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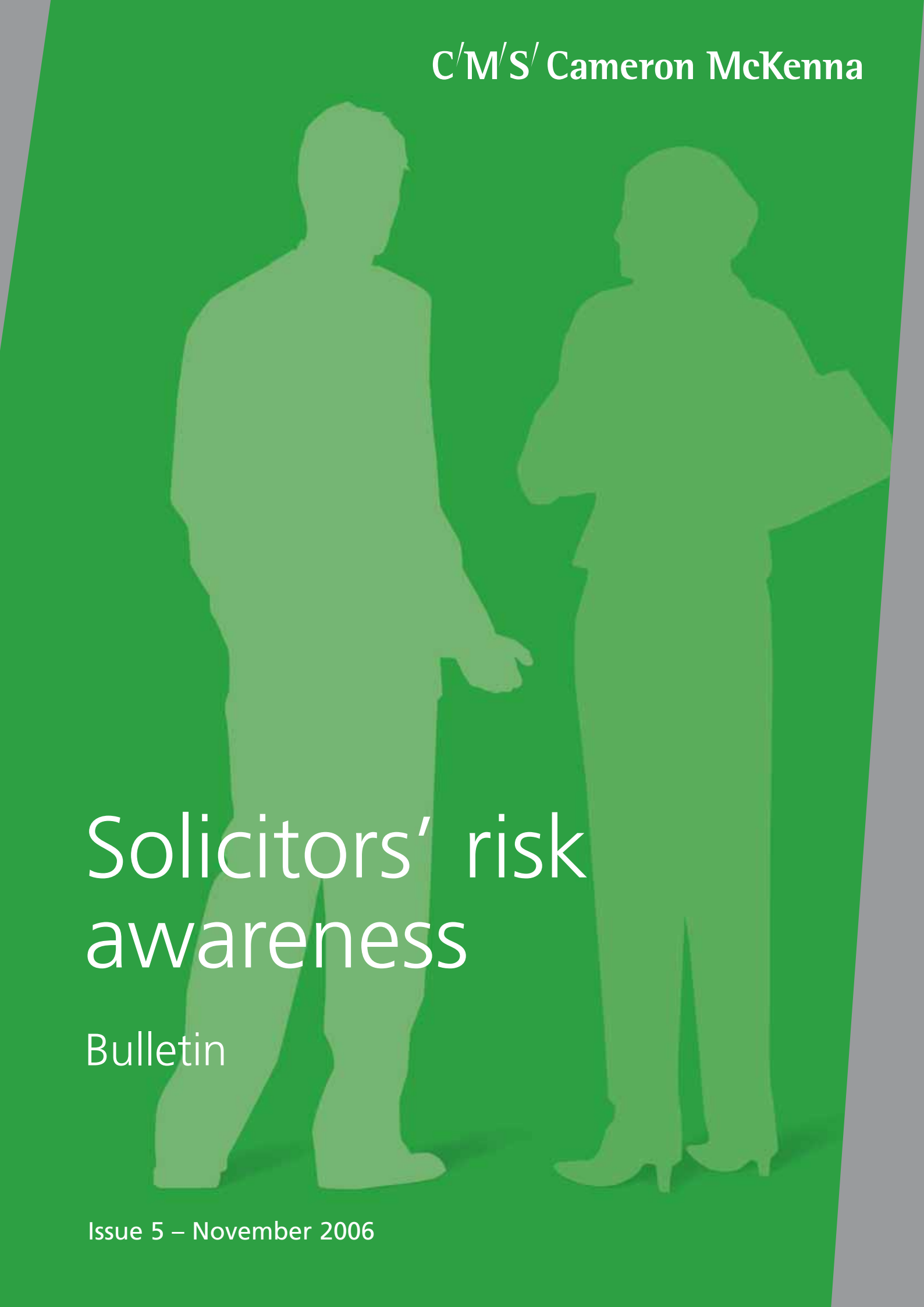

Solicitors' risk awareness

Bulletin

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Contents

In this issue of the Bulletin, Peter Maguire looks at the topical issue of limiting liability, including the options available to law firms, the application of UCTA and a number of practical and drafting issues.

Peter Maguire, partner
Head of the Solicitors' Group

Risk management: limiting liability

In contrast to the attitude of major firms of accountants (and, indeed actuaries), solicitors have been generally reluctant to seek to agree limitations of liability with their clients (such limitations being permissible under the professional conduct rules, provided that they are not less than the minimum level of cover required by the Law Society – £3 million for LLPs and £2 million for other firms).

In response to research undertaken in 1999 by the City of London Law Society, one quarter of all the respondent firms stated that they included provisions to limit their liability, although most did so only rarely. Significantly, concern was also expressed by over half the respondents that they might become uncompetitive if they sought to impose limitations in circumstances where other firms had no such policy.

Subsequent surveys and anecdotal evidence demonstrate a trend towards a greater use of limitations of liability and these are, for example, now relatively commonplace in vendor due diligence reports prepared for bidders in M & A auctions (recognising that such reports address liabilities to third parties, not to clients). Concerns about becoming uncompetitive nevertheless remain and there is no evidence to suggest that limitations of liability are now widely accepted in mainstream M & A or finance work.

> *"Concerns about becoming uncompetitive …remain and there is no evidence to suggest that limitations of liability are now widely accepted in mainstream M & A or finance work."*

Whilst solicitors have been much less aggressive than accountants in limiting their liability, there are a number of reasons for this, arising out of important distinctions between the two professions. They include:

- their different claims profiles – whilst solicitors suffer a large number of attritional losses, the quantum of even the largest historical claims has been very much smaller than those against the large accountants;
- the greater level of insurance cover available to solicitors from (effectively) "the ground up";
- the greater propensity of accountants to become embroiled in large corporate collapses;
- Competition Act considerations, which preclude discussion on limitations of liability as between law firms (solicitors having come to the issue later in the day); and
- the fact that the solicitor market is less consolidated at the top end, which makes it very competitive.

> *…the current availability of plentiful and reasonably priced excess layer cover cannot be guaranteed in the future (as to which, see the capacity "squeeze" of 2002).*

Notwithstanding the above and the increasing number of LLPs, the use of limitations of liability is increasing. There is unlikely to be any abatement in this trend, particularly given the propensity of other professions to limit their liability and the fact that the current availability of plentiful and reasonably priced excess layer cover cannot be guaranteed in the future (as to which, see the capacity "squeeze" of 2002).

Against that backcloth, what options are available to firms?

Options

They include the following:

- where other advisers (e.g. accountants) are proposing to limit their liability, the solicitor could seek to agree a similar limitation, although it may be difficult to ascertain the existence and terms of any such limitation. Accordingly, the better (and safer) option is for the solicitor to seek to agree a proportionate liability clause with the client, whereby if the solicitor's ability to claim contribution is prejudiced, he will not be liable for any amount that he would have been able to recover but for the limitation agreed between the client and the other adviser;
- a limitation based upon the firm's available insurance cover.
  - In that event, the firm would probably need to accept the risk of insurer insolvency and of the policy being vitiated or any claim for indemnity being repudiated for breach of policy terms and conditions;
- a specific monetary amount or "liability cap."
  - Note, however, the need for some objective justification for the figure chosen. In this regard, it needs to be borne in mind that, in view of the "claims made" nature of professional indemnity insurance, the level of excess layer cover currently available to the solicitor may not be available should a claim materialise some years later.

Other possibilities include (a) a straight proportionate liability clause, (b) a default limitation in the firm's General Terms of Business or (c) an exclusion in respect of indirect and consequential losses. Depending upon the particular facts, (a) and (b) may possibly be open to attack under the Unfair Contract Terms Act 1977 ("UCTA"), or the fairness requirements of the Unfair Terms in Consumer Contract Regulations 1999 where the client is a consumer. In relation to (c), the distinction between direct losses (on the one hand) and indirect and consequential losses (on the other) may not always be an easy one to draw (or, indeed, to explain to clients).

UCTA

Any limitation of liability will need to satisfy the requirements of the "reasonableness" test of Section 11. It follows that detailed consideration needs to be given to any proposed limitation of liability, having regard to the circumstances of the particular case.

In this respect, there are a number of points to bear in mind:

- a Judge will test the clause at its weakest point. If it fails at that point, it may well fail in its entirety as the court has no power of severance;
- the test is ultimately a discretionary one which depends on all the facts and the courts have not been wholly consistent in their approach;
- a Judge will apply the *contra proferentem* rule and construe any ambiguity against the party seeking to limit their liability.

The burden of establishing the reasonableness of the limitation will be on the solicitor. The court will have "*regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made*" (see Section 11). Thus, the reasonableness of the limitation is to be judged at the time the contract was made and the circumstances of the loss which the client ultimately suffers are not directly relevant.

Section 11(4) of UCTA specifies two particular matters to which regard must be had where a person seeks, by reference to a contract term, to limit his liability (as to which, see 2 and 3 below).

Schedule 2 of UCTA also sets out five guidelines for the application of the reasonableness test. Although they are only statutorily applicable to other sections of UCTA (namely, Sections 6 and 7 relating to sale of goods, hire purchase etc), the courts nevertheless consider them. See *The Flamar Pride* [1991] LR 434.

In the context of a solicitor's limitation of liability, the principal factors which a court is likely to take into account are:

1 The client's likely level of loss
   - In a sense, this is the starting point in considering the reasonableness of any limitation. See the approach adopted by Dyson J in *Moores v Yakeley Associates Limited*, 28th October 1998. In the case of a specific monetary limit/"liability cap", can an objective justification be offered for the figure agreed with the client?

2 The level of insurance cover available to the firm
   - What is relevant, for present purposes, is the availability of insurance cover, rather than the actual insurance position. Hence, the fact that a solicitor had chosen to insure himself for substantially more than the limitation does not, in itself, establish that the limitation was unreasonable (although this may be a factor to take into consideration).
   - Having regard to the "claims made" basis of cover, a firm is also entitled to take into account the fact that the current level of cover may not be available in the future, at the time when a claim might be made against it (or when a circumstance is notified to insurers). This should, where relevant, be reflected in the definition of the "available insurance" in any limitation of liability;

3 Any other resources available to the firm
   - Although this is also one of the specific considerations mentioned in Section 11(4), in the context of larger limitations running into tens of millions of pounds, it is less likely to be a major factor;

4 The bargaining position of the parties
   - In many cases, the client will have substantial bargaining power, e.g. because of its corporate size and financial strength or its ability to instruct the firm's competitors if it dislikes the firm's proposed terms. There may, however, be particular circumstances where such apparent bargaining power may be diminished, e.g. where most firms with the relevant expertise and resources to undertake the work are conflicted out. Time pressures may also leave the client in a weak position, e.g. where the firm had previously acted for the client in circumstances where it would now be difficult or time consuming for the client to change solicitors in respect of a new matter. Hence, in *St Albans City Council v International Computers* (1995) FSR 686, Scott Baker J was prepared to take account of the suggestion that the Claimants were "over a barrel" because of the tight timescale;

5 Alternative opportunities available to the client to instruct another firm of solicitors without having to accept a similar limitation of liability clause.
   - If such an opportunity was available, it will strengthen the firm's position under this factor, but potentially weaken it in relation to the practice of the profession (see 7 below);

6 The client's knowledge of the term
   - This factor is very important and it will always assist the firm to show that the client was made fully aware of the existence, scope and terms of the limitation clause (for example, where the limitation was freely negotiated or drawn clearly to the client's attention). The firm should also endeavour to ensure that appropriate representatives of the client were made aware of the term, i.e. directors or senior representatives, rather than subordinate employees.
   - Apart from nurturing good client relations, in the event of a subsequent challenge to the reasonableness of

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a clause, the firm's position will also be strengthened if it is able to demonstrate that the reason for the introduction of the limitation was explained to the client in relatively simple terms;

7 The practice of the profession
   – It will assist the firm to show that other firms of solicitors incorporate similar types of limitation clauses. In practice, the more common they become, the more willing Judges are likely to be to accept that they are reasonable, particularly in the commercial context.

A further consideration is the fee charged for the assignment. Although this is not a designated factor under UCTA, it is relevant to the broader commercial context and was referred to in this respect by the Court in *Moores v Yakeley Associates Limited*.

The important point, for practical purposes, is that if the reasonableness of any limitation of liability is challenged, the firm's actual level of insurance cover will be before the court and a partner from the firm will have to get into the witness box in order to try and justify the reasonableness of the limitation. Whilst it must, therefore, be a matter for each firm to consider and formulate its own policy on these issues, it is suggested these matters militate in favour of not taking too restrictive a view.

Where a limitation of liability is being sought, the factors set out should be considered, internal advice can be obtained and a short note can be placed on the file in order to record the thinking behind the relevant limitation (recognising that the exercise is, to an extent, necessarily "broadbrush"). If this approach is adopted and the position is explained to the client in an open and transparent way, there should be reasonably good prospects of withstanding any challenge under UCTA.

Limiting liability to third parties

If advice may be passed to third parties, it is important to clarify the existence and scope of any duty which may arise. Whilst the policy of most firms is to try and limit the persons to whom they owe a duty of care, there are occasions where a third party's reliance upon the solicitor's advice is reasonable and is in accordance with accepted commercial practice. Where a decision is made that a third party ought reasonably to be entitled to rely upon such advice, consideration can be given to agreeing an appropriate limitation of liability.

There are a number of ways in which this can be achieved, including the following:

- The solicitor can seek to utilise the provisions of the Contracts (Rights of Third Parties) Act 1999 and include a term in his retainer letter which gives the third party a benefit, subject to a limitation of liability (i.e. the right to rely upon the firm's advice, with the remedy of a claim for damages, but subject to a limitation clause).
  – Although such a contractual limitation clause is not subject to UCTA (the relevant provisions of the Act having been disapplied by Section 7(2) of the 1999 Act), this would not preclude a claim by the third party against the firm in tort. Accordingly, any limitation will be subject to the reasonableness test.
  – The retainer letter can be drafted in such a way as to make it clear that nothing therein will create a solicitor-client relationship between the firm and the third party.

- An alternative approach would be for the client to enter into a simple contract with the third party (e.g. its bankers), which includes a term limiting the liability of the solicitor in respect of any advice provided to the third party (with the firm utilising the provisions of the 1999 Act).

- The firm could expressly acknowledge the existence of a duty of care in correspondence with the third party, subject to a limitation of liability. Hence, the firm consents to reliance being placed upon its advice, acknowledges that it owes a duty of care to the third party and limits its liability to that third party.

  - Where appropriate, use can also be made of signed acknowledgment letters, under which the third party acknowledges the basis upon which a duty of care is accepted by the solicitor. Where a third party can be persuaded to sign such a letter, this has the considerable advantage that it cannot then credibly deny having full knowledge of the matters set out therein, including the limitation of liability. In appropriate cases, such letters might also operate as an evidential estoppel.

- In some limited circumstances, it may be possible to contend that the client was acting as an agent for the third party when agreeing to a limitation. *Killick and Anor v PricewaterhouseCoopers* [2001] PNLR 17 concerned a claim by the estate of the late Matthew Harding against PwC in connection with PwC's valuation of his shares in Benfield. Pursuant to the company's articles of association, the shares were to be offered to various classes of person at a valuation to be determined by the company's auditors.
  - PwC valued the shares at £2.10 per share, whilst the estate contended for a valuation of £4 per share (giving rise to a claim of around £30 million). PwC had, as a term of their engagement, agreed a limitation of liability of £10 million with the company. The estate denied that they were bound by this limitation and also contested its reasonableness. Both issues came before the court on the claimants' application for summary judgment.
  - Neuberger J (as he then was) held that, although the claimants were not a party to PwC's retainer, it was arguable that PwC could rely upon the £10 million cap on the grounds, inter alia, that in negotiating it, the directors of the company had acted as the shareholders' agents. Accordingly, he ordered that this issue should proceed to a trial.
  - The Judge declined to deal with the reasonableness of the £10 million cap on the grounds that this was a question of fact which should not be dealt with on an interlocutory basis, save in a clear case. He therefore ordered that the action should proceed to trial on that issue also.

Drafting issues

The drafting of limitation clauses requires considerable care, particularly given the application of the *contra proferentem* rule and UCTA.

A number of relevant considerations are summarised below:

- consideration can be given to an aggregate limitation of liability to:
  - all persons collectively who are the firm's clients in relation to the retainer; and
  - (where applicable) to any person who is not a client in relation to the matter (i.e. a third party) but who the firm agrees should be entitled to rely upon its services or advice in relation to the matter (e.g. the client's financiers).

Note also that the aggregation provisions introduced into the Law Society's 2005 Minimum Terms and Conditions. Clause 2.5(b) provides that "*…when considering what may be regarded as one claim for the purposes of the limit … (b) all claims against one or more Insured arising from one matter or transaction would be regarded as one claim.*" Thus, for example, if problems arose on a substantial M&A transaction, claims against a law firm by its client and the relevant financiers would fall to be aggregated and could potentially take the aggregate sum in issue beyond the limit of the firm's available insurance resources;

- it is prudent for the scope of the operative clause to be broadly drafted so as to encompass all claims arising out of, or in connection with, the retainer, whether arising as a result of negligence or otherwise;
- consideration can be given to agreeing costs-inclusive limitations of liability, although if a liability cap is for a relatively modest sum, it may be prudent to include a "carve out" in respect of legal costs in order to

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> *…ensure that draft specimen limitation of liability wordings (together with explanatory notes) are available to partners and fee earners.*

strengthen the firm's position should the reasonableness of the limitation be subsequently challenged under UCTA. The rationale of this approach is that any clause which would reduce the effective compensation below the designated figure by reference to the claimant's costs is more likely to be perceived as unreasonable under UCTA because of the opportunity which it would afford the solicitor to reduce the claimant's compensation by insisting upon contesting liability;

- any clause should expressly state that there will be no limitation in respect of any liability for fraud, dishonesty, reckless disregard of professional obligations or any liability which cannot be lawfully limited;
- where there is a possibility of claims being pursued in other jurisdictions, consideration must be given as to what impact the local law will have on any limitation of liability and how the courts of that jurisdiction will interpret it;
- following the Court of Appeal decision in *Merrett v Babb* [2001], it is now relatively common for firms to disclaim and/or exclude personal liability for individual lawyers (save for partners in non-LLPs), given the exposure which solicitors face as a result of their personal dealings with clients. Consideration can also be given to encompassing LLP members, employees, consultants and any service company within the limitation of liability on a "belt and braces" basis. The inclusion of such personnel will provide a further line of defence should any disclaimer and exclusion not prove effective in law and language can be used which does not cast real doubt upon their effectiveness.

Practical steps

- consider the use of General Terms and Conditions of Business in order to:
  - incorporate a proportionate liability clause where other advisers limit their liability
  - lay the ground for the negotiation of specific limitations (e.g. liability caps), where appropriate
  - disclaim and exclude any personal liability on the part of employees, consultants, any service company and, in the case of LLPs, members
- explain any limitation to the client in simple terms
- be prepared to offer an objective justification for any limitation proposed to, or agreed with, the client
- ensure that draft specimen limitation of liability wordings (together with explanatory notes) are available to partners and fee earners
- ensure that internal advice is available
- keep it simple
- consider adopting an incremental approach, both internally and in dealings with clients

Future developments

Although LLPs are increasingly common, they are not a panacea for the liability risks facing lawyers in an increasingly demanding environment. The size of deals continues to increase, few (if any) relationships are sacrosanct and, as illustrated in recent years in the US, the fall out from corporate collapses can have serious implications for professional firms.

The extent to which contractual limitations of liability become commonplace in large corporate and commercial work will, however, depend upon a number of cultural issues and, in particular, the developing attitudes of:

- **Partners** – partner resistance is still probably a significant barrier to the introduction of limitations owing to concerns about potential loss of business;

- **Clients** – whilst the available evidence presents a mixed picture, there is still undoubtedly client resistance in certain sectors, such as finance;
- **Professional indemnity insurers** – although insurers encourage the use of limitations, they will generally not reduce their premiums just because the firm has a policy of limiting its liability. This is unsurprising in circumstances where there may be uncertainty as to how comprehensively any policy is operated in practice and also whether any such limitations will prove effective in law. Moreover, a large proportion of premia is attributable to the primary and lower excess layers of any law firm's professional indemnity cover, covering exposures where limitations of liability are likely to be less common.

In conclusion, whilst there is still perceived to be some cultural resistance to seeking limitations of liability amongst lawyers, together with a degree of complacency, the issue is now regularly debated in the legal and professional press and there appears to be a greater willingness to raise it with clients. The likelihood is that such provisions will become more common during the next three or four years, although the extent to which they do so will probably be determined by the continued availability of reasonably priced excess layer cover and, in particular, whether the profession continues to avoid catastrophic losses.

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"The likelihood is that such provisions will become more common… although the extent to which they do so will probably be determined by… in particular, whether the profession continues to avoid catastrophic losses."

Peter Mansfield, partner

In this section of the Bulletin, Peter Mansfield looks at a number of recent cases and their implications in risk management terms. The first of these, The Football League decision, illustrates the limits of the Solicitor's retainer; the second concerns issues of contribution as between Co-Defendants; and the third and fourth look at recent House of Lords interpretations of the Limitation Act 1980.

Recent caselaw and its implications

"What's true for football is true for business; when something goes wrong, someone gets blamed."

The Football League Limited v Edge Ellison [2006] EWHC 1462

Solicitors negligence – duty of care to advise on commercial issues – causation.

What's true for football is true for business; when something goes wrong, someone gets blamed. In the World Cup, it was Sven; and in *The Football League v Edge Ellison* it was, well, Edge Ellison.

In 2000, the Football League had entered into a lucrative deal with ONdigital for the television rights for football league matches. ONdigital subsequently went into liquidation and the Football League lost a lot of money. The Football League, therefore, indulged in a bit of post-match analysis. They decided (quite rightly) that they would have been protected if they had had guarantees from ONdigital's parent companies, Granada and Carlton. They decided (quite wrongly) that the failure to have these guarantees was the fault of their solicitors, Edge Ellison.

Facts

The facts are long and, to be honest, tedious. We have tried to keep them brief, but, we regret, without much success.

Prior to 2001, the television rights to Football League matches were held by Sky. However, this licence was coming to an end at the close of the 2000/2001 season and the Football League were keen to secure the best possible deal to replace it. They therefore established a Commercial Committee to negotiate the new television rights deal. The committee members were all experienced businessmen. Edge Ellison were their solicitors.

Edge Ellison's retainer was agreed in or around December 1999. It placed no obligation upon Edge Ellison to advise on the financial security of the potential bidders for the television rights.

On 10 January 2000, letters were sent to various broadcasters informing them that the Sky licence was coming to an end. One of the broadcasters was ONdigital, which was a joint venture owned by Granada and Carlton, who had invested hundreds of millions in ONdigital. Their aim was that ONdigital would eventually compete with Sky.

Several of the broadcasters expressed an interest in bidding for the television rights. However, on 5 May 2000, ONdigital indicated that they would be prepared to pay £50 million per year for three years and they requested an exclusive negotiating period. On 10 May, the Commercial Committee agreed to continue discussions with ONdigital.

At a meeting on that day, ONdigital tabled a short-form licence agreement. It is common in these types of negotiations for a short-form agreement to be signed on the basis that a longer agreement will subsequently be negotiated and agreed. In practice, however, the long-form agreement is rarely agreed and the relationship proceeds on the basis of the short-form agreement. The offer in the short-form document was £70 million per year for three years. During the meeting, this increased to £75 million. Ultimately, though, there was no agreement and the talks with ONdigital came to an end.

On 26 May, the television rights were put out to tender. By the deadline of 7 June, seven bids were received, including ONdigital's bid. Page 9 of their bid contained this provision:

> "*ONdigital and its shareholders will guarantee all funding to the* [Football League] *outlined in this document.*"

It was not entirely clear what this "Financial Arrangements Clause" was intended to achieve. It was a model of ambiguity. Did it mean that the shareholders, Granada and Carlton, were offering formal guarantees? Or did it simply mean that ONdigital had the commercial backing of Granada and Carlton? It simply was not clear.

The ONdigital bid document was not seen by Edge Ellison until after the contract with ONdigital had been signed on 15 June 2000.

Of the seven bids, the highest unconditional bidder was Sky with a bid of £273 million over three years. ONdigital's bid was £240 million.

On 14 June 2000, the Football League wrote to the broadcasters and asked them to submit revised proposals by noon the next day. The three main players were Sky (possibly in conjunction with the BBC), ONdigital and NTL. ONdigital submitted an increased bid of £96.1 million per year, which was subsequently increased to £105 million. NTL, though, pulled out. All eyes were on Sky/BBC.

At 7.55pm, the Football League's negotiators learnt that there would be no bid from Sky/BBC. ONdigital were, therefore, the sole bidder. If ONdigital discovered this fact, there was a very genuine risk that the market might collapse. Accordingly, it was imperative that a deal was struck with them urgently. The Football League's negotiators were authorised to proceed and they began to negotiate the short-form agreement with ONdigital. Edge Ellison were present during these final discussions. At around midnight, the contract was signed. ONdigital agreed to pay £315 million over three years for the television rights to watch Hull City v Brentford and the like.

> *"The Football League… indulged in a bit of post-match analysis. They decided (quite rightly) that they would have been protected if they had had guarantees… They decided (quite wrongly) that the failure to have theses guarantees was the fault of their solicitors, Edge Ellison."*

> *ONdigital were, therefore, the sole bidder. If ONdigital discovered this fact, there was a very genuine risk that the market might collapse.*

The short-form agreement did not include guarantees from ONdigital's parent companies, Granada and Carlton. The long-form agreement was never finalised.

ONdigital went into administration on 27 March 2002 and into liquidation on 29 October 2002. ONdigital had only paid £136.5 million of the £315 million to the Football League. The Football League was, therefore, still owed £178.5 million.

The Football League issued proceedings against Granada and Carlton, arguing that they had agreed to guarantee the deal (pursuant to the Financial Arrangements Clause quoted above from ONdigital's bid document of 7 June). It was a hopeless argument. "*Lord Grabiner QC, who was briefed… by Carlton and Granada, can have had few easier cases*" (paragraph 229).

The Football League renegotiated the television rights with Sky at a cost of £100 million spread over 4 years. The Football League did not ask for a guarantee from Sky's parent company.

The Football League then turned their attention to Edge Ellison.

The task

If the Football League were to win the litigation, they needed to prove:

- that Edge Ellison owed a duty to the Football League to obtain instructions from them as to whether they wanted parent company guarantees from Granada and Carlton;
- that Edge Ellison failed to obtain such instructions;
- that, if Edge Ellison had obtained instructions, then parent company guarantees would have been obtained; and
- that, accordingly, Edge Ellison's breach of duty had caused the Football League's loss.

The judgment

The Football League raised two main arguments as to when a duty of care allegedly arose:

- **a general duty**: the duty of care arose as a natural part of Edge Ellison's retainer.
- **specific duties**: Edge Ellison had a duty to advise upon the "Financial Arrangements Clause" in ONdigital's bid document of 7 June. This would have included a duty to ask the Football League whether they wanted guarantees from Granada and Carlton. They also had a duty to discuss the need for guarantees when negotiating the long-form agreement.

General duty

Mr Justice Rimer rejected the General Duty argument.

The starting point, as always, was Edge Ellison's retainer. In this case, there was nothing in the retainer which expressly required Edge Ellison to advise on the need for parent company guarantees. The more contentious issue, therefore, was whether there was an implied term to that effect.

In this respect, Mr Justice Rimer drew the distinction between legal advice and commercial advice. He referred to two Privy Council decisions, *Clark Boyce v Mouat* [1994] AC428 and *Pickersgill v Riley* [2004] PNLR31, both of which stated that it was ordinarily not part of a solicitor's implied duty to advise on commercial matters. It would only be an implied term if the circumstances of the case warranted it. The example given by Lord Scott in *Pickersgill* was of "*a youthful client, unversed in business affairs*"; in such circumstances, there may be an implied term to advise on commercial issues. However, if the client is an experienced businessman, there is unlikely to be an implied term.

The circumstances of this case were that the members of the Football League's Commercial Committee were all experienced businessmen, who had been "*handpicked for the task in hand*". They were all aware of the potential risks of corporate insolvency and the benefit of parent company guarantees. Moreover, "*The particular issue was an exclusively business one: can the client safely enter into a commitment at a particular level with a particular counterparty without security? That must be the most basic consideration for a businessman in any substantial transaction*" (paragraph 268).

Accordingly, Mr Justice Rimer concluded that Edge Ellison owed no generally implied duty to the Football League to advise on the need for parent company guarantees. He accepted, of course, that other solicitors may have raised this issue, but that did not mean that it was the implied duty of Edge Ellison to have done so.

Despite this conclusion (that Edge Ellison were not liable), Mr Justice Rimer went on to consider causation. Remember that this allegation primarily relates to the time period in May 2000, during the early negotiations with ONdigital. If the issue of guarantees had been raised by Edge Ellison at that stage, Mr Justice Rimer accepted that the Football League would have asked for them from Granada and Carlton. But would they have been provided by Granada and Carlton? Mr Justice Rimer concluded that there was a 70% chance that guarantees would have been provided for the first £160 million and a 40% chance for the remaining £155 million. However, for good measure, he added that he would have held the Football League contributorily negligent to the tune of 75%. The reasoning behind these decisions is not relevant for this article.

Specific duties

But that only dealt with the General Duty argument. There was still the Specific Duty argument and, on that one, the Football League had some success.

Edge Ellison's retainer included an express duty to advise the Football League on "*the legal ramifications of the recommended bid*". If it hadn't been an express term, it would have been implied. Advising on the law is, after all, a lawyer's job. This duty kicked in during the evening of 15 June 2000.

As explained above, Edge Ellison were involved in negotiating the terms of the short-form agreement. It was Edge Ellison's responsibility to explain the legal ramifications of this document to their client. Clause 18 of the short-form agreement cross-referred to ONdigital's bid document of 7 June 2000, which Edge Ellison had not seen. Mr Justice Rimer stated that Edge Ellison had a duty to read the bid document. "*A solicitor can only advise a client properly on a document if he has first considered the whole of it and any documents incorporated into it by reference*" (paragraph 306). If they had read the bid document, Edge Ellison would have seen the Financial Arrangements Clause and they would have then advised their client on its legal ramifications. This would have included a discussion of whether the Football League wanted to ask ONdigital for parent company guarantees.

Moreover, for the same reason, Mr Justice Rimer agreed that, when negotiating the long-form agreement, Edge Ellison should have raised the issue of guarantees.

In other words, Edge Ellison had breached their duty in two respects. But had these breaches of duty caused any loss? Mr Justice Rimer decided that they had not. Remember that the relevant time period for this allegation was the meeting on 15 June. Remember that ONdigital (unbeknownst to them) were the sole bidder. Remember that the Football League were rightly concerned that the market may collapse. Remember that the Football League were desperate to reach an agreement with ONdigital. In those circumstances, Mr Justice Rimer held that the negotiations would not have been put on hold so that a parent company guarantee could be agreed. This process would have needed board approval of both Granada and Carlton and this would have caused a delay. This delay could have been fatal to the Football League. Mr Justice Rimer therefore held that the Football League would have continued without guarantees. In other words, Edge Ellison's breach of contract had not caused any loss. He awarded the Football League nominal damages of £2.

Similar arguments applied to Edge Ellison's failure to raise the issue of guarantees during the negotiation of the long-form agreement. Mr Justice Rimer therefore awarded the Football League a further £2.

Commentary

- Although it merely reiterates the existing law, *The Football League v Edge Ellison* is an excellent example of the general

> *Edge Ellison is authority for the principle that failure to read all cross-referenced documents is likely to be regarded as negligent.*

"Although it merely reiterates the existing law, The Football League v Edge Ellison is an excellent example of the general rule that solicitors have no generally implied duty to advise on commercial matters… business people cannot turn their lawyers into scapegoats for their own commercial indiscretions or poor business deals."

rule that solicitors have no generally implied duty to advise on commercial matters. It follows in the wake of *Carradine Properties Ltd v D J Freeman & Co* [1989] 5 Const. LJ267 and two subsequent *Privy Council cases, Clark Boyce v Mouat* [1994] AC 428 and *Pickersgill v Riley* [2004] PNLR 31, which say the same thing. The latter decision was discussed in issue 3 of the Bulletin.

- The logic behind the general rule is that lawyers advise on law and they should allow the business people to take the business decisions. In areas where the 'client knows best', the lawyer has no obligation to open his or her mouth. As Lord Scott said in *Pickersgill*, it would be "*pointless, or even an impertinence*" for the solicitor to offer commercial advice to a business person. The effect of the rule, therefore, is that business people cannot turn their lawyers into scapegoats for their own commercial indiscretions or poor business deals. It is, therefore, a rule which should be welcomed by lawyers.
- The general rule can, of course, be overridden by express agreement. If, on a proper analysis the solicitor has agreed to advise on the commercial desirability of a deal, then that is what he must do. It is important, therefore, that retainers are not too generally worded, and that no potentially onerous obligations are assumed during the course of the assignment.
- Similarly, beware what is written in pitch documents. It is always tempting to overstate your abilities in a pitch in order to win the job. As a result, lawyers may offer a 'complete business service' or some such sentiment. Lawyers need to be very careful about doing this; their task is to provide legal advice in the commercial context. If the pitch document is incorporated expressly or impliedly into the retainer, then suddenly the lawyer has a duty to advise on commercial issues.
- The general rule can also be overridden by the specific circumstances. Lord Scott in *Pickersgill v Riley* made it clear that, if your client is "*a youthful client, unversed in business affairs*", then the solicitor may have a duty to explain the commercial wisdom, as well as the legal consequences, of a transaction. You take your client as you find them. For some clients there may be some commercial decisions where the 'client does not know best'.
- The line between commercial advice and legal advice may be very fine. This can be seen clearly in Edge Ellison. In May 2000, the issue of guarantees was a commercial issue. However, as soon as the issue of guarantees cropped up in a legal document (i.e. the 'Financial Arrangements Clause' of the bid document of 7 June), it became a legal issue. What was previously a commercial issue, was now a legal issue. Whereas Edge Ellison had previously owed no duty, now they owed a duty. It did not take much for a commercial issue to become a legal issue.
- When advising on a document, it is essential that solicitors also read all documents that are mentioned in that document. *Edge Ellison* is authority for the principle that failure to read all cross-referenced documents is likely to be regarded as negligent.
- Finally, as explained above, there is no implied duty upon a solicitor to advise an experienced client on commercial issues. However, there is no duty to keep quiet either. If the lawyer does spot some commercial flaw in a transaction, it is obviously sensible for the lawyer to point it out. It may not be a duty, but it is desirable. If Edge Ellison had raised the issue of guarantees, they would have saved themselves some very expensive litigation.

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Brian Warwicker Partnership v HOK International Limited [2005] EWCA Civ 962

Contribution; application of causation principles in contribution proceedings.

Claimant sues Defendant A. Defendant A is negligent, but their negligence did not cause the Claimant's loss. Defendant A wins. Meanwhile, back in Court, Claimant sues Defendant B. Defendant B loses. Defendant B pays Claimant £1 million. Defendant B then argues that Defendant A should contribute to the £1 million. Defendant A says "sorry, we have a causation defence". Is Defendant A correct? Logically yes, but – as we shall see – legally no. You can be liable to a co-defendant even though you are not liable to the Claimant. Barmy? Yes. The law? An ass.

Background

The O_2 Centre on Finchley Road is a sizeable development incorporating a mix of retail, leisure and restaurant facilities. It has a Sainsbury's. It has a Warner Village Multiplex. More to the point, it also has a central piazza. This is, of course, entirely indoors with a 20m high ceiling and should perhaps be described as an atrium. The piazza/atrium has several restaurants around its edge. These restaurants have seats in the piazza itself. The concept is to recreate the feel of a European city, with a Mediterranean climate and al fresco eating. Obviously, to achieve this myth, the atrium had to be warm. Unfortunately, it was not.

> *"If Defendant A has a defence against the Claimant, then surely he has a defence against Defendant B. Wrong on all counts."*

At either end of the atrium there were doors. Both sets of doors were automatic. Because of the huge number of people entering and exiting the O_2 Centre, the doors were often open at the same time. This had the unfortunate effect of creating a wind tunnel. The outside came inside. And, when the outside was cold, the inside became cold as well. The al fresco experience became distinctly al fredo. There were occasions when the internal temperature fell to 8 degrees, which by any reckoning is chilly. The customers scurried for the heated interiors of the restaurants. The piazza emptied and, in so doing, it did indeed take on the identity of a European city, but regrettably Oslo rather than Rome.

The developer was Burford NW3 Limited. They brought a claim against their mechanical and electrical contractor, Brian Warwicker Partnership. They, in turn, brought contribution proceedings against the architect, HOK International Limited. On 22 April 2004, Brian Warwicker settled Burford's claim for £1.25 million, without admission of liability. Brian Warwicker continued its contribution claim against HOK and this came to trial in the summer of 2004.

The decision of recorder David Blunt QC

Brian Warwicker alleged that HOK were also liable to Burford. Accordingly, Brian Warwicker alleged that HOK should contribute to the £1.25 million. Brian Warwicker specifically made various allegations of negligence/breach of contract against HOK. The specifics and number of these allegations are irrelevant for present purposes. All that is relevant is that there were a number of separate allegations. For the sake of argument, let us say that there were 10 in total.

> *…the Court of Appeal …decided that the Deputy Judge had been justified in taking into account non-causative material when assessing the level of contribution. However, they did try to place some limits on this principle.*

In relation to Allegations 1 to 5, the Deputy Judge decided that HOK had not been negligent. In relation to Allegations 6 to 9, he decided that HOK had been negligent and that their negligence had caused Burford's loss. The key allegation for us, however, is allegation 10.

Allegation 10 related to the fact that, during the design stage, the doors were changed from manual to automatic. It was alleged that HOK should have specifically discussed this with Brain Warwicker. HOK did not and were therefore negligent and/or in breach of contract. However, the Deputy Judge decided that HOK's negligence had not caused Burford's loss. Even if HOK had consulted with Brian Warwicker, it would have made no difference to the final design. This is important. Indeed, it is the reason why we are discussing this case in this Bulletin. If Burford had sued HOK, and if Allegation 10 had been the only allegation against HOK, then HOK would have won. Their causation defence would have been a complete defence.

Logically, therefore, it should also have been a complete defence to the contribution claim from Brian Warwicker. Logically, if HOK had a defence against Burford, they should also have had a defence against Brian Warwicker. Logically, HOK could not be liable to Brian Warwicker in circumstances where they were not liable to Burford. If Defendant A has a defence against the Claimant, then surely he has a defence against Defendant B.

Wrong on all counts. The Deputy Judge expressly took Allegation 10 into account when assessing HOK's contribution. He eventually decided that HOK should contribute 40%, albeit not in relation to the whole claim. Unsurprisingly, HOK appealed.

The Court of Appeal decision

Lady Justice Arden gave the leading judgement on this issue. She quoted from the Civil Liability (Contribution) Act 1978, which is the statute that allows a defendant to seek contribution from another party. Section 2 enables the court to assess the amount of contribution, which shall be: "*…such as may be found by the court to be just and equitable having regard to the extent of that person's responsibility for the damage in question.*"

The key word here is 'responsibility'. The Deputy Judge had said that this "*encompasses more than causative responsibility: it encompasses blameworthiness as well as causative potency.*" Accordingly, "*acts and omissions which are not causative may be taken into account for the purposes of assessing… contribution.*"

The Court of Appeal agreed that these statements accurately represented the law. In particular, they referred to a Court of Appeal case from 2004 called *Re-Source America International v Platt Site Services* [2004] 95 Con LR 1, in which it was held that: "*…the court's assessment has to be just and equitable and this must enable the court to take account of other factors as well as those which are strictly causative.*"

The facts of *Re-Source* are enlightening. A contractor employed a welding sub-contractor to undertake hotwork on a roof, which caused a fire. The welding sub-contractor was negligent and sought a contribution from the contractor. The contractor had (a) negligently instigated and directed the work, (b) deliberately decided to leave the site immediately after the fire had started and (c) subsequently, and dishonestly, claimed to have left the site before the fire had started. Allegation (a) had caused the fire. Allegations (b) and (c) had occurred after the fire and were not causative of any loss. Nonetheless, the judge took these two allegations into account when assessing the contractor's contribution at 100%. That's right, 100%. This was upheld by the Court of Appeal.

So, the Court of Appeal in *Brian Warwicker*, decided that the Deputy Judge had been justified in taking into account non-causative material when assessing the level of contribution. However, they did try to place some limits on this principle.

Lady Justice Arden stated that non-causative material has only a "*limited role to play. It must be given less weight than the material showing the defendant's responsibility for the act in question.*"

Take note of this quotation, because we will discuss it later in this article. In particular, take note of Lady Justice Arden's use of the word '*responsibility*', which she uses to mean '*causative responsibility*'.

Lady Justice Arden's view was that non-causative material should not make a party liable in a situation where the party would otherwise not be liable. Indeed, non-causative material should not make a party a lot liable in a situation where the party would otherwise be a little liable. However, if a party is already liable, it may increase the level of that party's contribution. In other words, a Judge can use non-causative material to increase a contribution from 35% to 40%; but he cannot use non-causative material to increase a contribution from 0% to 40%.

Let us return to the example in the very first paragraph of this article. Claimant sues Defendant A. Defendant A is negligent, but their negligence did not cause the Claimant's loss. Defendant A wins. Meanwhile, back in Court, Claimant sues Defendant B. Defendant B loses. Defendant B pays Claimant £1 million. Defendant B then argues that Defendant A should contribute to the £1 million. Defendant A says "sorry, we have a causation defence". Is Defendant A correct?

The answer is more nuanced than suggested in the first paragraph. It is not a straightforward 'no'. If Defendant A has a causation defence in relation to the whole of the Claimant's claim, then Defendant A should not be liable to contribute anything to Defendant B. However, if Defendant A is liable to the Claimant in relation to some of the claim, but is able to use causation to defeat the rest of the claim, then the judge may be able to take the non-causative material into account when assessing Defendant A's contribution to Defendant B. This is subject to the overriding caveat that the end result must be "*just and equitable*".

Commentary

- The decision is illogical. The Civil Liability (Contribution) Act 1978, section 2, uses the word '*responsibility*'. The Court of Appeal believes that this encompasses 'blameworthiness' as well as causative potency. But this is illogical. If I do not cause your loss, then I cannot be responsible for it no matter how morally reprehensible I have been. Lest we forget, the full quotation from section 2 is: '*responsibility for the damage*'. In Re-Source, the contractor behaved dishonestly and was very naughty, but this was after the fire had occurred. So, how could these lies and deceptions be '*responsible for the damage*'? Of course, they could not. '*Responsibility*' means '*causative responsibility*', as is clear from the quotation from Lady Justice Arden highlighted above. Any other interpretation mangles the English language.
- The decision is also illogical from a practical perspective. The practical consequence was that HOK were liable to contribute to Brian Warwicker in relation to Allegations 6 to 10, whereas HOK would only have been liable to Burford in relation to Allegations 6 to 9. In a very real sense, therefore, HOK were more liable to Brian Warwicker than to their own client, Burford.
- Nonetheless, it is clearly the law. Two Court of Appeal decisions in two years can't be wrong, can they? Anyway, unless and until the House of Lords has a chance to consider the issue, it is clear that judges can and will take into account non-causative material when assessing levels of contribution.
- In this respect, Lady Justice Arden's attempts to limit the scope of the decision are admirable. She did this in three ways. First, the non-causative material should be given less weight than the causative material. Second, there must be a close connection between the non-causative material and the causative material. Third, the end result must be just and equitable. If her approach is followed, then the impact of this case should be limited. As explained above, it may be the difference between a 35% contribution and a 40% contribution but it should not be much worse than that.
- How does this affect solicitors? When solicitors are sued, there are often other parties who are involved or who could become involved. On a

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> *…the case shows that a solicitor's behaviour after the loss has occurred still has the potential to be relevant.… this behaviour can affect, not just costs, but the assessment of contribution.*

conveyancing claim, it may be a valuer or surveyor. On a corporate claim, it may be an accountant or a banker. On a pensions claim, it may be an actuary. On a litigation claim, it may be a barrister. *Brian Warwicker* shows that, even if you have a great causation defence against one of the allegations, it may be completely ineffective against the co-defendant. Conversely, the co-defendant may have a causation defence that is ineffective against you.

- In addition, the case shows that a solicitor's behaviour after the loss has occurred still has the potential to be relevant. This has always been the case with costs. As an example, CPR rule 44.3(5) makes it clear that Judges can take into account pre-action behaviour when assessing costs. However, *Brian Warwicker* (and more particularly *Re-Source*) shows that this behaviour can affect, not just costs, but the assessment of contribution. It is essential, therefore, that the solicitor's behaviour after a loss has occurred is professional at all times.
- There are likely to be cases in the next few years which test the parameters of this principle. If non-causative material can be taken into account, then can the court also take into account statute-barred allegations? Or can the court disregard contractual limitations on damage that are only relevant between defendant and client? How does the court take into account the Claimant's own contributory negligence? Or what if one party is insolvent (*Fisher v CMT Limited* [1996] 2QB 475)? Watch this space.

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Haward v Fawcetts [2006] UKHL 9

Limitation – Date of 'knowledge' for purposes of Section 14A, Limitation Act 1980

No matter how one tries to dress it up, limitation is not a scintillating subject. However, for all litigators, it is a subject that simply must be understood. Solicitors who act for claimants must commence their client's action within the limitation period. If they fail to do so, then a negligence claim is likely to be brought against them. Conversely, solicitors who act for defendants must also be alert to any limitation arguments that their clients may have. Limitation is a fundamental risk awareness issue for litigators and this is why *Haward v Fawcetts* is so important.

It is the first time that the House of Lords has opined on Section 14A, Limitation Act 1980. This section was introduced into the Limitation Act by the Latent Damage Act 1986 and it was introduced to solve a problem. The problem was this: *Pirelli General Cable Works Limited v Oscar Faber & Partners* [1983] 2 AC 1. The case is well known but the facts bear repetition. A chimney had been built in 1969. Damage occurred to the chimney in 1972. But the damage was not discovered until 1977. A writ was issued in 1978. The 6-year contractual limitation period had expired in 1975 at the latest. But what of the 6-year limitation period in tort? What indeed. The period starts when loss is suffered and the House of Lords said that this was in 1972 even though (and get this) the claimant did not know it had suffered loss until 1977. Accordingly, the writ had been issued outside the limitation period. This was a problem. *Pirelli* showed that it was possible for the limitation period to expire even before the Claimant knew he or she had a claim.

"It is the first time that the House of Lords has opined on Section 14A, Limitation Act 1980."

Hence, the Latent Damage Act 1986 (which introduced section 14A into the Limitation Act 1980). This solved the problem by introducing a new 3-year limitation period for claims in tort. The trigger for this new limitation period was 'knowledge'. As soon as a claimant had the relevant knowledge, they had three years in which to bring a claim. However, as is the way with law, one problem was replaced with another one. What constitutes knowledge? When does a claimant know enough for the 3-year period to be triggered? These were the issues considered in *Haward v Fawcetts*.

Facts

Fawcetts are a firm of accountants. Mr Haward was their client. Mr Haward wanted to buy Kings Stag Engineering Limited (subsequently renamed Haward Agriculture Limited). Mr Haward asked Fawcetts for advice. Fawcetts provided it. On 9 December 1994, and in reliance upon Fawcetts' advice, Mr Haward directly or indirectly invested £160,000 in the company. The company lost money. Mr Haward invested a further £431,000 in 1995, £102,985 in 1996, £509,525 in 1997 and £208,950 in 1998. Mr Haward lost his money.

Mr Haward commenced litigation against Fawcetts on 6th December 2001. He accepted that the 1994 and 1995 investments fell outside the 6-year limitation periods in both contract and tort. The question that was posed to the House of Lords, therefore, was whether they fell within the 3-year limitation period provided by Section 14A. If Mr Haward did not have the requisite 'knowledge' prior to 6th December 1998, then he was within the limitation period; if he did, then he was scuppered.

> *The essence test was expressed most clearly by Lord Scott: "The requisite knowledge is knowledge of the facts constituting the essence of the complaint of negligence".*

Section 14A

Section 14A applies to any action in negligence, other than personal injury claims. It creates a 3-year limitation period, the starting date for which is:

> *"…the earliest date on which the plaintiff … had both the knowledge required for bringing an action for damages in respect of the relevant damage and a right to bring such an action." Section 14A(5).*

It sounds so simple, doesn't it? But then the section goes on to explain what is meant by 'knowledge required for bringing an action'. It means:

> *"knowledge of the material facts about the damage in respect of which damages are claimed."* Section 14A(6)(a).

Helpfully (or confusingly, depending on your point of view), the section then tells us what 'material facts about the damage' means:

> *"… facts about the damage as would lead a reasonable person who had suffered such damage to consider it sufficiently serious to justify his instituting proceedings for damages against a defendant who did not dispute liability and was able to satisfy a judgment."* Section 14A(7).

In other words, you've suffered damage at the hands of Mr X. If you knew Mr X had money and if you knew he would not defend an action, would a reasonable person in your position sue him? Put aside all human sentiment for a moment. This is not about forgiveness or mercy. It is about fact. Do you know enough to sue a defendant who will not defend himself? If the answer is 'yes', then you have knowledge of the material facts about the damage. If the answer is 'no', then you don't.

So that's 'knowledge of the material facts about the damage'. In addition, you need to have knowledge of certain other facts. For example, fairly obviously, you need to know the identity of the defendant. However, the key one for present purposes is the following:

> "[Knowledge] *that the damage was attributable in whole or in part to the act or omission which is alleged to constitute negligence."* Section 14A(8)(a).

Let's go back to 'knowledge of the material facts about the damage.' In simplistic terms, this means: I know that I have been damaged. Section 14A(8)(a) means: I know whose actions have caused my damage. (Actually, this analysis is far too simplistic and does not tally absolutely with Lord Mance's analysis, but it is sufficient for current purposes.) It is the combination of the two that triggers the start date. With one caveat:

> "*Knowledge that any acts or omissions did or did not, as a matter of law involve negligence is irrelevant…*" Section 14A(9).

So, I need to know who has damaged me. Let's call them Mr Q. I need to know that Mr Q's actions have (in whole or in part) damaged me, but I do not need to know that Mr Q has been negligent in damaging me. This is a subtle distinction and it is this distinction which exercised the minds of their Lordships.

The arguments

Fawcetts' argument can be simplified as follows. By the crucial date of 6 December 1998:

- Mr Haward knew that he had suffered damage. His company was losing money hand over fist.
- Mr Haward knew Fawcetts may have had a part to play in causing that damage. They had, after all, advised on the original purchase.
- This was all he needed to know to trigger the 3-year limitation period. He may not have known that Fawcetts were (allegedly) negligent, but he didn't need to know that.
- Therefore, he was outside the limitation period.

Mr Haward's argument can be similarly simplified as follows. By 6th December 1998:

- Mr Haward knew that he had suffered damage.

- Mr Haward did not know what had caused that damage. It could have been any number of factors (for example, the effect of BSE on the farming economy).
- Section 14A(8)(a) requires him to know, in effect, that the damage is 'attributable' to Fawcetts. He did not know that until May 1999, when he was advised to that effect by his solicitor.
- Therefore, he was inside the limitation period.

The Court of Appeal

The Court of Appeal accepted Mr Haward's argument. They concentrated on the word 'attributable' and they decided that Mr Haward did not know that the damage was 'attributable' to Fawcetts until he was told this by his solicitor in May 1999. Accordingly, Mr Haward was within the limitation period.

The Court of Appeal's decision did not receive much attention in the legal press, but its implications were vast. It meant that the 3-year limitation period would not be triggered until a claimant knew that the damage was 'attributable to' (in effect, 'caused by') the potential defendant. For Mr Haward, this was in May 1999. In *Haward v Fawcetts*, the outcome was not obviously unjust. There is very little gap between December 1998 and May 1999. But what if Mr Haward was not informed of Fawcetts' culpability until 2000, or 2001, or 2006? The logic of the Court of Appeal's decision was that the 3-year limitation period would not start running until then. Accordingly, the decision of the Court of Appeal had the potential to extend the 3-year limitation period by many years, (subject to the 15-year "longstop" period).

The House of Lords' decision

Their Lordships agreed with the Court of Appeal that the key issue was as follows: prior to 6 December 1998, did Mr Haward know that his damage (i.e. the investment in 1994 and 1995) was 'attributable in whole or in part' to the acts or omissions of Fawcetts? This is a relatively simple question. It revolves entirely around the date of 6th December 1998. Their Lordships did not need to work out precisely when Mr Haward first acquired this knowledge. They merely had to say whether it had been acquired before or after 6 December 1998.

However, contained within this straightforward question, was a much more difficult issue: what precisely did Mr Haward need to know in order to have sufficient knowledge that his damage was attributable to Fawcetts? Their answer to this question would be of general application. What test would they, therefore, lay down? What formula would they stipulate? How would they define 'knowledge'?

Needless to say, their Lordships did not answer these questions as unambiguously as one would like. All five Lords handed down judgments and, although they all agreed, they did so in subtly different ways. The following analysis, therefore, is an interpretation of their judgments rather than a regurgitation.

In our opinion, there were two main tests proposed by the Lords, both of which have an admirable history in caselaw:

The essence test

- This was expressed most clearly by Lord Scott: "*The requisite knowledge is knowledge of the facts constituting the essence of the complaint of the negligence.*" (Paragraph 49). This is a test that works retrospectively. You look at the allegations of negligence in the Statement of Claim and establish what the factual essence of those allegations is. This 'factual essence' is the matrix of facts that suggests that the damage was caused by the defendant. You then work backwards to discover when the claimant first knew of that factual essence.
- According to Lord Scott, the essence of the claim against Fawcetts was "*that Fawcetts … did not give* [Mr Haward] *the advice that the true state of the company warranted and that, if given, would have warned* [him] *against a disastrous investment of* [his] *money.*" (Paragraph 50). By 6 December 1998, Mr Haward knew that he had been given advice by Fawcetts and he knew

> *"The investigations test was expressed most clearly by Lord Nicholls: "Time did not start to run against Mr. Haward until he knew enough for it to be reasonable to embark on preliminary investigations…"*

> [the decision] *indicates a keenness by the House of Lords to ensure that the traditional balance between claimant and defendant is maintained.*

that the company was losing money. These were the facts that constituted the essence of the complaint. Because Mr Haward knew these facts prior to 6th December 1998, he was outside the limitation period.

The investigations test

- This was expressed most clearly by Lord Nicholls. "*Time did not start to run against Mr Haward until he knew enough for it to be reasonable to embark on preliminary investigations into this possibility.*" (Paragraph 20, and also 23). It was also favoured by Lord Mance (paragraph 128). This is a practical test. You start with the act of negligence and then work forward until you reach the point when the claimant knew enough to commence investigations.
- As Lord Nicholls pointed out, there are some cases where the advice is self-evidently negligent. However, that was not the case with Fawcetts' advice. *"Something more was needed to put Mr Haward on inquiry."* (Paragraph 21). Lord Nicholls did not say what this 'something more' was. However, he concluded: *"the disparity between* [Fawcetts'] *advice and the company's disastrous losses stared Mr Haward in the face long before December 1998."* (Paragraph 24.) Accordingly, Mr Haward was outside the limitation period.

Lord Brown, in reaching his decision, combined the two tests. "*What the claimant must know to set the time running is the essence of the act or omission to which his damage is attributable… But he surely knows enough … to realize that there is a real possibility of his damage having been caused by some flaw or inadequacy in his advisers' investment advice, and enough therefore to start an investigation into that possibility.*" (Paragraph 90).

In *Haward v Fawcetts* the application of these two tests led to the same result, namely that Mr Haward was outside the limitation period. It was not until May 1999 that he knew he could bring a claim against Fawcetts when he was advised to that effect by his solicitor. However, at some point prior to 6th December 1998:

- he knew enough to realize that there was a real possibility of his damage having been caused by some flaw or inadequacy in Fawcetts' advice and he therefore knew enough to start an investigation into that possibility; and
- he knew the facts constituting the essence of the complaint of negligence.

In deciding these issues, Lord Walker (and possibly the other Lords, albeit less explicitly) was influenced by one obvious, but easily overlooked, fact: section 14A was introduced into the Limitation Act 1980 by the Latent Damage Act 1986. It was therefore *"intended to cover cases of latent damage … and not cases of patent damage."* (Lord Walker, paragraph 66). In *Haward v Fawcetts*, the damage was patent and was known to Mr Haward. This was not, therefore, the sort of case in which one would expect section 14A to come to Mr Haward's rescue. And, indeed, it did not.

Commentary

- The purpose of limitation periods is to create a balance between the rights of the claimant to bring legitimate claims and the rights of the defendant not to have to defend stale claims. This was a point made expressly by most of their Lordships. Their view was that the Court of Appeal decision had disturbed this balance by favouring the rights of the claimant too much. The House of Lords therefore restored the balance and, in that respect, the decision should be welcomed by defendants. It is the second time in recent years that the House of Lords has needed to correct the Court of Appeal in this way on limitation issues, the first being *Cave v Robinson Jarvis & Rolfe* [2002] UKHL 18, which dealt with section 32, Limitation Act 1980. It indicates a keenness by the House of Lords to ensure that the traditional balance between claimant and defendant is maintained.
- *Haward v Fawcetts* provides a useful exploration of section 14A by the House of Lords. It is essential reading for anyone who has a section 14A case. However, it is limited in its scope. It deals with a situation where the

damage is patent, but where the claimant did not know that the defendant was at fault. The more common situation with section 14A, however, is likely to be where the damage is latent and the question is: when did the claimant first know of the damage? *Haward v Fawcetts* does not have much to say on that issue.

- Where it does apply, the test for 'knowledge' is now fairly clear. As explained above, there appear to be two tests: the investigation test and the essence test. In most cases, the application of these two tests will result in the same conclusion (as was the case in *Haward v Fawcetts*). However, there will be situations when the two tests point towards different conclusions. It is unclear what the court will do in situations such as that. They will presumably use whichever test seems most suited to them to create a just and reasonable solution.
- One possible example of this problem is as follows. Two of the Lords, Nicholls and Mance, referred to an article by Janet O'Sullivan called 'Limitation, Latent Damage and Solicitors Negligence', in which she posed "*a penetrating question*". In *Haward* the damage arose from positive advice given by Fawcetts. What happens, she asked, when the damage arises from an adviser's failure to do something. And what happens when the claimant does not know that the adviser had an obligation to do that something. How then can the claimant know that the damage is attributable to the adviser? Because Ms O'Sullivan's example differed from the facts in Haward, the Lords did not provide an answer. It therefore remains an open question. However, it is a question where the answers to the two tests may well diverge. A defendant may know enough to investigate well in advance of the date when he knows the essence of the facts.
- *Haward v Fawcetts* was decided on the basis of Mr Haward's actual knowledge. Section 14A, however, also allows a defendant to rely upon the claimant's constructive knowledge. This was not argued in Haward for procedural reasons, but their Lordships hinted that it would have been an easier case to decide if constructive knowledge had been argued. This is not, however, necessarily, correct. We do not need to consider constructive knowledge in this article, but its definition in section 14A is far from straightforward. Because of the interpretation placed upon actual knowledge by the Lords, it is far from certain that the definition of constructive knowledge adds anything.
- There is a very obvious risk management issue here for all litigators. Make sure that you issue proceedings in plenty of time. With the arrival of protocols, litigators are now expected to use litigation as a last resort. Jaw jaw, rather than war war. It is remarkably easy, therefore, to overlook the fact that a limitation period is approaching. It is essential that all litigators identify the relevant limitation period, note this prominently on the file and utilise computerised diary and reminder systems to avoid this risk. Furthermore, if a limitation period is approaching, even on a dormant file, the solicitor should obtain his client's express instructions as to whether he wants to proceed or not. There is nothing worse than a long-lost client reappearing with eagerness in their eyes, just one week after the expiry of the limitation period.
- Finally, in an ideal world, you do not want to be relying on section 14A at all. If there is a contract, always issue within 6 years of breach. If there is no contract, always issue within 6 years of loss. That way you avoid any risk of limitation problems. If you have to rely on section 14A, though, get the Claim Form in quickly. It is possible that your client obtained the requisite knowledge well before he first approached you as solicitor. As *Haward v Fawcetts* shows, it is dangerous to rely on your assessment of the date of knowledge. Any delay, therefore, is potentially fatal.

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Law Society v Sephton & Co & Others [2006] UKHL 22

Section 2 Limitation Act 1980; accrual of cause of action in tort; meaning of "damage"

There have recently been a number of high profile cases which have sought to bring much needed clarity to the operation of the Limitation Act 1980. In one of these, *Law Society v Sephton*, the House of Lords (led by Lord Hoffman) considered the meaning of "damage" within Section 2 of the Act and, in particular, whether a cause of action in tort accrued when the Claimant incurred a contingent or an actual liability.

Background

The case originated from the misappropriation of client funds by a solicitor, a Mr Payne. Mr Payne misappropriated his clients' money and managed to avoid detection for over six years.

In accordance with the Solicitors' Account Rules, Mr Payne had his books and accounts annually audited by a firm of qualified accountants, Sephton & Co ("Sephton"). From 1989 to 1995, Sephton negligently certified to the Law Society that Mr Payne's accounts complied with these rules. The Law Society relied on such certificates, in the sense that, if the report had not been delivered or had indicated that something was amiss, the Law Society would have investigated the position and discovered the theft of client funds.

> *"A contingent liability is not, as such, damage until the contingency occurs… standing alone, as in the present case, the contingency is not damage."*
>
> per Lord Hoffman

In April 1996, a client of Mr Payne's complained to the Law Society about a delay in payment. This complaint triggered an investigation by the Law Society in May 1996. The investigation revealed a deficiency in Mr Payne's client account to the value of £750,000 and the practice was intervened.

The Law Society, under its discretionary scheme, made compensation payments of approximately £1.25 million to clients of Mr Payne. The first claim was made in July 1996 and the first payment was issued in October of the same year.

In October 1996, the Law Society formally notified Sephton that it would hold it liable for compensation to Mr Payne's clients following their negligent preparation/assessment of Mr Payne's annual accounts.

There was a delay in issuing the claim form, as the Law Society concluded related litigation (*Law Society v KPMG Peat Marwick*) to establish whether a firm of accountants who provided it with annual certifications owed it a duty of care. Upon receipt of a favourable judgment (and after avenues of appeal had been extinguished), the Law Society issued a claim form against Sephton. The claim form was issued in May 2002.

Sephton argued that the Law Society was time barred from pursuing a claim against it as the cause of action arose before 16 May 1996. Sephton alleged that the Law Society suffered damage from the dates of each misappropriation following submission of the accountant's annual certificates. Such misappropriations gave the client a right to make a claim on the fund and Sephton contended that liability in respect of such a claim was "damage" for the purposes of Section 2.

The Law Society contended that, even though it was faced with claims under its compensation scheme arising out of the solicitor's negligence, it did not suffer any actual damage until it resolved (under its discretionary scheme) to make the first payment out of the compensation fund to a former client of Mr Payne.

The Law Society put forward a reasoned argument as to why it did not suffer any damage until it had received an actual claim. If the solicitor's misappropriations had been repaid and/or set off against other client accounts (as had occurred in the past), the Law Society would not have been liable to these claims. As such, it argued that knowledge of a potential liability to a potential claim was not enough to start time running.

The first instance decision

At first instance, Mr Michael Briggs QC (sitting as a deputy judge in the Chancery Division) ruled against the Law Society on the grounds that a cause of action had accrued before 16 May 1996 (when it was aware of the accountant's negligence). Accordingly, Sephton were able to rely on a limitation defence.

The decisions of the Court of Appeal and House of Lords

Both the Court of Appeal and then the House of Lords found in favour of the Law Society on the basis that a cause of action could not (and did not) accrue until the Society had suffered a quantifiable loss in consequence of the solicitor's negligence, i.e. when the first claim on the compensation fund was received. Thus, their Lordships rejected the Society's argument that the cause of action did not accrue until the first claim was paid by the compensation fund.

Lord Hoffman delivered the leading judgment.

After reviewing and citing his opinion on a number of earlier cases, including *Forster v Outred & Co* [1982] and *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd* (No 2) [1997], Lord Hoffman's view was that incurring the possibility of a future liability to make a payment was not a sufficient basis upon which to make a claim as no actual loss had occurred. He said:

> *"A contingent liability is not, as such, damage until the contingency occurs. The existence of a contingent liability may depress the value of other property…or it may mean that a party to a bilateral transaction has received less that he should have done, or is worse off than if he had not entered into the transaction….But, standing alone, as in this case, the contingency is not damage."*

Accordingly, it was not sufficient that the Law Society was at risk of having to meet claims arising from the solicitor's theft of client funds, even if that risk was real and likely. The possibility of an obligation to pay money in the future was not, of itself, "damage" for the purposes of section 2.

Commentary

- *Law Society v Sephton* provides helpful clarity to a central aspect of the Limitation Act 1980, namely when a cause of action accrues in tort and when the time in which to bring such a claim begins to run. The House of Lords unanimously decided that a cause of action accrues in tort from the point when a quantifiable/ascertainable loss is suffered; a contingent liability is not enough to start time running.
- The position contrasts with cases where actual damage occurred at an earlier date. Thus in *Foster v Outred* [1982] the property in question had been mortgaged; in *Knapp v Ecclesiastical Insurance Group plc* [1998], a policy of insurance was voidable owing to a broker's non-disclosure; and in *Khan v Falvey* [2002] a solicitor's negligence meant that his client's claim was susceptible to a strike out for want of prosecution.
- The House of Lords decision, whilst having broader application in certain circumstances, does not represent a radical departure from the courts'

"The House of Lords decision, whilst having broader application in certain circumstances, does not represent a radical departure from the courts' general approach to issues of limitation."

Lord Hoffman cited with approval the principle enunciated by Lord Nicholls in Nykredit [1997], in which he said that "within the bands of sense and reasonableness, the policy of the law should be to advance, rather than retard, the accrual of a cause of action". Accordingly, Sephton is largely a decision on its particular facts.

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- Much of the case law on limitation in recent years has concerned the interpretation of s.14A Limitation Act 1980, under which a claimant has a period of three years from date of "knowledge" (as defined) to bring a claim in tort (as to which see, the preceeding article on *Haward v Fawcetts*. In Sephton, s.14A would have been of no assistance to the Law Society, as they had the requisite knowledge for approximately six years prior to the commencement of proceedings.

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In this issue of the Bulletin, Maria Botelho and Peter Maguire highlight a number of risk areas facing solicitors undertaking employment work and offer some practical guidance as to how such problems can be avoided.

Maria Botelho, senior solicitor Employment group

Focus on specialist practice areas: employment law

Conflicts of interest

As with other commercial matters, conflicts of interest can arise when employment lawyers accept instructions from clients or, indeed, during the course of the retainer.

- On a very basic level, a solicitor may despatch a letter before action on behalf of a new client to that client's employer, only to later discover that the employer is an existing client of the firm (usually when another partner has received a telephone call of complaint). Whilst this may, on occasions, give rise to a commercial – rather than a legal – conflict of interest, the result will (at a minimum) be severe embarrassment for the firm. To avoid this type of problem, practitioners need to ensure that full conflict searches are completed before instructions are accepted and any advice is proffered to the prospective client.
- It is important to take care when advising a team of employees who wish to move to another employer. Often firms act for both the team and the prospective employer and must ensure that the prospective employer does not induce the team to breach their current contracts of employment, as this may have consequences for both the employer and for the firm. It is not advisable to use a member of the team as a team leader to negotiate the move with the prospective employer company and it may be appropriate for the prospective employer to use a headhunter and to negotiate the contract of each member of the team individually.
- Where accepting such a joint retainer on behalf of a prospective employer and a team of employees from another company, practitioners must also be aware of the potential competing interests between the team and the employer. The employer often pays the bill and may wish to control the instructions. Firms must, therefore, satisfy themselves that they can act responsibly in the best interests of both parties, without causing detriment to either. Consideration should also be given at the outset as to how any difficulties that may arise will be resolved.

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> *…since the introduction of The Employment Act 2002 (Dispute Resolution) Regulations 2004 (on 1 October 1 2004)… solicitors… have to be very careful about advising in absolute terms on time limits, as the employee may, depending on the circumstances, be able to bring a claim outside the normal time limits.*

- Similarly, a conflict may arise when a divergence of interest occurs during a discrimination case. An employer may give instructions to a firm of solicitors to defend an employee who has been accused by a fellow employee of discrimination in the workplace. If, at a later date, the employer instructs the solicitors to cease representing the employee, an actual conflict may arise and all parties must be advised immediately. Once again, consideration should be given at the outset to issues such as the conduct of the proceedings and how the interests of both clients will be protected should their interests diverge and independent advice be required.

Deadlines and time limits

Missing deadlines and time limits is an inherent risk in litigation, and employment law is no different. Failure to comply with the CPR and Employment Tribunal deadlines can, and frequently do, expose solicitors to wasted cost orders and negligence claims. It is vital that solicitors are aware of the specific time limits imposed by Employment Tribunals, which are far shorter than those for other civil claims.

- Claims for unfair dismissal, sex, race, disability etc. discrimination must normally be lodged within three calendar months of dismissal or of the act complained of.
- Claims for statutory redundancy payments must normally be lodged within six calendar months of dismissal.
- The Respondent's Notice of Appearance (ET3) must be submitted within 28 days of the date of the ET1. It is advisable to check with the relevant Employment Tribunal exactly when the ET3 is due.

Whilst individual fee earners will maintain their own diary reminder systems, a centralised electronic diary system can also be set up to help avoid missing deadlines. This will, in practice, only be effective where entries are comprehensive, where the system can be accessed by all relevant personnel and where it is possible for someone else to identify an urgent issue and deal with it in the fee earner's absence. Entries will typically include:

- the case name and number;
- which Employment Tribunal or court the case is assigned to;
- the scheduled date of the hearing; and
- any other relevant timetable dates or directions

Examples of the very serious consequences, for employment solicitors, of getting deadlines wrong can be found in case law. In one such case, *The Wise Group v Mitchell* [2005] UKEAT/0693/04/ILB, the EAT gave an illustrative example of when a claim could be brought against solicitors: an employee who has been with an employer for eleven months seeks her solicitor's advice because she can no longer endure the bad treatment to which she is being subjected by her employer. The solicitor negligently advises that she can resign immediately and that this will amount to constructive unfair dismissal, allowing her to bring a claim for statutory unfair dismissal. If she relies on this advice and resigns immediately, she will not be able to bring a claim for unfair dismissal as she has not been employed for a period of a year. But for her solicitor's advice, she would have stayed on for an extra month, enabling her to bring an unfair dismissal claim. Her subsequent claim for breach of contract against the solicitor is likely to include a claim for damages for the lost opportunity to claim unfair dismissal, following the loss of an accrued statutory right to do so.

The Employment Act 2002 (Dispute Resolution) Regulations 2004

To complicate matters further, since the introduction of The Employment Act 2002 (Dispute Resolution) Regulations 2004 (on 1 October 1 2004), there are automatic extensions of the time-limits set out above in certain situations, as well as an ability for the tribunal to exercise discretion to extend time. Solicitors therefore have to be very careful about advising in absolute terms on time limits, as the employee may, depending on the circumstances, be able to bring a claim outside the normal time limits.

Internal referrals

Owing to the specialist nature of employment law advice, solicitors are often called upon to give advice to clients by other departments in their firm. This gives rise to two practical points:

- practitioners should be wary of giving advice in a 'vacuum' or of being rushed into giving an answer. As a matter of practice, employment solicitors should always qualify their advice by reference to the level of background information provided and request such documentation as is necessary to enable proper consideration to be given to all relevant issues. "Shorthand" instructions via a solicitor from another department can ultimately lead to incomplete or incorrect advice;
- similarly, when providing advice to other departments, there is a risk that such advice may be misunderstood or miscommunicated to the client. It will, therefore, usually be appropriate for the advice to be confirmed in writing. In other cases, it will be appropriate or, indeed, necessary for the employment solicitor to meet with the client.

Technical developments and accurate advice

Employment law is a technical area and, whilst it is the responsibility of each individual solicitor to keep up to date with developments in case law and legislation, firms typically provide support to their fee earners through regular technical updates and training. The latter can, on occasions, usefully be extended to include other departments (e.g. corporate), so that their fee earners are able to identify the existence of an employment issue which requires specialist input.

Qualifying advice

Difficult issues often arise in the area of employment, requiring a detailed analysis and interpretation of the relevant statutory provisions and authorities. Whilst the fact that a solicitor's view is not ultimately upheld does not, of itself, connote negligence, where the outcome of an issue is uncertain (for example, in relation to the enforceability of a restrictive covenant), the solicitor should take this into account in his advice and put the client in a position to make an informed decision as to the best way forward.

Practical points

- complete full conflict checks before any advice is provided in order to avoid costly and embarrassing conflicts of interest (whether legal or commercial)
- where acting for more than one client with common interests, be alert to conflicts of interest which may arise during the course of the retainer. Discuss how these might be resolved at the outset
- maintain an effective diary system, including centralised reminders where appropriate
- ensure that employment specialists have full instructions and adequate time in which to formulate their advice; do not proceed on the basis of "half baked" instructions from other members of the firm;
- employment law is a technical area; ensure that solicitors in other departments do not "dabble" in it
- qualify advice where appropriate
- confirm important advice in writing and retain notes of all meetings and discussions (including handwritten notes) on the file in order to reduce the scope for potentially damaging and costly conflicts of oral evidence.

"…employment law is a technical area; ensure that solicitors in other departments do not "dabble" in it."

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