given". In any event, Mr Langsam had been given detailed advice on the computation of loss and had received more optimistic advice from Beachcrofts at an earlier stage – and the fact that there had been a change in the advice given did not of itself mean that the later advice was negligent.

The decision therefore offers some reassurance to litigation lawyers that the courts recognise that giving advice on the prospects of litigation and on settlement is an art rather than an exact science. Some lawyers are naturally more bullish, and others more cautious. That does not necessarily mean that the views or approach of either are wrong or negligent. The key is that the views expressed must be within the range of views that a reasonably competent solicitor could hold.

The involvement of counsel

Also of interest for litigation solicitors and their insurers is the decision in relation to Beachcrofts' argument that they were relying on leading counsel and that it was his advice, not theirs, which was the operative advice.

The underlying principle in this area is that where a solicitor properly instructs leading counsel, and counsel gives considered advice to the client, the solicitor's duty is only to apply his mind and expertise to the advice received and if, but only if, he considers that counsel's advice on an important point is seriously wrong, to give separate advice. The more specialist the nature of the advice given by counsel, the more reasonable it is likely to be for a solicitor to accept it.

That principle has been upheld and developed in *Langsam*. By a majority, the Court of Appeal upheld the trial judge's finding that the advice relied upon by Mr Langsam in settling the claim was that given by leading counsel, that in the circumstances the only duty on Beachcrofts was to apply their minds (including their specialist expertise) to that advice and to consider whether it was "obviously or glaringly wrong", and that since the advice was not wrong (still less obviously or glaringly so) they had not breached their duty. The judge described the role of solicitors in such circumstances as a "whistleblower" role. The Court rejected Mr Langsam's argument that Beachcrofts had given the relevant advice jointly with counsel, or that Beachcrofts owed more than a "whistleblower" duty because they had specialist professional negligence experience and the case was a professional negligence one. The Court further found that the fact that a solicitor gives advice which is consistent with advice previously given by leading counsel when leading counsel is not present does not mean that the solicitor has accepted an independent duty in relation to that advice.

It should be noted that Lord Justice Longmore departed from the judge's decision and that of the majority of the Court of Appeal on one point. He considered that, on the facts of the case, it appeared that Beachcrofts had continued to advise after the instruction of counsel. He therefore commented that if the advice on settlement had been negligent, Beachcrofts should have been responsible for that negligence jointly with counsel. However, since he agreed that the advice given was not negligent, this point of disagreement was immaterial to the decision.

The Court of Appeal's decision therefore confirms that a solicitor will not be under a duty to do more than alert a client to "obviously or glaringly wrong" advice just because he or she has specialist expertise in the area of law involved in a case. In addition, the repetition by a solicitor of leading counsel's advice will not of itself amount to the acceptance of an independent duty in relation to that advice. The decision is therefore likely to be welcomed by solicitors and their insurers. However, there is a need for caution. As the dissenting judgment of Lord Justice Longmore underlines, decisions on the respective roles and duties of solicitors and barristers are fact-sensitive and there may well be circumstances in which a court will find that both a solicitor and a barrister were giving relevant advice on a case. Even the majority gave the example of the situation where a solicitor uses leading counsel effectively to "frank" his own advice.

In practice: a note of caution

The recognition by the Court of Appeal that different litigation lawyers may reasonably take a range of different approaches to the giving of advice on settlement is to be welcomed by litigators and their insurers. However, risk management remains as important as ever. What can be done to try to reduce the risk of being on the receiving end of claims arising out of the handling of litigation? Some points to keep in mind include the following:

– Advice should be given in clear and unambiguous terms. *Levicom* highlights that, whilst a solicitor may tailor the manner in which he gives advice to the particular client, even sophisticated clients must receive clear advice
– Both the positives and negatives of a piece of litigation, and the options available for taking the matter forward, should be spelled out for the client. Even following *Langsam*, it is likely to be a sensible precaution, wherever reasonably possible, to set out the spectrum of possible outcomes of the litigation as well as indicating where, in the lawyer's professional judgment, he feels a reasonable settlement would lie
– Particular care should be taken if advising in percentage terms: in *Levicom* the Court of Appeal considered that advice that prospects of success were in the region of 70% could reasonably be relied upon by the client as indicating that the case on liability was a "home run"
– If possible, advice should be given in writing. If this is not possible, for example because the advice is given at court, then (as ever) it should be recorded in a detailed attendance note and, ideally, followed up afterwards in a letter to the client. Although litigation solicitors are generally good at making attendance notes, this practice can sometimes fall by the wayside where, for example, settlement discussions take place at the door of court and result in a settlement agreement recording what has been agreed between the parties and concluding the matter. Barristers are also well advised to keep detailed attendance notes, as far as is reasonably practical.
– Where counsel is involved in meetings at which advice is given, or in settlement discussions, it may be prudent for the solicitor to ask counsel to review the solicitor's attendance note. Likewise, barristers may wish to ask for copies of their instructing solicitors' attendance notes so as to satisfy themselves that their contents are complete and accurate
– The recording of advice and of the reasons for that advice is particularly important where there has been a change in advice, particularly if the advice has become less optimistic. This should help to dispel any impression on the part of the client that his legal team is simply 'wobbling' close to trial
– Although Langsam has confirmed the availability of the defence of reliance on counsel even to specialist solicitors acting within their particular areas of expertise, all solicitors should keep in mind that the defence will not be available unless counsel has been properly instructed and provided with all of the necessary documentation

Emilie Jones and Richard Harrison

When partners cheat

Like the end of a romance, discovering that a partner has cheated stings every law firm to its core. Trust built up over decades of service disappears in the blink of an eye when fraudulent partners, valued and admired by their colleagues, are discovered all along to have had their hands in the till.

In too many cases, it is a star lawyer, who, having brought considerable work into a firm, increased profits, become a partner quickly and built up a position almost beyond scrutiny, is found to have raided the expense account or creamed off client funds.

As the recent well-reported cases of city law firm partners claiming false expenses, or moving money out of client accounts, demonstrate, it can be months or even years before the losses come to light, during which time irreparable damage may be caused to the firm and client relations.

Many signs of wrong-doing are, however, evident from much earlier on, and by taking some simple steps, firms can minimise the likelihood of falling victim to these breaches of trust, investigate suspected wrong-doing expeditiously, and manage the fallout of a rogue partner.

Prevention is better than cure

There are different sorts of fraudulent partner, for example, the conscientious type who patiently bides his time, or the star performer who confidently believes he won't be caught. Either way, such individuals create masks to hide erratic behaviour and record keeping, which others in the firm may be willing to turn a blind eye to. Although frauds do not happen simply because processes fail, a failure to examine all aspects of a business will be much more likely to lead to its undermining. Firms should be aware at all times of cheating partners, and be ready to spot them. Here are some tell-tale signs and ways of managing risk.

- Be aware of any activity spikes which appear at odds with the market. For example, if numerous property transactions appear suddenly, they may be a consequence of the solicitor involved hiding dubious practices behind a veneer of respectability. Similarly, a sudden growth in the number of personal injury claims being managed in a crowded market could be the product of an unlawful referral source
- A typical fraudulent partner will operate over several years, and so look for radical changes in new work or improbable billings. Make sure the source of the work and the actual work done are appropriate and in line with market figures for similar work. The high number of chargeable hours may be in fact the outcome of overcharging clients, especially if they are high net worth people. One fraud, for example, involved a partner billing more than 15 hours a day every day of the week for over a year
- Consider developing accounting practices superior to the Solicitors' Accounts Rules (to stop theft of client monies)
- Assess the lifestyle of the partner. Does their standard of living suddenly jump considerably? A lifestyle incompatible with income and position may indicate unlawful earnings
- Accounts, HR or legal secretaries may be the ones who spot the cheating or fraud. Firms need a culture of openness where no one is afraid to raise their fears and suspicions about the managing partner or chief executive. A system of confidence(s) may be developed, perhaps using mentors or another peer-based process for whistle-blowing and expressing doubts. Build a firm culture where no one is too important to challenge, and a culture of checking work and cross-scrutiny
- Have mechanisms in place for the regular and efficient auditing of expenses and fees. A tight financial system will prohibit the incurring of large business expenses on personal credit cards. Other carefully observed financial control procedures include self-certification to be avoided after a certain level, after which proof is needed and certification should only be done by a department head or the finance team
- Carry out external audits from time to time

Investigating partners

Investigations might occur either routinely, as a form of regular audit to deter and prevent fraud, or when suspicions are raised about a specific individual. The level of investigation depends on the severity of what has happened, distinguishing theft and fraud from innocent error. Investigators must also consider whether a partner is acting alone, or with the involvement of others. Investigators should include consideration of the following:

- Bringing in external investigators. External, independent consultants bring fresh pairs of eyes and will have less concern about treading on toes than internal investigators, plus specialist skills and experience
- Consideration of the wide range of evidence available. Electronic evidence will often be the best, for example, from hard drives and telephones. Evidence of changes in personal spending can be found in credit checks and car insurance registers, as asset acquisition usually leaves a trace. Social networking sites show changing social circles and displays of wealth. All of these open and closed sources of information are best accessed by those with the training and skill to do so, as pitfalls (like the Data Protection Act) may catch the unwary

- Calling in the police. This is something that requires careful thought. Once the police are involved, the firm will lose control of the investigation. However, the police will be able to investigate avenues not open to the firm itself, and a swift report to them may help put the firm itself beyond criticism. There may of course be specific obligations to report to authorities and, for example, money laundering obligations must be considered.
- Firms must also consider regulatory obligations, and it will be necessary to report matters to the SRA
- Notification of PI insurers immediately is important to ensure cover is not prejudiced

Disaster management

Once it has been ascertained that a partner has been cheating, the first step in managing the problem is often to confront them. There may be considerable anger and bitterness from other partners, as well as associates and others who worked with the partner, and from the firm's clients and the wider legal community.

One important factor is the media. There may be copious reporting in the legal (and potentially the mainstream) press. Ensure that the firm's press officers are fully involved, and in some cases you may even wish to consider getting an external public relations firm involved.

Numerous processes will commence, all of which will need the firm to manage or give substantial input. Criminal and regulatory proceedings are the most obvious. Many of the following will play some part: the police; the Serious Fraud Office; the CPS; PI insurers; the SRA and Law Society (or even Bar Council and Bar Standards Board); and later down the track lawyers acting for the victims; and the Official Receivers if the defendant is declared bankrupt. If there is a foreign element to matters then they will become even more complicated, and extradition proceedings may be necessary.

Proceedings to recover firm or client money may be a possibility, although these are also likely to be expensive, as asset tracing is complex and multi-jurisdictional.

Above all, the general approach the firm should adopt is to confront the issue head on and properly resource a full investigation supervised at a senior level. Client confidentiality and privilege and criminal court proceedings may necessarily reduce the information revealed, but in general the best idea is to approach all inquiries in a "cards-on-the-table" fashion. Don't let information trickle out: it will do much more damage.

Conclusion

In most cases, the disruption caused by a rogue partner is preventable and thus avoidable. No system will ever be perfect, of course, and a determined thief will be able to circumvent all but the strictest of rules. Oppressive procedures are not always desirable as they undermine the collegiality and trust of the partnership. All regulations and procedures which increase scrutiny must be balanced with freedom and trust. However, the combination of fewer temptations, increased scrutiny and sensible detection processes will, one hopes, act as a strong deterrent to wrongdoing and keep the firm safe.

Richard Harrison

A collective cause for concern

Transactional and advisory work in the UK real estate sector continues to be the source of a vast number of claims against property professionals, particularly solicitors but also surveyors. With the economy lurching from one crisis to the next and fears of further drops in property prices, it is unlikely that improved property market conditions will help to disguise the consequences of negligence in the near future.

The last thing insurers needed, therefore, was a new source of property claims to add to those which were around during the last major recession of the early 1990s. However, that is what they are having to contend with in the shape of claims resulting from the collective enfranchisement legislation which did not exist until 1993. Collective enfranchisement is the procedure by which a group of tenants in a block of flats is entitled to acquire the freehold in the block provided that certain criteria are met and a specified procedure is followed. That procedure is set out in the Leasehold Reform Housing and Urban Development Act 1993 which contains a complex web of requirements including the service of notices and counter-notices and for the commencement of court/tribunal proceedings within strict and specified time limits. There can be serious consequences if those time limits are missed or a notice is wrong.

As with the Landlord and Tenant Act 1954 for the renewal of business leases, the 1993 Act is in danger of turning into a graveyard for professional advisers. For high value properties in central London the stakes can be very high with one missed deadline or a defective notice resulting in a seven figure claim. It is not unusual for enfranchisement applications to comprise dozens of flats with a cumulative value of GBP 20 million or more – equivalent size to a large corporate transaction but with a much higher risk profile.

The most common causes of claims in this area are generally down to lack of attention to detail or poor administration:

- A failure on the part of the professional to define clearly the scope of his duty – for example in *Littlewood v Radford (2009)* (which related to a slightly different type of enfranchisement, but the same principles apply) a surveyor came unstuck because, despite being without instructions and his bills not being paid, he had not done enough to terminate his retainer before one of the deadlines imposed by the 1993 Act passed
- Mistakes contained in notices served on behalf of the tenants such as incorrect names or mis-description of the property – a good example of how technical this area can be is *Hilmi & Associates Ltd v 20 Pembridge Villas Freehold Ltd (2010)* in which the Court of Appeal found that an initial notice served on behalf of a group of tenants which included a corporate tenant was invalid because the notice had only been signed by one director of the company, rather than having been executed in accordance with the requirements of the Companies Act 1985 (as was in force at the relevant time)
- Errors in plans accompanying notices
- Missed deadlines for commencing proceedings, which can lead to the application being deemed withdrawn
- Errors in valuations undertaken on behalf of landlords and tenants pursuant to complex valuation principles

Collective enfranchisement has proved popular, all the more so in recent years as it has been extended to a wider range of tenants. A time of depressed property values can also be seen as a good time to launch an application. The law of averages dictates that the more applications that are made the greater will be the number of human errors in processing them.

One piece of good news is that unlike the 1954 Act where a missed deadline can kill off a tenant's rights once and for all, if something goes wrong with a collective enfranchisement application the tenants can usually restart the process, either immediately or a year later depending on the nature of the mistake. However, restarting the enfranchisement process is likely only to mitigate loss and not avoid it altogether. At the very least there will be wasted costs by having to go through the same steps twice. In addition, postponing the valuation date can lead to an increase in the price for the freehold sometimes to a painfully large degree. For example, if the delay causes the length of the tenants' leases to fall below 80 years they must share the marriage value created by the merger of the freehold and leasehold interests with the landlord. This is not required if the leases have more than 80 years left to run. For precisely this reason a large proportion of enfranchisement applications relate to leases of fractionally over 80 years thereby raising the stakes for those who have the responsibility for getting the procedure right.

In light of these risks and exposures the safest course might be to steer clear of this work altogether but that is not a realistic option for firms that specialise in residential property work for whom this can be a lucrative source of business. However, the emphasis must be on the word specialist: this is an area where professionals and their insurers must recognise that it is extremely risky to dabble. To solicitors and surveyors with a real expertise and experience in this area the intricacies of the legislation and the time limits involved become second nature which, combined with tailored risk management systems involving computerised double diary entries, reminder procedures and adequate supervision of juniors, helps to reduce the risk of claims.

Of course, it is impossible to eradicate errors entirely even in the best run office. To limit the exposure in those cases which do slip through the net it is important that a liability cap is in place. Even more important is a culture which leads to the early identification and reporting of problems. In common with other areas of landlord and tenant work there is often an opportunity to take corrective measures provided that the options are considered without delay.

It may be possible, for example, to serve a fresh notice but if the window for doing so has closed by the time the mistake is uncovered that will not just be frustrating, it may also lead to awkward conversations between insurers and insured.

Neil Jamieson and Tom White

Holding back the flood or has the storm passed? The current landscape for UK solicitors' liability

Some years after the economic downturn began we have still not seen the flood of litigation that many predicted. Whilst there has certainly been an increase in the number of claims brought against solicitors, the question remains as to whether claims will continue to rise or whether we have seen a peak.

The recession undoubtedly led to an increase in claims. High Court statistics for 2008 and 2009 revealed a rise in the number of professional negligence claims issued against solicitors (the number of claims issued against solicitors in the Chancery Division of the High Court in London rose from 80 in 2008 to 210 in 2009), confirming fears amongst professional advisors that they would, as in previous years, be targeted in the downturn. However, surprisingly in 2010 and 2011 (the most recent years for which statistics are available) levels of claims fell again (there were 144 claims issued in the Chancery Division of the High Court in London in 2010 and 125 claims in 2011).

In this article, we consider the areas in which we have seen a proliferation in claims against solicitors, consider likely future trends, and speculate as to whether the figures show that the peak has passed.

Property claims

It is well known that the downturn has again uncovered fraudulent behaviour leading to a rise in mortgage fraud claims against solicitors. This is unsurprising since a declining market makes it likely that lenders will scrutinise files and look to recover losses from professional advisers. There are some indications that such claims are at their peak. However, a continuing subdued property market and a potential increase in defaulting borrowers if interest rates increase, means that we are likely to see relatively high levels of activity in this area for some time. Although the end of the six year primary limitation period for bringing claims is approaching in respect of the claims relating to the boom-time lending and peak of the housing market in 2007, we have seen an increase in the use of standstill agreements, where the parties agree between them effectively to halt the limitation period.

We have also seen an increase in claims arising in relation to commercial property work, again no doubt linked to the drop in property values.

Corporate fraud

In 2009, the House of Lords in *Stone & Rolls v Moore Stephens* held that the auditors of a company in liquidation could not be pursued by the company's creditors (suing on behalf of the company) as the claim was based on the company's own fraudulent acts. Although the judgment related to a claim against auditors, this area of law is developing in respect of other professionals who are sued in the context of corporate and non-corporate frauds both in the UK and the US. For example, in the case of *Nayyar & Ors v Denton Wilde Sapte & Ors* (in which we were instructed on behalf of Denton Wilde Sapte (DWS)) it was held that a bribe made by the claimants in an attempt to obtain a sales agency from Air India was sufficient to engage the *ex turpi causa* (illegality) principle. The claim was therefore dismissed on the basis of such illegality (albeit that the claim against DWS was held also to be unmeritorious for separate reasons).

The *Nayyar* case, and others, raises the prospect of professionals and their insurers being able successfully to rely on the illegality defence and to avoid costly adverse findings, albeit that the costs of defending such claims can still be considerable. Nevertheless, we consider that the approach taken by the courts in cases such as *Stone & Rolls* and *Nayyar* is a welcome development for professionals and their insurers in today's difficult economic climate.

Pension claims

The recent double-dip recession meant that a number of pension schemes found themselves in severe funding difficulties. As schemes fall into deficit, the scope for blaming legal advisors increases. Further, with trustees now being replaced by independent trustee firms, who have a duty to investigate work carried out by previous professional firms to see if anything has been done wrong, the prospect of additional claims only increases.

Claims tend to revolve around:

– Funding and benefit entitlement issues
– Document drafting
– Barber equalisation (failing to advise that trust deeds need amending to prevent more favourable benefits accruing for men or women)

Other problems arise from changes from a final salary pension scheme to a money purchase basis. Powers of amendment in the trust deed may not have been exercised correctly by lawyers, meaning that schemes may have been administered on the wrong basis for years. The potentially enormous losses suffered by schemes and the difficulty in quantifying (even with actuarial assistance) those losses means that these claims are difficult and expensive to defend. Given that there is often a time-lag between errors in administration coming to light and claims being pursued whilst investigations are carried out, such claims are likely to continue in their prevalence for the foreseeable future.

Claims stemming from insolvencies

An economic downturn leads to companies entering into liquidation or administration. In particular, a number of well-known high street chains have reported difficulties or gone into administration in recent times. Liquidators or administrators will carry out a review of past transactions entered into by a company. Problems might emerge, for example, in relation to rent reviews, employment contracts or guarantees, which can trigger professional negligence claims against the solicitors involved.

Regulatory investigations

As the scale of regulatory pressure on companies in the aftermath of the financial crisis continues to be high, solicitors remain at risk of becoming caught up in the resulting investigations and could find themselves targets for civil and regulatory action as a result of their roles coming under the spotlight. Further, it should be noted that the Solicitors Minimum Terms for PI cover have been amended so that the costs of disciplinary proceedings are now not necessarily covered. Given the prospect of the SRA ramping up its enforcement activities, firms may wish to look carefully at their insurance position.

New business structures

Over the last few years, the management structure of law firms has become increasingly corporate. CEOs and COOs, who are often non-lawyers, are becoming more common. New regulation brought in by the SRA and which has an outcomes-focused approach, also creates additional roles of Compliance Officers for Legal Practice ("COLP") and for Finance and Administration ("COFA"), both of whom will have wide ranging responsibility for ensuring firmwide compliance with practice and accounts rules.

Further, the new regime for alternative business structures (ABSs), will potentially see more non-lawyers taking on management responsibility. How many firms adopt this opportunity remains to be seen but take up is growing and the proliferation of non-lawyers on firms' management boards may impact on the firms' commercial dynamics and put pressure on client relationships. Litigation from potential outside investors may also invite public scrutiny of business strategies, and firms will need to consider how their regulatory duties will sit alongside their obligations to investors.

There are a variety of business structures that international law firms adopt. Larger international law firms may operate as a single LLP throughout the world. Other international firms operate as a single LLP in much of the world but as separate partnerships in some jurisdictions, due to local regulatory requirements. Some law firms, however, are now choosing to structure themselves more like accountancy firms, with a number of separate LLPs/ partnerships in each country all of which are members of a network administered by a single non-trading management entity (known as an "umbrella management entity"). Some are using the Swiss Verein structure, which consists of a number of independent offices each of which has limited liability vis-à-vis the others.

The reasons for the new business structures are clear; professional liabilities are ring-fenced and individual offices have complete regional autonomy. However, a lack of cohesiveness between individual offices may impact on quality control and the oversight needed for a fully-integrated international organisation. Further, as can be seen from the US accountants' negligence cases, *Banco Espirito Santo* and *Parmalat*, the use of umbrella structures may not be completely successful in ring-fencing liabilities as there remains a risk that the non-trading management entity may find itself vicariously liable for the acts and omissions of its member firms. In the right circumstances, we could also see attempts being made to pierce the corporate veil in the case of the Swiss Verein structure.

Litigation Reforms

Significant reforms to litigation funding and procedure are being brought in by the Legal Aid Sentencing and Punishment of Offenders Act 2012 in April 2013. Amongst other things success fees under conditional fee agreements and after-the-event insurance premiums will no longer be recoverable by a successful party from the losing party. Damages-based-agreements ("DBAs") (or contingency fees) where the lawyer takes a percentage of the claimant's damages should the claimant win will also be permitted. We expect that numbers of professional negligence claims will increase in the run up to April, as claimants seek to take advantage of the outgoing costs regime.

The new regime itself has the potential to give rise to claims against solicitors practising in litigation. For example there may be claims of conflicts of interest in relation to solicitors advising clients to enter into DBAs, and it is likely that there will be an increased number of disputes with clients over fees which in turn can generate allegations of negligence. Furthermore, a failure to comply with the new requirement to file (and update) a costs budget at an early stage could lead to a claim regarding a failure to do so, resulting in a winning party recovering a smaller proportion of its costs.

Conclusion

What is clear is that the current economic outlook remains uncertain, particularly in light of the difficulties being experienced by the UK economy and worldwide, and it is unknown what effect this will have on claims. On the one hand, it may result in the tide of claims that many have predicted, but it may delay further the anticipated spike in claims, perpetuating the log-jam that we have seen over the past two years. Of course, it is equally possible that as the economy recovers, claimants will focus on looking ahead rather than picking over the details of past transactions.

So what advice can we give going forward?

– Consider claims for unpaid fees carefully, and whether a claim is likely to be met with a counterclaim of negligence. At a time when clients themselves are likely to be hard pressed by the economic climate, they may be more likely to try to come up with reasons not to pay. If there is likely to be anything in this, and particularly if the fee claim is small, it might not be worth pursuing. In any event, it may be prudent to liaise with insurers before commencing such a claim

– Ensure that levels of risk management remain high and emphasise to partners the need to ensure that, even when there is pressure on fees, corners should not be cut in relation to areas like the supervision of junior fee earners

– There is likely to be continuing pressure to perform more tasks for free, such as giving an isolated piece of advice off the cuff when there might previously have been a formal instruction. Ensure that such tasks are performed to a proper standard and/or with appropriate disclaimers in place

– It may seem obvious, but stay on top of the regulatory changes coming into force, such as the outcomes-focused regulation and the SRA's new risk-based approach to regulation and enforcement. The SRA's approach to regulation following the advent of OFR and what is expected following the recent introduction of the COLP and COFA regime is still relatively uncertain. In a survey published by the SRA last month, only 51% of respondents agreed or strongly agreed that OFR made it clear what outcomes the SRA expected to be delivered

– Given our comments above in relation to new business structures, UK law firms with international offices may wish to consider whether their insurance cover provides appropriate protection for claims based on engagements performed by other member firms/overseas offices

Gaby Kaiser and Charlotte Hall

Lawyers' liability in Canada – a (slow) wave of tax-services claims?

In this article we consider how tax-services is a particular area in which a wave of claims is slowly developing against lawyers and other tax professionals in Canada.

Canadian tax law traditionally recognised the *Duke of Westminster* principle, from a decision of the same name rendered by the House of Lords, to the effect that taxpayers may arrange their affairs so as to minimise the amount of tax payable. However, in the past half-decade, Canada's tax authorities and legislators have taken an increasingly tough stance against aggressive tax planning. In 1988, the Canadian parliament added a general anti-avoidance rule (GAAR) to Canada's Income Tax Act that denies tax benefits to "avoidance" transactions if they constitute "misuse" or "abuse" of tax regulations as a whole. Since that time, tax lawyers in Canada have generally taken this notion into account in the advice provided to their clients. However, it was not until 2005 that the Supreme Court of Canada first rendered decisions interpreting the GAAR, and they generally took a restrictive view as to what is permissible tax planning in Canada. Subsequent decisions by the Supreme Court have heightened these issues by interpreting broadly the notion of "abusive" transactions. In fact, the GAAR provision and these decisions constitute but one aspect of a trend in Canada toward an increasingly tough stance against aggressive tax planning, which goes so far as to include the enactment of retroactive legislation in some jurisdictions in order to close tax loopholes.

In this climate, Canadian taxpayers are increasingly finding themselves the subject of audits, reassessments and tax litigation, particularly in respect of complex tax strategies devised by Canadian tax lawyers. These disputes tend to proceed slowly through the Canadian court system and can take as much as a decade to resolve.

Lawyers and other tax advice professionals are now facing actual and potential claims in respect of the advice they have provided to their clients. Not all claims have yet emerged from the woodwork. Those claims that have been brought are often suspended pending resolution of the underlying tax issues, which may not occur for some time. We may in fact be just at the beginning of a wave of tax-related claims against lawyers in Canada.

That said, tax lawyers facing such claims have a number of arguments in response at their disposal. First, it has been common practice to warn about uncertainty in tax law and in the interpretation of the GAAR, even prior to the 2005 decisions of the Supreme Court. Depending on the circumstances, it is possible that such warnings could constitute a full response to any claim. Second, it is not uncommon for tax advice to come with a clause limiting liability in the event of reassessment. In those Canadian jurisdictions where such limitations are permitted and upheld, they may limit exposure. Third, in the absence of a suspended claim or tolling agreement, a number of taxpayers may be running out of time to bring their claims. Canadian jurisdictions have a variety of limitations periods and courts in at least some of them have found that limitations begin to run from the moment of the taxpayer's reassessment, not only when the taxpayer has come to the end of the line in its dispute with the revenue authorities.

Trevor McCann

Partner promotion in the Lawyers' Liability Team

We are delighted that Jim Taylor, based in our Oxford office, has been promoted to Equity Partner. Jim specialises in professional liability, including the defence of solicitors, barristers, surveyors, brokers and accountants and on coverage. Significant landmarks include *Bhamjee v Forsdick and Others*, the Court of Appeal decision that introduced the Civil Restraint Procedures to the CPR and *Chesham Properties Ltd v Bucknall Austin Project Management Ltd & others* in relation to the existence of and extent of a professionals' duty to warn for professional negligence against architects, engineers, surveyors and project managers.

Jim was based in our London office until July 2009 when he moved to Oxford, where he is responsible for our professional indemnity pre-action claims handling service and acts for a wide range of clients in the defence of claims against professionals and associated insurance coverage issues.

Footnotes

Supreme Court confirms that legal advice privilege applies only to advice given by lawyers

The Supreme Court has given its much anticipated judgment in *R (on the application of Prudential) v Special Commissioners* (2013) which was an attempt to extend legal advice privilege (LAP) to tax advice given by accountants. Prudential was served with statutory notices requiring the production of documents. Prudential brought judicial review proceedings to challenge the notice on the basis that it required production of privileged documents by which Prudential had sought or received legal advice on tax matters from an accountancy firm. Both the High Court and Court of Appeal rejected the claimant's case.

The Supreme Court has rejected an appeal from those decisions by a majority of 5:2.

The three primary grounds for the decision were as follows:

(a) it would create a risk of uncertainty if LAP was to be extended to other professions;

(b) it is a matter for Parliament (and not the courts) to decide whether LAP should be further extended; and

(c) Parliament has already enacted legislation on the basis that LAP is restricted to lawyers.

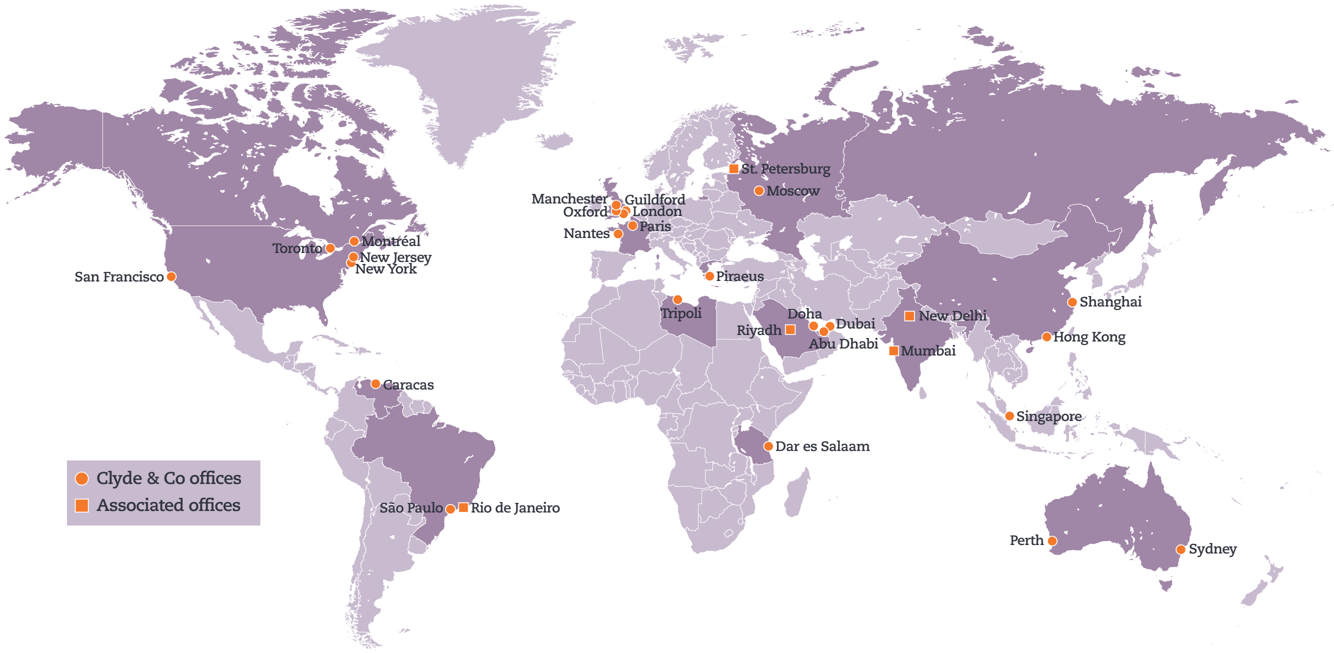
Lord Sumption and Lord Clarke gave dissenting judgements, finding that it was the character of the advice that was important and not the status of the adviser. Lord Sumption formulated a test which included deciding if the advice was given in the course of a professional relationship and in the exercise by the adviser of a profession which has, as an ordinary part of its function, the giving of skilled legal advice on the subject in question. However, the majority considered that that test was too uncertain.

Court of Appeal considers breach of trust issues in two recent cases

In *Nationwide v Davisons Solicitors* (2013) the defendant solicitors acted for the claimant mortgage lender and borrower. Prior to paying the mortgage advance to the vendor's solicitor, the defendants had checked the existence of the vendor's solicitors on the Law Society and SRA websites, confirming that the firm existed, the individual in question was a qualified solicitor and that the firm had a branch office at the address from which the correspondence was sent. However, it subsequently transpired that the monies had been paid to an imposter who had notified a purported branch office of a genuine firm to the SRA and Law Society. The advance was therefore lost, and a prior charge remained in place on the property. The claimant lender claimed against the defendants alleging breach of trust and breach of retainer. At first instance the Court found in favour of the claimant lender. The Court of Appeal allowed an appeal against this decision. The Court found that there was a breach of trust by reason of the defendant firm having parted with the loan money prior to completion, and when no completion in fact ever took place. However, the defendants were relieved from liability under section 61 of the Trustee Act 1925. The Court found that the defendants had obtained the benefit of an undertaking to redeem the prior charge from a person they reasonably believed to be the vendor's solicitor. The loss sustained by the claimant was caused by the fraud of an unconnected party, and any lapse from best practice did not cause the claimant's loss. The Court also found that contractual obligations imposed by the CML Handbook were not strict and absolute, but obligations of reasonable skill and care, and there was no strict obligation to obtain a fully enforceable first legal charge and redemption of all existing charges but an obligation to exercise reasonable skill and care to procure that outcome.

In *AIB v Redler & Co* (2013) the defendant solicitors were instructed by a claimant lender in respect of a remortgage, where the advance was £3.3 million. An existing Barclays mortgage over the property was to be discharged out of the advance. The existing mortgage secured two Barclays accounts, one of £1.2 million and one of £280,000 but the solicitors only obtained redemption figures in respect of one account, and paid only £1.2 million to Barclays, which was insufficient to redeem the Barclays mortgage (the rest of the money was paid to the borrowers). The claimant lender's charge was therefore registered as a second charge. The borrowers defaulted, the property was sold for £1.2 million and the claimant lender received only £868,999. The claimant argued that the defendants were in breach of trust and as a consequence liable to reconstitute the full trust fund of £3.3 million. The first instance judge held that there was a breach of trust but only to the extent of the £280,000 paid to the borrowers. The Court of Appeal disagreed. The Court found that there had been a breach of trust, as the defendants had parted with the money before completion of the relevant transaction. Completion had not occurred as the defendants had not been in receipt of a solicitor's undertaking or unconditional confirmation from Barclays that the advance monies would be used to discharge the existing charge. However, the claimant lender's argument that the consequence of the breach of trust was that they were entitled to have the entire fund reconstituted was rejected. *Target v Redferns* (1996) confirmed that although equitable principles of compensation do not employ the same principles of causation and remoteness as the common law, they do recognise what loss has actually been suffered due to the breach of trust. The loss suffered was that the claimant obtained less security for its loan than should have been the case, and the transaction would have gone ahead even if a proper redemption statement and undertaking had been obtained. Therefore the judge's award of £323,000 (£280,000 plus interest) was upheld.

International coverage



Further information
If you would like further information on any issue raised in this newsletter please contact:

London

Richard Harrison
E: richard.harrison@clydeco.com

Andrew Blair
E: andrew.blair@clydeco.com

Fergal Cathie
E: fergal.cathie@clydeco.com

Sarah Clover
E: sarah.clover@clydeco.com

Andrew Horrocks
E: andrew.horrocks@clydeco.com

Neil Jamieson
E: neil.jamieson@clydeco.com

Gaby Kaiser
E: gaby.kaiser@clydeco.com

James Roberts
E: james.roberts@clydeco.com

Andrew Scott
E: andrew.scott@clydeco.com

Manchester

James Preece
E: james.preece@clydeco.com

Oxford

Clive Brett
E: clive.brett@clydeco.com

Tony Nurse-Marsh
E: tony.nurse-marsh@clydeco.com

Jim Taylor
E: james.taylor@clydeco.com

Australia

John Edmond
E: john.edmond@clydeco.com

Jenni Priestley
E: jenni.priestley@clydeco.com

Jenny Thornton
E: jenny.thornton@clydeco.com

Hong Kong

Patrick Perry
E: patrick.perry@clydeco.com

Simon McConnell
E: simon.mcconnell@clydeco.com

Mun Yeow
E: mun.yeow@clydeco.com

Singapore

Ian Roberts
E: ian.roberts@clydeco.com

Shanghai

Ik Wei Chong
E: ikwei.chong@clydeco.com

Middle East

Mark Beswetherick
E: mark.beswetherick@clydeco.ae

France

Gildas Rostain
E: gildas.rostain@clydeco.fr

Canada

Jo-Anne Demers
E: jo-anne.demers@clydeco.ca

Graeme Mew
E: graeme.mew@clydeco.ca

Trevor McCann
E: trevor.mccann@clydeco.ca

US

Bill Casey
E: bill.casey@clydeco.us

Joan D'Ambrosio
E: joan.dambrosio@clydeco.us

Eric Moon
E: eric.moon@clydeco.us

Clyde & Co LLP
The St Botolph Building
138 Houndsditch
London EC3A 7AR
T: +44 (0)20 7876 5000
F: +44 (0)20 7876 5111

Further advice should be taken before relying on the contents of this summary.

www.clydeco.com

CC000946 - March 2013